29 June 2007

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Australian Energy Market Commission
PO Box H166
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Dear Commissioners

Victorian Retail Competition Review – Response to Issues Paper

The Consumer Action Law Centre (Consumer Action) welcomes the opportunity to comment on the Australian Energy Market Commission’s (Commission) Review of the Effectiveness of Competition in Gas and Electricity Retail Markets Issues Paper (the Issues Paper), which was released for consultation on 1 June 2007.

1 Background

Consumer Action is very appreciative of the Commission’s early and informal consultation undertaken in preparation for the review. The Commission’s willingness to consult directly with consumer representatives in Victoria demonstrates its commitment to undertake a robust and comprehensive analysis. This gives consumers confidence in the process, and we hope that it continues throughout the review.

Consumer Action believes that fair, effective and competitive energy markets deliver the best price, quality and access to energy for the majority of Australian consumers. We strongly support the role of the Commission in setting a policy framework to ensure that a competitive energy market is maintained. However, Consumer Action maintains that competition policy is not an end of itself, but rather is one of several means to achieve market outcomes which satisfy consumer needs and are in the best interests of the community as a whole. In preparing its advice for the Victorian Government, we ask the Commission to consider not only measures that promote competition, but measures that ensure market outcomes are in the public interest.

In this submission, we have responded to the each of the following ‘Issues for Consultation’ listed in the Issues Paper:

- Market structure and conditions of entry, exit and expansion;
• Independent rivalry and the behaviour of retailers;
• Customer choice and behaviour;
• Price and service quality outcomes for customers;
• The role and impact of retail price regulation; and
• Impact of competition on vulnerable customers.

Rather than answering each question listed in the paper, we have limited our comments to each of these issues.

While we understand that the Commission primarily wants information about the extent of competition that has been experienced since the introduction of full retail competition, we note that it is very difficult to make conclusions about this due to the lack of market data, especially on the demand side. For example, there has been no published research about the outcomes for consumers who have switched in the competitive energy market. We believe that, as part of the review, research needs to be undertaken to understand consumers’ experiences with switching. Such research needs to be more than the Commission’s proposed consumer survey, which does not have the capacity to determine whether consumers have benefited from switching. Research should focus on whether consumers have received what they expected from the offer, including price benefits, if that was the reason they switched. We are concerned that, primarily due to complexity and information asymmetries, consumers may be making poor choices in the competitive market.

Further, there is not currently any comprehensive published information about the types of offers available in the market, comparing their price and other pertinent terms and conditions. Such information is required to determine whether offers actually match customers’ needs. Unfortunately, consumer organisations do not currently have the resources to collate this information. For Consumer Action to fully participate in this review and provide comments on the effectiveness of competition, we would require the Commission to collate and publish this information as soon as possible.

2 Issues for consideration

2.1 Market structure and conditions of entry, exit and expansion

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<td>• Despite bringing about some positive outcomes, there are still fundamental problems with the structure of energy markets in Victoria.</td>
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<td>• Increasing levels of vertical integration may be increasing incumbents’ market power and barriers to entry.</td>
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Consumer Action is generally supportive of the disaggregated energy market in Victoria in that it has contributed to improved outcomes for consumers.¹ We believe, however, that there are fundamental problems with the market structure and design which impede the operation of effective competition.

Increasing levels of vertical integration between competitive generation and retail sectors is proving to be a quandary for energy consumers. We do believe that there are significant efficiency benefits passed onto consumers from generator-retailer mergers, including improved risk management and reduced transaction costs. Paradoxically, these efficiency benefits arise through a process which may in fact diminish competition.

Vertical integration can result in a loss in the liquidity of hedge markets as integrated retailers hedge internally. Such a loss can result in barriers to new retail entry (as it becomes more difficult for new entrants to secure competitively priced contracts) and risk management problems for smaller retailers. This occurs when an integrated generator-retailer withdraws from the wholesale market because of the hedge that is created by the merger. The contract market becomes ‘thinner’ post-merger simply because there would be two less participants in that market. Generally speaking, the ‘thinner’ the contract market becomes, the greater are the incentives for remaining market participants to integrate vertically thereby causing further market concentration. Furthermore, the remaining generators may take advantage of a ‘thinner’ market to raise the price of wholesale electricity. This would have detrimental effects on all consumers given that wholesale price is a significant component of end-user prices.

While such diminished competition can impact adversely on consumers by not applying competitive pressure to prices, we are not yet convinced that this is a problem that efficiency gains from vertical integration do not overcome. There is some research from overseas that suggests that the best price outcome for consumers may come from joint ownership and re-aggregation.²

Related to this is the recent increase in wholesale prices across the national energy market that has occurred as a result of drought-related pressures. In Queensland and New South Wales, significant increases in forward prices for hedging contracts has led to arguments for increased allowances for wholesale energy costs in retail energy price cap determinations.³ This is likely to follow in Victoria. While not specifically demonstrating a problem with competition (but rather with market design), any increases in retail price caps which are purely a result of increased wholesale energy costs is a bad outcome for consumers. This is because retailers are far better placed to deal with risks of price spikes in wholesale energy markets. Passing on risks associated with wholesale price spikes to consumers, who aren’t

knowledgeable about the operation of the market, would result in inefficiencies and impede competitive outcomes.

In its recent retail price cap determination, the Independent Pricing and Regulatory Tribunal (IPART) concluded that there was no need to increase retail prices due to rises in wholesale prices. This was informed by analysis from Frontier Economics, which demonstrated that most retailers are substantially hedged (and may be even over-hedged) so as to manage wholesale price risks. Frontier Economics further stated:

In the current environment it is likely to be the case that retailers will not compete for new customers if this means that the retailers have to purchase new hedging contracts at current (high) prices. Retailers will be concerned that these relatively high price contracts will face a higher probability of being stranded (out-of-the-money) in the future; for example, if rainfall patterns return to normal and water restrictions are lifted earlier than current commitments.⁴

A decreased competitive environment because of rising wholesale energy prices has also been noted in recent reports suggesting that some new entrants are being driven out of the market.⁵ Reports from some retailers suggest they are scaling back entry into Queensland due to price volatility, and it can be assumed that there will be a scaling back of marketing activity in Victoria for similar reasons.

