

**Submission  
No 39**

**INQUIRY INTO ELECTRICITY SUPPLY, DEMAND AND  
PRICES IN NEW SOUTH WALES**

**Organisation:** NSW Business Chamber

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The Hon. Paul Green MLC  
Committee Chair  
Senate Committee on Electricity Supply, Demand and Prices in NSW  
Inquiry into Electricity Supply, Demand and Prices in NSW

*Via electronic upload*

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Dear Chair,

The NSW Business welcomes the opportunity to comment on the *Inquiry into Electricity Supply, Demand and Prices in NSW*. The NSW Business Chamber is one of Australia's largest business support groups, with a direct membership of more than 20,000 businesses, providing services to over 30,000 businesses each year. Tracing its heritage back to the Sydney Chamber of Commerce established in 1825, the NSW Business Chamber works with thousands of businesses ranging in size from owner operators to large corporations, and spanning all industry sectors from product-based manufacturers to service provider enterprises.

High electricity prices are having a significant and increasing impact on businesses in NSW. The NSW Business Chamber's September 2017 Business Conditions Survey found that 67% of businesses are being affected by higher energy prices, which has increased from 45% of business in the March 2017 quarter survey. Of these businesses:

- 90% had subsequently experienced a reduction in profits;
- 22% had subsequently reduced investments or expansions; and
- only 16% had been able to pass on any increased costs to customers.

### **Drivers behind increased electricity prices**

There has been significant analysis undertaken of the key drivers behind recent increases in energy costs, most recently in the ACCC's Inquiry into the cost and supply of retail electricity. Each component of electricity costs – wholesale, network and retail – has increased to varying degrees over previous years.

#### *Wholesale costs*

The wholesale cost of electricity, which comprises around 22% of a household electricity bill, has increased dramatically since 2015-16. The average annual wholesale price of electricity in NSW was \$35.17 in 2015 and

is currently \$81.22 for 2017<sup>1</sup>, representing a 130% increase in just two years. Prior to this recent increase, wholesale electricity prices fell slightly between 2007-08 and 2015-16. The ACCC attributed the high concentration of the generation market, the tightening of the demand-supply balance triggered largely by the closure of coal-fired generators, and higher gas prices as likely drivers of recent higher wholesale prices.

In NSW, AGL (40%), Origin Energy (27%) and Energy Australia (15%) generate more than 80% of dispatched electricity. The ACCC indicates that this high level of market concentration raises concerns about the potential for the exercise of market power and is therefore a risk to wholesale prices.<sup>2</sup> The ACCC will be looking further into whether the high levels of vertical integration of wholesalers and retailers is driving up wholesale prices.

Over the past five years, the National Electricity Market (NEM) has seen the closure of generators representing around 10% of NSW's generation capacity, 20% of Victoria's capacity and 20% of South Australia's capacity. This exit of baseload capacity has not been matched by new investment in replacement capacity which has led to the tighter demand-supply balance.<sup>3</sup>

Recent increases in gas commodity prices have been well-documented. While gas-powered generation comprises less than 10% of NSW generation capacity, the ACCC concludes that gas-powered generators have a disproportionately large impact on wholesale electricity prices because they are often the marginal supplier and therefore set the market price. The tight gas market has also likely minimised investment in gas-powered generation, contributing to the tighter supply-demand balance of the NEM.<sup>4</sup> It is worth noting that the ACCC's separate inquiry into the gas market found that moratoria and regulatory restrictions in NSW have contributed to uncertainty about the adequacy of gas supply for east coast Australia.<sup>5</sup>

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<sup>1</sup> AEMO (2017) <https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Data-dashboard#average-price-table>

<sup>2</sup> ACCC (2017) *Retail Electricity Pricing: Preliminary Report* pp. 80-81.  
<https://www.accc.gov.au/system/files/ACCC%20Retail%20Electricity%20Pricing%20Inquiry%20-%20Preliminary%20Report%20-%202022%20September%202017.pdf>

<sup>3</sup> ACCC (2017) p. 83.

