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By email: submissions@aemc.gov.au

Australian Energy Market Commission
PO Box A2449
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Dear Commissioners

Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria – Second Draft Report

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Australian Energy Market Commission's (the **Commission**) *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets – Second Draft Report* (the **Second Draft Report**), which was released for consultation on 19 December 2007.

1 Overview

The Commission has found competition in the Victorian electricity and gas retail markets to be effective¹ and subsequently has provided advice for the removal of price regulation in Victoria.

Consumer Action believes that energy is an essential service, integral to health and wellbeing, and maintains that the social and environmental costs of removing price regulation have been insufficiently considered in the Commission's analysis, therefore undermining its finding of effective competition. As such, with respect, we disagree with the Commission's findings.

Specifically, we have consistently found the Commission's analysis to be overlooking the role of consumers in the market. The evidence, including the customer survey undertaken by the Wallis Group,² demonstrates that the vast majority of consumers are not actively participating in the market, but are responding only passively. The Commission's decision

¹ Australian Energy Market Commission, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets – Second Draft Report* December 2007, p.vii

² Wallis Group, *AEMC Review of Competition in the Gas and Electricity Retail Markets Retailer Study Research Report*

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that there is effective demand side engagement is, in our view, not supported by the available evidence.

If pricing regulation is removed, however, we are not convinced that the Commission's transitional policies will be sufficient to protect consumers. In particular, it is our view that consumers require information regarding tariff structures and rates across all products available in the market to ensure active participation in the purchasing of energy. Further, any price monitoring function must be accompanied by a defined role for government to re-enter the market should findings of unfair profiteering be found.

We do strongly support the Commission's proposal for a consumer awareness and education campaign, as well as its recognition of the need for better enforcement of consumer protections, particularly marketing misconduct. We do believe, however, that the consumer protection framework that applies to marketing could be extended so that consumers are able to centrally opt-out of all direct marketing, including door-to-door marketing.

2 Removal of price regulation

As outlined in our previous submissions to this Review, Consumer Action does not accept the logic that once energy markets are deemed to be competitive, the appropriate policy response need be to remove price regulation. While we acknowledge that the Australian Energy Market Agreement (**AEMA**) requires jurisdictions to phase out price regulation once the Commission finds that the market is effective, it is our view that the economic assumptions underlying this approach do not take into account the complexities and special characteristics of the energy market.

The energy market is characterised by the following:

- That energy is affordable, in recognition of the fact that it's an essential service; and
- That we must encourage conservation of energy to reduce consumer costs and greenhouse gas emissions.

Considering these characteristics, we are not convinced that the traditional economic approach to phasing out pricing regulation is appropriate. It is our view that it is erroneous for governments and regulators to automatically presume particular regulatory interventions (or non-interventions), without considering the entire market, including any special qualities in that market, such as the two outlined above.

The Commission argues that price regulation will distort efficient market outcomes. Rather than distorting price signals, it is our view that regulation that provides for default arrangements can actually ensure that consumers less able to exercise rational and informed choice in the competitive market can still access services at a fair and reasonable price. Better use of default options is based on a new understanding from behavioural economics about the systematic and predictable difficulties consumers can face in making informed and rational choices in complex markets, thus it responds to these problems to enhance the effectiveness of demand-side interaction in the market. Only 10 per cent of

consumers are actively shopping in this market.³ The evidence previously provided demonstrates that consumers who are passively shopping (ie, respond to direct marketing) are not always acting in their best interests.⁴ Pricing regulation that promotes default arrangements, therefore, has a broader role in promoting competition, by encouraging effective demand side responses.

We are also concerned about the removal of pricing regulation will also remove discipline from the market, leading to an increase in the types of offers being made. While the Commission supports this as “market innovation”, we are concerned that it will encourage intentional obfuscation and consumer confusion, leading to consumers having to rely on intermediaries⁵ or just making poor decisions. We discussed this issue in some detail in our submission to the First Draft Report, so will only recommend Scott Adams’ *The Dilbert Future* and his concept of ‘confusopoly’ for further reading by the Commission.

While the Commission has attempted to ensure it has followed the principles of good regulatory practice, it has failed to fully consider the implications of its decision to remove price regulation on social and environmental aspects of our society. We note that the OECD principles, quoted by the Commission, state that regulation should ‘produce benefits that justify costs, considering the distribution of effects across society and taking economic, environmental and social effects into account’.⁶ We believe that these effects have been ignored. Enabling market forces to determine efficient prices for retailers does not ensure affordable energy for all consumers. Targeted and relentless direct marketing campaigns do not ensure informed participation by consumers.

We are also disappointed that the Commission did not fully consider our suggestion regarding pricing principles as an alternative form of pricing regulation to the regulated price path, which has existed until now. In the context of increasing energy prices due to climate change responses, effective pricing principles might not only deliver affordable and environmentally positive outcomes for consumers⁷ but provide for default options as discussed above.

