



3 March 2014

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Commissioners,

Submission to the AEMC's 2014 Retail Competition Review

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Australian Energy Market Commission's (the **AEMC**) 2014 Retail Competition Review Approach Paper (the **Approach Paper**).

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal assistance, litigation services and financial counselling to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

The Approach Paper

We welcome ongoing reviews of competition within retail markets across the National Electricity Market (**NEM**), and the early consultation undertaken by the AEMC. In Victoria, the market has changed significantly since the last review of competition. At that time, despite the finding that competition was effective in both electricity and gas markets, we were concerned that there was no mechanism to review the impact of that decision, particularly the deregulation of retail prices. This review provides an opportunity to consider whether competition remains effective.

At the outset, we have two particular concerns about the framing of the Approach Paper. Firstly, it neglects to reference the role of energy in society—recognising that affordable access is a key issue, and competition will not be effective if it means that energy is unaffordable for a significant proportion of the population.

Consumer Action believes that the AEMC has not fully appreciated the nature of energy and the fact that the market for energy is in many ways unique. Energy is an essential service used by all consumers across Australia. Except in rare and exceptional circumstances, a regular connection to electricity supply is not discretionary or optional. In most instances there is no alternative to electricity. Electricity supports fundamental human needs including safe food

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(storage, preparation) and safe shelter (hygiene, lighting, temperature control). Electricity supports equipment that is critical to wellbeing and independence (health, communication). Beyond these fundamentals, electricity supports community engagement and family life (social interactions, employment and education). Gas currently holds the same position, especially in Victoria, where many households rely upon gas for cooking, hot water and as a low cost alternative for heating.

We acknowledge that competition is the framework chosen by policy makers to ensure consumers benefit in the energy market. But we believe that the AEMC needs to more clearly analyse the role of competition in driving market exclusion.

Our second concern is that the Approach Paper, as in previous competition reviews, focuses largely on the operation of retail markets from a supply side perspective, rather than the demand side. We acknowledge that work will be done to engage with consumers through surveys and focus groups and welcome that. However, if the terms of this engagement merely focus on consumer engagement and attitudes, it may lack any insight into whether competition is actually benefiting consumers, particularly in the price they pay and service they receive. We think examination of the demand-side must consider objective consumer outcomes after consumers have made decision to engage and switch providers.

We acknowledge that the terms of reference set by the Standing Council of Energy and Resources (SCER) do play a role in determining the approach taken by the AEMC. However, as energy is an essential service, any benefits from competition should be shared equitably across customer groups, including disadvantaged and low-income consumers. The AEMC needs to consider outcomes and benefits not only for consumers generally, but for particular classes of consumers, particularly those whose access may be restricted.

In a submission Consumer Action wrote to the Commission in 2007, in response to the First Draft Report for the Review of Competition in Victoria, we suggested that the Commission refer to the Organisation for Economic Co-operation and Development (OECD) Consumer Policy Committee's comprehensive checklist and toolkit for assessing regulatory change. The toolkit begins with questions assessing both the supply side and the demand side of the market, with questions for the demand side looking at consumer experience and behaviour, such as "Is the market sound?", "Are consumers enjoying the benefits of a competitive market?", "Is there information failure?" and "Are there behavioural biases affecting consumer decision making and outcomes?". We repeat this recommendation, and encourage the AEMC, seven years on, to undertake a detailed analysis of consumer outcomes on the demand side. Given that reviews of competition are annual, there is an opportunity to begin longitudinal surveys and data collection to develop insight into objective consumer outcomes.

Market definition

We support the AEMC's recognition of the differences between South East Queensland and the remainder of the Queensland market.