<sup>4</sup> ACCC (2017) pp. 90-92.

<sup>5</sup> ACCC (2017) *Gas Inquiry 2017–2020: Interim Report*  
<https://www.accc.gov.au/system/files/ACCC%20gas%20inquiry%20first%20interim%20report%20%20September%202017%20-%20FINAL.PDF>

### *Network costs*

Network costs comprise approximately 49% of an average residential bill in NSW (compared with a NEM-average of 48%) in 2015-16. Over the period between 2007-08 and 2015-08, the network costs of an average residential bill in NSW increased by 41-66%.<sup>6</sup> An Ernst & Young report found that network prices increased in real terms by 122% in NSW between 1996 and 2013.<sup>7</sup>

The ACCC found there was less data available on cost components for SME and commercial and industrial electricity customers but did note that network costs have also been the main driver of increased electricity costs for these customers.<sup>8</sup>

Network cost increases are the result of a significant period of investment in network assets in NSW. The ACCC Inquiry concludes that there is evidence that customers have not received value for money from these investments and found that the key drivers of these increasing costs were:

- meeting regulatory obligations and reliability standards;
- unnecessary investments made in underutilised assets due to inaccurate forecasting and perverse incentives; and
- an ineffective economic regulatory regime, including the Limited Merits Review process, that has allowed inefficient network expenditure and expenditure recovery.<sup>9</sup>

As the ACCC makes clear, given investments have already been made, consumers will be burdened with these costs for years to come.

### *Retail costs*

The current structure and operations of the retail market have also contributed somewhat to higher electricity costs. In NSW, the costs of retailing (including profits) for an average household bill increased by 34-53% between 2007-08 and 2015-16. In addition, retail profit margins are increasing in NSW.<sup>10</sup>

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<sup>6</sup> ACCC (2017) *Retail Electricity Pricing: Preliminary Report* pp. 43-44.

<sup>7</sup> Ernst & Young (2014) *Electricity network services: Long-term trends in prices and costs*, p. 6 [http://www.ey.com/Publication/vwLUAssets/EY-electricity-network-services-eng/\\$FILE/EY-electricity-network-services-eng.pdf](http://www.ey.com/Publication/vwLUAssets/EY-electricity-network-services-eng/$FILE/EY-electricity-network-services-eng.pdf)

<sup>8</sup> ACCC (2017) p. 50.

<sup>9</sup> ACCC (2017) pp. 108-114.

<sup>10</sup> ACCC (2017) pp. 43-44, 75.

The ACCC Inquiry found that while the retail market has some characteristics of a competitive market, it is missing some vital signs of a well-functioning competitive market. Retail markets across the NEM have numerous retailers with a range of offers, relatively high rates of switching, and significant price dispersion. However, they do not have low levels of market concentration, low margins and prices, nor a range of innovative tariff types and service options.<sup>11</sup>

The ACCC Inquiry will further investigate why the introduction of competition is not driving down or constraining retail costs, including whether the extent of vertical integration is limiting the ability of smaller retailers to compete. It notes that despite 10 years of competition in Victoria, the retail component of customer bills continues to increase.<sup>12</sup>

A recent Grattan Institute report also found that competition in the retail market has not delivered the promise of lower prices for consumers while the profit margins of retailers in Victoria – the most mature deregulated retail market in the National Electricity Market (NEM) – were found to be excessively high.<sup>13</sup>

The recent Victorian Review of Electricity and Gas Retail Markets noted that:

*Traditional reviews into retail energy prices have focused on using either standing offers, current market offers, or a combination of the two in reaching conclusions, and not what consumers are actually paying. This gap in real data was made clear to the review panel by consumer advocacy groups at the start of the review. The review panel was unable to compel retailers to provide details of their operating costs or margins. To address this gap, the review panel commissioned new research to collect and analyse data on what Victorian energy consumers are paying, sourced from their actual energy bills. This provided critical research on actual prices being paid and benefits that could be achieved by switching.*

