AEMC Review
Review of Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia

Comments on AEMC First Draft Report:

A submission from

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Prepared with contributions from Headberry Partners and Bob Lim & Co

Preparation of this report has been partly funded by the National Electricity Consumers Advocacy Panel. The support of the Advocacy Panel is gratefully acknowledged by the Uniting*Care* Wesley Adelaide.

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"What the wise men promised has not happened, and what the d – d fools said would happen has come to pass" [1]

William Lamb, 2nd Lord Melbourne

British Whig Politician
Prime Minister 1834, 1835-41

[1] Of the Catholic Emancipation Act (1829), in H Dunckley *Lord Melbourne* (1890) ch 9

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Executive Summary

The Uniting*Care* Wesley is very disappointed with the AEMC draft First Report. We were very surprised that the AEMC could arrive at a firm conclusion that there is effective retail competition in electricity and gas in South Australia, without seeming to take significant issues, raised in submissions, into account. It is also disappointing that the AEMC had not ascertained for medium and large users and the AER their respective views of the competitiveness of the wholesale and retail electricity and gas markets in SA. We urge the AEMC to improve its processes in gathering evidence from a full range of stakeholders, and to give full consideration to all input.

This submission critiques the AEMC draft First Report and details the key issues that the AEMC must consider in order to reach an unambiguous conclusion.

1. <u>Introduction</u>

Uniting Care Wesley Adelaide (UCW) considers the AEMC's First Draft Report to be disappointing and this submission seeks to analyse and debate the evidence and information to further support its contentions. We focus on key issues that we made in our initial submission, evidence that we do not consider was fully considered in reaching the conclusions of in the draft report.

The Executive Summary of the AEMC's Draft Report said:

"Full retail competition (FRC) was introduced for electricity customers in South Australia in January 2003 and, in practical terms, for gas customers in July 2004. The objective of retail energy competition is to deliver efficient prices and services to energy customers, and to give customers the opportunity to choose amongst competing retailers and their various price and service offerings. Rivalry between competing retailers and the exercise of choice by customers maintains competitive pressure on retailers to manage their input costs effectively, to offer more cost-reflective prices and to improve and diversify the retail services they offer in order to better satisfy customers' preferences." (page ix).

The key elements of the quote above are:

- "The objective of retail energy competition is to deliver efficient prices and services to energy customers" and,
- "The exercise of choice by customers maintains competitive pressure on retailers to manage their input costs effectively to offer more cost-reflective prices (i.e. "efficient prices") and to improve and diversify the retail services they offer…"

This submission will comment on the AEMC's First Draft Report against the above two criteria concerning the raison d'être of retail competition.

Before doing so, however, UCW Adelaide would wish to place on the record its strong contention that the AEMC's First Draft Report has not only failed to analyse and debate all of the key issues comprehensively provided in our submission, but also, its conclusion that retail competition in electricity is "effective for small electricity" customers is simply an assertion that is not supported by comprehensive and rigorous analysis. It is not a Report that could justify a conclusion of effective retail competition in electricity, even at a preliminary stage.

The next sections address UCW's contentions and concerns with the first Draft Report.

2. UCW Adelaide's First Submission

This section repeats the key contentions presented in the UCW's First Submission and it is requested that the AEMC analyses these and provides the evidence and information and develops an argument that refutes the views of UCW, rather than disdainfully rejecting them with the words (page 32)

> *"…has not been persuaded by the evidence or information …"* .

Unless the AEMC does provide clear and concise reasons why it rejects the views put to it by submitters, it is difficult to escape the implication that it may have avoided debating the issues that are considered inconvenient.

2.1 The AEMC's approach to Retail Contestability

On pages 11 and 12 of UCW's First Submission, we argued that the AEMC's three analytical strands for assessing the effectiveness of retail competition were inadequate and that a fourth analytical strand – effectiveness of competition in the wholesale market – must be included in the AEMC's analytical framework.

The UCW submission stated:

> *"The AEMC notes that there are three analytical strands that need to be addressed (page 8):*
>
> - *the ease of entry into energy retailing in South Australia;*
> - *the nature and extent of rivalrous behaviour between retailers; and*
> - *customer behaviour, attitudes and information requirements in relation to the purchase of energy products and services.*
>
> ***This submission considers that addressing just these three strands is insufficient, and that a fourth analytical strand must be included in the analytical framework.***
>
> *In an electricity and gas market, a retailer must either provide its own energy (by being a generator or a gas field producer) or to have ready access to multiple and competing supply providers so that the optimum procurement strategy for the energy can be developed by the retailer to match the usage profile of its customers. This market for sourcing the energy by retailers is referred to as the "wholesale market", and this covers self supply (eg self generation) and supply procured from third parties (eg electricity spot market or "pool")*

If the retailer identifies that there is no competition at the wholesale level, then it has two options – to exit the market or to provide its own product. The costs of providing its own product creates an effective barrier to entry due to the retailer having to purchase its own generation or gas supply, and in the markets for both gas and electricity, this barrier constitutes a very high cost. Thus for the purposes of assessing retail competitiveness, it must be assumed that there is a wholesale market from which retailers can freely purchase energy supplies for the purposes of aggregation and on-sale. If a retailer is to be competitive, then this wholesale market must be competitive. If the wholesale market is not competitive (i.e. access to wholesale energy by a retailer is not at competitive prices) the scope for retail competition will, perforce, be limited or will be controlled by a dominant retailer vertically integrated with a dominant producer, as is currently the case in SA and will also apply as we move into the future."

The AEMC Issues paper in part addresses this issue as follows (page 12):

> *"Barriers to entry, expansion or exit in energy retailing in South Australia may take a variety of forms. A retailer may face a barrier to entry if it cannot secure access to wholesale energy supplies at prices that enable it to compete profitably with existing market participants, or if there are insufficient financial contracts available to allow the retailer to mitigate its price and volume risks. In the case of gas, retailers may require access to smaller, additional supplies of gas – "swing gas" – to balance discrepancies between system injections and withdrawals. Questions of access to wholesale energy and risk mitigation tools may also affect existing retailers seeking to expand their energy retail businesses."*

However, having access to the wholesale market does not necessarily imply there is effective retail competition, for if the wholesale market is not competitive then the retailers have limited scope to provide effective competitive retail offerings. This view is supported by the observations made by NERA to ESCoSA on a lack of competition in the SA wholesale gas market, even though there is access to gas by retailers, the limited competition in its supply reduces the effective competition amongst retailers.

The volatility of the SA electricity wholesale market must also be considered. SA in the summer of 2008 has exhibited the greatest volatility in the National Electricity Market since it began. It is axiomatic that the higher the volatility of the market, the higher the risk premiums that retailers have to bear to obtain financial hedges. In such a market situation, retailers that are not integrated with generators are at a *significant cost disadvantage, relative to a vertically integrated "gentailer".*

Thus a fourth analytical strand must be added to the three nominated by the AEMC – is there a viable, effective and competitive wholesale market from which retailers can freely source their energy supplies?"