Most recently we have seen the withdrawal of Energy One, a second tier retailer in Victoria, from the retail market.⁶ This resulted in the first ‘retailer of last resort’ event in the national energy market, with a number of consumers being placed with alternative retailers. It should be noted that competitive markets will always bring about winners and losers – and the withdrawal of Energy One should be viewed as the failure of a competitor, not a failure of competition or regulation.

We do not accept that Energy One’s withdrawal relates to its inability to pass on rising wholesale prices to consumers, as it has suggested.⁷ Rather, it is our view that the failure of Energy One possibly relates to poor business practices, such as not adequately hedging against the risk of rising wholesale prices. Alternatively, we are concerned that Energy One’s withdrawal was strategic – and that it saw profits to be made through the on-selling of its hedge contracts. Its ability to continue trading and focus its activity on its marketing of billing software system suggests that it was not pushed to withdraw from the market due to solvency concerns. Indeed, it has claimed it was largely insulated from wholesale price spikes though hedge contracts.⁸ If Energy One’s withdrawal is strategic, it highlights considerable problems with the structure of the national energy market, and its consequent ability to bring about efficient outcomes that are in the long term interests of consumers. We additionally note that these events are particularly detrimental for consumers who are subject to transferral under the retail of last resort scheme, as they are charged $44 for electricity and $30 for gas to be transferred.⁹

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The Issues Paper also raises questions relating to development costs imposed by regulation, and business to business systems and processes. We do not believe that these costs create barriers to new entry. This is because they are placed on all market entrants equally. Additionally, the experience of the Victorian market suggests that these have not been a barrier to entry, considering the numerous new entrants to the market over the last couple of years.\(^\text{10}\)

In conclusion, Consumer Action holds serious concerns about the structure of the energy market in Victoria, and the ability of industry to push costs and risks onto consumers. Our concerns are magnified by the potential removal of retail price regulation, which would potentially push wholesale price risk onto consumers.

2.2 Independent rivalry and the behaviour of retailers

**Key points**

- Switching rates alone cannot be used to make conclusions about the competitive behaviour of retailers.
- There is evidence of many consumers signing market contracts without explicit informed consent.
- Marketing misconduct is widespread, and retailers commonly engage in misleading conduct in relation to green energy, upfront inducements and other contractual benefits.
- A market that relies upon direct sales, that is door-to-door and telephone sales, will rarely demonstrate effective demand side participation.

At the outset, it is our view that switching rates alone cannot be used to make conclusions about the competitive behaviour of retailers in the market. We believe that the Commission must undertake a more robust analysis of the types of marketing strategies being undertaken, as well as the financial benefits to consumers who do actively switch.

The Issues Paper asks about the extent of retailer conduct that distorts effective consumer choice or otherwise interferes with customers’ decision making processes (for example, misleading or coercive marketing). We agree that such conduct undermines effective competition and is likely to result in inefficient outcomes and reduce consumer welfare. It is our view that such activity is reasonably widespread in the market, despite the operation of the Essential Services Commission’s (ESC) *Code of Conduct for the Marketing of Retail Energy in Victoria* (the Marketing Code).

The Energy and Water Ombudsman (Victoria) (EWOV) continues to report that retail competition complaints make up almost 20 per cent of its case load.\(^\text{11}\) This is a significant amount, and many such complaints relate to marketing conduct. Further, we understand

\(^{10}\) There were 14 active retailers at the time of the 2004 full retail contestability review and there are currently 19 licensed retailers

that the ESC has recently referred at least one systemic marketing complaint to Consumer Affairs Victoria for regulatory enforcement activity.\textsuperscript{12} Consumer Action is currently preparing to undertake some research about marketing conduct, especially around the levels of informed consent.\textsuperscript{13}

We note that the Marketing Code provides that explicit informed consent must be provided before consumers enter into market contract.\textsuperscript{14} This is an integral consumer protection that enables the demand side, that is consumers, to effectively participate in the market. Explicit consent ensures that the consent is verifiable and auditable (in writing signed by the customer or recorded by electronic communication). Informed consent means that consumers are provided with all the relevant information prior to entering a market contract. Clause 6.3 of the Marketing Code sets out the required information:

- the type, frequency of bills and payment methods the consumer will receive;
- the details of all applicable prices, charges, tariffs and service levels that will apply to the consumer, where the retailer must declare that the price offered is inclusive of all costs, including GST;
- the full name, address and telephone number of the retailer;
- any rights the consumer has to cancel the contract, the charges, if any, that would apply on cancellation and the circumstances where these charges would apply;
- that the consumer may be contacted as part of an audit procedure, to confirm their understanding of and consent to the contract;
- all relevant information about any difference between the contract’s terms and conditions and the basic terms and conditions under the Energy Retail Code;
- in the case of contracts formed by marketing representatives in person off the business premises of the retailer, the full terms of the contract including the period of the contract; and
- whether the marketing representative will receive a commission or fee from the retailer if the customer enters into a contract.

We believe that the Commission should be undertaking research to ensure that explicit informed consent is being provided by consumers. If the above information is not being provided and understood, the Commission could not conclude that the demand side of the market is effective. Preliminary research undertaken by Consumer Action indicates that explicit informed consent remains a real problem in the market.\textsuperscript{15} The result of our proposed research will investigate this further – our case study report will demonstrate consumers’ experiences with switching, and whether the above information was provided and


\textsuperscript{13} It is proposed that this research will be undertaken jointly with the Financial & Consumer Rights Council.