*The research results found that Victorian households are paying much higher prices than official estimates.<sup>14</sup>*

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<sup>11</sup> ACCC(2017) p. 120-121

<sup>12</sup> ACCC (2017) p. 101

<sup>13</sup> Grattan Institute (2017) *Price Shock: Is the retail electricity market failing consumers?* <https://grattan.edu.au/wp-content/uploads/2017/03/Price-shock-is-the-retail-market-failing-consumers.pdf>

<sup>14</sup> Victorian Government (2017) *Review of Electricity and Gas Retail Markets*, p. viii [https://engage.vic.gov.au/application/files/7415/0267/4425/Retail\\_Energy\\_Review\\_-\\_Final\\_Report.pdf](https://engage.vic.gov.au/application/files/7415/0267/4425/Retail_Energy_Review_-_Final_Report.pdf)

The review found that the retail charge – the component of the total bill that covers the retailer’s costs and profits from selling energy – is a major contributor to energy prices in Victoria. Using the above methodology, the review compared average retail charges in Victoria with other jurisdictions, and found that NSW had the second highest retail charge<sup>15</sup>:



The review found that rises in the fixed charge component of the bill has contributed to price increases, which locks in costs for consumers despite declining consumption. Like the Grattan Institute, the review concluded that the benefits associated with competition have not been delivered to consumers. The review identified that based on the higher relative retail electricity costs in Victoria, there was evidence of market failure due to:

- the cost of competition;
- the structure of the market; and
- the practices of industry.

<sup>15</sup> Victorian Government (2007) p. 17.

## Retail electricity deregulation

Electricity prices were deregulated in NSW on 1 July 2014 following the introduction of full retail contestability in 2002. The NSW Government deregulated the electricity retail market following determinations reached by IPART and the AEMC that price regulation in NSW was no longer necessary due to the extent of competition in the market, with the AEMC adding that regulation may be inhibiting price competition.<sup>16</sup>

At the time of the Government's consideration of retail deregulation, the NSW Business Chamber wrote to the relevant Minister to support the principle of price deregulation in a competitive market, but also expressing concerns about the lack of transparent, comprehensible information available to both electricity and gas consumers. This lack of consumer information was evidenced by the AEMC's finding that while the majority of surveyed consumers were satisfied with their current offering, many could access equivalent services at cheaper prices by switching offerings or providers. As a result, the NSW Business Chamber recommended that deregulation should be delayed until the widespread implementation of measures to increase consumer access to information.

In addition the Chamber recommended that if and when the market was deregulated, market monitoring as well as the power to reintroduce regulation should be in place to assess and address uncompetitive outcomes.

Following the decision to deregulate, the Government directed IPART to monitor and review the performance and competition of the retail electricity market. IPART recently released its draft report for 2016-17 which found that competition is continuing to improve<sup>17</sup>.

The NSW Business Chamber has some concerns with the approach used by IPART to determine the level of competition in NSW. As expanded on below, these concerns specifically relate to IPART's contentions that:

- the existence of innovative new products confirms competition;

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<sup>16</sup> NSW Government [http://www.resourcesandenergy.nsw.gov.au/energy-consumers/energy-sources/electricity/removal-of-electricity-price-regulation-faqs#\\_why-did-the-n-s-w-government-remove-retail-electricity-price-regulation\\_003f](http://www.resourcesandenergy.nsw.gov.au/energy-consumers/energy-sources/electricity/removal-of-electricity-price-regulation-faqs#_why-did-the-n-s-w-government-remove-retail-electricity-price-regulation_003f) (accessed 16 October 2017).