That the AEMC paid scant attention to this issue is concerning and throws doubt on the conclusions reached by the AEMC.

2.2 What the AEMC mean by "forward looking approach"?

On pages 10 and 11 of UCW's First Submission, whilst not disagreeing with the AEMC's stance in wishing "to take a forward rather than backward looking approach" (to assessing retail contestability), we emphasised that "it is only by assessing current and past performance that the future structure of the market can be assessed as being competitive or not "(page 10).

Thus UCW said:

"If the underlying market structure shows deeply entrenched uncompetitive aspects, then irrespective of what assessments are made (eg based on promises by retailers) that might imply that the future might be more competitive, there can be no certainty that this will occur – in fact the reverse is true, if the underlying market structure is uncompetitive and likely to remain so, then future arrangements are, perforce, likely to be uncompetitive.

However, it must be accepted that any changes made to the historical structure that might affect the balance that did apply in the past, must also be taken into consideration. In this regard, it must be pointed out that the purchase of the dominant generator in SA (Torrens Island Power station) by the dominant retailer in SA (AGL Retail) which came about in early 2007, must be considered in detail in any assessment of retail competition in the SA region.

Thus the focus of attention must be on whether the underlying market structure is competitive, rather than only assessing the competitiveness (or otherwise) of the retail function in isolation.

The outcome of such analysis can be stated quite succinctly – an economically efficient market will deliver economically efficient prices, and to do so the economically efficient market must be economically efficient at all levels. Yet if there is one element of the market that is not economically efficient, then the market as a whole will not be economically efficient. If the inefficiency relates to a small element of the market cost structure, then there may be grounds to assume this

> *inefficiency will have minimal impact on the market as a whole. However, if the inefficiency relates to a large element, then the market as a whole must be considered inefficient."*

It comes, therefore, as somewhat surprising and confusing that the AEMC's First Draft Report, whilst recognising some

> *"…competitive risks and pressures in the small customer electricity sector… (that) have emerged that were not previously evident" (page 16)*

and that the

> *"…recent tightening of the supply/demand balance in the wholesale electricity market has contributed to increases in spot and contract prices, which have in turn increased prudential obligations and working capital requirements" (page 16)*

and whilst recognising that

> *"…these changes in wholesale market conditions in the presence of regulated standing contract prices with which retailers must compete (and) alter the environment in which energy retailers in South Australia are required to operate". (page 16)*

nevertheless, the AEMC concludes that

> *"…it expects that effective retail competition can accommodate these changes in the real cost of inputs as long as the standing contract and/or market contract prices are able to adjust to provide competitive retail margins." (page 16).*

UCW considers that:

- The AEMC appears to be selective with respect to what influences the future but more importantly it seems to have dismissed the importance of recent changes and their impact on the future. Whilst it clearly has noted the changes up to recent times are likely to influence outcomes, it then seems to blithely dismiss them as having a modest (if any) impact on the future of retail performance.

- Whilst recognising recent changes in the wholesale market might have an impact, the AEMC without any analysis or evidence or information, takes a big leap and arrives at a conclusion that

  "…effective retail competition can accommodate these changes" (page 16).
  In other words, the AEMC arrives at a (very significant) conclusion with limited analysis, evidence or information provided!

This approach is especially disappointing in a review of such critical importance to consumers, especially low income and disadvantaged consumers.

We wish to remind the AEMC that South Australian residential consumers took 'a hammering' when FRC was introduced for electricity, with average bills rising by about 25%. This was despite assurances from government, at the time, that competition would reduce prices.

Any process where the removal of price control for energy bills for SA households is being contemplated, or may be contemplated, must be undertaken with <u>extreme diligence.</u>

3. The Importance of Competition

The AEMC's First Draft Report states:

> *"In the absence of collusion or coordination, sellers' price and output decisions will be constrained by the competitive responses of actual and potential rivals and by the exercise of informed choice by customers. In the presence of these competitive conditions, no seller will be able to exert market power by raising prices above efficient costs or restricting output. The prices paid for products supplied in such a market will be economically efficient; that is, prices will reflect the efficient costs of supply" (p.6,7).*

UCW would wish to examine the AEMC's view of the importance of competition (as stated above) against our first submission and other key factors.

In UCW's first submission, very substantial material was provided to demonstrate that the SA wholesale electricity market is not competitive in that AGL/TIPS was able to persistently exercise market power during the March quarter 2008. We also pointed out that the AEMC's own consultants (NERA) had assessed that effective retail market competition was not possible if the wholesale market was not competitive. The AEMC's First Draft Report completely ignores those assessments. It is especially worth noting that during the March Quarter 2008 price events, there were no countervailing consumer responses sufficient to minimise the prices set by AGL/TIPS. Prices set were not at economically efficient levels (or costs); output was restrained and AGL/TIPS was able to exercise market power. In other words, there was an absence of competitive conditions.

The AEMC's attention is also drawn to the AER's Report[2]on the spot price in SA from 5-17 March 2008.

The AER Report stated:

> *"This report suggests that there were a number of contributing factors to the high priced events in South Australia. At the time South Australia was in the midst of an extended heatwave which created unprecedented levels of electricity demand. Electricity demand peaked at 3077 MW on 17 March, the highest demand ever recorded in South Australia.*
>
> *However, the report finds that bidding behaviour by AGL significantly contributed to the high priced events. On 5, 6, 7, 12 and 13 March, AGL was the only participant who offered significant amounts of*

[2] Australian Energy Regulator Spot Prices Greater Than $5000/MWh. May 2008

> *capacity at over $5000/MWh. In fact, around 80 per cent of capacity at AGL's Torrens Island power station was priced above $5000/MWh.*
>
> *The report also finds that network availability, in particular the import limit into South Australia from Victoria, contributed to the high priced events. The AER is continuing to investigate this issue."*

AGL/TIPS's bidding was not constrained by

> *"…the competitive responses of actual and potential rivals and by the exercise of informed choice by customers…" (AEMC, p7)*.

Moreover, AGL/TIPS was able to withhold capacity from the market in order to drive up spot prices, so that in March the average volume weighted price for the entire month increased to $325/MWh,

> *"…the highest-ever monthly price since the market started in 1998" (AER, p1).*

The AER report (Appendix B) on the SA price events showed that in March, very substantial amounts of capacity (predominantly owned by AGL) was not presented to the market when compared to the summer ratings of the plant. (AER, p9)

In addition, the AER report also demonstrated AGL's capacity to set spot prices at levels which avoided triggering the cumulative price threshold level (AER, p6).

The AER report demonstrates beyond any shadow of doubt that the largest electricity retailer and dominant gentailer in the SA region is able to aggressively exercise market power and raise spot prices to unreasonable and inefficient levels, without any ability on the part of competitors or consumers to mitigate such predatory behaviour.