\textsuperscript{14} Essential Services Commission, Code of Conduct for Marketing of Retail Energy in Victoria, clause 7.1.

understood. The research will focus on the experiences of clients of financial counsellors, who are perhaps the more vulnerable consumers in the marketplace. This research will be made available to the Commission upon its completion.

Another widespread marketing strategy that remains problematic is in relation to renewable or “green” energy. Despite the existence of accredited GreenPower, we are still seeing sales of “renewable” energy that is not accredited.16 Similarly, some companies offer a non-accredited portion (usually called the ‘backfill’) and market these products as “100% renewable”.17 We believe that these marketing strategies are consciously designed to confuse consumers and take advantage of consumers’ desires to be environmentally friendly. We note that the Public Interest Advocacy Centre, acting for environmental group Total Environmental Centre (TEC), has made an official complaint to the Australian Competition and Consumer Commission about the environmental claims in the advertising of some renewable products.18 TEC alleged that several companies misrepresented the environmental benefits of their products and engaged in misleading advertising. While some of the offending products have already been withdrawn from the market following this complaint, many consumers are still signed up to these products. It is our view that misleading marketing of green products significantly inhibits effective demand side participation in the energy market.

Consumer Action is similarly concerned about marketing strategies that rely upon upfront inducements to encourage consumers to enter into contracts. We are concerned that these inducements cause consumers to make irrational decisions not based on the actual subject matter of the contract – electricity or gas.19 Instead, inducements can actually impede demand side signals about efficiency by encouraging consumers to enter contracts which might not have the best price or service outcomes. While such upfront inducements might satisfy consumer preferences for a DVD player or magazine subscription, we are not convinced that they promote the market objective in relation to efficiency.

We are also becoming increasingly aware of misleading conduct in the provision of upfront inducements. For example, AGL is currently widely promoting its ‘Freedom Energy Plan’, which provides a 5 per cent discount of standard electricity and gas usage rates as well as a $50 AGL voucher. A letter of offer states:

There’s another way you’ll save with AGL – you’ll also receive a $50 AGL voucher. You can redeem it on a range of popular brand appliances at AGL Energy Shops, in regional areas or use it to pay for the services of one of AGL Assist’s reliable tradespeople.

However, after signing the contract, the voucher comes with stringent conditions that mean it is merely a credit on purchases of appliances greater than $400. This information is not made known to the consumer prior to signing the contract. Unless a consumer had planned to make a large appliance purchase, this voucher is next to useless. Consumer Action is currently preparing a complaint in relation to this practice.

16 See, eg, Red Energy which sells “100% renewable energy” from Snowy Hydro.
17 See, eg, AGL’s Green Living and Green Spirit products.
Consumer Action is additionally preparing a complaint in relation to a marketing practice of Origin Energy, which offers ‘free’ bill insurance from Tower Insurance should a consumer suffer accidental death.\(^{20}\) This conduct is misleading as it states that the insurance lessens the financial burden on family should a customer die – we note that should a customer pass away, their family would not be liable for their energy bill. We further believe that such conduct adversely impacts the competitive market, as its ties customers to Origin who would mistakenly believe they are gaining a benefit from their loyalty, thereby providing a disincentive to switching.

Finally, we note that most marketing of energy in Victoria is through door-to-door and telephone sales. Consumer Action believes that these sales channels are in and of themselves problematic, not only for individual consumers but also for the competitive market. By their very nature, door-to-door and telephone sales involve high pressure sales techniques. We note that in the financial services industry, there is an outright ban on door-to-door sales of financial products and services\(^{21}\) and there is also a ban on door-to-door selling of consumer credit.\(^{22}\) This is proscriptive regulation, which recognises that, faced with a salesperson on their doorstep, people infrequently make rational, welfare maximising decisions, especially those most vulnerable consumers with limited contractual experience. While the Marketing Code does strictly regulate door-to-door sales by prescribing certain information requirements and cooling-off periods, the financial services and consumer credit approach recognises the immense detriment that can ensue where consumers face pressure to purchase financial products and services where the transaction has been unsolicited. Energy contracts share some important features with consumer credit, namely that they both involve a deferred debt to be repaid, and if not repaid, can mean a default is listed on the consumer’s credit information file. While we are not currently seeking an outright ban on door-to-door sales in the energy market, we think the Commission should be aware of the reasons for the proscriptions which exist in other industries. Consumer Action believes 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’, so that to door-to-door marketers would be banned from contacting households who have indicated that they do not want to be harassed at home.\(^{23}\)

Furthermore, it is our view that a market which relies upon such marketing techniques will rarely demonstrate effective competition. This is because many consumer decisions in such a high-pressure sales context will not be rational, welfare maximising decisions, which give marketers appropriate signals about the types of products and services desired by consumers. It is our view that effective demand-side participation is a central tenet of effective competition.

\(^{21}\) Corporations Act 2001 (Cth), ss 992A and 992AA.
\(^{22}\) Consumer Credit Code s 146.
\(^{23}\) See the Do Not Call Register Act 2006 (Cth) and [www.donotcall.gov.au](http://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.
2.3 Customer choice and behaviour

**Key points**

- While regulatory tools have improved information asymmetries in the energy market, consumers still struggle with complexity and confusing information about energy offers.
- There is no evidence that consumers who switch actually receive promised benefits, and there is some evidence from comparable markets that suggest that consumers who switch obtain worse deals.
- Barriers to consumer switching are still significant, and regulators should investigate ways to reduce barriers to improve the effectiveness of competition.

a. Information asymmetries

Since the introduction of full retail contestability in Victoria, a number of market developments have occurred which have improved the ability of consumers to exercise choice. Importantly, the ESC had developed information tools that allow customers to effectively compare the price and non-price aspects of alternative offers.