<sup>17</sup> IPART(2017) *Review of the performance and competitiveness of the retail electricity market in NSW: From 1 July 2016 to 30 June 2017* <https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/investigation-compliance-monitoring-electricity-publications-market-monitoring-201617/draft-report-performance-and-competitiveness-of-the-retail-electricity-market-in-nsw-october-2017.pdf>.

- NSW retail prices are efficient; and
- the market is working despite many consumers not being on the lowest price.

### *Market innovation*

In its 2015/16 review of competition, IPART stated that its prime reason to conclude competition is working in NSW was due to the fact that:

*In the two years since retail electricity price regulation was removed in NSW, market-led product and service innovation and price discounting have provided benefits to customers. We expect these dynamic efficiency benefits to continue.<sup>18</sup>*

The Chamber questions whether the mere existence of new products and discounting equates with better outcomes for consumers, particularly given the complexity associated with many of these offers. The Grattan Institute argues:

*(not) all pricing practices in the market add value for the customer – many make the actual offer more opaque. Discounts can obscure the actual price a consumer is paying for electricity. Bundling the electricity use with another product – a magazine subscription for example – can make it difficult for the customer to distinguish between what they are paying for the electricity and what they are paying for the other product.<sup>19</sup>*

The ACCC also found that the vast majority of consumers are still on a standard tariff suggesting that for the majority of customers, retail innovation has not delivered substantial improvements to help them manage their usage or materially improve the way they access energy.<sup>20</sup>

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<sup>18</sup> IPART (2016) *Review of the performance and competitiveness of the retail electricity market in NSW Energy – Final Report November 2016: From 1 July 2015 to 30 June 2016* p. 1.

<https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/pricing-reviews-electricity-publications-retail-electricity-market-monitoring-2016/review-of-the-performance-and-competitiveness-of-the-retail-electricity-market-in-nsw-november-2016.pdf>

<sup>19</sup> Grattan Institute (2017) p. 23.

<sup>20</sup> ACCC (2017) p. 101.



### *Efficient pricing*

IPART also stated that retail offers broadly reflected changes in the underlying market costs of supplying electricity.<sup>21</sup>

However, in addition to the findings of the ACCC and the Victorian review, analysis undertaken by CME for GetUp! found that on average, retailer charges (that is, the price paid for electricity by households minus wholesale and network charges) are significantly lower in the regulated ACT market than in the NSW market. This raises doubts about IPART's conclusion that retail offers in NSW reflected changes in the underlying market costs as it would be expected that retail charges in NSW should closely align with retail charges in the ACT.<sup>22</sup>

### *Prices paid by consumers*

IPART considers that if it is possible to shop around for a better price, this is a sign that the market is working and that "By some customers paying more than they need to, retailers are able to offer lower prices to others who do shop around".<sup>23</sup>

However, the ACCC argues "that customers paying the most for their electricity are not receiving additional services or specific benefits, but rather receiving services either equal to or less than those received by customers on competitively priced offers".<sup>24</sup>

The CME report found that in NSW, the retailer charge in the average of the best three offers from all retailers is considerably lower than the retailer charge in the average of the best offer from the big three retailers.<sup>25</sup> This is relevant given that the big three retailers still serve more than 85% of NSW small customers<sup>26</sup> and approximately 90% of all NSW customers.<sup>27</sup> This questions the presumption that consumers are actually better off given a strong majority of consumers are remaining with the big three retailers despite higher prices.

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<sup>21</sup> IPART (2016) p. 3.

<sup>22</sup> CME (2016) *Australia's retail electricity markets: who is serving whom?* p. 18  
[https://d68ej2dhhub09.cloudfront.net/1879-Australia's retail electricity markets Bruce Mountain FINAL.pdf](https://d68ej2dhhub09.cloudfront.net/1879-Australia's%20retail%20electricity%20markets%20Bruce%20Mountain%20FINAL.pdf)

<sup>23</sup> IPART (2016) p.5.

<sup>24</sup> ACCC (2017), p. 98.

<sup>25</sup> CME (2016) p. 23.