The consequences of the March price events are manifold:

- retail contracts will rise substantially, as increased margins are necessary to meet the high spot prices and the increased risk margins
- actual and potential retail competitors to AGL will face higher risk premiums for hedge contracts
- actual and potential retail competitors to AGL unable to obtain hedge contracts (and not integrated to generation) will be forced out of the retail market
- retail price caps will need to be raised to reflect the increased costs of electricity and risks
- large users in SA are already being offered contracts at unreasonably high prices

In UCW's view, the SA electricity market at the wholesale level cannot be assessed as "effectively competitive" and therefore nor can the retail market, as the ability of AGL/TIPS to exercise sustained market power at the wholesale level have adverse implications for retail competition – AGL Retail will have a decided competitive advantage over competitors and potential competitors without access to hedge contracts or physical generation. This statement is not directly criticising AGL, which is rightly operating to maximise returns to shareholders. However, we are stating facts relevant to the SA energy market that impact directly on competitiveness.

The price outcomes at the wholesale and retail levels cannot be described as "prices (that) will reflect the efficient costs of supply" (AEMC, p7).

3.1 What is "effective competition"?

The AEMC states that:

> "Where markets are effectively or workably competitive, there is sufficient rivalry between firms to ensure that they strive to deliver the goods and services consumers demand at least cost, and for product and process improvement. Effective competition will also ensure resources move relatively freely between and within markets in response to consumer demand and price signals. Firms in an effectively or workably competitive market may have a degree of market power associated with products differentiation or innovation, but that market power will not be substantial or sustainable and will be subject to competitive erosion over time. At any particular point in time, resources may not be employed in their most valuable use, prices may deviate from costs and technologies can deviate from the most efficient ones available. However, over time, effective competition will drive the market towards efficient outcomes. Firms will continuously strive for competitive advantage against actual and potential rivals, they will seek out new profit opportunities to deliver the goods and services consumers want, and the market may always appear to be in a state of disequilibrium and change. This is the very essence of real world dynamic competition".

The AEMC further states (p8) that:

> "While economic models of competition can help inform our understanding of real world markets, the Commission's approach to evaluating effective competition draws on the approach adopted in relation to the development and application of competition law and policy (see Box 2.1 below). For any given market, an assessment of whether competition is effective will be a fact-based exercise, which assesses all of the relevant structural, behavioural and performance characteristics and their interaction."

UCW regrets to observe that the AEMC's First Draft Report is not adequately "fact-based" and does not assess "all of the relevant structural, behavioural and performance characteristics and their interaction" (p9).

It is disappointing that the AEMC sets out the criteria for assessment but then fails to provide adequate assessment which it could then use to develop its conclusions. Despite this the AEMC is able to reach an unambiguous conclusion that there is effective retail competition. We cannot reach the same conclusion on the basis of the evidence presented

To add insult to injury, the AEMC dismisses assessments from stakeholders that present a contrary conclusion, without providing any analysis or critique, simply stating that the AEMC is "not persuaded" is not an analytical assessment.

In UCW's view, the March Quarter 2008 and subsequent events clearly show that:

- potential and actual rivals will be impeded and not provide that "…[expected] competitive response…[to]…constrain the exercise of that market power." (AEMC, p9). The fact that AGL/TIPS can set the upper and lower prices on the spot market provide significant risks to potential new entrants and second tier retail competitors.

- medium to larger users have been unable to obtain quotes from retailers other than from one or two major retailers. The terms of the contracts have generally been for short duration and at prices that are around 50 to 100% higher than previously. There is very limited ability on the part of these customers to obtain rival contracts, thereby negating the AEMC's hope of "…competitive response…" from "…actual and potential rivals…' (AEMC, p.9).

The AEMC considers that its adoption of "a forward rather than backward looking approach" means that it "is therefore necessary (and appropriate) to consider the likely state of competition with and without such regulation and whether past trends are likely to continue" (AEMC, p.10).

UCW's first submission points to the changed market environment in SA since 2007, when in April 2007 the ACCC approved the merger of AGL and TIPS to create a dominant 'gentailer'. We understand that the ECCSA is prepared to provide separately lodged confidential submissions to the AER, to the AEMC which provide its views on the lack of competition in the SA wholesale and retail market (from a medium and large users' perspective) since 2007and into 2009. The "competitive' situation facing medium and large users are as follows:

- very limited interest on the part of retailers to offer contracts
- the offers from a very limited number of retailers are for short durations and at very high prices (some 50% - 100% higher than previously contracted prices).

4. Information Gathering and Consultation

Whilst the UCW notes the processes stated by the AEMC as necessary to

> "…ensure the Commission's assessment of the effectiveness of retail energy competition in South Australia is robust…" (p.16)

We are bemused by the AEMC's processes to date in:

- arriving at its conclusion (albeit in a First Draft Report) that the electricity retail market is effectively competitive, apparently without examining our assessment that the wholesale market is not effectively competitive, let alone simply dismissing that assessment on the basis that the AEMC is 'not convinced"!
- ignoring its own consultant's (NERA) view that effective retail competition is not possible if the wholesale market is not competitive.
- ignoring its own consultant's (LECG) survey results which reported that second tier retailers were exiting the retail market
- ignoring second tier retailers' concerns with the lack of liquidity in the wholesale market.
- ignoring the AER's recent $5000/MWh Reports on the 2008 South Australian Price Events which concluded that:
  - AGL/TIPS is able to exercise market power on a sustained basis
  - AGL/TIPS is able to raise or lower spot prices and to avoid infringing on the cumulative Price Threshold
  - AGL/TIPS is able to withhold generating capacity (especially during periods of high demand).

UCW is very concerned that the entire AEMC process appears to be about assessing the effectiveness of the retail market in SA so that retail price caps can be removed. The AEMC has embarked on an exercise on which its conclusions are based on a simplified view of economic theory whilst avoiding analysis of readily available first hand information.

The AEMC has available to it first hand information as to whether there is competitive retail competition in SA, by seeking input from consumers who do not have any retail price cap protection but are exposed to both the wholesale and retail markets. Consumers using more than 160 MWh of electricity each year are able to provide first hand information as to the state of competition in the retail market without the constraint of the retail price cap. Unfortunately, the AEMC did not elect to report information from this class of consumer at all, relying on observations from consumers who do have the protection of the price cap, and from retailers.

In this regard, UCW has approached the Energy Consumers Coalition of SA (ECCSA) whose members are exposed to an uncapped retail market, and even to the wholesale and spot markets. The ECCSA has advised UCW that they have been closely involved in addressing the issues of market power with the AER, as a direct result of the activities of AGL/TIPS during last summer. The ECCSA has provided detailed reports (some confidential) to the AER of how their members were impacted by the events during the March quarter of 2008. The UCW strongly suggests that AEMC seek access to this first hand information about the activities of the electricity market since the acquisition of TIPS by AGL in 2007.

