



12 April 2007

By email: submissions@aemc.gov.au

Australian Energy Market Commission
PO Box H166
Australia Square NSW 1215

Dear Commissioners

Reviews of the effectiveness of competition in the gas and electricity retail markets

Draft Statement of Approach

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Australian Energy Market Commission's (the **AEMC**) Draft Statement of Approach to the reviews of the effectiveness of competition in the gas and electricity retail markets (the **Draft Statement**).

We would like to comment on the following areas raised by the Draft Statement:

- The AEMC's approach and indicators;
- The AEMC's timetable and consultation methodology; and
- The relationship between competition and pricing regulation.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign focused, casework and policy organisation. It is formed by the merger of the Consumer Law Centre Victoria and the Consumer Credit Legal Service, and builds on the significant strengths of these two centres.

Consumer Action provides free legal advice and representation 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 throughout the community directly.

AEMC's approach and indicators

We broadly support the AEMC's proposed approach and the market structure, market conduct and market performance indicators it proposes to use to guide and inform its decision about the effectiveness of competition in energy markets.

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Importantly, it will be a robust analysis of how the indicators interact with each other that will present the best picture about the state of competition in energy markets.

We agree that the AEMC should examine how the indicators track over time. We believe that a mere “snapshot” of an energy market will not tell the AEMC or Governments much about what is happening in the market, such as how consumers are faring and the likely directions for the future. Analysis of performance over time is required to ensure that a rigorous understanding of the energy market is obtained. In overseas jurisdictions, we have seen market data trends that suggest the market does not automatically become more competitive over time, but that it can ebb and flow, with switching rates, for example, both increasing and decreasing substantially over time.

We are, however, concerned about the availability and quality of data available to the AEMC. For example, we continue to be concerned about switching data. If customer churn rates are to be referenced to indicate levels of competition, they must be an accurate measure of customer awareness and response to market signals. Their reliability as an indicator is compromised when the data does not distinguish between ‘active shopping’ by the customer and ‘passive transfers’. By ‘passive transfers’ we mean consumers who do not demonstrate any awareness of choice (for example, signing up with the dominant retailer in the area when moving house) or seek to compare offers.

Further, it is our understanding that market data collected from the National Electricity Market Management Company Ltd (**NEMMCO**) varies to some degree between jurisdictions. In Victoria, for example, NEMMCO has not, to date, recorded information about customers transferring from a deemed/standing offer to a market offer with their existing retailer. In South Australia, on the other hand, this information has been collected. In an Issues Paper released in 2003, the Victorian Essential Services Commission (**ESC**) argued that effective competition can be observed through ‘consumers switching between retailers, from market contracts being accepted with the existing (standing offer) retailer, active marketing by retailers and an absence of misleading or deceptive marketing by retailers’.¹ We are thus surprised (and concerned) to learn that the market data collected in Victoria three years later does not record consumers taking up a market offer with their existing retailer.

We believe accurate switching data overlapped with data on price variations would produce a much more interesting and valuable indicator. An indicator of an effective market would be one in which a high level of price variation coincides with a high level of switching. Price variations without customer response (through switching) on the other hand should, if consistent over time, cause concern. We note the AEMC’s position that it will be difficult for price (and profit margin) analysis to provide meaningful results. While we agree, we believe that it can be used in conjunction with other indicators to determine whether effective competition exists.

We therefore ask that the AEMC’s final statement of approach set out how it intends to analyse data sources critically and deal with gaps and inconsistencies in collected data sources.

¹ ESC, *Issues Paper – Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity*, (December 2003) p 11.

We agree that the AEMC should comprehensively examine activities upstream in the market. We are concerned that increasing vertical integration is dampening competition by making it more difficult for second-tier retailers to secure long-term energy contracts. This is not only relevant to the question of barriers to entry, however, but to how second-tier retailers that have entered the market are able to conduct themselves with regards to price and product innovation, including the extent to which second-tier retailers are ultimately able to charge competitive prices that cover their costs and maintain a reasonable profit margin.

We welcome the AEMC's approach to market definition. However, in assessing the effectiveness of competition, it is important for the AEMC to consider competition within various sub-markets, not only geographical, but also segmented by customer class. Such sub-markets may, for example, separate residential consumers from small business customers (i.e. by energy usage). Within these sub-markets, vulnerable customers such as tenants, customers with low incomes or customers residing in rural and remote areas may have varying experiences with competition.