We do, however, believe there is evidence to support alternative market definitions that further recognise the diversity in the demand side of the market. In particular, the AEMC doesn't appear to have considered the 'sub-markets', which already exist in the market, and which will have different types of retail contract needs, for example those with solar installations with feed-

in contract arrangements in place. As consumers engage more with third parties, specifically those offering demand aggregation products, retail offerings available may change. As consumers become locked-in to particular types of retail offerings because of distributed generation or contracts with third parties, the AEMC needs to consider the effectiveness of competition for those subject to these restrictions.

Customer activity in the market

These questions form the crux of the information required to assess the effectiveness of competition in energy markets. There has been, since the AEMC first undertook competition reviews in Victoria, insufficient analysis of the experience of consumers in the marketplace.

AEMC should also consider the accessibility and reliability of energy related information that is easy to understand. Such information is a necessary pre-requisite to any decision to change provider. The AEMC should also consider whether robust information is used by consumers prior to making a switch, or whether decisions are made that are not considered, i.e. on the basis of a door-to-door marketer, or advertising which does not explain the offer in full.

Private as well as government run information sites/comparators can assist consumers with information as to deals available. Analysis needs to consider the extent that these sorts of tools are used by consumers, and whether it assists with their decision making. Consideration needs to be given to whether these tools provide reliable information. For example, only showing the tariff or discount without recognising that prices can be increased during the period of a fixed-term contract renders the information incomplete. We refer the AEMC to our recent rule change request, which discusses this issue in some detail.

In relation to switching, there needs to be some analysis and evidence sought as to whether switching is actually resulting in price reductions. For too long industry (as well as policy makers and regulators) have relied on the quantum of switching to inform them of whether competition actually occurs, regularly citing Victoria as the most competitive market (in the world). As noted above, we think there is a real opportunity for the AEMC to set up some longitudinal research tracking a number of customers that enter the market and what this means for the prices they pay and how that conforms to their expectations. And certainly, whether they have made decisions in their best interests. We refer the AEMC to the research of Catherine Waddams in the UK, and particular her work on "why customers leave money on the table".¹

We welcome detailed analysis on the motivators for customers switching, particularly from a standing offer to a market. We encourage this to consider the switch in the context of consumers moving household and the role of connection services which are often used by real estate agents and the like. We believe that these services takes the decision of which retailer to choose out of the hands of consumers.

We also encourage the AEMC to consider the impact of large retailers' decisions to no longer market energy contracts door-to-door, and whether this has impact on motivators for customer

¹ See, Catherine Waddams, ESRC Centre for Competition Policy & Norwich Business School University of East Anglia, Presentation to ACCC, 9 July 2013.

switching. It is our long-standing experience that the information provided to consumers at the door is poor and unreliable, and it is welcome that the large retailers recognised their inability to control salespeople who are largely working on commission. Recent analysis of complaints by EWOV in its Marketing and Transfer report², January 2014, shows an astounding reduction of 41% of complaints in relation to door to door sales following the welcome withdrawal from the practice by Origin, AGL and EnergyAustralia from September last year. We also note the overall trend in energy marketing and transfers in Victoria has been a decline (see Figure 1 below) since these withdrawals, and venture to suggest that this indicates that the previous level of switching was not in relation to considered decisions of consumers, but rather pressure at the door-step. This data does not suggest a robust competitive market with an engaged demand side.