Responses to the AEMC from second tier retailers were that they were exiting the SA market. The most common reasons given for this action were an uncompetitive wholesale market and insufficient “head room” between the wholesale costs and the price cap. If the AEMC had analysed the information provided to it by UCW it would have recognised that the second tier retailers were reflecting the concerns provided by us. It is primarily the lack of competition in the wholesale market that has caused the costs to rise to a level where the price cap is being reached.

This observation is also replicated in feedback received from consumers not under the retail price cap. They advise that second tier (and even some first tier) retailers are reporting to them that it is impossible to get hedges at any price from generators. Amongst the reasons given by generators for not providing hedges is that they are reducing their hedge book from what used to cover some 70-80% of their installed capacity to amounts closer to 50%. The reason given for this move is that the market is so volatile that if a generator losses some generation capacity, they are exposed to the spot market. Particularly in SA, where AGL/TIPS has a dominant generation position, this risk is perceived by generators as being too high, resulting is a reduction of hedges being made available.

Larger consumers of electricity have also seen the exiting of second tier (and even first tier) retailers, and the reasons for this exiting cannot be laid at the door of the retail price cap. If the AEMC had sought feedback from larger consumers it would have been advised of this trend, and the trend of significant price rises. It has been alleged that these price rises are a result of market pressures such as insufficient generation capacity in SA. Analysis of the SA region generation capacity does not support this contention. In fact the reasons provided to larger consumers is that there are fewer hedges being made available from generators, and the excessive volatility observed in SA over the past 12 months (and particularly the March quarter of 2008) has increased the risk to such a level that prices must rise.

If the AEMC had been broader in its analysis, particularly as it had been made aware of the UCW concerns, and had approached larger consumers of electricity to assess the degree of retail competition it would have been made aware of the price pressure being observed, but also of the significant reduction in the number of retailers prepared to make offers in the SA market. Larger consumers have reported to their advocates that for tenders sent out to 5-6 retailers, whereas two or more years ago they would have received an offer from all, and even unsolicited offers, they are now receiving one or two offers at most, and no unsolicited or other offers from retailers eager to retain the business.

There is no doubt that the reduction in retailer competition is currently occurring and this reduction has been increasing over the past 12 months. This puts the lie to the assumption made by AEMC that retail competition would burgeon if the retail price cap were removed.

UCW points out that, as a result of the AEMC recommendation late last year to the Victorian government that it remove the retail price cap, from the beginning of 2008, small business consumers have no longer been provided with a retail price cap. The AEMC had the perfect opportunity to assess whether the price cap removal has been beneficial. UCW notes that we have heard that there are concerns that this might not be the case.

For example, the Victorian Energy and Water Ombudsman (EWOV) provided insight into the potential of high retails prices, when it stated in its submission to MCE on the National Customer Framework for Distribution and Retail[3] in reference to imposition of a high deemed tariff:-

> *"An uncontrolled deemed tariff for customers whose contract has ended appears even more punitive and unnecessary than it does for customers who have moved in and started to use energy without setting up an account. It is common business practice that it is the merchant who is responsible for informing a customer of when a contract is about to expire and for offering terms for a new contract, and it appears to be quite unreasonable that customers whose contracts finish are put onto high tariffs.* ***It is a matter about which EWOV receives complaints, especially from business customers who are no longer protected by a standing tariff.*** *Again, a delay in transfer may expose a customer to these higher rates quite unjustly.*
>
> *An example of this was a case received on 21 February 2008 (C/2008/3418). A representative of a company that operated a lounge said that his retailer had not informed him that his contract was about to expire. He received a bill where the rate (in cents per kWh) had changed from 7.26 peak and 3.3 off peak to 17.2 peak and 9.4 off peak. He had made numerous attempts to be charged at the same rate as his contract. After he came to EWOV the retailer offered him a $2,000 credit provided he paid the rest of the bill.*
>
> *In effect, Victoria already has a high deemed tariff for business customers who come off contracts. It is leading to disputes, unexpected expenses for businesses and acrimonious transfers. Price regulation*

[3] Energy and Water Ombudsman (Victoria) Limited letter dated 28 July 2008 to MCE Secretariat, pages 3 and 4.

> *for residential customers is due to finish as from 1 January 2009. There appears to be no merit in subjecting these customers to high deemed tariffs merely because they have come off contract. EWOV has had cases in which a customer has entered into a contract over the phone and was not sent a welcome pack. In this situation, the customer has no way of knowing that the contract is about to come to an end."* (emphasis added)

What EWOV alludes to is that the presence of a retail price cap provides a degree of certainty for a consumer that if the consumer does come off a contract, that at worst, it will only be required to pay the price cap. As many businesses have learned to their cost, retailers have high [read punitive] default tariffs and its invocation could be for a number reasons such as coming off a contract (and failing to renew), metering error, etc. It should be noted that retailers effectively set their default tariffs based on the spot wholesale market, and bypassing any allowances for hedging. Therefore being placed on a default tariff can be very expensive.

EWOV was less than supportive of the AEMC decision to recommend to the Victorian Government that it should remove retail price caps. In its letter[4] to the AEMC in response to the second draft report EWOV made the observation that:-

> *"…even though we still believe that the AEMC is being too sanguine about the state of marketing in the state [of Victoria]."*

It is unusual for a body such as EWOV to comment on political matters, but from the tenor of its comment, EWOV was clearly not as convinced as the AEMC that energy retailing in Victoria was as competitive as the AEMC considers. That EWOV was compelled to make such a statement is highly instructive, and as it is clear that energy retailing in SA is less competitive than in Victoria (particularly as the Victorian wholesale markets are more competitive than in SA).

Whilst businesses are expected to manage their affairs to avoid this circumstance, small consumers have had a historic reliance on the charges for essential services (including power) being considered reasonable by governments. It is accepted that the changes in the energy markets no longer provides this comfort for large consumers of power and gas, but there is still a general expectation that governments will ensure that providers of essential services do not use their unique position so that they can levy unreasonable costs. When this expectation is combined with the conventional 2-3 month billing cycle for small consumers, it is quite probable that, in the absence of a retail price cap, unprincipled retailers are able to use its absence to the considerable detriment of consumers.

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[4] EWOV letter to AEMC 16 January 2008 Re: The Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria – Second Draft Report

That the AEMC has not accessed such an obvious source of factual and current information and hard data, but has continued to relay on input from consumers who have never been exposed to a “cap free” environment, is extremely concerning.

As a minimum the AEMC should seek hard data from the Victorian Ombudsman to identify if the outcomes for small businesses as a result of the retail price cap removal. That this was not done prior to releasing a view that there is a retail competitive market in SA for power and gas, reduces the confidence consumers have for the AEMC processes and for the AEMC as an impartial review body.

5. Commission's Preliminary Findings

The AEMC has identified that they consider there is a competitive retail environment for all SA electricity consumers, and for most of SA gas users.