The ESC, in its 2004 *Review of the Effectiveness of Retail Competition in Gas and Electricity*, was particularly interested in the experiences of different classes of consumers in the market place.² The ESC examined the attractiveness of various classes of customers to retailers by their consumption, by their energy type (whether they consumed both electricity and gas so as to be appropriate for dual fuel retail offers) and the experiences of low-income consumers, including concession card holders.³ In our view, any criteria for assessing the effectiveness of competition should specifically consider the experiences of a range of consumer groups in participating in the market.

AEMC's timetable and consultation methodology

We welcome the AEMC consulting on its methodology in undertaking the reviews of the effectiveness of competition. A rigorous methodology is essential to ensuring that the review process delivers advice that is based upon evidence, rather than perceptions, about what is happening in the market.

We understand that as part of its data collection activities, the AEMC will undertake customer surveys. We agree that customer surveys can give significant insight into customer and retailer behaviour in the market and the level of awareness and knowledge among customers about the market. However, we believe that any such surveys must be carefully cast and broken down by customer classes. We also note that many disadvantaged and vulnerable consumers (such as the elderly, people from non-English speaking backgrounds, etc) might not be able to participate in such surveys. As such, the surveys may not give a complete understanding about how the market is operating for all classes of consumers.

We also believe that customer surveys should consider consumers' experiences in regard to the marketing of energy. We are concerned about particular marketing

² ESC, *Review of Effectiveness of Retail Competition in Gas and Electricity – Public Draft Report*, (October 2004) p 32-3.

³ The Report found that while competition increased, it was not fully effective for around 60 percent of residential and small business customers. Within that group, customer classes perceived to have low consumption, poor credit or subject to off-peak tariffs were unlikely to be targeted by retailers. Another class of consumers having difficulty accessing any benefits from competition were tenants. Consumers within low income metropolitan areas and regional centres were also unlikely to be offered market contracts.

practices that do not encourage a competitive market, but in fact dampen competitive outcomes. For example, consumer confusion about the marketing of green energy continues even though there is now Government-accredited GreenPower. This is because many retailers still market energy as renewable although it is not accredited. We are also concerned with the practice of door-to-door marketing, which we believe targets lower socio-economic consumers, where it is perhaps 'easier' to obtain a sale. While the signing of an energy market contract requires a consumer to provide explicit informed consent, we are concerned about the level of information actually provided to consumers in a door-to-door or telephone marketing situation, including information about price or other fundamental contractual terms. Consumer Action plans to undertake a case study report on inappropriate marketing practices in the energy sector which we hope will be useful to the AEMC in its reviews.

We are also concerned about consumer motivations for switching – in our view, the AEMC's consumer surveys should determine whether consumers are receiving price benefits because they switched, and whether this was their main motivation for switching. Recent research from the UK suggests that some consumers who believed they were switching to gain a lower price actually obtained worse deals.⁴ This is concerning, and may have implications as to whether markets demonstrating rivalrous marketing conduct between suppliers necessarily deliver efficient outcomes. We believe that the AEMC should undertake similar research in the Australian context. We also recommend that the AEMC's proposed market conduct indicators also include an indicator examining the reasons or motivations for customers switching retailers.

We are pleased with the AEMC's commitment to rigorous stakeholder consultation as part of the reviews. We understand that Victoria is to be the first jurisdiction which the AEMC is to assess, and, as such, would strongly suggest that the AEMC make a concerted effort to engage with representatives of residential customers, including from consumer organisations, financial counselling organisations, emergency relief organisations and community legal centres throughout Victoria. The AEMC should also engage with customers outside of metropolitan Melbourne, who may have significantly different experiences with the energy market.

We also believe that the AEMC should engage with consumer representatives in other jurisdictions throughout the Victorian review, as the methodology used for Victoria is likely to be repeated for other jurisdictions. We suggest that the establishment of a national consumer consultative committee to the AEMC would assist the AEMC in this respect, together with assisting in other functions that the AEMC is charged to carry out. If the AEMC chooses to establish a national consumer consultative committee, we recommend the Commonwealth Consumer Affairs Advisory Council's *Principles for the Appointment of Consumer Representatives* to the AEMC.⁵ In our view, the application of these principles will ensure that the resulting advice or decisions will be more robust and more likely to be accepted by stakeholders.

