



Bulletin

- Water
- Energy
- Retailing
- Transport
- Financial services
- Healthcare
- Telecoms
- Media
- Post
- Competition policy
- Policy analysis and design
- Regulation
- Strategy
- Contract design and evaluation
- Dispute support services
- Market design and auctions

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Switching made simple

BRINGING CHOICE TO ELECTRICITY CUSTOMERS IN NEW SOUTH WALES

Competitive markets in electricity are now common, but few governments have extended the benefits of competition to the vast majority of users: domestic customers. One such is the state of New South Wales in Australia. Domestic customers in this relatively small market, compared to early liberalisers such as the UK and Germany, now enjoy a choice of retailers. As California shows, power reform is not easy. Frontier helped the government of NSW to get it right.

WHY LIBERALISE?

Delivering choice of electricity retailer is not a simple task and required considerable effort from Government, regulators, industry, and community stakeholders. So why go to all that effort? The answer lies in the benefits that competitive pressure can bring for customers. First and foremost is the downward pressure that competition applies to prices. Retailers will seek out more efficient ways of doing business, expand their customer base to spread their costs, and work harder to get better wholesale electricity →

deals from generators. But perhaps more important are the dynamic changes driven by competition. Since liberalisation in the UK, for example, retailers have developed services to better meet customer requirements, such as environmentally-friendly “green” power, choice of fixed versus variable tariffs, or offering bundled utility services: electricity, gas, telephone service and others. As the body responsible for energy policy, and the owner of the incumbent retailers in NSW, the Government was keen to let service be driven by customers’ own choices.



Competitive supply to large users was already in place when Frontier was called in to advise the Government in early 2000. Around 45,000 customers were enjoying the benefits of a competitive market, and many achieved significant savings.

Where these large customers were concerned, little Government intervention beyond the high

level regulation of the sector was necessary to ensure its smooth operation. However, extending competition to the remaining 2.8 million small business and residential customers in NSW a different framework was required. Frontier was engaged to advise the NSW Government on the appropriate policy settings for a fully competitive market and to oversee the entire implementation of these policies, from defining and drafting the regulatory instruments to the overseeing the development of the required IT systems. On Frontier's advice, the Government set the ambitious timetable of opening up the remainder of the market to full retail competition from 1 January 2002.

MAKING A MARKET COMPETITIVE

In practice, competition may be delivered by the stroke of a pen, as a Government may remove a franchise through a simple regulatory order: “As of date X, it is now legal to supply electricity to residential and small business customers”. But this is meaningless if customers don’t trust the process, competitors can’t afford to offer alternatives, or if the systems to support switching are simply not in place. Even worse, exposing customers to competition without a well thought out framework in place can leave customers worse off, and with a distrust of competition that could take many years to overcome.

The objective of retail competition is to deliver benefits to customers. Benefits will be maximised only where there is a real threat that a customer will choose a different retailer if they offer a better or cheaper service. Only a credible threat of losing or winning customers will alter retailer behaviour in favour of customers. We sought to maximise the potential for customer choice by:

- ensuring customers are confident about switching to a new retailer; and
- improving the scope for competing retailers to make offers for customers.

These two fundamental principles drove Frontier's advice on the design of the market, and its philosophy in overseeing implementation.

Customers’ willingness to switch from an existing retailer to a competing one will be driven by their perception of the costs of doing so, relative to the benefits they expect to achieve from such a switch. It is therefore important to minimise the actual costs of

Switching made simple

switching retailer, but also the perception of those costs, if the notion of customer choice is to be a credible one. The policy framework therefore addressed customer switching costs at a number of levels.

First, customers need to understand the service they are buying. The community is used to making trade offs about the costs and benefits of purchasing their meat from a supermarket or a butcher, but they have no such experience with electricity. It has simply been provided on the existing terms and conditions by the same entity forever. There is very little capacity for these customers, at least in the short term, to understand the range of trade offs between the price of electricity, and the level of service they receive. On the other hand, retailers are acutely aware that the removal of certain rights for customers may give them a competitive edge, at least until the market wises up. Governments intervene if they expect the market to fail to deliver efficient outcomes. For retail electricity competition, this meant addressing the information asymmetry between small customers on the one hand, and retail businesses on the other. To address the asymmetry, Frontier established core retail terms and conditions from which it is not possible to negotiate. Fundamental customer rights include a number of basic service standards, the right to free external dispute resolution through an Ombudsman, and a requirement on the retailer to follow a process, which ensures that payment issues are properly addressed, before a customer is disconnected. Beyond the core requirements, retailers are free to offer innovative services.