This view is based on the fact that the AEMC considers there is competitive pressure on retailers to provide efficient pricing for consumers of power and gas. It pointed to the fact that there has been switching between retailers, consumers understand that they have the right to change retailers, and that consumers have some understanding of the way the new electricity and gas markets operate.

Moving from this position to assuming there is a competitive market is a huge leap of faith, which has not been tested in the country. It has, however, been tested overseas, and to a significant degree found wanting.

At the Public Forum and also in separate discussions with UCW, the AEMC stated that the high level of switching was not the main plank supporting the AEMC view there is a competitive retail market. Yet despite this assertion, much of the AEMC first draft report hones in on this observation. The research in other jurisdictions (both local and overseas) confirms that there is significant switching between retailers, usually as a result of a new retailer making contact with a consumer. Despite that the consumer might switch, it is not an uncommon outcome that the switching is done to the detriment of the consumer. This implies that the consumer has been advised poorly by the prospective retailer. Reports from the Victorian Ombudsman support this contention.

The new market for gas and electricity is complex – much more complex than the AEMC would seem to indicate in its first draft report. It is so complex that it has been identified in ombudsman reports that retailer sales staff do not understand the market sufficiently to be able to clearly spell out how it works to consumers, and this has resulted in a significant workload for ombudsmen.

It is indicative that the AEMC itself notes that consumers are relatively passive in relation to electricity and gas supplies – indeed so passive that the AEMC observes that it is retailers themselves that are the prime cause of the retailer switching – a result of their "push marketing" strategies.

It is concerning that the AEMC has not considered that the bases on which they have assessed there is sufficient retail competition could be flawed. Recent research in the UK (where there is a market similar to that in SA and which does not have a retail price cap) indicates that even after more time than SA consumers have had in a "competitive electricity market" there is still doubt as to whether the market delivers the expectations of the competitive market model.

The OECD[5] makes the observation

> *"The discipline of mainstream or conventional economics assumes that well-informed consumers rationally calculate their best options in market transactions. Mainstream or conventional economics, however, recognises that failures can occur in structurally efficient markets to the detriment of consumers. Apart from consumer detriment resulting from suppliers' conduct, examples include the absence of meaningful price information, a lack of information on the quality of goods and services on offer, and difficulties in making comparisons between competing products" (page 4).*

Wilson and Price[6] for the Centre for Competition Policy, UK takes this view further and observes that attainment of such a view is unlikely to be attained:-

> *"Using two independent datasets from the UK electricity market our results show that the capacity of consumers to choose efficiently between suppliers may be limited, even when switching purely for price reasons. While the results are not necessarily representative of the general population, our estimations show that, at best, a fifth of the consumers in our samples actually lost surplus as a result of switching; and that, in aggregate, switching consumers appropriated only half of the maximum gains available to them. Such a failure of consumers to compare accurately between alternative suppliers can damage their welfare, both directly in lost savings, and indirectly by delivering firms with a source of market power. Indeed, together with the well established effects of switching costs in reducing the willingness of consumers to switch suppliers, such behaviour may seriously impede the competitive process, even after a market has been liberalized or made subject to standard competition policy (as recently argued by Waterson 2003).*
>
> *We have examined and rejected several explanations of consumer errors, including preferences for particular tariff structures or dual fuel supply, and misleading sales activities by firms. Instead, despite the apparent simplicity and transparency of the market,* ***consumers' poor choices seem more consistent with an explanation of pure decision error. This finding casts doubt on the ability of consumers to generate competitive forces through accurate switching decisions and raises many important policy concerns****." (page 25, emphasis added)*

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[5] Organisation for Economic Co-operation and Development, Directorate for Science, Technology and Industry, Committee on Consumer Policy Roundtable on demand-side economics for consumer policy: Summary report JT0320776220-Apr-2006

[6] Do Consumers Switch to the Best Supplier? Chris M. Wilson (Department of Economics, University of Oxford) & Catherine Waddams Price (ESRC Centre for Competition Policy and Norwich Business School, University of East Anglia) CCP Working Paper 07-6

This outcome is replicated in earlier work of Wilson and Price[7]

> *We confirm previous findings that show a large proportion of consumers choose to switch supplier despite making apparent losses from doing so, and we provide new evidence to show the poor accuracy of consumers' decisions. Roughly a third of switching consumers over-switched in a way that apparently reduced their surplus, and in aggregate, switching consumers only appropriated a quarter of the maximum gains available. We suggest that these errors can, at least in part, be explained by irrational behaviour. Consumers' mistakes seem to be positively related to the number of competitors in the market, consistent with an information overload hypothesis of consumer confusion. This finding cannot easily be accounted for by rational explanations of consumer mistakes involving consumers' perceptions of difference in firm quality or uncertainty about their own demand.*
>
> *Our analysis has some limitations. Firstly, low income consumers are overrepresented in our sample and the magnitude of our estimates may not be replicated in the wider consumer population. Secondly, as we have already noted, the presence of misleading sales activities that prompt consumers to switch inaccurately may provide a secondary explanation for the estimated relationship between consumer mistakes and the number of competitors; this would be the case if and only if firms rely more heavily on such sales tactics as the number of competitors increase.*
>
> *Our finding that consumers suffer from increased decision noise in markets with larger number of competitors is important for competition and consumer protection authorities. While increases in numbers of competitors may increase the total gains available through competition, an increased number of competitors may also limit the consumers' ability to appropriate these gains, and further, may damage competition itself by increasing equilibrium market power. The interconnection of competition and consumer protection policy in these matters is clear when one considers possible policy recommendations. The least controversial of these would suggest the improvement of consumers' access to tariff information.* ***Alternatively, it may not be the access to information per se that is important, but the access to information in an easily understood format.*** *The existence of complex, nonlinear tariffs may contradict this principle and welfare could increase if authorities forced firms to compete with cognitively simpler tariffs. However, even more controversially, welfare improvements might be*

[7] Irrationality in Consumers' Switching Decisions: When More Firms May Mean Less Benefit
Revised: August 2005 Chris M. Wilson and Catherine Waddams Price, ESRC Centre for Competition Policy,

achievable if authorities limited the number of competitors or options faced by the consumer. Indeed, consumers may benefit from such a restriction of competitors within our market. The negligible correlation (+0.01) between maximum available gains and the number of firms suggests that a restriction in the number of firms could leave the level of competition unchanged while improving decision efficiency, enabling consumer surplus to increase. This apparently perverse conclusion parallels Hortacsu and Syverson's (2004) cautious advice that a limit to the number of U.S. mutual funds could be welfare enhancing due to the benefits from (efficient) reductions in search behaviour and increased usage of economies of scale, despite the potential losses in competitive effects on price and product variety. The findings of this paper provide some further weight to such arguments and more generally, suggest that competition authorities should account for possible limitations in consumers' decision making capabilities when designing competition policy".(pages 24-26, emphasis added)

The OECD report comments that (page 13)

"In general, these biases[8] arise from the application of decision-making heuristics. These are simple rules of thumb, which are functional means of simplifying decision making, and which, most of the time, lead to optimum or at least satisfactory outcomes. In certain situations, however, they can have adverse consequences in terms of consumer welfare.