We note that clause 14.11(a)(iii) of the Australian Energy Market Agreement (**AEMA**) states that reviews are to be conducted biennially for each jurisdiction. The AEMC proposes that the reviews will take a significant period of time, but no longer than 12 months. We imagine that jurisdictions will take up to six months to respond to the

⁴ Chris M Wilson and Catherine Waddams Price, *Do consumers switch to the best supplier?*, CCP Working Paper 07-06, available at: <http://www.ccp.uea.ac.uk/publicfiles/workingpapers/CCP07-6.pdf>.

⁵ Available at: <http://www.treasury.gov.au/contentitem.asp?NavId=014&ContentID=994>.

reviews. If these assumptions are correct, it appears that the AEMC will be required to begin a new review very soon after a jurisdiction has responded to a review. Considering the significant resources required to undertake the reviews, we find this concerning, and encourage the AEMC to recommend to the MCE to expand the biennial requirement.

The relationship between competition and pricing regulation

The AEMA committed jurisdictions to the phasing out of retail price regulation where effective competition can be demonstrated.

Consumer Action believes that fair, effective competitive markets deliver the best price, quality and access to goods and services for the majority of Australian consumers. We strongly support the role of government and the AEMC in setting a policy framework to ensure that a competitive energy sector is maintained.

However, Consumer Action maintains that competition policy is not an end in itself, but rather it 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. Further, we are concerned with the logic behind the commitment in the AEMA that assumes in advance that where effective competition is occurring, retail price regulation should automatically be phased out.

In our view, pricing regulation can contribute to effective competition. In this respect, where pricing regulation is removed, there is a real danger that once-effective competition may in fact be diminished, delivering poorer outcomes for consumers.

In Victoria, pricing regulation is currently achieved through the price path negotiated between licensed retailers and the State Government. This negotiated agreement is enforced by energy retailers having a licence condition requiring them to offer consumers who live in particular areas (ie. the energy retailers' host area) the 'standing contract' on regulated terms and conditions, including at prices that accord with the negotiated agreement. This is known as the consumer safety-net. Energy retailers are free to offer 'market contracts' to all customers at prices above or below those regulated through the price path.

In our view, this form of pricing regulation actually contributes to competition by providing retailers with a 'price to beat'. The addition of 'retail headroom' in the regulated tariff enables host retailers, as well as competitive 'second-tier' retailers, to competitively offer products at a price discounted from the regulated rate. While we would argue that the regulated price path should be monitored to ensure it does not allow retailers to over-recover, it is our view that the regulated tariff actually encourages competition.

We recognise that the AEMC is constrained by the terms of the AEMA in conducting its reviews and in the recommendations it may make where it finds that effective competition can be demonstrated. However, we ask the AEMC to ensure that, in undertaking its reviews of the effectiveness of competition, consumer welfare remains the central consideration. Consumer welfare in terms of the provision of energy is advanced not only by fostering competitive price and service offerings, but by ensuring continuous access to the affordable, reliable and safe supply of energy, in recognition that energy is not just another product but an essential service in the community. We trust that the understanding that energy is an essential service will underline the AEMC's reviews.

Further, in its advice to jurisdictions under clause 14.11 of the AEMA, we note that there is scope for the AEMC to consider and report on the extent to which retail pricing regulation may be assisting competitive market outcomes, even if it is not able to advise a jurisdiction to simply retain such retail price regulation. We have confidence that the AEMC will not merely advise that a Government deregulate where the market is competitive, but will consider issues in a more rigorous fashion, understanding the extent to which pricing regulation may contribute to competitive market outcomes.

In this respect, we note that the AEMA does leave scope for the AEMC to make recommendations as to, and for the jurisdictions to implement, specific retail price control measures aimed at different groups of users or regions if appropriate. For example, we are aware that pricing regulation continues to play a function as an important consumer protection when there is market failure. Many consumers, who are not targeted for competitive market offers, perhaps because of their location or consumption profile, continue to benefit from pricing regulation which ensures that they have access to energy services and are not redlined from the market.

Clause 14.14 of the AEMA also recognises that jurisdictions may maintain certain types of retail energy regulation notwithstanding the phasing out of retail price regulation, meaning that these sorts of measures may also be considered by the AEMC in its advice to jurisdictions.

Finally, while ultimately the AEMC must conduct the reviews in line with the terms of the AEMA, we urge the AEMC as a separate matter to consider advice it may be able to provide to the jurisdictions on areas in which the terms of the AEMA might be improved.

Should you have any questions in relation to this submission, please contact Gerard Brody on 03 9629 6300.

A handwritten signature in black ink, reading "Gerard Brody", enclosed in a thin black rectangular border.

Gerard Brody
Senior Policy Officer