

ENERGY CONSUMERS' COUNCIL

Submission to the AEMC Review of effectiveness of competition in the electricity and gas retail markets in South Australia

Introduction

The Energy Consumers' Council (The Council) welcomes the opportunity to comment on the AEMC Review of effectiveness of competition in the electricity and gas retail markets in South Australia.

The Council is a body established by the South Australian Minister for Energy in 2002 to directly provide high level policy advice on energy policy issues, including pricing and the reliability of supplies and services in the South Australian energy sector. The Council reports to the Government on a regular basis, thereby allowing representatives of energy users direct access to the Government and the ability to have a real and practical input into energy policy development.

The Council has been drawn from diverse backgrounds and represents the following groups:

- State Retailers' Association
- Electricity Consumers' Coalition of SA
- Business SA
- South Australia Farmers Federation
- Chamber of Mines and Energy
- The Property Council
- Council of the Ageing
- Consumers Association of South Australia
- South Australia Council for Social Service

Essentially, the Council does not believe that the retail market in South Australia is sufficiently robust and competitive to remove retail price regulation at this point in time. The points below highlight the Council's issues regarding the structure of the market and advertising and promotional concerns which may be affecting competition. The Council believes further encouragement of competition needs to be couched in terms of consumers having the ability to make active choices with a clear understanding of the reasoning behind the choice.

1. Market Structure

The Council believes there are market structure issues that affect the competitiveness of the electricity and gas retail markets that should be considered in any process of reviewing retail competition.

Barriers to Entry /Re- integration

The Council is concerned that the re-integration of some market participants in South Australia is a substantial inhibitor to the development of effective retail competition.

The Council notes that increased wholesale spot prices flows through to more expensive hedge contracts, thereby increasing the risk mitigation costs faced by all retailers. The Council considers these higher costs are better able to be defrayed by reintegrated retailers/generators, resulting in a cost barrier for smaller retailers. This market structure implies barriers to entry for smaller retailers.

In addition, the Council considers the privatisation of electricity and gas industries in SA has resulted in the creation of a retail duopoly where the sectors are dominated by AGL and Origin. The Council believes this duopoly makes entry by smaller, new retailers and their building up a cost effective scale of operations in SA more difficult.

Interconnection

The Council notes that the South Australian electricity market only has two physical interconnectors to the eastern regional pricing regions in the National Electricity Market (NEM). At times when there are interconnector outages (or when the available interconnector capacity is fully utilised), additional lower priced electricity is unable to be imported from Victoria, thereby removing or reducing the price constraints faced by South Australian generators and so increasing the risk for retailers operating in South Australia. The Council is concerned that in a situation where some retailers are vertically integrated and some are not, it is possible for the vertically integrated retailer to engage in behaviour that can have a significant effect on the profitability of their retail competitors.

Access to gas

The Council believes that, due to their location, some consumers may be limited in terms of the number of gas retailers from whom they can obtain supply. In particular, some small businesses may not be able to obtain multiple bids in sourcing their gas supply. The Council is also concerned with the effect of contractual restrictions on the ability of small retailers to source gas from both pipelines.

2. Information

The Council believes that there are issues in the marketplace in relation to information. These issues would need to be comprehensively addressed prior to any decision regarding the competitive nature of the market.

Awareness and understanding

The Council submits that there exists a duty of care to customers to ensure that adequate measures exist to protect the interests of small and/or

vulnerable customers. This is a relevant consideration in relation to ensuring consumers are able to access and understand information related to the market and market offers.

Despite high customer churn statistics, ECC members are concerned that awareness of full retail competition (FRC) appears to be low amongst certain customers in South Australia. For example, some customers are unaware that they can choose their retailer. The Council believes that some customers' understanding of the structure of the energy sector and how it operates is poor. For example, some customers appear to believe that ETSA Utilities (ie. the distribution enterprise) is their energy retailer.

The Council believes that the information that is currently available on the market can be exclusory and difficult to understand. If a customer is not aware of, or does not take advantage of, the ESCOSA Estimator service, information regarding market offers cannot be easily compared and bonuses included in offers cannot accurately be assigned values. Furthermore, information asymmetry between retailers and consumers can leave consumers at a substantial disadvantage when dealing with retailer sales representatives, especially "door-knocker" direct sales. The adverse implications of this asymmetry are exacerbated by instances of miss-selling, as some customers will accept the statements made by the salesperson as factually accurate and will not have sufficient awareness of the energy sector to question the representations made to them.

