



# Progress of Electricity Retail Competition in Victoria

Research Paper

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# 1 Introduction

The Essential Services Commission (ESC) is Victoria's economic regulator of energy retail services. The ESC ensures compliance with, and enforcement of, Victoria's energy retail customer protection laws and codes, and maintains the YourChoice website. It also has a broad monitoring role in relation to the energy retail market, and each year produces two monitoring reports, on comparative pricing and on customer service standards and compliance. In recent years there have been substantial increases in electricity retail prices. While some of the factors behind these movements, such as network access prices, are well known, much less is known about the relative importance of these and other cost drivers on retail price outcomes. This question is far from being a simple one, and is influenced by a range of changes in the marketplace, such as green energy schemes, the carbon tax, and the rollout of interval meters. This paper examines the drivers of retail electricity price movements in Victoria so that the community can gain a better understanding of these trends.

## 1.1 Background to Energy Retail Deregulation

Full Retail Competition (FRC) for electricity was introduced in Victoria in January 2002. This enabled new retailers to enter into the small customer market and compete with the incumbents who acquired their electricity retail businesses through privatization or subsequent acquisition. The incumbents could also compete against each other in all distribution zones. FRC was introduced in New South Wales (NSW) at the same time, in South Australia in January 2003 and in Queensland in July 2007, but not yet in Tasmania. In Victoria, FRC completed a progressive phasing-in of competition which began with larger customers in the 1990's.

With FRC, retailers could make competitive or 'market' offers, but the obligation for the incumbent (or 'host') retailers to provide default 'standing offer' tariffs was retained, and these were under regulatory control in Victoria until 1 January 2009. Although standing offer prices are no longer regulated in Victoria, each



retailer (including entrants) is required to publish a standing offer tariff. Until recently, Victoria was the only state in the NEM to have deregulated electricity retail prices, but on 1 February 2013, South Australia also deregulated electricity standing offer prices.

The deregulation of retail prices followed from a 2004 agreement of the Council of Australian Governments (COAG) to review the continued need for energy retail price regulation where competition was effective. Although the ESC conducted several reviews of the effectiveness of energy retail competition in Victoria, they were inconclusive (ESC 2002; ESC 2004). It was not until the Australian Energy Markets Commission (AEMC) review in 2007 — carried out to fulfil the COAG agreement — that energy retail competition in Victoria was found to be fully effective. This finding formed the basis of the Victorian Government’s decision to remove energy retail price controls from January 2009.

The AEMC carried out competition reviews for South Australia in 2008 and Australian Capital Territory in 2011 and is currently conducting a review of the effectiveness of energy retail competition in New South Wales.

Since 2009 the ESC has not regulated electricity retail tariffs in Victoria. The *Electricity Industry Act 2000 (Vic)* provides that the Governor in Council may, by Order, regulate electricity retail tariffs (s.13), but only if the AEMC conducts a review under terms of reference from the Standing Committee on Energy and Resources (SCER), and it finds electricity retail competition to be ineffective, and recommends that price controls on prices for retail electricity services be reintroduced (s.13A).

The ESC is not aware of any plans for the AEMC to conduct another competition review for Victoria, and hence there is little present likelihood of electricity retail tariffs in Victoria being re-regulated. However, SCER has recently decided to widen the AEMC’s competition reviews, so that in future it will conduct “a more market-wide and ongoing review of the state of competition” (SCER 2012, 1). The ESC’s current research on the drivers of electricity prices may complement any future AEMC review of that kind.

## **1.2 Purpose of this Paper**

Since the introduction of FRC in Victoria there have been no follow-up reviews to shed light on how competition is progressing since price deregulation and to better understand retail price outcomes for small consumers.



The purpose of this paper is to recap the main findings of past reviews of the competitiveness of the Victorian electricity retail market and to present some more recent information on the structure of the market, dynamic features such as competitive entry and customer switching, and indicators relating to the conduct of participants, such as complaints. These indicators may be relevant to any future reviews of competition.

### **1.3 Structure of the Paper**

Chapter 2 of this paper summarises the findings of previous reviews of competition in the Victorian electricity market and also briefly discusses the findings of similar reviews carried out recently in the UK. Chapter 3 provides some information about market shares, rates of competitive entry and churn rates in the Victorian retail electricity market.



## 2 Previous Reviews

There have been several major studies of the effectiveness of competition in the energy retail market in Victoria,<sup>1</sup> including the Essential Services Commission (ESC 2002; ESC 2004), and the Australian Energy Markets Commission (AEMC 2007). These reviews progressively found the energy retail market to be increasingly competitive, with the last review concluding that competition was fully effective. This chapter briefly reviews the findings of those reviews.

### 2.1 ESC (2002)

The first of the ESC's reviews of the effectiveness of competition in the retail electricity market in Victoria followed shortly after the introduction of full retail contestability (FRC) for 35 000 customers consuming 40–160 MWh/year in January 2001, and for 2.1 million customers using less than 40 MWh/year in January 2002.<sup>2</sup> Inevitably, it could say very little about the development of competition in that timeframe.

In the months following introduction of FRC, most new entrants into the Victorian market were interstate retailers. Few of these were active in the residential retail market, with greater interest initially in business customers. Given the timing of the review, there was uncertainty about future rates of competitive entry under FRC. And there was uncertainty about the prospects for further consolidation following acquisitions of Powercor and Citipower's electricity retail businesses by Origin Energy and Pulse's energy retail business by AGL, between June 2001 and

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<sup>1</sup> The 'retail' electricity market refers to customers consuming less than 160 MWh/year.