Evidence suggests that while some consumers are aware of these biases and have the discipline to overcome them when necessary, in general, their manifestations are not highly related to factors such as education and income[9]. They tend to arise in certain situations, or types of transactions, rather than among certain classifications of consumers. That is, anyone can be subject to these biases in certain situations".

The direct outcome of these studies in relation to the AEMC analysis could be reduced to two main aspects.

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[8] Four such biases tended to dominate the discussions at the Roundtable – the *endowment effect*, *time variant preferences*, *framing effects* and *choice overload*.

[9] Behavioural economics distinguishes between consumers who know and do not know their biases; evidence is provided by the proliferation of self-binding mechanisms. For an early work see Schelling, T. (1984), "The Intimate Contest for Self-Command" in Schelling, T., *Choice and Consequence: Perspectives of an errant economics* (Harvard University Press). For later, empirical work, see DellaVigna, S. and Malmendier, U. (2004), "Contract Design and Self-Control: Theory and evidence" *Quarterly Journal of Economics* Vol CXIX Issue 2. For evidence of weakness of the relationship to education and income see, for example, Belsky, G. and Gilovich, T. (1999), *Why Smart People Make Big Money Mistakes and How to Correct Them*, Simon & Schuster. For evidence from a controlled field study see Bertrand, M., Karlan, D. Mullainathan, S., Shafir, E., and Zinman, A. (2005), *What's Psychology Worth? A field experiment in the consumer credit market*, Economic Growth Center, Yale University, Discussion Paper 918.

1. The extent of switching observed is probably not a good indicator of informed decision making, and that probably a significant proportion of the switching that has occurred is not an indicator of **consumers using** the apparent retailer competition, but more retailers pushing for changes
2. Despite consumers considering they are well informed about the market, in fact their decisions clearly indicate that this is not the case.

It is concerning that the AEMC has taken the appearance that consumers consider themselves to be well informed and takes the McGregor Tan survey at its face value, without assessing the reality. These UK studies and OECD analysis indicate that the AEMC could well have developed its view of competition that is not sustained by deeper analysis.

Unfortunately, as noted in earlier sections, this lack of analysis pervades the AEMC first draft report.

A view from the UK

Allan Asher (erstwhile former Deputy Chair of ACCC, and now CE of Energwatch UK make the observation[10]

> *"Consumers who at first actively embraced choice have been reluctant to switch suppliers. Seven years after liberalization half of customers had not moved from their original supplier. This reluctance, despite the savings on offer (Energywatch estimated bills could be cut by up to half) was due in part to business practices and a failure of regulation. Contrary to the assumptions of conventional economics, consumers do not switch, mainly because of complexity. In response to surveys, only a quarter of consumers find price comparisons between suppliers "very easy" or "fairly" easy"; 42% have never tried to switch. Energy suppliers make switching time-consuming and prone to mistakes, bills are difficult to understand, energy usage is hard to calculate and because of different billing systems price comparisons are very difficult. (Energy suppliers admit that they value the flexibility to differentiate their bills from those of their competitors.)*
>
> *The UK energy market is a good example of what happens when markets are de-regulated with insufficient understanding of, or interest in, the impact on consumers. Many suppliers are not customer-focused except in terms of winning new customers. They take advantage of customers' inertia and their lack of confidence in the market – a lack of confidence that has resulted from the processes of deregulation. Reliance on market-based mechanisms falls short of the ideal: more*

[10] CONSUMER EXPERIENCE IN THE UK ENERGY MARKET by Allan Asher, Chief Executive, Energywatch, UK, at page 28 in Organisation for Economic Co-operation and Development, Directorate for Science, Technology and Industry, Committee on Consumer Policy Roundtable on demand-side economics for consumer policy: Summary report JT0320776220-Apr-2006

> *choice does not automatically empower consumers to make the best choice.*
>
> *The consumer voice is potentially powerful but weak in practice. Education, information, self-regulation and transparency have to be part of a consumer protection package but so do regulators who intervene in markets to prevent detriment**, even when this reduces competition by reducing differentiation between suppliers**. …. Regulation and consumer policy should be based on real consumer experience and understanding of consumer detriment and what affects consumer choice. In fact it is not clear what "choice" means to consumers in energy markets. Without this knowledge it is difficult to identify market indicators which could provide early warning of consumer detriment."* (emphasis added)

UCW supports this view that great care needs to be attendant with any proposal to remove what has been a demonstrably potent and consumer supportive regulatory approach such as the existence of a price cap. Simplistic views about the "effectiveness of retail competition" are not acceptable.

6. Wholesale competition

Electricity

In its earlier submission UCW highlighted the fact that AGL/TIPS has the power in the market to set prices. As a result retailers other than AGL recognise that there are potentially exposed to a very high market risk.

Because of this risk second tier retailers have exited the SA market, and retailers other than AGL need to build into their retail prices a risk premium to provide some insulation against AGL/TIPS spiking the spot market.

The AEMC report made no attempt to assess whether this high degree of market power was the cause of retailers exiting the market as was evidenced by the LECG report which did confirm this recent trend.

The AEMC, rather than assessing the impact of the wholesale market on the retail market, elected instead to use this information as support for its view that the cause of this exiting was attributable to the presence of a price cap, which retailers found there was the cause of the disappearing retail margin.

UCW has been advised by large consumers[11], that they are also seeing the disappearance of retail competition in the SA market. This tends to support the UCW view that it is not the presence of the price cap that has caused the reducing competition, but the risks extant in the wholesale market.

That the AEMC did not research this aspect as a result of UCW bringing the issue to the attention of the AEMC in its first submission, is quite disappointing.

There is a partial reference to the issue of a tightening wholesale market in the AEMC draft report (page xii)

> *"The recent tightening of the supply/demand balance in the wholesale electricity market has contributed to increases in spot and contract prices, which have in turn increased prudential obligations and working capital requirements."*

UCW does not dispute the obvious outcome, that there have been increases in the spot and contract markets. Indeed, UCW is aware that this is the case. What UCW disputes is the cause, which AEMC attributes to a tightening supply/demand balance. Work carried out by ECCSA has identified that there is adequate dispatchable generation in SA to meet the actual peak demands, with more than 10% margin. Origin Energy's decision to augment its Quarantine PS by an additional 100 MW further increases this margin. In addition to dispatchable generation in the region, there is more than 400 MW

[11] In particular by ECCSA whose members are exposed to an uncapped market

of wind generation and (in theory) nearly 700 MW of interconnection. This amount of generation in the SA region implies there is ample generation for the region's immediate needs.

What has caused the increase in spot and contract prices is that AGL has the power to set market prices for considerable periods of time, because it controls more than 40% of dispatchable power generation in the region. It is on this basis that UCW considers that to remove the price cap will expose small SA consumers to the very high prices being experienced by consumers who do not have the benefit of the price cap.