First, the ESC has established the on-line Energy Comparator which allows consumers to compare a new offer with their current energy contract, by using a web-based form which undertakes the required analysis. Although it is not widely used (perhaps due to its complexity), the Energy Comparator is an important market development tool. Second, the ESC has released a product disclosure guideline which requires a standard form for energy product information on retailers’ websites, enabling consumers to compare like with like. Despite these developments, it is our view that there are still significant information asymmetries in this market which impedes consumers’ ability to make effective decisions.

Energy offers are most often presented to consumers in terms of a price per kilowatt hour, or as a discount from the regulated tariff. These are not frameworks in which a consumer can simply determine whether they will be better or worse off. For example, consumers for the most part have no idea about their levels of their consumption in terms of kilowatt hours. Presenting this information can merely serve to confuse consumers, rather than providing them with the information needed to make a rational decision. Providing price information as a discount from the regulated tariff relies upon consumers being on a standing contract. The ESC reports that 60 per cent of the electricity market and 53 per cent of the gas market have already switched and may have a different tariff, making the comparison irrelevant. We note that the energy is a complex market and there is no simple way to provide the relevant price information in a format that is easy to understand for consumers.

A particular example of confusing pricing structures relates to green energy. A recent investigation by CHOICE found that there are massive differences for accredited

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GreenPower products between both retailers and products.\textsuperscript{26} For an average household purchasing 100 per cent accredited GreenPower in Victoria, the premium involved ranged from $104 per year to $396.61 per year. The CHOICE article demonstrates that the variable pricing bases for green energy (ie, per week, per quarter, per kWh), and the complexity that this means for consumers, makes it difficult for consumers to choose the best product on the market.

Further, it should be remembered that energy is an essential service and, as such, is a service required by all households. Vision Australia reports that almost 17.5 per cent of the Australian population have a ‘print disability’ which means that they cannot easily interpret information that the majority of Australians take for granted.\textsuperscript{27} This will impact their ability to participate in the competitive energy market. Causes of print disabilities include:

- vision impairment or blindness;
- physical dexterity problems such as multiple sclerosis, Parkinson's disease, arthritis or paralysis;
- learning disability, such as dyslexia;
- brain injury or cognitive impairment;
- English as a second language – the ability to understand spoken English but not process written English;
- literacy difficulties; and
- early dementia.

It is not common for relevant information to be presented in a format accessible to people with a print disability. Absence of such information will result in no action, sole reliance on the advice of a third party, or, most worryingly, decisions being made without the requisite information being provided. Considering this, it is our view that safety-net protections must be maintained to ensure consumers are not unfairly disadvantaged by information being presented in a complex or confusing manner, or due to consumers not being able to understand or access relevant information.

We are similarly concerned about the primary method of information in the energy market being through the internet. We are of course supportive of information being provided through the internet, which is convenient to many consumers. However, there remains a “digital divide” among consumers, which results from unequal access to and usage of, information and communication technologies.\textsuperscript{28} The Commission needs to be aware that the potential for the internet to be used in constructive ways (such as empowering consumers through access to information) may not extend to more vulnerable and disadvantaged members of the community.

\textsuperscript{27} Vision Australia, ‘Including all consumers – communicating and transacting with people with a print disability’, Financial Literacy, Banking & Identity Conference – RMIT University, 25-26 October 2006.
\textsuperscript{28} ABS data for 2005-06 shows that only 47 per cent of households with an annual income less than $40,000 have access to a home computer, compared to 95 per cent of households with an annual income more than $120,000 or over: Australian Bureau of Statistics, \textit{Household Use of Information Technology, Australia, 2005-06}, Canberra: ABS.
Finally, while we recognise that the Commission undertakes its activities through the lens of the national energy market objective about economic efficiency, it must be remembered that consumers do not participate in the market in an economic vacuum. Information asymmetries in the energy market do not only relate to tariff structures and contract terms and conditions, but also in relation to demand management and energy efficiency. Any decision about the ongoing need for price regulation must be made with these factors in mind and with a view to creating a robustly competitive market that will be in the interests of consumers. In doing so, we urge the Commission to consider ways in which competition can be enhanced not only within an economic framework, but also within a socially and environmentally sustainable framework.

**b. Motivations for switching**

Consumer Action has considerable concerns about consumers’ motivations for making the decision to switch retailers. We are pleased that the Commission’s proposed consumer survey asks what motivates consumers to switch. We anticipate that many consumers will point to promises of discounts or price benefits. We believe it is incumbent on the Commission to undertake research that investigates such claims more rigorously.

For example, the Commission should undertake analysis to determine whether such consumers are in fact receiving the price benefits that they were lead to believe were to apply. Whether consumers actually receive price benefits will be dependent upon the contract and tariff they were initially on, and their consumption patterns. Recent research from the UK suggests that some consumers who believed they were switching to gain a lower price actually obtained worse deals.\(^{29}\) This is concerning, and may have implications as to whether markets demonstrating rivalrous marketing conduct between suppliers necessarily deliver efficient outcomes. Without such analysis, the Commission would be unable to make robust conclusions about the effectiveness of competition.

**c. Barriers to switching**

The Commission has asked for comment about barriers to a customer switching. We note that one particularly problematic barrier to consumers switching is the imposition of early termination fees. Such fees lock consumers into long-term contracts by charging a fee should the consumer switch. The ESC recently undertook an inquiry into the charging of early termination fees in Victoria, and consequently amended the Energy Retail Code’s regulation of such fees.\(^{30}\) The Energy Retail Code now provides:

> Any amount of an early termination fee payable by a customer upon the customer breaching their energy contract must be determined by reference to, and must not exceed, the total of the following direct costs incurred by the retailer in relation to that particular customer which remain unamortised at the time of termination:

i) pro-rata costs of procuring the customer to enter into the contract

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ii) additional costs of giving effect to the early termination of the contract, final billing and ceasing to be responsible for the supply address; and

iii) the value of any imbalance in the retailer’s electricity or gas hedging program to the extent that it is directly attributable to that breach of contract.\textsuperscript{31}

In its final decision, the ESC estimated such fees to be no more than $20 for the incremental administrative costs and hedge book imbalance costs for each energy account, plus the observable unamortised cost of an inducement received by the customer.\textsuperscript{32} Consumer Action strongly supported this finding and efforts by the Commission to estimate the cost to a retailer should a consumer terminate early. In spite of this, we are still seeing significant early termination fees in the market place which may discourage consumers from switching.