<sup>2</sup> All prices for customers consuming greater than 160 MWh/year continued to be unregulated. Host retailers were required to have standing offer prices to all customers using less than 160 MWh/year, and these were subject to regulation.





July 2002.<sup>3</sup> Although the ESC observed there were enough retailers operating in the Victorian market to permit effective competition and customer choice, future trends were unclear given the uncertainties mentioned (ESC 2002, 33).

The ESC's terms of reference required it to consider: (a) the number of competing retailers and the range of prices and services on offer; (b) the history of entry and exit of retailers; (c) how retailers compete and differentiate themselves to customers; (d) any evidence of barriers to entry; (e) the number of customers switching retailers; (f) the financial and time cost to customers when switching retailers; (g) customer awareness of full retail contestability; and (h) the extent to which these characteristics vary between types of customers and retailers.

The ESC used the Structure-Conduct-Performance (SCP) conceptual framework (see: ESC 2002 ch.3), and its analysis was supported by quantitative and qualitative retailer and customer surveys and a 'mystery shopper' exercise.

### **2.1.1 Structure**

The ESC found the structure of the market was "consistent with the progressive development of effective competition". The only important structural barriers to entry were regulatory — relating to the influence of price caps and compliance costs. The ESC was concerned that price cap regulation discouraged participation by suppressing potential margins and increasing risk because of uncertainty about the future direction of price caps (ESC 2002, 33). Excessive compliance costs were also considered to be inhibiting entry. On the other hand, the ESC considered that alleged incumbent advantages were inconclusive, and where relevant, short-term only (ESC 2002, 40).<sup>4</sup> The ESC emphasised the need to assess carefully whether the existing regulatory arrangements were having adverse effects on the development of competition, and to minimise such effects (ESC 2002, 43–44).

### **2.1.2 Conduct**

The market conduct expected in an effectively competitive market includes active retailer efforts to offer customers innovative pricing and products, and well-

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<sup>3</sup> At the time FRC was introduced, the electricity retail market shares were: Pulse, 27 per cent; Origin (Powercor), 26 per cent; TXU, 24 per cent; AGL, 12 per cent; and Citipower, 12 per cent.

<sup>4</sup> This refers to possible advantages due to scale, established branding or the inertia of customers, among other things.



informed customers actively seeking the best deals. The ESC used various indicators for these characteristics.

Among its findings, the ESC observed “a degree of rivalrous behaviour”, and noted that “there does not appear to be a significant degree of anticompetitive or misleading and deceptive behaviour by retailers” (ESC 2002, 53,59). On the other hand, there were concerns about “the complexity of offers and the ability to compare market offers across retailers” given the bundling and lack of detail about price components (ESC 2002, 56).

Customer switching was also considered to be an indicator of market competitiveness.<sup>5</sup> After almost six months of FRC, the number of customers switching retailers was over 8500 per month, or 0.4 per cent of the market—although the ESC noted that 40 per cent of these were associated with new dwelling construction or customers moving between premises (ESC 2002, 58). Excluding this component, the annualised net churn rate at the time of the review was lower than 3 per cent.

### **2.1.3 Performance**

Although the 2002 review was conducted at an early stage in FRC, it found some evidence of innovative offerings, of which perhaps the most important were ‘green’ energy products. Other innovations included discounts on bundled electricity and gas supply and loyalty schemes (eg, discounts on other products such as movie tickets etc). The ESC anticipated that innovation would develop over time (ESC 2002, 75).

During this early phase the emphasis of competitive activity was on the larger customer segments, with a lower degree of competitive activity for the small customers. The ESC considered the performance of the electricity market at the time of the review was not yet consistent with an effectively competitive market. Competition alone was not imposing enough pressure on retailers to ensure their prices reflected costs, and that service offerings were suited to customer requirements.

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<sup>5</sup> Strictly speaking it is the threat that customer may switch suppliers which imposes competitive discipline rather than actual switching. If the existing supplier responds to the threat of switching by matching the best offers in the market, the customer has no incentive to switch, but receives a competitively priced service.



#### **2.1.4 Conclusions**

While the ESC did not find the electricity retail market to be effectively competitive at the time of the 2002 review, it observed that:

*... considering the relatively short period during which consumer choice has been available, considerable progress has been made in the development of a competitive electricity retail market. While there are remaining impediments to competition, many of the pre-conditions for effective competition are present in the market and the outlook for the development of an effectively competitive retail market in the period ahead remains positive. (ESC 2002, 79)*

## **2.2 ESC (2004)**

A subsequent review in 2004 had the benefit of a further two years of experience with FRC in the residential market.<sup>6</sup> The ESC again used the structure-conduct-performance (SCP) framework of analysis, and again drew information from specifically designed market and consumer surveys.

### **2.2.1 Structure**

In addition to the three host retailers, by 2004 there were seven entrants, each serving less than 50 000 customers, and other new licensees yet to attract residential customers. The ESC did not identify any significant barriers to entry or expansion (ESC 2004, 15). It noted some customer inertia, some problems with business-to-business customer transfer systems and inconsistencies between customer protection arrangements between jurisdictions (ESC 2004, 17).

### **2.2.2 Conduct**

All retailers were found to be active in contacting customers and making market offers and also made available on their websites universal market contract offers.

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<sup>6</sup> At this time, host retailers were obliged to have regulated standing offer prices to all customers using less than 160 MWh/year—including smaller customers such as residential and small businesses, and larger commercial customers consuming 40 MWh/year. The largest customers, consuming greater than 160 MWh/year, continued to be unregulated.