<sup>26</sup> AER (2017) <https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customers>

<sup>27</sup> ACCC (2017) p. 102.

In its 2017 Retail Energy Competition Review, the AEMC found that over the past five years in NSW, 44% of residential customers and 47% of small business customers have not changed their electricity retailer or plan.<sup>28</sup> This is relevant because:

*Market offer benefit periods typically apply for around 12 months from when consumers sign up with a retailer, whereas most consumers generally stay with their retailer for longer periods.<sup>29</sup>*

This means that almost half of all consumers could be paying too much for energy. The recent Victorian Review of Electricity and Gas Retail Markets found that Victorian households are paying on average around 21% per year more for their electricity than the cheapest offer available in the market.<sup>30</sup>

Of those business who reported being affected by energy prices in the NSW Business Chamber's September Business Conditions Survey, almost one-quarter reported that energy bills and offers were too hard to understand. This demonstrates the presence of a strong barrier to consumer participation in the market and explains the high levels of customer inertia.

### *Regional Competition*

The Business Conditions Survey also found that of those businesses affected by energy prices, 27% reported there to be insufficient competition in their region, and this was felt particularly in regional NSW.

Anecdotally, several regionally-based Chamber members that negotiate directly with retailers because of their higher energy use, claim there to be very few offers available to them.

### *Timing of offers*

While not necessarily related to deregulation, NSW Business Chamber members that are larger energy users have also reported concerns about the length of time which retail offers are available, and the inability for businesses to adequately assess and approve these offers in such limited time. For example, one business found retail offers in Autumn 2017 were only valid for less than 48 hours which made it almost impossible to properly consider. Other business have also cited seven day offers as difficult to

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<sup>28</sup> AEMC (2017) 2017 AEMC Retail Energy Competition Review p. 236  
<http://www.aemc.gov.au/getattachment/006ad951-7c42-4058-9724-51fe114cabb6/Final-Report.aspx>

<sup>29</sup> AEMC (2017) p. 34.

<sup>30</sup> Victorian Government (2017) p. viii

consider given the limited time and resources available to smaller businesses to duly consider these offers.

### **Government policy options**

The NSW Business Chamber contends that there is scope for government and market-led action to improve competition in the market. However, in any approach, there must be a balance struck between protecting consumers through additional regulation, minimising compliance costs (which would be passed onto consumers) and attracting/retaining new entrants in the market.

Given the impact that high energy costs are having on businesses and households now, there is an urgent need for government and energy industry action.

#### *Voluntary industry code*

As a first step, the Chamber recommends that a voluntary industry code should be developed for the retail industry, similar to the recent Australian Supplier Payment Code. This code would provide minimum standards for retailers to follow in presenting bills and offers to consumers. These standards would be designed to provide a common basis for comparison between offers, a minimum length of time to consider retail offers, and requirements for more legible information to be presented in bills. This would better equip consumers to navigate the energy market to ensure they are on the best deal.

The NSW Business Chamber notes the recent commitments from retailers to reduce complexity for customers following a meeting with the Prime Minister. While these efforts are supported, the NSW Business Chamber considers that these moves do not go far enough and that an industry code would ensure retailers' commitment to reduce complexity becomes business as usual.

#### *Updated review on NSW competition*

The NSW Business Chamber also recommends that IPART revises its approach to reviewing competition in NSW. As outlined above, there are some important concerns about how IPART arrives at its conclusions which should be addressed in any new approach.

As part of this review, work should be undertaken to access actual customer data rather than relying on retailer-provided data, to determine a consumer-

perspective of available offers. The Victorian Government commissioned such work as part of its review into the retail market.<sup>31</sup>

### *Additional regulation*

In the event that a revised approach by IPART finds that a significant proportion of consumers continue to remain on suboptimal offers, there is likely scope to further specify how retailers present offers and bills and communicate with customers about their level of usage and the opportunities for bill savings. This would allow more time for rigorous real-time retail price comparison and/or switching services to be developed.