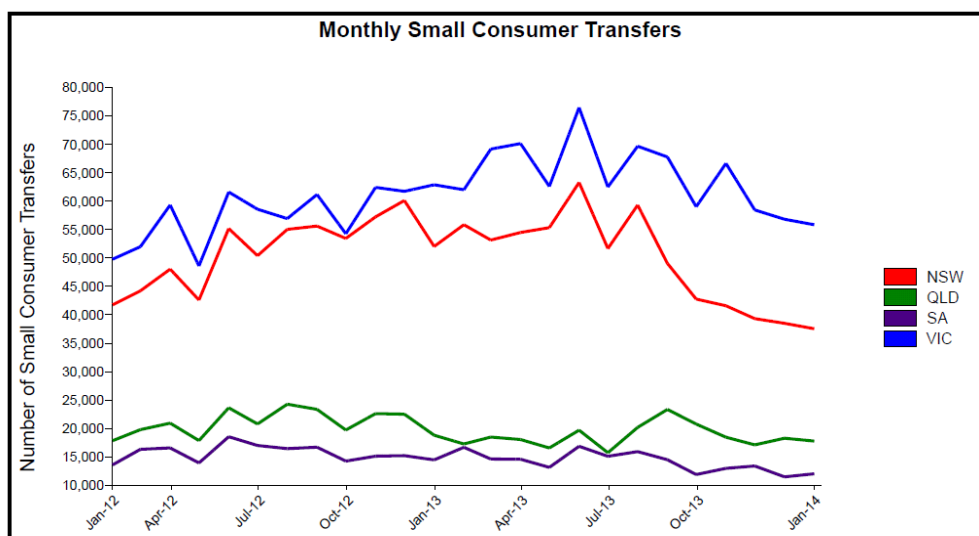


Fig 1: NEM Monthly Retail Transfer Statistics - January 2014³

In assessing the demand-side and motivations to switch, it is also important that the AEMC consider insights from behavioural economics and related analysis. Much work has been done by the UK energy regulator Ofgem, and we encourage the AEMC to consider that work in its analysis.⁴ The below table outlines a number of consumer biases and the effects on decision making in energy markets. In assessing measures to improve competition, the AEMC should consider these consumer biases and the way in which particular measures could be adopted to improve consumer decision-making.

² See, EWOV, Marketing Report, January 2014, available at: <http://www.ewov.com.au/reports/marketing-and-transfer-report-january-2014>.

³ AEMO, NEM Monthly Retail Transfer Statistics, January 2014, available at: <http://www.aemo.com.au/Electricity/Data/Metering/Retail-Transfer-Statistical-Data>

⁴ Ofgem, 'What can behavioural economics say about GB energy consumers?', available at: <https://www.ofgem.gov.uk/ofgem-publications/75192/behaviouraleconomicsgbenergy.pdf>

Consumer biases and effects on the decision making process

Bias	What does it mean?	How does it affect the decision making process?		
		Access	Assess	Act
Limited consumer capacity	Consumers have difficulties assessing many different options and large amounts of information about them.	Consumers' awareness of the challenges they face means that they do not search at all.	Consumers adopt filters or shortcuts to navigate the information (eg 'rules of thumb', 'reference points').	Consumers switch to an option that is 'better' instead of the best one for them.
Status quo bias	Consumers prefer the current option.	Consumers do not search for alternative deals beyond their current package and/or provider.	Consumers over-emphasise knowledge of existing package and/or provider.	Consumers do not switch away from current package and/or provider.
Loss aversion	Consumers attach more weight to monetary losses than to monetary gains and avoid risk taking behaviour.	Consumers search less when energy prices fall than when they rise.	Consumers give too much weight to possible losses relative to potential gains.	Consumers postpone making a decision.
Time inconsistency	Their preference for immediate gains means that they place too much weight on costs incurred now compared to future savings.	Consumers do not search for new or alternative energy deals.	Consumers over-emphasise short-term discounts.	Consumers do not make a decision.

Barriers to entry, exit or expansion

Increasing levels of vertical integration in energy markets must be assessed as a key factor affecting new market entry, exit or expansion. We refer the AEMC to our recent submission on the ACCC's assessment of AGL Energy's acquisition of Macquarie Generation for a detailed assessment on this issue.⁵

We note the recent, apparent strategic exit of Australian Power and Gas (**APG**) from the Victorian market (it was subsequently acquired by AGL). Not only did this exit contribute to further market concentration, it perhaps highlights a failure of competition producing durable consumer benefits. The customers of APG, who have, via a range of means, attempted to engage in the market, have likely ended up with an incumbent retailer, back at the price they originally paid, or more.