But the Victorian energy retail market was segmented, with the active marketing by retailers being focused on the larger end of the retail market in Melbourne and larger regional centres. This represented approximately 40 per cent of all retail customers.<sup>7</sup> The remaining customers tended to provide retailers with low or negative margins against standing offer prices, did not generally receive attractive market offers, and tended to remain on standing offer tariffs (ESC 2004, 13).

There was no evidence of systemic misleading or deceptive or anti-competitive conduct, with the level of complaints less than one per cent of all market offers made (ESC 2004, 16).<sup>8</sup> By the end of 2003, 17 per cent of electricity customers had entered into market offer contracts, and by April 2004, 13 per cent had switched retailers.<sup>9</sup>

### 2.2.3 Conclusions

Competition had been fully effective in constraining prices and delivering other benefits to the larger retail customer segment. But the evidence considered by the ESC suggested that it was less than fully effective for the smaller retail customers. ESC's overall conclusion was that:


*... competition is likely to become effective for a much larger proportion of small energy customers in the next few years, as the current competitive momentum in the Victoria retail energy markets continues to build and the full effects of existing and proposed measures to enhance competition are felt. Based on this assessment, the Commission considers that the competitive market has developed to a stage where it will discipline any potential to exercise market power and that consideration can now be given to a gradual roll back, and potentially the elimination of retail price regulation, over the coming period without the risk of significant disadvantage to energy customers. (ESC 2004, 13)*

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<sup>7</sup> The ESC noted that, for this group, a larger proportion of electricity consumption tended to be during peak periods (ESC 2004, 17).

<sup>8</sup> The complaints referred to were complaints directed to the Energy and Water Ombudsman of Victoria (EWOV) requiring investigation either because they remained unresolved after referral back to the retailer or where the customer had already made several attempts at resolution. Between January 2002 and June 2004, EWOV received 700 such complaints. The ESC estimated that in December 2003 there were 605,000 electricity and gas customers that had accepted market contracts.

<sup>9</sup> Recall that many of these may be new dwellings or customers changing their premises.



The ESC also noted that “adopting interval meters will improve the competitiveness of market offers” by removing prevailing cross-subsidies of large customers by those customers who consume a higher proportion of electricity during off-peak periods (ESC 2004, 21). The ESC also proposed a number of initiatives to enhance competition, including the price-comparator website YourChoice, which was subsequently established in 2009 and which it still administers.

### 2.3 AEMC (2007)

In 2007, the AEMC found the Victorian electricity and gas retail markets had reached a stage where they were effectively (or workably) competitive. The AEMC’s analysis did not rely on the structure-conduct-performance (SCP) paradigm directly, but it distilled the most relevant elements into its framework for assessing effective competition. In explaining the derivation of its assessment criteria, the AEMC stated:

*For competition to be effective, a retail energy market needs to be characterised by:*

- *rivalrous conduct between retailers (and/or the threat of entry by new retailers) to offer the products, services, prices and other conditions of supply which are most attractive to customers;*
- *informed and active consumers seeking to obtain energy products, prices and other terms and conditions of supply which best meet their needs; and*
- *freedom of movement for resources into and out of the market(s) in pursuit of profit opportunities, thereby eroding any excess profits over time and allocating resources to supply the goods and services most valued by consumers. (AEMC 2007, 20)*

In regard to the second of these items, the AEMC explained the role of consumer responsiveness as follows:

*Rivalry between firms, and therefore the effectiveness of competition, is enhanced where there are enough customers – “switchers” – who will switch to another product or supplier in the event of a price increase or equivalent deterioration in quality or service. (AEMC 2007, 18)*



Within the broad strands of analysis listed above, the AEMC had regard to a number of specific criteria, including:

- (a) independent rivalry within the market
- (b) ability of suppliers to enter the market
- (c) exercise of market choice by customers
- (d) differentiated products and services
- (e) price and profit margins
- (f) customer switching behaviour.

The AEMC's findings against some of these criteria are discussed below.

### **2.3.1 Evidence of active rivalry**

The AEMC found evidence that energy retailers were actively seeking to sign-up customers using door-to-door sales and telemarketing. While this may indicate rivalry, it may also foster undesirable 'hard sell' marketing methods. The AEMC observed:

*If direct marketing is to facilitate consumer choice and competition, however, it must provide customers with accurate and useful information and not pressure consumers into making decisions against their own best interests. ... one of the main causes of complaint against retailers, while not systemic, concerned provision (or lack thereof) of information. (AEMC 2007, 6-7)*

### **2.3.2 Barriers to entry & expansion**

The AEMC found that barriers to entry in electricity retailing were quite low. There was little or no impediment to accessing wholesale electricity and related risk management instruments (which might arise if there was extensive vertical integration between retailing and generation combined with market power in generation). The AEMC also suggested that economies of scale in retailing were modest and diminishing.

AEMC observed that six out of 13 retailers in the Victorian market were vertically integrated, although two of these were net purchasers of electricity. The study noted that any retailer registered with the system operator is entitled to buy electricity from the spot market. Studies conducted by KPMG and



PricewaterhouseCoopers in 2006 had found that there was sufficient liquidity in the hedging market for contract periods of up to three years. A survey of retailers found that while access to energy and risk mitigation services could potentially deter entrants, there was no evidence that any new retailers had been unable to access sufficient forward cover to enable them to enter the market and operate efficiently (AEMC 2007, 113–115). More specifically, the retailer survey found:

*While new retailers, including those without generation affiliation, acknowledged the importance of vertical integration to be competitive in retailing electricity in Victoria, they were also of the view that the current level of vertical integration was not impacting on their ability to access energy. Indeed, they considered that as long as there was sufficient independent generation in Victoria access to energy would not be a particular problem. (AEMC 2007, p. 116)*

The AEMC concluded that economies of scale were diminishing due to developments in technology and, in some cases, by outsourcing retailing services to specialist third-party providers.<sup>10</sup> That said, the costs of regulation were considered to impose an entry barrier.