3 Obligation to offer to supply to sell energy and deemed supply arrangements

Consumer Action is pleased that the Commission acknowledges the importance of an obligation to offer to supply to sell energy being placed on retailers. This obligation responds to the fact that energy is an essential service, required by all to ensure health and wellbeing.

However, Consumer Action questions the value of an ‘obligation to supply’ when there is no price attached. Should retailers be in a position where they are obliged to offer to supply to sell energy, there is a risk that they will respond to this requirement by offering undesirable consumers market contracts that are highly priced. While the Commission found in its First

³ Wallis Group, *AEMC Review of Competition in the Gas and Electricity Retail Markets Consumer Research Report* August 2007 p.ii

⁴ Waddams, C. *Deregulating Residential Electricity Markets: What’s on offer?*

⁵ See our discussion below as to why intermediaries have not and will not emerge in this market.

⁶ Australian Energy Market Commission, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets – Second Draft Report* December 2007, p.11

⁷ Gavin Dufty, *Electricity Pricing – Delivering Social Justice and Environmental Equity*, in CUAC Expert Forum on Energy Pricing. 2007

Final Report that there was little evidence to suggest that customers who are considered 'undesirable' (perhaps high credit risk) are being excluded from marketing activities, it is our view that the incentive and ability of retailers to price discriminate will increase with technological advances and the removal of price regulation. This is discussed further below.

In terms of who should be obligated to offer to supply energy, Consumer Action believes that the host retailer/franchise approach should be maintained, at least for a transitional period.

As the Commission would no doubt be aware, the Ministerial Council of Energy's Retail Policy Working Group considered this issue in a recent consultant working paper.⁸ The recommendation of that consultant for the national regime was that;

The Law should provide that, for the purpose of the obligation to supply, a designated retailer is a retailer designated as such by a jurisdictional instrument of the jurisdiction or jurisdictions in which it supplies energy, and its designated supply remit is as specified in the instrument.

A designated retailer's supply remit may be specified by reference to:

- a geographical area;
- particular premises or classes of premises; or
- particular customers or classes of customers.

Under this approach, whether the obligation applies or not will be a jurisdictional decision, depending on whether or not individual jurisdictions elect to make a designation. Similarly, the method of specifying the scope of the obligation (whether on the basis of geographical areas, financial responsibility for the supply point or some other means) will be a jurisdictional decision.

We, along with other consumer groups, supported this recommendation, noticing that the financially responsible market participant (**FRMP**) approach, which is favoured by the Commission, has advantages including removal of the competitive advantage enjoyed by incumbent retailers. However, we were concerned that the model is untested and would require material changes to current consumer protection arrangements. For this reason, we support the status quo approach until the FRMP model has been tested in practice, as in occurring with its implementation in Queensland.

In relation to new connections, we also support the host retailer model. We see the significant risk with the distributor tender model being whether there is any assurance that retailers will want to compete for all new connections. There may be a range of reasons that retailers will not want to compete for new connections, including where the cost to provide energy is high (ie, rural areas) or there are other risks in relation to the connection applicants. It is essential for an obligation to supply to ensure that retailers cannot refuse to supply or facilitate a new connection due to increased cost or inconvenience.

⁸ MCE Retail Policy Working Group, *Composite Consultation Paper – National Framework for Distribution and Retail Regulation*, 2007.

4 Publication of standing offer prices

The Commission recommends that both host and new retailers ‘determine and publish their own standing offer prices in the place of the current regulated retail prices’. Consumer Action strongly supports this as a legal obligation provided the structure and content of information is also mandated and meaningful. However, we are concerned that the recommendation does not extend to a requirement to publish all energy offers and believe this is essential for the full engagement of consumers in a competitive market.

Economic theory states that effectively competitive markets require perfect information. There is no reason why we shouldn’t expect publication of all offers to ensure transparency in energy markets, as exists in competitive markets in the United Kingdom and Norway. The argument that transparent information promotes collusion⁹ is incorrect and misleading; transparent information in fact enhances competition by facilitating effective choice.¹⁰ The Norwegian Competition Authority itself plays a central role in facilitating access to information across Norwegian retailer offers by displaying all retailer price information, ensuring consumers are informed.¹¹

The principle of effective demand side engagement infers that should a consumer wish to shop around, they will need to know what offers are available in order to make a decision about which offer is in their best interests. We insist on price tagging in supermarkets; why should energy be exempt?