Consumer Action believes that the Commission should investigate solutions that would promote competition by reducing consumer switching costs. The UK’s National Consumer Council has argued that early termination fees are a particular barrier to switching that should be addressed by regulators.\textsuperscript{33} The UK energy market has addressed this issue – there is a requirement that a consumer can switch without penalty with 28 days notice. Consumer Action believes a similar rule in the Victorian energy market could improve competition.

Consumer Action would also like to point the Commission to the empirical work of Michael Waterson who has examined, \textit{inter alia}, the role of consumers in the operation of competitive energy markets in the UK. Waterson has concluded that structural solutions alone ‘will not suffice to render the industry competitive because of the behaviour of consumers’.\textsuperscript{34} Waterson argues that there are a range of barriers to consumers switching arising from consumer inertia, confusion and even sales and marketing pressure, resulting in consumers not necessarily acting ‘rationally’ when confronted with competitive market offers. Waterson’s research suggests that while energy markets are potentially competitive, in that the product is amenable to competition, there is not yet clear evidence that consumers are benefiting from competition in terms of consumers taking advantage of more competitive market offers.\textsuperscript{35} Learnings from behavioural economics more broadly, which examines actual consumer behaviour and identifies systemic biases and departures from the perfect rational consumer that is assumed by classical economics, should be used by the Commission to inform recommendations about how to promote effective competition.

\begin{itemize}
\item \textsuperscript{31} Essential Services Commission, \textit{Energy Retail Code}, clause 32(c).
\item \textsuperscript{32} Essential Services Commission, \textit{Final Decision: Early Termination Fees Compliance Review}, December 2006, 5.
\item \textsuperscript{33} National Consumer Council (UK), \textit{Switched on Switching? A survey of consumer behaviour and attitudes, 2000-2005}, December 2005.
\item \textsuperscript{34} Michael Waterson, \textit{The Role of Consumers in Competition and Competition Policy}, Warwick Economic Research Papers, July 2001.
\item \textsuperscript{35} Other research suggests that consumers’ are rationally reluctant to choose new suppliers, even where they may well-informed about product characteristics: Timothy J Brennan, \textit{Consumer Preference Not to Choose: Methodological and Policy Implications}, Discussion Paper, Resources for the Future, 2005.
\end{itemize}
2.4 Price and service outcomes for customers

**Key points**

- There is insufficient market data to easily determine whether price and service outcomes are reflective of long run supply costs and that services are those which customers desire.
- There are some market contract terms and conditions that are clearly not in the interests of consumers, such as terms which require consumers to sign direct debit agreements.
- Price benefits from competition have not been shared uniformly or equitably across all consumers.

The Issues Paper seeks comments and data on the extent to which the competitive market has been providing prices that are reflective of long run supply costs and services that are efficient and that customers desire. This is difficult information to source, and we believe that it is incumbent on the Commission to undertake this analysis itself. In particular, the Commission should identify and document the range of offers currently available in the Victorian market, together with relevant terms and conditions. Consumer Action is unable to comment fully on price and service outcomes for customers without such information.

We are concerned, however, that product and service offerings from retailers do not always accord with consumer preferences and needs. For example, we have significant concerns about contracts which require the use of direct debit.\(^{36}\) While for many consumers this payment method can be beneficial and lead to decreased costs of service delivery, for many low-income and vulnerable consumers, direct debit contracts can be inappropriate and leave consumers vulnerable to bank default fees should they not have adequate funds to cover the debit. While theoretically a consumer should be providing explicit informed consent before entering into a contract that requires a direct debit arrangement, as outlined in part 2.2 above, we hold considerable concerns about consumers providing the requisite consent. We believe that the Commission should be investigating the types of consumers that have signed up to these contracts.

A recent review of direct debit agreements undertaken by Consumer Action highlights this issue.\(^{37}\) The review determined that many direct debit agreements are effectively not a voluntary payment method for the benefit of both consumers and retailers (as they are meant to be), but are instead mandatory credit collection methods for the benefit of retailers alone. In particular, variation clauses of direct debit agreements mean that consumers’ accounts could be debited at any time, without notice. It is our view that such clauses are in breach of the Energy Retail Code, and manifestly unfair to consumers. Additionally, we believe that many such clauses could be in breach of Part 2B of the *Fair Trading Act 1999* (Vic) which deals with unfair contract terms.

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\(^{36}\) For example, Red Energy’s EvenPay product.

In relation to price competition and evidence of prices being reflective of the efficient long run costs of supply, Consumer Action believes that the competitive marketing of energy by retailers has not distributed price benefits uniformly or equitably across all consumers. Where price savings have been realised, greater benefits have gone to higher volume business consumers, and Melbourne metropolitan consumers, in preference to low volume, rural or regional consumers. In the energy market, profitability most often depends upon particular household’s consumption patterns. This is because higher retail margins can be made where consumption is high and, due to acquisition and other costs, households with low electricity loads (who perhaps use cheaper gas for space and water heating) are seen as relatively “low margin” consumers. Research of consumption patterns also suggests that low-income consumers generally consume less energy than high income consumers. This means that the market necessarily tends towards higher prices for consumers who have low-incomes and low-consumption.