In fact it is arguable that the very presence of the price cap is partially because it provides a reference point for both consumers and marketers, but it also contributes by constraining the behaviour of providers, especially in the wholesale market.

UCW is concerned at the selective use of the data and how the AEMC has used this information to support a view that there is retail competition. UCW strongly recommends that AEMC access the data provided to AER by ECCSA before it finalizes its recommendation on retail competition in the electricity market.

In the updated report provided to AEMC by NERA for this review NERA states (pages 100 and 102)

> *"The key role of a retailer is therefore to manage the financial and physical risks that arise in supplying the retail market at predetermined fixed prices. Effective retail competition therefore requires retailers to be able to:*
>
> - *access wholesale electricity supplies, which is achieved through access to the NEM spot market allowing retailers to purchase electricity when required to meet customer needs, and also manage demand variations;*
> - *access hedging instruments to provide an opportunity to manage price volatility risks in the NEM, as required, although there is debate about whether the hedging market and spot market are indeed separate 'markets' in competition terms; and*
> - *flexibility to manage exogenous shocks, such as those arising from significant wholesale electricity cost increases – as in the example of airline fuel levies.*
>
> *As indicated above, in competition terms it is open to debate whether the hedging market and electricity spot market are sufficiently separate such that any reduction in liquidity in the hedging market (say, arising from vertical integration) is a potential impediment to competitive entry in the electricity retail market. Some factors to consider include:*
>
> - *the spot market is, by definition, a substitute for the hedging market, since it is always possible for a retailer to settle its requirements*

exclusively by reference to the spot market if there are insufficient hedging products available;

- *in theory, the price of a hedge should equal the expected value of the future spot price plus the cost/value of any financial risks transferred, such that hedging amounts to a form of insurance that allows both generators and retailers to improve the management of cash flows;*
- *there are transactions costs associated with hedging, such that it is not itself a costless exercise;*
- *hedging is not itself a risk free process since the cost usually means that retailers do not hedge their full requirements, and in any case it is necessary to decide how much of a retailer's expected load to hedge.*

In our view, these complicating factors are important considerations in any assessment of the implications of hedge market liquidity and vertical integration on competition in the retail market.

In addition, it is also relevant when considering the effectiveness of retail competition to examine:

- *the effectiveness of wholesale market competition, since this affects the expected cost of wholesale electricity supply to new entrant retailers, particularly in the presence of increasing vertical integration between generators and retailers;*
- *the effectiveness of the market in delivering new generation investment when warranted by changing demand and supply conditions; and*
- *the ability of retailers to contract across region boundaries, which impacts on the number of generators a retailer in a particular NEM region has access to when seeking supply contracts." (emphasis added)*

That AEMC had this very clear indication from its own consultant that it should perforce examine the wholesale market as a precursor to reaching a conclusion on retail competition, yet it failed to do so, is again a great concern to UCW.

It is also interesting to note that in the data provided by NERA in its report, it used data from 2005/06 in relation to generator market shares. The report should have been updated to reflect the acquisition of TIPS by AGL which is one of the main reasons why there has been a tightening of the wholesale market, rather than a tightening of the supply/demand balance which the AEMC seemed to rely on to explain the recent rise in electricity wholesale prices.

Overall the AEMC has been remiss in not examining the wholesale market changes and trends as a key part of its review.

Gas

The AEMC considers that there is, to some degree, a lack of retail competition in the supply of gas. It attributes the element of low or no competition to the fact that the capacity on the SESA, Angaston and Whyalla lateral pipelines is fully contracted, mainly to Origin Energy.

What the AEMC does not do is to examine in more depth, the gas wholesale market. In regard to this the UCW has been provided with information from ECCSA which indicates that large gas consumers are seeing a gas market in SA which has strong elements which reduces competition in the gas wholesale market.

Gas is provided in SA from either Moomba or from the Otway basin.

Gas from Otway basin is controlled by capacity on SEAGas pipeline which delivers gas from SW Victoria to Adelaide. All of the firm capacity on this pipeline has been contracted. New entrants are effectively (both contractually and commercially[12]) prevented from acquiring firm capacity on SEAGas and therefore access to gas from Victoria is prevented to new entrants

Gas for Moomba is delivered by MAPS and there is capacity available on this pipeline for new entrants. The challenge for a new entrant is to secure uncontracted gas from the declining Moomba resource. Whilst there is potential for gas supplies from Queensland to be delivered to Moomba by the new QSN (Ballera to Moomba) pipeline, access to gas from the Queensland CSM fields is effectively prevented to new entrants as all the capacity on SWP (Wallumbilla to Ballera) is fully contracted.

There is almost no interconnection between SEAGas and MAPS pipelines which prevents any gas from flowing from one to other.

The contractual issues have created a condition where new entrants to the gas market in SA are severely constrained to a single source and single pipeline, and have no ability to access gas markets south of Adelaide.

The fact that new entrants are effectively prevented from seeking gas except from a single source raises serious concerns as to the competitiveness of the wholesale market for gas in SA.

It is concerning that whilst AEMC considers that as capacity on the laterals to Whyalla, Angaston and Mt Gambier are fully contracted this implies a lack of competition in the downstream gas markets, it has not considered that similar

[12] It is accepted that new capacity could be made available but the costs of doing so are considerable and would make the cost of additional gas prohibitive for a new entrant retailer

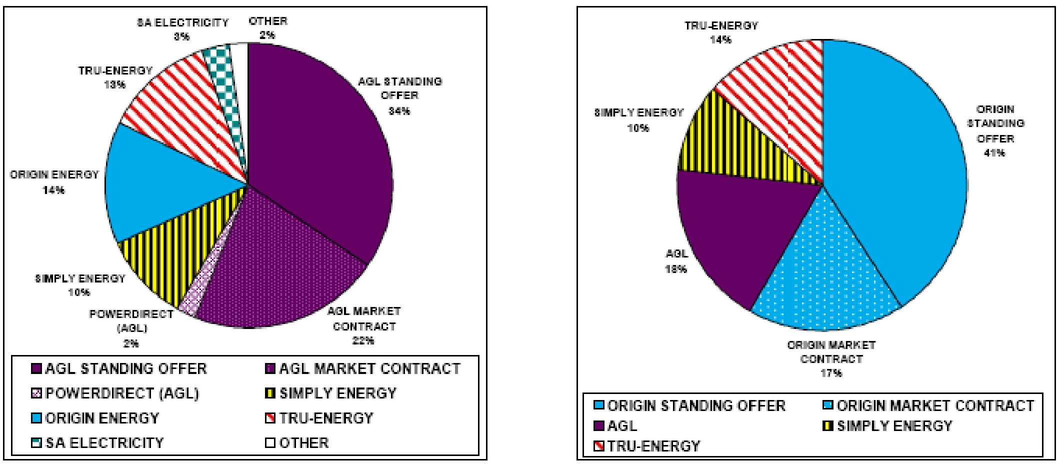
condition in the transmission pipelines creates an identical issue for the wholesale gas market.