Further, as more information is collected by retailers about customer consumption with the rollout of advanced metering technology, the ability for retailers to price discriminate will be greatly facilitated. Retailers can learn about consumption patterns and willingness to pay of particular consumers, thereby tailoring offers. Currently, success in energy retailing seems to be predicated on growth in sales rather than profits. However, with improved information, it is not unlikely that retailers will seek to maximise profits by targeting particular types of offers to particular customers. While cross-subsidisation between consumers might not be a problem in some circumstances (especially in an environment where overall prices are efficient), more consideration needs to be given as to whether it will be the retailers’ inclination to cross-subsidise from low-income consumers to wealthier consumers. In a market for essential services, this would be patently unfair.

We also believe that failure to require publication of available offers will prevent intermediaries from entering the market. It is our understanding that energy brokers who have attempted to establish businesses have failed or are continuing to be delayed by the failure of some incumbent retailers to contract with them. This appears to be a market power issue – incumbents would prefer to keep customers they have rather than actively attract more customers on price. Mandatory publication of energy offers might facilitate the necessary introduction of intermediaries into the Australian market.

⁹ Davies S et al *Introducing Competition and Deregulating the British Domestic Energy Markets* CCP Working Paper 2006 S Davies, C Waddams Price and C Whittaker 2007 and Harker and Waddams Price

¹⁰ Ofgem, *Domestic Retail Market Report*, June 2007

¹¹ See <http://www.konkurransetilsynet.no>.

Consumer Action believes that standing offer prices should continue to be published in the Government Gazette as a central point of publication. The Government Gazette is particularly useful for advocates and policy makers, while publication in newspapers would be of direct benefit to consumers. Consumer Action also supports a requirement that both standing offer and market prices are published on retailer websites.

5 Price monitoring

Consumer Action supports price monitoring and believes that it is essential, should price regulation be removed. In the context of increasing energy prices due to climate change responses and other issues, a comprehensive regime of price monitoring will be required to ensure consumer confidence that industry isn't price gouging. We do question, however, why only standing offers will be monitored – to be useful, price monitoring should examine prices across the whole market or would otherwise provide a distorted analysis.

We also believe that, for price monitoring to provide incentives to business to price efficiently, there should be repercussions if the monitoring finds they are unfairly profiteering. As such, there should be a defined role for Government to step into the market should the price monitoring body make an assessment that there are pricing issues that need to be addressed.

6 Awareness and education campaign

Consumer Action welcomes the Commission's discussion of a consumer awareness and education campaign. Removal of price regulation is such a major change in the market that a wide ranging campaign will be required to ensure consumers are aware of their rights under the consumer protection framework as well as opportunities to maximise the benefits of a competitive market.

7 Retailer of Last Resort prices (RoLR)

We note that the Commission suggests that retailers' published standing offer prices may be appropriate RoLR prices. If each retailer has its own standing offer, which one would be the appropriate RoLR price? This issue is not canvassed by the Second Draft Report.

In our view, the market will always require there to be a regulatory process to determine a RoLR price. Further, some level of cost build up would be required to ensure that RoLR prices are no more than is reasonable.

8 Consumer protection enforcement

Consumer Action strongly supports the Commission's expectation that regulators respond appropriately and timely to instances of breaches of consumer protection provisions. We support more effective incentives for retailer compliance with current requirements, more effective monitoring of compliance and more targeted enforcement action where serious contraventions occur. Consumer groups are regularly dismayed by lack of explanation by regulators about why enforcement activities are or are not taken. And when enforcement

action is taken, significant delays frustrate the ability of enforcement to have a market wide impact. It is our view that regulators should be required to report more publicly and regularly about enforcement action that is taken.

We note the Commission's observation that none of the submissions appeared to refer to conduct that is not covered by the current consumer protection region, and that therefore no additional consumer protection regulation seems appropriate. We do not necessarily disagree with this finding, but would argue that the enforcement of current consumer protection regulation is often lacking so that breaches occur without significant penalties.

One enhancement to the existing consumer protection regime that we believe is required, however, relates to continued mis-selling practices in the door-to-door context. The joint Consumer Action and Financial & Consumer Rights Council report, *Coercion and harassment at the door: Consumer experiences with energy direct marketers*, demonstrates that breaches of the current regulations are occurring, and that regulators seem unable to prevent this. It is our view that an enhancement to the regulatory structure for direct sales would be an extension of the recently created Do Not Call Register, to become a 'Do Not Contact Register',¹² so that door-to-door marketers would be banned from contacting households who have indicated that they do not want to be harassed at home, thereby enabling consumers to centrally opt out of direct marketing campaigns.

We thank the Commission again for the opportunity to respond to this Review. Should you have any questions about this submission, please contact us on 03 9670 5088.

Yours sincerely

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¹² See the *Do Not Call Register Act 2006* (Cth) and www.donotcall.gov.au for details of the Do Not Call Register. We note that the Marketing Code currently provides for do not contact lists, but this is limited in that applies to individual retailers, not to the market as a whole.