*The regulatory obligations that apply to energy retailers are, in large part, shared by all retailers. However, the scope and compliance costs of these obligations may affect potential entrants' willingness (or their perception of their ability) to commence efficient retail obligations in Victoria. (AEMC 2007, 9)*


These findings were consistent with earlier findings of the ESC.

### **2.3.3 Customer switching activity**

The AEMC found that by 2007 (approximately five years after FRC was introduced), 50 per cent of residential customers and 70 per cent of small businesses had switched to a market contract (AEMC 2007, 98). Those customers remaining on standing offers tended to do so either because they liked their current retailer or they considered the choice between retailers to be unimportant for them. It could not be assumed that those customers were not receiving benefits from competition (AEMC 2007, 100).

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<sup>10</sup> Economies of scale can arise due to heavy use of customer management systems, often custom designed, which can handle additional customers at relatively small cost. As such systems become cheaper and more generic, economies of scale from this source may diminish. That said, PricewaterhouseCoopers (PwC) cites research that suggests the efficient scale of an electricity retailer may be in the range of 1 to 2 million customers: (PwC, 28).



Although only half of all residential customers had taken up market offers after five years of FRC, this was not considered unusual. Indeed, the AEMC observed that the Victorian market had one of the highest switching rates in the world. Furthermore, the AEMC found:

*... no evidence to suggest any particular customer group has been precluded from participation in the market or that information constraints had imposed a barrier to switching. (AEMC 2007, 109)*

## 2.4 Ofgem's 2011 Retail Market Review


Ofgem has recently conducted reviews of the UK retail electricity market, and although that market differs from Victoria, its findings are of interest. Energy retail competition was introduced in the UK slightly ahead of Victoria, with competition for the largest customers opened in 1990 and for residential customers in 1998. Ofgem has observed that competition in the retail energy markets has brought considerable benefits to customers since it was introduced, and notes that fixed price and capped price offers are now available to domestic customers in the UK.<sup>11</sup> Ofgem has an overall market monitoring role, and publishes periodic reports on developments in the domestic retail market and conducts investigations and consultations into performance of the domestic and the non-domestic markets when necessary. This regulatory framework is reviewed periodically as retail competition develops.

The British electricity and gas markets are predominantly supplied by six large vertically integrated energy utilities. In the context of rising energy prices, Ofgem had concerns about possible collusion. It was also concerned about lack of customer contact and complexity of tariff structures. In its 2011 Retail Market Review, Ofgem did not find any evidence of collusion (Ofgem 2011, p.4). It estimated average retail margins of 4.2 per cent in 2010, but previous years' margins had often been low and sometimes negative. However, it observed that the 'big six' adjusted prices in response to rising costs more quickly than they reduced them when costs fell. This was considered key indicator of ineffective competition.

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<sup>11</sup> <http://www.ofgem.gov.uk/MARKETS/RETMKTS/Pages/RetMrkts.aspx>.





Ofgem found a number of structural factors were weakening competition in the energy retail markets: inertia of domestic consumers coupled with large incumbent market shares; vertical integration and low wholesale market liquidity; and similarity in supplier pricing and hedging strategies. Among other things, Ofgem proposed:

- A rule to reduce the complexity of retail tariffs to facilitate customer switching by restricting each retailer to offering only one tariff per payment method for standard evergreen products. Retailers would still be free to offer any number of fixed-term products, enabling them to innovate and providing customers with choices.
- A licence condition to require the “big 6” gentailers<sup>12</sup> to make available 10–20 per cent of their power generation into the wholesale market through a regular Mandatory Auction (MA) to facilitate competitive entry.<sup>13</sup> There were also related wholesale electricity market reforms to ensure market participants can trade continuously and mitigate imbalance risks.
- Enhanced compliance activities and greater information to consumers relating to switching.
- Improved transparency of transfer pricing and hedge accounting practices of vertically integrated utilities, and improved segment reporting (Ofgem 2011).

Recently Ofgem has updated its proposals intended to increase competition and improve transparency in retail supply.

*The changes include limiting each supplier to four tariffs per fuel, per meter, and per payment type, and requiring a common standing-charge-plus-unit-rate structure for all tariffs. Suppliers will also be required to give customers personalised information on the estimated savings they will make by moving to the cheapest tariff charged by that supplier. In addition, suppliers will have to send all their customers an annual statement providing information to help consumers make switching decisions. (NERA 2012, 3).*

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<sup>12</sup> ‘Gentailer’ refers to an electricity business that carries out both generation and retailing but has no network interests.

<sup>13</sup> The UK operates a net pool wholesale electricity market rather than the gross pool used in the NEM. In a net pool only non-contract trades occur through the pool but under the gross pool all trades occur through the wholesale spot market.



The findings of Ofgem suggest that marketing practices and transparency in contract offerings remain significant issues in the UK. Issues relating to access to wholesale electricity contracts may not be relevant to the NEM, given the gross pool structure used here and a less extensive degree of vertical integration. That said, to the extent that Victoria can be seen as a discrete market, it appears to have a higher degree of vertical integration than most other states/nodes in the NEM.

# 3 Market Overview

This chapter provides some information on the patterns of development of the Victorian electricity retail market since FRC was introduced.