The Essential Services Commission’s Comparative Performance Report for 2005/06 – Retail Energy Businesses does provide some useful information about the market contract offers that are being accepted by customers and their relationship to standing offer prices. Usefully, this report compared market price and non-price benefits (ie, upfront inducements) to the standing offer. The report showed that for customers in the Origin and TruEnergy local retailer areas, a number of market offers were actually at prices above the standing offer. Where market offers were better value, this generally related to an upfront inducement, and not ongoing energy costs. The report also shows very low levels of discounts from the standing offer tariff, which indicates that the standing offer rates generally set residential tariffs, rather than acted as a cap. This is contrary to the stated intention of the standing offer tariffs, when they were set in 2003. While not conclusive, it is our view that this analysis indicates that there is not a lot of competition on price in market offers in these markets.

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38 Above n 1. We note that a full assessment of distributional outcomes across classes is also unfortunately problematic because of the limited comprehensive and independent data.
41 See our comments above on upfront inducements.
42 CRA (Asia Pacific), Electricity and Gas Standing Offers and Deemed Contracts, report prepared for the Victorian Department of Infrastructure, December 2003, 43.
2.5 The role and impact of retail price regulation

**Key points**

- Retail price regulation in Victoria, that is the safety-net arrangement, promotes competition by acting as a ‘price to beat’.
- There is no evidence to demonstrate that the safety-net tariff does not allow retailers to earn a sufficient margin.
- It would be inefficient (and perhaps impossible) for tariffs to reflect the real costs of energy for individual consumers, and even if it was possible, residential consumers have a very limited ability to respond to price signals.
- The safety-net arrangements do not exist to address equity issues only, as they primarily encourage effective demand side responses through the provision of default options.

Consumer Action believes that the consumer safety-net arrangements that have operated in the Victorian energy market since the introduction of full retail contestability have been effective not only in ensuring access to supply, but in promoting effective competition. It is our view that if the safety-net arrangements were to be removed, there is a real danger that once-effective competition may in fact be diminished, delivering poorer outcomes for consumers. That being said, we believe there can and should be improvements to the way in which the retail safety-net operates.

In our view, the safety-net tariffs that are currently achieved through the price path negotiated between licensed retailers and the Victorian Government actually contribute to competition by providing retailers with a ‘price to beat’. Evidence that Victoria has the most contestable market in the world demonstrates that the safety-net tariff has not impeded competition.\(^43\)

In determining the standing offer tariff, the Victorian Government drew on advice from the ESC and independent consultants\(^44\) on the operating costs and margins that Victorian energy retailers faced in supplying standard domestic and small business customers. The Government accepted recommendations for the addition of ‘retail headroom’ in the margins allowed to retail businesses to compete below the standing offer. As such, the net margins included a significant allowance that would not be realised by any participant if competition were sufficiently robust.\(^45\) As stated above, we have since seen the standing offer tariff largely set the price in the market rather than act as a cap. This suggests that competition is not yet sufficient to push prices down. Yet the potential is there for competition – should the demand side really participate in this market, retailers would have to price below the standing tariff to maintain custom. While there is some indication that this is beginning to occur, we have limited data about the types of offers consumers are choosing to make a firm conclusion.

\(^44\) CRA (Asia Pacific), above n 42.
\(^45\) As above, 41-5.
Issues relating to retailers maintaining headroom as profit were exacerbated when the price path was re-opened in July 2006. The re-opening was largely the result of the ESC’s decision regarding Distribution Use of System charges, which were lower than expected. The ESC’s decision applied from January 2006, but retailers were not required to pass on reductions until July 2006 – essentially allowing retailers to profit for a period of six months. We see this failure to allow for network pass throughs as a failure of the regulatory regime supporting the standing offer, which in this case proved to be significantly detrimental to consumers.

We note that the Commission is concerned that the consumer safety-net arrangements may actually prevent further development of competition to the extent that the agreed price path is set at a level that provides insufficient margin for new entrants or to profitably supply some classes of customers. As outlined above, to date there has been no evidence to suggest that the margins allowed for in the price imputed by the standing tariff have been insufficient for retailers to profit. We note that recent increases in the wholesale spot markets have led to complaints from industry that they are being squeezed from the market.\(^\text{46}\) As outlined in part 2.1, we cannot support such views and believe that the Commission should be undertaking the relevant margin analysis to determine whether such claims are true. We note that the Commission has stated that such analysis is particularly difficult for the energy retail sector as the relevant costs are not easily observable.\(^\text{47}\) We recognise this, but believe that the Commission should scrutinise retailers’ claims about margins and not accept them without question.

Finally, we note that there has been much public campaigning from industry to remove price regulation, arguing that it actually creates costs for consumers.\(^\text{48}\) Consumer Action believes that such positioning is misguided, and that industry should be working with user representatives and governments to discuss and work on the future of pricing regulation. This is especially important as new technologies enter the market which will impact the way consumers consume energy, such as advanced metering technologies.

The Energy Supply Association of Australia (the ESAA) argues that there are significant direct and indirect costs of retail price regulation, which are ultimately paid for by consumers.\(^\text{49}\) The ESAA argues the costs of the regulatory processes required to determine the standing offer tariff are the primary direct costs. We note that the market will always require there to be a regulatory process to determine a regulated tariff. This is due to the operation of the ‘retailer of last resort’ (RoLR) scheme, which in Victoria is regulated by the ESC.\(^\text{50}\) Such a scheme is required to determine what supply contract (which includes a price) will exist between the RoLR and affected customers. In its most recent RoLR decision, the ESC found that the safety-net contract provides RoLR customers, who are in a vulnerable position due to their inability to exercise choice, with the necessary protection without placing them on more advantageous terms and conditions that similar customers

\(^{46}\) Matthew Murphy, ‘Retailer warns more may pull plug’, The Age, Monday 25 June 2007.


\(^{49}\) As above.

\(^{50}\) Essential Services Commission, above n 9.
served by other retailers.\textsuperscript{51} This was also an efficient outcome, as it didn't require the ESC to undertake the necessary work to re-determine an appropriate tariff.