Independent rivalry

In Victoria, where prices are deregulated, there has been much noise in relation to innovation (retailers often cite this as the core reason why regulation should not be imposed upon them), but on close analysis, there is little evidence of innovation producing consumer benefits. While it could be perceived to exist largely in relation to the way businesses compete with each other, in reality it is largely based on the level of discounts, offers and incentives, obfuscated in contract terms and conditions.

⁵ Consumer Action, Submission to ACCC on AGL Energy acquisition of Macquarie Generation, available at: <http://consumeraction.org.au/submission-acc-consideration-of-agl-energys-proposed-acquisition-of-macquarie-generation/>.

We perceive there to be several other areas where businesses can 'innovate', as a first step, including basic regulatory compliance and customer care. There are several examples where businesses quite simply do not put their customers first, such as recent problems with EnergyAustralia's billing arrangements necessitating intervention by the regulator.⁶ By simply working to invest in long term customer retention strategies, energy retailers would be 'innovating' in a way that brings about customer benefits.

This is not to say that there is no innovation. We note that new entrants, such as Powershop, are offering innovative retail offers that do not seek to bind consumers to long-term contracts. Retailers that retain customers by offering quality services and competitive prices are more likely to be evidence of innovation than those that simply use confusing "discounts" and long-term contracts. That said, it is perhaps too early to determine whether newer business models are able to provide sufficient competitive pressure to encourage incumbent retailers to improve.

Customer satisfaction

We refer to our response on Customer Activity in the Market. Moreover, it is our view that customer satisfaction can only provide limited information about the effectiveness of competition. Especially given the consistent low ratings of consumer confidence in the energy retail sector, there is perhaps a risk that consumers become 'satisfied' with what would objectively be poor outcomes. We think this analysis needs to go beyond satisfaction and consider objectively the price and service outcomes for consumers, perhaps even in comparison with other industries (at least for service). We note the consumer website, Service Rage, consistently rates energy retailers far lower for service quality compared to other sectors, like banks or insurance companies.⁷

Similarly, recent research found the average ability of customers to understand pricing offers had fallen steadily since 2004, as had the ease of comparing new offers to the customer's existing terms and conditions.⁸ This finding suggests that customer satisfaction and experience of the market has not improved with previous findings about the effectiveness of competition.

It is true, however, that retailers are now offering greater service offerings to customers (i.e. ability to monitor usage through web portals, smart meter data etc). We encourage the AEMC to undertake some research about the extent of use of these tools, the ability of consumers to use and value this information, including an assessment of the risk that consumers become tired of these additional services and revert to passive consumption and low levels of engagement.

⁶ See, ESC, EnergyAustralia compliance issues, available at: <http://www.esc.vic.gov.au/Energy/EnergyAustralia-Compliance>.

⁷ Service Rage, www.servicerage.com.au

⁸ Wallis Consulting, Victorian's experience of the energy market, 2013, available at: <http://www.esc.vic.gov.au/getattachment/e9d3a916-1448-4e6e-bea5-48f3efc5c68a/ddd.pdf>.

Retailer outcomes

We encourage the AEMC to undertake detailed analysis of profit margins of energy retailers and assess whether retail margins are covering efficient costs only. In our view, this should be a key indicator in the AEMC's analysis. The research from the Victorian Essential Service Commission indicates a sustained increase in the level of profit margins, and that this indicated a decline in competitive tension.⁹

Please contact Janine on 03 9670 5088 or at janine@consumeraction.org.au if you would like to discuss these matters further/have any questions.

Yours sincerely

CONSUMER ACTION LAW CENTRE



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⁹ Essential Services Commission, Electricity Retail Margins Discussion Paper, available at: <http://www.esc.vic.gov.au/getattachment/18cdbc4-107b-497a-ab59-6cce797957c7/Electricity-Retail-Margins-Discussion-Paper.pdf>