## 3.1 Description of market participants

### 3.1.1 Host Retailers

The three electricity ‘host retailers’ in Victoria are AGL, Origin Energy and EnergyAustralia (formerly TRUenergy). They also remain the largest retailers at present. All three are vertically integrated ‘gentailers’ and two are publicly listed companies.<sup>14</sup> These three businesses are also the largest retailers in all of the eastern mainland states.

In 2003, shortly after the introduction of FRC, the ESC’s data indicated that AGL had 864 000 Victorian electricity retail customers.<sup>15</sup> Origin Energy had 877 000 and TRUenergy had 552 000. Together they held the whole market. In 2012, on a consolidated basis (including acquisitions) their customer bases were 667 000 for AGL, 612 000 for Origin Energy and 626 000 for TRUenergy (now EnergyAustralia). Their combined share of the electricity retail market decreased from 100.0 per cent to 72.1 per cent over that period.

These three retailers benefitted from the following acquisitions through the privatisation processes in Queensland and NSW.

- **Powerdirect:** Formerly a Queensland government-owned business acquired by AGL in 2007, it still operates as a separately branded retailer

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<sup>14</sup> Energy Australia is presently unlisted but has plans to publicly list.

<sup>15</sup> ‘Retail customers’ refers to residential and small/medium business consumers.

in Victoria, with 1.6 per cent of the market, but offers exactly the same terms as AGL.

- **Country Energy & Energy Australia:** Both NSW government-owned retailers sold in 2011. The former was acquired by Origin Energy and was integrated into Origin, while the latter was acquired by TRUenergy, which were combined to form EnergyAustralia.

### 3.1.2 Entrants

Other retailers have emerged as significant retailers in some jurisdictions such as Simply Energy, Lumo Energy, Australian Power & Gas (APG), Neighbourhood Energy and Click Energy, and more recent entrants such as Dodo Power & Gas. Some government-owned retailers are also active, including Momentum Energy, which is owned by the Tasmanian government, and Red Energy, owned by Snowy Hydro.

The combined market share of entrants in the Victorian electricity retail market has increased from 0.0 per cent in 2003 to 27.9 per cent in 2012. Today the major competitors to the three host retailers in Victoria are Lumo Energy, Red Energy, APG, Simply Energy, Neighbourhood Energy and Momentum. These are briefly described below.

- **Lumo Energy:** Established by Infratil New Zealand (a diversified infrastructure fund) originally as Victoria Electricity, which commenced in the Victorian energy retail market in 2004. With related entities in South Australia and Queensland, it was combined to form Lumo Energy in 2010. In 2012, Lumo Energy has 441,000 energy customers Australia-wide, including 199,000 electricity retail customers in Victoria (or 7.5 per cent of the market).
- **Red Energy:** Entered the Victorian electricity retail market in 2004, a subsidiary of government-owned Snowy Hydro.<sup>16</sup> It has since expanded into the South Australia and NSW electricity markets and supplies gas in Victoria. In 2012 it had 171,000 electricity customers in Victoria, or 6.5 per cent of the market.

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<sup>16</sup> Jointly owned by the Commonwealth (13%), New South Wales (58%) and Victorian (29%) governments and established by the *Snowy Mountains Hydro-electric Power Act 1949 (Cth)*.

- **APG:** Commencing as a start-up retailer in 2007, APG is an ASX-listed company. In 2012 it had 117,000 electricity retail customers in Victoria (or 4.4 per cent of the market) and 341,000 customers in total, including Victorian gas customers and energy customers in NSW and Queensland. Approximately 62 per cent of its customers are electricity customers and the remainder gas.
- **Simply Energy:** A subsidiary of GDF SUEZ Energy International, a private international electricity generation business. Simply Energy commenced electricity retailing in Victoria in 2004 and also operates in South Australia. It had 113,000 electricity retail customers in Victoria in 2012, or 4.2 per cent of the market. GDF SUEZ also owns and operates 3540 MW of generating plants in Victoria, South Australia and Western Australia.
- **Neighbourhood Energy:** Established in 2006 by Alinta Energy as a start-up electricity retailer focussing on the Victorian market. It grew to 77,000 customers in 2012 (ie, 2.9 per cent of the Victorian electricity retail market). Although Neighbourhood Energy is owned by Alinta, the latter is also now marketing to residential customers in its own name.
- **Momentum Energy:** A subsidiary of Tasmanian government-owned Hydro Tasmania. It started electricity retailing in Victoria in 2005 and in 2012 has 32,000 customers, or 1.2 per cent of the market.

## 3.2 Market concentration & entry

Table 3.1 shows data for selected groups of retailers, including the host retailers, the major entrants, retailers that have been acquired by the host retailers, and smaller retailers. The table shows that the number of active retailers in the market has grown to 17 by 2013.

### 3.2.1 Market shares

The total number of customers of the three host retailers combined decreased from 2.3 million in 2003 to 1.8 million in 2011, a fall of 22 per cent. The customer numbers of these retailers increased to 1.9 million in 2012, due to acquisitions. The combined market shares of the three major incumbents declined to 69 per cent in 2011, increasing to 72 per cent in 2012 after the acquisitions.

From 2003 to 2012 the customers served by the four largest entrants increased from zero to 0.6 million, taking their share to 23 per cent of the market. By 2012 there were also 10 smaller entrants with approximately 140 000 retail customers in total, or 5 per cent of the market. Most of their growth occurred between 2010 and 2012. These smaller retailers included Neighbourhood Energy, Momentum and the fast growing Dodo Energy.