Customer access to information is enhanced by a Marketing Code of Conduct which regulates what customers must be told when approached, supply contracts that must disclose key terms and conditions, and bills that must allow customers to compare the offer they accepted with the billed amount. The Government also established a communication campaign to inform customers. With the catch phrase “Change or Stay, You’ll be OK”, it offers an objective, informative view of customer rights and obligations in the newly contestable market as a counterpoint to commercial offers being made by retailers.



Customers have a 10-day cooling off period if they move to negotiated supply. Also, once their contracts are finished, they can elect to return to a “default” level of service. The Government estab-

lished a safety net level of supply where specified retailers are obliged to offer supply to customers in their area on set terms and conditions, and at a price set by the independent regulator. These arrangements reflect terms of supply prior to the implementation of competition, and allow customers to “test the water” in the competitive market, knowing that they can go back to the regulated arrangements. This is another mechanism aimed at lowering the real and perceived costs of switching. Corresponding financial provisions back up these arrangements. To avoid a crisis similar to that in California, where regulated retail prices did not follow wholesale price increases, the Electricity Tariff Equalisation Fund was established. The purpose of the fund is to accommodate variations from trend in wholesale prices and to ensure that retailers supplying customers on regulated terms and conditions do so on terms that are competitively neutral. A “retailer of last resort” scheme was put in place to ensure a seamless transition back to a viable retailer in the event that a retailer fails.

KEEPING COMPETITORS HAPPY

Effective competition requires a sufficient number of credible alternative suppliers. We therefore sought to minimise the costs of entry to the market for retail electricity by smoothing the interfaces between competing retailers, on the one hand, and the various other parties whose cooperation is required to offer supply to customers.

Switching made simple

Central customer registration and transfer systems were developed so incumbent retailers could not withhold information or game the transfer process. It is also simpler for new entrants to deal with one central system under known rules, rather than interacting with all other retailers in the market.

Retailers must also deal with the network businesses that operate the poles and wires to customer households. In NSW, incumbent retailers are linked to the network service providers in their former franchises. It was therefore necessary to separate and clarify the obligations of the network businesses, and to set rules for their dealings with associated and competing retailers on competitively neutral terms. This also removes the requirement for new retailers to have to negotiate with a network monopolist for services.

Metering arrangements were a major issue. Requiring competing retailers to install new meters for customers wanting to switch would clearly create a cost barrier to customers taking competitive supplies. For a domestic user, the costs will probably exceed any cost savings from competition (as the Norwegian regulator discovered, after few domestic customers took up this option when markets were liberalised for all customers possessing half-hourly meters). Instead, as in the UK, a system of allocating customer loads to each half hour using existing meters – load profiling – was developed. At the same time, retailers can now use more expensive half-hour meters where they would like to offer prices to customers that reward them for shifting their use of electricity to cheaper, off-peak times.

KEEPING THE GOVERNMENT HAPPY

Competitive reform of the electricity industry is a key aspect of NSW Government policy, and it has a strong interest in its success. This meant not only setting the right policy framework, but also ensuring that the physical systems and processes needed to support customer switching were in place. We oversaw, and reported to Government, on the implementation of these systems which took place on time and consistent with Government policy objectives

Having set the rules, it is important that they are also enforced. In this regard, the responsibilities of the Independent Pricing and Regulatory Tribunal - responsible for electricity retail licence compliance and enforcement – were increased. Close ties between IPART and the Minister for Energy will ensure that the Government can respond to unforeseen market developments should this prove necessary.

And so far, the market is operating effectively. Many customers have switched to competing retailers, and incumbent retailers are targeting existing customers with better deals in the hope they will not lose them. But the market is in its infancy. The fine balance between protecting customer interests and allowing unfettered competition is yet to be fully tested and it is likely that over the next few months further refinement will be required. But the journey towards a brave new world of services and options for electricity customers in NSW has started.

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