Wholesale/retail competitiveness

The AEMC draft report and its Issues paper highlights that between them AGL and Origin control some three quarters of the gas and electricity retail sales. Of the balance the bulk is controlled by TRUenergy and Simply Energy (a subsidiary of International Power) which are both “gentailers” and import gas for generation purposes.

Figure 3.3 Retailer customer shares: electricity and gas

Electricity **Gas**



Note. Electricity retailers listed as “Other” are those with one per cent or less of the total share of customers. For a complete list of retailers currently selling electricity to small customers in South Australia, refer to Table 3.1.

Source: AEMC first draft report page 44

If both gas (100%) and electricity (96%) is dominated by four gentailers, and two control three quarters of the retail markets, it raises serious concerns that there is a view there are no (or low) barriers to new entrants. The ability for new entrants to enter the market is the first of the key indicators for which the AEMC considers is essential for market competitiveness. As the wholesale market for both electricity and gas is dominated by the four incumbents, new entrant retailers must seek offers from their competitors to enter the market.

The actuality of the wholesale markets for electricity and gas clearly shows that there is a barrier to new entrants, and the outcomes identified by the AEMC support that this is the case. It is therefore confusing for the AEMC to decide that in spite of the evidence to the contrary, it considers there is a competitive retail market for electricity and gas except for isolated pockets for gas supplies.

The AEMC points to the reducing profit margins under a price cap as a significant element which supports their view that the price cap is constraining competition. What it then assumes is that a price cap approach reduces competition. In fact it is not the existence of the price cap that has reduced the margins, but that the price cap has been set at a level which is comparatively to low.

As noted above, the experience learned in the large consumer market (where there is no price cap) is that there still has been the loss of retail competition in the electricity market (and to a lesser extent) the gas market. If the loss of retail competition has occurred in an uncapped market, then it is not the loss of the retail margin that has been the primary cause of retailer reduction.

7. Conclusions

The AEMC states that it has predicated its view on market competitiveness on

1. Ability for new retailers to enter the market
2. Rivalrous behaviour between retailers
3. Consumer awareness

With regard to point 1,

the AEMC provided evidence that new retailers were not entering the market and existing retailers were exiting the market. UCW Adelaide provided a view that the reasons for this were unrelated to the competition or the price cap, but the AEMC chose to not consider this view in it's report. This submission has sought to provide more evidence that there is an uncompetitive wholesale market.

The AEMC consultant NERA has offered the view that a competitive retail market is dependent on a competitive wholesale market. The AEMC has blithely stated that it was not persuaded by the evidence provided that the wholesale markets in SA are not competitive, yet neglected to provide reasons for its view. This decision is in contrast to the AER which has stated a view that AGL/TIPS can set the market price above a certain demand level; this clearly provides a view that the SA market is unlikely to be competitive.

This submission (along with the views provided both publicly and privately to the AEMC) seeks to provide more support for its views about the wholesale market.

With regard to point 2,

it must be conceded that in the past there has been rivalrous behaviour between retailers. However, this has reduced in the past 12 months, appearing to coincide with the acquisition of TIPS by AGL, and the price setting TIPS has achieved in the SA market. As a result we have seen retailers exiting the electricity market, and large consumers have advised that they are also seeing fewer retailers active in the market.

In a way, it could be assumed that the AGL acquisition of TIPS was rivalrous behaviour that has been so successful that AGL competitors are leaving the field.

It is clear across all sectors of the gas and electricity markets (large and small consumers), rivalrous behaviour between retailers has significantly reduced in the last 12 months, and as it is widespread, it can not be attributed to the presence of the price cap for smaller consumers.

The failure of the AEMC to seek information about what is extant in the unconstrained (larger consumer) markets has permitted it to make assumptions which are not being replicated in the wider market.

With regard to point 3,

Research has shown that although consumers may think they understand the electricity and gas markets, other than the fact they know they can change retailers, their lack of understanding of the markets due to the great information asymmetry and complexity that applies to both gas and electricity supplies, does lead consumers to consider they have a better understanding than they really do.

Research in the UK indicates that many consumers switch but do so to their detriment (perhaps up to 1/3rd of all switches). If switching is recognised as an indication of successful retailer rivalry and/or knowledgeable consumer decision, then there is an expectation that the outcomes of the switching would be heavily biased such that consumers actually benefit. But the research does not support this expectation.

The mere presence of a price cap has the ability to minimise the economic damage to consumers when retailers get consumers to switch to their detriment.

That retailers have had to resort to “push marketing” and consumers have taken a passive role in energy marketing, this is indicative of the lack of interest and understanding consumers have in regard to the supply of these essential services.

That consumers in the UK who have had much longer being exposed to a competitive retail market than SA consumers and who have been provided with extensive access to knowledge and information about the energy markets still show that consumers are being convinced to switch retailers even though they are disadvantaged by the transition.

Overall, there is clear evidence that the market in the SA region is not sufficiently competitive, and certainly not in a condition to warrant the removal of the price cap.

The AEMC first draft report is apparently contradictory, as it:-

- Provides evidence that supports a view that there is limited retail competition yet then appears to ignore its own evidence in developing a view that there is competition

- Ignores the report of its own consultant NERA, which highlights that wholesale market competitiveness is an essential precursor to a competitive retail market, but then does not debate the evidence that the wholesale electricity market shows significant aspects of being uncompetitive, a view which is supported by the AER
- Notes that new entrant retailers are declining to enter (and some existing retailers have exited) the market leaving the market to two dominant gentailers and two smaller gentailers. The AEMC seems to accept this as a reason to eliminate the price cap but does not assess why the four dominating gentailers can adequately operate under the price cap
- Stated at the SA forum that switching is not the main indicator of consumer competition yet bases much of its draft decision on this evidence

UCW is disappointed that the AEMC seems to base much of its decision on aspects that appear on face value to lead to a conclusion but fails to examine the evidence that is available. When this evidence is assessed and analysed in more detail using a wider spread of information, it would appear to result in an alternative conclusion to that developed by the AEMC.

As a result UCW urges the AEMC to seek access to the reports (including confidential reports) provided by the ECCSA to the AER in respect of the high price events in SA in Q1 of 2008. The ECCSA also has access to information from its members about the extent of the competition existing in SA at the large consumer level. Such information provides a different view to that provided to the AEMC from the retailers who, it must be stated, have a vested interest in the removal of the retail price caps.

UCW is very concerned that the AEMC has not adequately explained why it treats the first hand observations of the market provided by UCW with such scant attention. This is of concern to us for this particular review, but also highlights an area for prompt and careful consideration by the AEMC, namely the way the AEMC engages with consumer experience and observation.

Further Comment or Information:
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