### **3.2.2 Concentration**

Table 3.1 also shows the Hirschman-Herfindahl Index (HHI) calculated using market shares based on customer numbers. The HHI is a commonly used measure of market concentration. It is defined as the sum of the squared market shares of all retailers in the market. The HHI declined consistently over the period, with the exception of 2012, when it was influenced by acquisitions. From 2009 to 2012 it remained below 2000.

The benchmark HHI level of 2000 is treated by the Australian Competition Commission (ACCC) as a 'safe harbour' for the purpose of merger assessment under s.50 of the *Competition and Consumer Act 2010*, meaning it "will generally be less likely to identify horizontal competition concerns when the post-merger HHI is less than 2000" (ACCC 2008, 37).

Table 3.1: **Customer numbers by retailer (#)** (Victorian Electricity 'Retail' Market)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b><u>Retailers (#)</u></b>										
Host retailers <sup>a</sup>	3	3	3	3	3	3	3	3	3	3
Entrants later acquired by host retailers <sup>b</sup>	.	2	2	2	1	2	2	2	2	.
Larger entrants <sup>c</sup>	.	2	3	3	4	4	4	4	4	4
Smaller entrants <sup>d</sup>	.	2	4	6	8	9	9	6	7	10
Total	3	9	12	14	16	18	18	15	16	17
<b><u>Customers (#)</u></b>										
Host retailers <sup>a</sup>	2,293,08	2,167,25	2,090,61	1,979,93	1,933,65	1,905,76	1,851,14	1,896,06	1,777,24	1,913,24
Entrants later acquired by host retailers <sup>b</sup>	.	54,963	90,289	104,958	76,364	72,675	91,774	106,213	140,263	.
Larger entrants <sup>c</sup>	.	46,758	122,610	279,190	398,133	454,863	556,468	569,633	579,361	600,117
Smaller entrants <sup>d</sup>	.	726	735	12,136	23,054	20,989	38,145	41,906	86,9891	138,852
Total	2,293,08	2,269,69	2,304,25	2,376,21	2,431,20	2,454,29	2,537,53	2,613,81	2,583,85	2,652,21
<b><u>Retailer shares (%)</u></b>										
Host retailers <sup>a</sup>	100.0	95.5	90.7	83.3	79.5	77.7	73.0	72.5	68.8	72.1
Retailers later acquired by host retailers <sup>b</sup>	.	2.4	3.9	4.4	3.1	3.0	3.6	4.1	5.4	.
Larger entrants <sup>c</sup>	.	2.1	5.3	11.7	16.4	18.5	21.9	21.8	22.4	22.6
Smaller entrants <sup>d</sup>	.	0.0	0.0	0.5	0.92	0.9	1.5	1.6	3.4	5.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Hirschman-Herfindahl Index	3,463	3,110	2,812	2,416	2,237	2,134	1,929	1,911	1,744	1,883

Source: ESC.

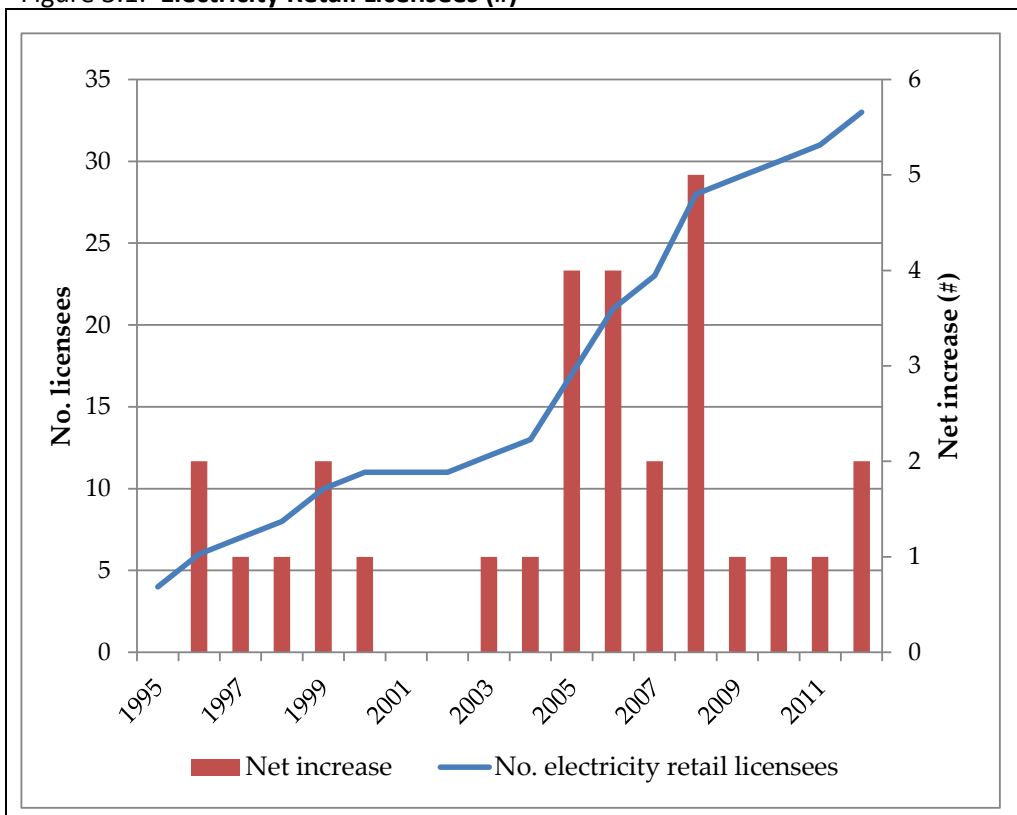
Notes: <sup>a</sup> AGL (including Powerdirect from 2007), Origin Energy (including Country Energy from 2012) and Energy Australia (includes former TRUenergy, Yallourn, and from 2012 the former EnergyAustralia); <sup>b</sup> Power direct (to 2006), Country Energy & the former EnergyAustralia (to 2011); <sup>c</sup> Australian Power & Gas, Lumo Energy, Red Energy and Simply Energy; <sup>d</sup> includes Neighbourhood Energy, Momentum Energy, Dodo Energy and Click Energy among others.