This power imbalance also manifests itself in a belief held by some customers that they are powerless to respond to increases in their energy bills, in terms of both the tariff charged and the amount billed. As a result, some customers behave simply as "price takers" and do not question the appropriateness or accuracy of their energy bill.

Some customers have found it difficult to assess the effect of non-price incentives such as free football club subscriptions and frequent flyer points.

Access to information

The Council believes that a proportion of the population is considered "information poor". This includes consumers without access to the internet, those with limited or no understanding of the operation of utilities markets and those who have a reduced capacity for domestic research and analysis. Those at risk include people with mental health issues, our aging population, those with English as a second language and those without access to information systems. For these consumers the ability to obtain information is significantly limited and, as a result, a "competitive market" essentially does not exist for them. It is also worth noting that South Australia is the state with the lowest internet saturation and the highest level of aging population in Australia, with currently 1 in 7 South Australians over the age of 65 years and this set to rise to 1 in 3 by 2051.

3. Price

Price trends

The Council submits that energy prices have increased significantly since pre-FRC, with bills rising by 25-30% (nominal, since mid 2002). This increase includes the initial increase in prices due to the privatisation of the industry. Discounts to the Standing Contract rates are available in market contracts, however.

Standing offer price

The Council notes that a standing offer price may be considered to be setting an artificial price ceiling and providing a false view of the "right" price for energy. The perception in the community that the standing price is approved by a legitimate source and therefore is a fair price in South Australia. Conversely, it also provides consumers with a level of protection by essentially setting a maximum rate; and thus the ability for retailers to exploit customers is therefore limited.

4. Other Issues

Churn rates

The Council notes that churn rates are often used as an indicator of effective competition. The Council does not consider these rates of switching between retailers to be a definitive measure of effectiveness of competition. In the case of the South Australian electricity market, government intervention was required to encourage churn. That is, the cash-rebate provided by the South Australian Government in 2004 to concession holders to encourage them to switch to a market contract indicates that the market was not inherently competitive. This resulted in an increase of the churn rates for that period (and potentially also for churn rates downstream when the contracts taken in 2004 expire).

Churn rates alone do not adequately indicate whether or not the South Australian market is competitive. Churn rates in South Australia are also influenced by customers who move from one retailer to another as they become disconnected.

The Council believes that there is strong anecdotal evidence to suggest that a significant number of customers are choosing to change retailers on the basis of aggressive marketing practices or non-price inducements (for example football club membership), rather than better energy prices. Some people are therefore signing contracts which give them an attractive one-off non-price inducement but which results in them paying more for their electricity over the life of the contract, suggesting that switching contracts is not a good measure of effective price based competition and informed consumer choice.

Cultural consideration

The Council submits that some households do not actively question the costs of their energy bills. Combined with the information issues outlined above, it is unlikely that such customers would actively participate in the retail market to seek "a better deal".

Inset customers - Shopping Centre owners acting as "retailer"

The Council submits that there are a number of large shopping centres that effectively act as "retailers" of energy. That is, shopping centres would obtain one contract with a retailer for each centre and then on-sell the energy to the centres' tenants. As a result of this the tenants have no feasible opportunity to obtain better offers from other suppliers. The Retail Legislation does limit the charge to a maximum amount, which generally becomes the rate paid by the tenant, plus an amount for meter reading and servicing of the account. Any retailer who was able to access the market would then be required to pay an additional cost to the landlord for the supply of the energy from Shopping Centre access to Tenant's outlet again prohibiting access. Furthermore, the landlord is not constrained by any of the consumer protection regulations to which a normal energy retailer is subject. For tenants in this situation, a competitive market does not exist. The Council believes that this situation could also be a potential barrier to entry as another retailer would not be able to gain any customers in this area since individual tenants would not have the ability to switch.

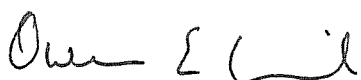
Lower Income Areas

The Council believes that some retailers may not be marketing to "lower income" suburbs. If this is the case, households in these areas are unlikely to be experiencing any competition in the retail market and are unlikely to be receiving any information related to gas or electricity issues to build their market understanding.

5. Summary

The Council believes that competition in the South Australian electricity and gas retail markets is not sufficiently effective to remove price regulation, leading us to the conclusion that regulation needs to be retained in the energy retail market in South Australia for the foreseeable future.

The Council believes that particular protection for lower income and other vulnerable households should remain and that the duty of care to the community is an important factor in considering any market developments.



Owen Covick

CHAIRPERSON

Energy Consumers' Council

15 April 2008