However, fully re-regulating retail electricity prices should not be a knee-jerk reaction to current issues within the retail electricity market. The NSW Business Chamber is not currently convinced that re-regulating the retail energy market would lead to better outcomes for consumers.

As the Grattan Institute outlines, there are a number of problems with governments setting a regulated tariff:

- Setting the tariff would be complex and costly. Governments and their regulators would not have all the information they need available to them, particularly on hedging and retailer costs. If the government sets the tariff too high the impact of the intervention will be limited. If it is too low, some retailers will earn insufficient revenue to remain in business.
- An insufficient profit margin for new entrants could reduce the incentive for genuine innovation.
- Some customers currently on very good tariffs would likely see these tariffs disappear and end up paying more for their electricity.

The Grattan Institute concludes that the likely outcome would be a return to a retail electricity market dominated by the big three retailers who would all offer similar prices and compete on their service rather than price.<sup>32</sup>

The ACCC Inquiry notes evidence of adverse impacts following adding regulation to pricing:

*For example, after the United Kingdom's Office of Gas and Electricity Markets (Ofgem) introduced new rules that prevented retailers from*

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<sup>31</sup> See CME Electricity Analysis and CME Gas Analysis reports on <https://engage.vic.gov.au/review-electricity-and-gas-retail-markets-victoria>

<sup>32</sup> Grattan Institute (2017) p. 34.

*varying discounts across supply areas, there was a period of reduced competitive pressure and a reduction in low priced electricity offers.<sup>33</sup>*

### *Regional NSW competition review*

There are some significant concerns about the level of competition within regional NSW. IPART should undertake a detailed assessment of competition within regional NSW using a revised approach to determine if there are an adequate number of retailers presenting viable offers at efficient prices.

### *Improving customer engagement*

There is also scope for the NSW Government to have a strong consumer (including small business) education campaign about the retail market as well as to work through COAG to enhance the Energy Made Easy (EME) website. There is a lack of awareness about the EME website as well as concerns that the website does not contain all discounted offers available and is difficult to use which should be addressed urgently.<sup>34</sup>

### *Network Costs*

Previous decisions on network investments means that the costs of these investments are largely locked in and will need to be paid for over the life of these assets. However, the ACCC is undertaking further assessment on how to mitigate these effects and ensure that network costs are further moderated.

The NSW Government was previously the owner of all electricity networks in NSW and still retains full ownership of Essential Energy and 49.6% ownership of Endeavour Energy and Ausgrid. The NSW Government should acknowledge the contribution of network costs to high energy bills and work closely with the ACCC and the COAG Energy Council to seek ways to mitigate these costs and ensure future network costs are minimised.

## **Adequacy of planning to meet future electricity demand**

The NSW Business Chamber supports a national approach to electricity planning and any state initiatives should be consistent and complementary with federal policy and initiatives.

The Finkel Review undertook a considered assessment of the ability of the market to meet electricity demand and ensure security of supply. Implementing these recommendations, in conjunction with the work being

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<sup>33</sup> ACCC (2017) p. 124.

<sup>34</sup> AEMC (2017) p. 1.

undertaken by the NSW Energy Security Taskforce, should ensure adequate planning to meet future electricity demand.

### **Adequacy of government assistance programs**

As outlined above, businesses are significantly impacted by high energy prices which is why the NSW Business Chamber has been consistently advocating for government programs targeted at helping small and medium sized businesses to mitigate high energy costs. These government programs should be directed towards helping businesses better manage their energy use to reduce the impact of higher energy prices on business operations. The NSW Business Chamber was pleased to recently see the Premier announce additional energy efficiency programs for business, and is working with the Office of Environment and Heritage on the implementation of the programs which should occur as soon as possible.

Thank you for the opportunity to comment on this Inquiry. For more information please contact Larissa Cassidy

Yours sincerely

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