### 3.2.3 Entry rates

Figure 3.1 shows the number of electricity retail licensees in the Victorian market. The number of licensees is greater than the number of retailers shown in Table 3.1 because the table only includes retailers active in the 'retail' market,<sup>17</sup> and there are a number of retailers that are only active in the large commercial/industrial customer market. The number of licenses issued is also greater because some licensees are not active. However, Figure 3.1 usefully conveys that the entry of new retailers is an ongoing process. From 2003 to 2012 there were on average just over two additional licensees each year.

Figure 3.1: Electricity Retail Licensees (#)



Data Source: ESC.

<sup>17</sup> The 'retail' market is defined in note 15.





### 3.3 'Churn' rates

Customer 'churn' occurs when a customer at a given premises switches retailer. Churn data has been used as a rough indicator of the degree to which demand-side substitution between retailers is likely to impose discipline on retailers. However, churn is difficult to define and measure accurately. While it is indicative information, few hard and fast conclusions can be drawn from it.

Table 3.2 shows data for 'Tier 1' and 'Tier 2' customers and for customer transfers produced by the Australian Energy Market Operator (AEMO). Tier 1 customers are those supplied by the host retailer for the distribution zone they are in.<sup>18</sup> All other retail customers are in Tier 2. All customers that have remained on standing offer contracts and never taken up a market offer are Tier 1 customers. However, Tier 1 also includes customers that have taken up a market offer with the host retailer for their zone, and may have done so after being supplied by another retailer. It may also include customers that took up a market contract with their host retailer and on the expiry of that contract, defaulted back to the host retailer's standing offer. The customers who have never entered into a market contract are only a subset of the Tier 1 customers. Their number is unknown.

A customer transfer occurs when a different retailer becomes responsible for supply at a given meter installation. Often AEMO customer transfers are reported as a measure of customer churn. However, while transfers include the switching of retailers by a customer at a given premises (what we call 'churn'), they also include situations where one customer moves out of a premises and another moves in, as well as meter installations associated with new dwellings.<sup>19</sup> These latter two kinds of 'transfers' are not relevant to the rate at which customers switch between retailers, and are deducted in Table 3.2 to estimate customer churn. The resulting estimate is only an approximate measure. The estimated churn rate, based on this methodology, was approximately 17 per cent in both 2011 and 2012.

These churn rate estimates are lower than the churn rates usually reported, such as by VaasaETT and the Energy Retailers' Association of Australia, which indicate churn rates of

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<sup>18</sup> Victoria has five distribution zones representing franchise areas for electricity distributors. These are the Citipower, Jemena, Powercor, SP Ausnet and United Energy distribution zones. The host retailer for a zone is the original franchised retailer for that zone prior to the introduction of FRC. Due to mergers there are only three host retailers, two of them being the 'hosts' in more than one zone.

<sup>19</sup> 'Transfers' are defined as completed change requests in MSATS for a change of retailer or to create a new second tier connection point. (AEMO 2011, 6)

nearly 28 per cent.<sup>20</sup> That statistic is consistent with total transfers as a percentage of total customers, including move-ins and new dwellings within the measure of customer 'switching'. Using the data in Table 3.2 this is 27 per cent both 2011 and 2012. The measure 17 per cent presented in Table 3.2 is more representative of the proportion of the market that is switching between retailers.

**Table 3.2: Tier 1 & 2 Customers and Churn Rates - Small Customers**

	2011	2012
<b><u>Customers at June</u></b>		
Tier 1 (with host retailer for zone)	996,530	956,908
Tier 2 (with another retailer)	1,587,328	1,695,303
Total	2,583,858	2,652,211
Tier 1 (%)	39	36
<b><u>Transfers</u></b>		
Total transfers*	698,973	680,741
less Move-ins**	232,522	197,664
less New NMIs (network metering installations)***	27,369	23,861
Switch Retailer (existing residence)	439,082	459,216
Estimated Churn Rate (%)	17	17

Notes: \* MSATS Statistic 57B; \*\* Change Reason Codes 1030, 1040, 1083 & 1084;

\*\*\* Change Reason Codes >=2000.

Data Source: AEMO.

### 3.4 Marketing Practices

Unsolicited direct marketing methods have given rise to the greatest concerns in regard to electricity retailer marketing practices. For consumers who agree to switch at the door, the aim is typically to save money—but this aim is not necessarily achieved. In the UK, a

<sup>20</sup> <http://eraa.com.au/wp-content/uploads/Australian-energy-markets-leading-the-world.pdf>

2008 study found that just under half of those switching at the door were actually made financially worse off by the change. This may be because door-to-door selling creates a 'situational monopoly': an environment in which the consumer is reliant on the information provided by only one supplier and cannot 'shop around' to find the best deal. Improved marketing practice is considered a prerequisite for effective energy retail competition (Brakey 2012, 2). No current data is available for Victorian customers' experiences in switching retailers or contracts.