The ESAA argues that indirect costs relate primarily to requirements for incumbent retailers to set prices on the basis of average retailer-wide costs, which means that the services to some customers are priced above incremental costs.\textsuperscript{52} Consumer Action notes that it would be impossible for the real costs of energy to be passed onto individual consumers, thereby providing efficient price signals – this would require each household requiring its own tariff. We note that the Commission agrees that it would be inefficient for retailers to conduct a cost build up for each type of customer in their customer base.\textsuperscript{53} The transaction costs in such an approach would outweigh any benefits from pricing signals. We agree with the Commission that cost efficiencies are more likely to be sought by retailers across the customer base rather than for specific customer types.\textsuperscript{54} Recognising that there will always be averaging of household energy prices, we believe that efficiencies are to be made by ensuring price regulation acts as a price to beat across the energy market. That way, retailers are free to compete by offering discounts from the regulated price where appropriate. In addition, where there is willingness to pay (as in the case of premiums for green energy), retailers could price above the regulated tariff so as to maintain their margin.

Regarding pricing signals, Consumer Action continues to be sceptical about market-wide efficiency gains arising from improved pricing signals for consumers. The elasticity of demand for energy, as an essential service that is non-substitutable, is extremely low. Indeed, research has suggested that to achieve a four per cent drop in demand for electricity, price changes in the order of 30-40 per cent would be required.\textsuperscript{55} This highlights how extraordinarily small consumer responses are relative to price changes. Considering this, Consumer Action remains unconvinced about the public benefits that can arise from the deregulation of prices which aim to ensure consumers respond to price signals in order to reduce demand.

Consumer Action has similar concerns relating to the rollout of advanced meters in Victoria.\textsuperscript{56} If the rollout depends on the deregulation of retail energy tariffs (as some advocate, to encourage time-of-use pricing), risks associated with volatile wholesale energy prices will be borne by consumers. Retailers will try to pass these costs on, to maintain profit margins. This will not necessarily be economically efficient, as industry is better placed to manage such risks, and may be able to keep costs down by taking out hedge contracts. Consumers are unable to do this, and will be forced to deal with price spikes. While advanced metering may help consumers understand and manage their demand for peak power, without concomitant regulatory supervision to ensure they are not unfairly disadvantaged, efficient outcomes may be thwarted.

\textsuperscript{51} As above, 20.
\textsuperscript{52} CRA International, above n 48.
\textsuperscript{53} AEMC, above n 47, 17.
\textsuperscript{54} As above.
We note other arguments that price regulation is a very blunt instrument for achieving equity or affordability objectives. The ESAA argues that pricing regulation requires the distortion of price signals to all customers even though the focus of government concern is usually a subset of the total customer base. It submits that ‘a well-targeted and transparent system of direct subsidies or vouchers to consumers is generally far more effective and equitable means of achieving social objectives’.  

The Energy Reform Implementation Group (ERIG) made similar proposals, claiming that ‘this avoids unintended supply-side effects that impact most on those most in need’.  

We agree that pricing regulation is a blunt tool if its sole use is to protect low-income and vulnerable consumers. However, we do not believe that the safety-net tariff which operates in Victoria constitutes such a blunt tool, both because it is not as “blunt” as is made out by ESAA and ERIG and because it does more than simply protect certain groups of consumers. The safety-net tariff is not blunt because it is not a price cap, but merely as a default option, and it allows consumers who are less able to exercise informed choice to still access an energy supply at a fair price. In its submission to the PC’s current review of the national consumer policy framework, national consumer group CHOICE makes the following recommendation:

Industry, consumers and government should work together to develop and implement better mechanisms, standards and contracts to enhance consumer confidence and market practices. These should include:

- a better use of “default options” in markets to ensure that that consumers who are less able to exercise informed choice can still access good quality products or services at a fair price (for example default superannuation funds),
- development of minimum standards for products in particular consumer markets (eg across the range of children’s products), and
- greater use of standard form contracts.

Consumer Action believes that this is one of the roles currently played by the safety-net arrangements that operate in the Victorian energy market. Rather than distorting price signals, it is our view that a default arrangement 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. In this way, it has a broader role in promoting competition, by encouraging effective demand side responses through the provision of default options. It is not simply a tool limited in its aims to protecting low-income and vulnerable consumers. We also note that the better use of default options, as recommended by CHOICE, is based on new understandings 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.

In summary, we are strongly concerned that removing the default price arrangements would diminish the effectiveness of competition in the Victoria energy market.

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57 CRA International, above n 48, 57.
2.6 Impact of competition on vulnerable customers

**Key points**

- Benefits of competition have not been shared equitably across consumers – in the competitive energy market, low-income and vulnerable consumers pay more to maintain a supply of energy.

- Efforts to assist energy consumers suffering from financial hardship are varied and inherently complex. Retailers, governments, consumers and community organisations have, and need to continue, to work together to ensure consumers maintain access to an affordable energy supply.

Consumer Action believes that competition, if left unchecked, will not necessarily bring about benefits to all classes of consumers, and may in fact be detrimental to low-income and disadvantaged consumers. In its review of National Competition Policy (NCP), the Productivity Commission (PC) found that although competition has brought about a number of key benefits for consumers, including improved productivity, sustained economic growth and increased consumer choice, it also concluded that the ‘experience with NCP reinforces the importance of ensuring that the potential adjustment and distributional implications are considered at the outset’.

The PC noted the ‘mixed impacts’ of reforms on regional communities and, in relation to its impact on inequality, stated that ‘it would be surprising if the NCP and related reforms had not contributed somewhat to the increasing dispersion of household incomes’.

Relating particularly to the competitive energy market, consumer research has demonstrated that the poor generally pay more for utility services. The research identifies four main causes for this.