### 3.5 Complaints

The Energy Water Ombudsman of Victoria (EWOV) provides the customer dispute resolution framework to which all electricity retailers are members under the applicable industry code of conduct. Table 3.3 shows the number of EWOV cases for electricity retailers by main EWOV issue category each financial year since 2007-08. The EWVO website provides detailed descriptions of the different categories of complaints.<sup>21</sup>

Table 3.3: Electricity retailing complaints to EWOV by issue type (per 1000 customers)

Complaint type	Year ending June				
	2008	2009	2010	2011	2012
Billing	3.35	5.24	5.29	6.96	9.53
Credit	0.87	1.13	1.39	2.12	2.51
Customer Service	0.06	0.10	0.13	0.10	0.13
General Enquiry	0.10	0.08	0.26	0.45	0.29
Land	0.02	0.01	0.01	0.00	0.00
Marketing	0.29	0.56	0.68	0.64	0.50
Provision	0.39	0.31	0.45	0.63	1.08
Supply	0.04	0.07	0.06	0.05	0.03
Transfer	1.00	1.72	1.51	1.80	1.78
<b>Total</b>	<b>6.11</b>	<b>9.22</b>	<b>9.77</b>	<b>12.76</b>	<b>15.85</b>

Data Source: EWOV.

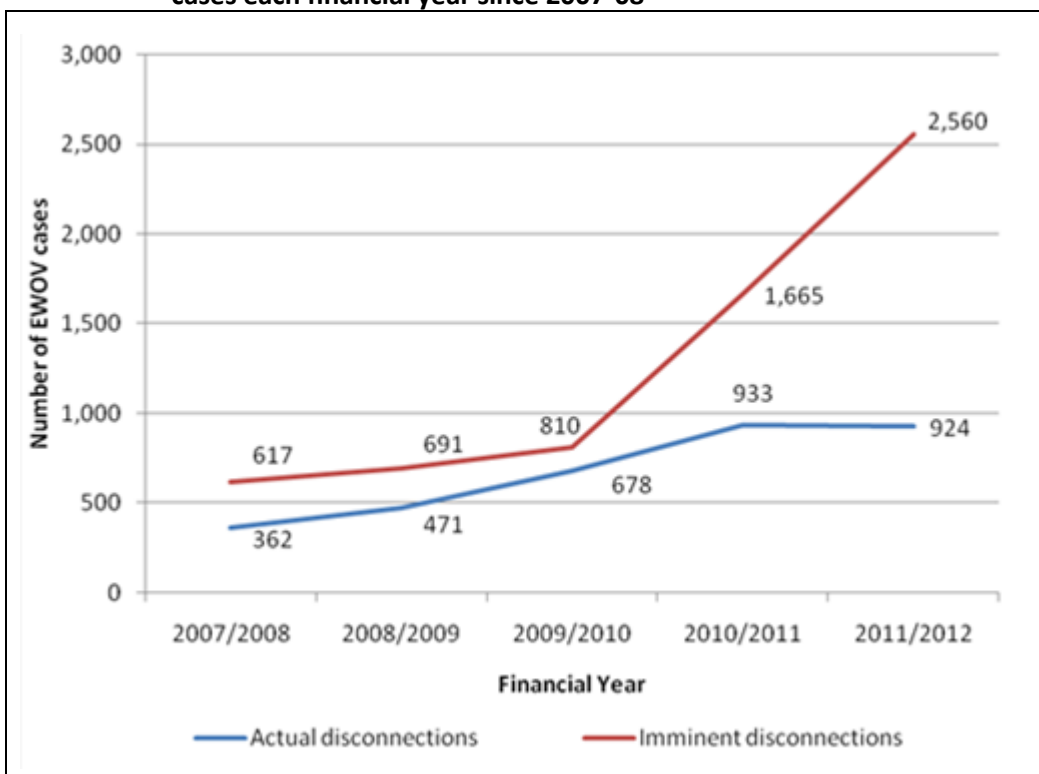
<sup>21</sup> <http://www.ewov.com.au/complaints/process-for-complaints/cases,-enquiries,-complaints/issue-categories>



Table 3.3 indicates that, when measured on a per customer basis, the overall level of complaints has increased from approximately 6 per 1000 electricity customers in 2007-08 to 16 per 1000 electricity customers in 2011-12. The most numerous types of complaints are billing and “credit” (which includes disconnections, hardship plans etc).

Figure 3.2 shows detail of EWOV complaint cases specifically relating to customer disconnections. It highlights the significant growth in such complaints over the last few years.

Figure 3.2: **Number of EWOV actual and imminent electricity retailer disconnection cases each financial year since 2007-08**



Data Source: EWOV.

### 3.6 Summary

Since 2003 there has been an ongoing process of competitive entry, and by 2012 there were over 30 licensed retailers operating in the Victorian market, approximately three times the number in 2003. Some of the entrants have gained substantial shares of the market, and by 2012 the combined market share of new entrants was close to 30 per cent



of all residential and small business market customers. Standard measures of concentration have been declining and suggest that the market would not be classed as highly concentrated today.

Customer 'churn' rates refer to the rates of switching between different retailers. This reflects the propensity of consumers to 'shop around' and obtain the best deal, and by doing so, impose competitive pressure on retailers. In Victoria the degree of customer churn has been estimated at approximately 17 per cent. This is significantly lower than statistics usually cited which are based only on total transfers, which include new dwellings and customers moving between dwellings. When these two sources of customer transfer are excluded, the switching rate reflects customer switching between retailers to obtain better terms and conditions of supply.

There have remained some general concerns among commentators about some retailer marketing practices, and complaints data show a strong increasing trend in the level of customer complaints. These trends emphasise the importance of retailer compliance with industry regulations and codes of conduct.



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