First, there is often a lack of access to competitive market offers for energy. In the ESC’s previous review of the effectiveness of competition, it was noted that customers regarded as a poor credit risk were unattractive due to ‘the probability of bad debts and the debt management response process under the Retail Code’. There is no evidence to suggest that this has changed since 2004. Further, as noted above, customer attractiveness in terms of marketing offers are often driven by consumption levels, and as the ESC noted, ‘lower consumption levels tends to be associated with low-income and potential credit risk’. This conclusion is supported by results of the Victorian Utility Consumption Survey 2001 which show that concession cardholder households consumer 22 per cent less electricity and 35 per cent less gas than non-concession cardholder households.

Second, low-income and vulnerable consumers usually experience higher bills caused by poor quality housing, inefficient appliances and more time spent at home due to illness or

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61 As above, 89.
64 As above, 64.
unemployment. For the competitive market to bring about equitable outcomes for consumers, these issues need to be addressed by Government and policy-makers.

Third, low-income and vulnerable consumers are more commonly penalised in the form of reconnection fees and contract termination fees. Following the ESC’s Energy Distribution Price Determination, a fee is charged by an energy distributor when reconnection occurs after disconnection due to non-payment. This amount is currently $65.90. Such a fee only hits households who have been disconnected, who, by their very nature, will be suffering financial difficulty. Disconnection does not only have financial impacts of course, and consumer research has demonstrated the physical and emotional distress caused when consumers are disconnected from an essential service. Contract termination fees, discussed in part 2.3, also disproportionately hit low-income consumers, who, for reasons possibly beyond their control, may have to terminate a fixed term contract prior to its expiration date. Typically, this may occur in situations where a tenant has entered a fixed term contract and subsequently has to move out of the property they are renting. Even where contracts are portable, they sometimes cannot be transferred to a new supply address on the same terms and conditions (that is, the price for the service may increase or unused rebate amounts at the previous supply address cannot be transferred). Alternatively, a tenant moving into share accommodation may have no choice over their energy retailer as the household may already have an existing relationship with another retailer. These additional charges have the potential to compound the cost of energy services for low-income households, particularly tenants.

Finally, due to the essential nature of utility services, low-income households will do what they can to avoid disconnection, often resorting to the use of high cost and exploitative credit to pay bills. Consumer research has demonstrated that low-income consumers are typically forced into high-interest fringe lending products, such as payday loans, rather than being able to access less costly mainstream credit products. Clearly, the use of credit to pay for everyday expenses, such as energy, not only adds to the cost of the service, in terms of fees or interest that may be payable on the loan, but more significantly, it can lead to a debt spiral. Unfortunately, for many low-income consumers, using credit in order to avoid disconnection from energy may be the lesser of two evils.

Considering the above, we believe that the Commission must undertake a rigorous analysis of how low-income consumers have fared in the competitive retail energy market. This analysis should not be restricted to whether consumers are receiving competitive offers, but should also consider other costs that low-income and vulnerable consumers might be forced to bear.

In the Issues Paper, the Commission has asked which customers are likely to be considered vulnerable customers. Income of course is a central factor, but it is Consumer Action’s view that the disadvantaged are those who lack what most would regard as the essentials for a

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65 Anna Stewart, above n 62, 69.
68 Dean Wilson, Payday lending in Victoria – a research report, Consumer Law Centre Victoria, July 2002.
decent life. It is often claimed that the vulnerable are only a small portion of the population. We note, however, that vulnerability is often transitory and could be experienced by any consumer should they, for example, lose their job and not have ready access to alternative support structures. The Independent Committee of Inquiry into Energy Financial Hardship (the **Committee of Inquiry**) agreed with this view, and noted that ‘rather than spending effort on fine-tuning definitions for a situation that is known to be complex and fluid, the more effective use of effort is to develop systems that will respond effectively to people identifying themselves as being in hardship’.  

Consumer Action has been extremely supportive of the Victorian Government’s commitment to ensuring access to supply of affordable energy for all members of the community. The Government’s Energy Consumer Hardship Policy Statement, following from the report of the Committee of Inquiry, demonstrated the Government’s commitment to this principle.  

Importantly, this approach required energy retailers to:

- have a clearly articulated hardship policy that reflects best practice principles;  
- acknowledge and participate in a collaborative hardship mitigation framework with Government, consumers and the community welfare sector.

These requirements, in conjunction with a strong consumer protection framework which treats disconnection as a principle of last resort and the Government’s scheme of concessions for low-income consumers, contribute to ensuring consumers are able to maintain access to an affordable energy supply.

While it is our view that this approach successfully addresses problems relating to the financial hardship of energy consumers, it does not mean that the problem is solved. We note the Committee of Inquiry’s conclusion that ‘efforts to assist in energy hardship are typically varied and inherently complex’. We are concerned that compartmentalising the problem as being dealt with through hardship policies and concessions downplays the important role that other policies play in ensuring that the financial hardship of energy consumers is not exacerbated. Reports from financial counsellors, who regularly assist consumers experiencing financial hardship, suggest that despite the protections in place, some consumers still do not receive their entitlements and are not dealt with in accordance with regulated procedures without assistance.

Considering the above, it is our view that the Commission should investigate and support all policies and processes that aim to address the financial hardship of energy consumers in the competitive market. Energy hardship is a complex and multi-faceted market problem that cannot be left solely for the ‘welfare system’ to deal with.

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71 This obligation was inserted into the *Electricity Industry Act 2000* and the *Gas Industry Act 2001*, through the *Energy Legislation (Hardship, Metering and other Matters) Act 2006*.
72 The most important protections are found in the Energy Retail Code, which is supported by the requirement for energy retailers to pay compensation should they disconnect a consumer in contravention of that Code.
74 Committee of Inquiry, above n 69.
Should you have any questions about this submission, please contact me on 03 9670 5088.

Yours sincerely

CONSUMER ACTION LAW CENTRE

[Signature]

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