



## **Australian Energy Market Commission Review of the Effectiveness of competition in Gas and Electricity Retail markets**

### **Issues Paper June 2007 Submission from the St Vincent de Paul Society Victoria Inc. Prepared by Gavin Dufty**

The St Vincent de Paul Society Victoria Inc (SVdP) welcomes the opportunity to comment on the review of the effectiveness of competition in the gas and electricity retail markets. This is a critical issue for both the 7000 member and volunteers of our organization and the 260,000 individuals we assist in Victoria each year (For more information about the activities of the Society, see Appendix 1.)

Access to fair and affordable essential energy supplies is critical in protecting and enhancing the wellbeing of all Victorian households, in particular those that are on low income or suffer some form of disadvantage.

Detailed below are various issues that we believe the Australian Energy Market Commission (AEMC) must investigate and address.

**The following points are issues which we expect the AEMC to consider and respond to in making its determination regarding the Effectiveness of retail competition in the Victorian market.**

**Transparency and validation of AEMC recommendations:** In reviewing the effectiveness of competition the discussion paper provides no detail of which indicators that are used to assess the effectiveness of competition. Nor does it provide details as to how these indicators are to be assessed.

Such details of the indicators and methodology used in assessment is critical in ensuring a transparent and independent decision is made but also affirm the perception of the independence and transparency of the AEMC in this matter.

Failure to provide details of the evaluation methodology will leave the AEMC and recommendations made by this review open to valid criticisms that the review is captured by key interested or the review is ideological driven.

#### **SVdP recommend:**

The AEMC must provide documentation in their assessment this should include longitudinal information of market development rather than the traditional approach of a snap shot in time. This documentation should include dynamics of the market and document trends in market activities and associated consumer behaviors



The AEMC must evaluate and detail the outcomes of decisions that are made by consumers. For example if customers indicate that they have made a choice on price we would expect that the AEMC would have evaluated if this decision actually resulted in cheaper energy bills.

**Standing offers and market churn:** The current presumption from retailers that the standing offers are limiting competition is not back up by fact or practical experience. For example it is widely recognized that Victoria has the most contestable market in the world<sup>1</sup>.

Furthermore it can be effectively argued that the current standing offer also provides a multifaceted function in stimulating the market. For example it act as a reference point that informs consumer behavior acting as the price to beat and it is this "reference point" function that stimulates competition.

In addition as the standing offers have been developed in conjunction with an independent third party it also acts to provide confidence to customers in making an informed choice, as such stimulates churn as they are assured that whatever the deal they accept is a good one relative to the standing offer.

This concept of comparison to the standing offer is supported by and used by retailers in promoting energy offers within the market. As all offers sighted by this author without exceptions refer to the "regulated tariff" as the comparison point.

Finally it serves to protect customers where the market is not in a position to make meaningful market offer due retailer unwillingness.

**SVdP recommend:** the AEMC must consider and evaluate the role of the standing offers in simulating the development of the market, though enhancing informed choice, customer understanding and confidence. It also must evaluate its role as default tariff where the market is stagnant or limited.

**Generation and retailing:** SVdP expects that the AEMC would explore the relationship between first tier (incumbent) retailer and vertical integration with generation capacity and the impact if any this has on the broader energy retailing market.

SVdP raise this matter as there has been suggestions that the ownership of generation plan by the larger incumbent retailers has in effect resulted in second tier retailers being excluded from accessing a best price in regards to wholesale energy prices. This it is argued has lead to distortions that have a disproportional impact on second tier retailers, limiting the ability for new entrants to enter the market and existing entrants to continue to be competitive within the market.

**SVdP recommend:** The AEMC explore the relationship between first tier (incumbent) retailer and vertical integration with generation capacity and the impact if any this has on the broader energy retailing market.

**Price volatility and customer behavior:** Demand and price elasticities have an important impact on underpinning hardship, affordability and ultimately customer behavior within the residential energy sector, Langmore and Dufty<sup>2</sup> found,

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<sup>1</sup> [http://www.firstdatautilities.com/customer-switching/press\\_releases/WorldsHottestEnergyMarkets2006.html](http://www.firstdatautilities.com/customer-switching/press_releases/WorldsHottestEnergyMarkets2006.html)

<sup>2</sup> Langmore and Dufty, *Domestic electricity demand inelasticities: Issues for the Victorian Energy Market*, June 2004, (available online at <http://www.vinnies.org.au/files/VIC.2004%20June%20->



“Data from 1980-1995 and estimated that the long run price elasticity of demand for the Australian residential sector was  $-0.25$ .<sup>3</sup> This means a 10% rise in price results in a 2.5% fall in demand for electricity, an inelastic response. The Victorian PED (price elasticity of demand) was estimated to lie between  $-0.23$  and  $-0.53$  with a mean value of  $-0.38$ .<sup>4</sup> Since elasticity estimates are contingent upon the magnitude of price rises, NIEIR reported that these could rise to  $-0.4$  if prices changed by 30-40%.<sup>5</sup> In other words, to elicit a 4% drop in demand for electricity, price changes in the order of 30-40% would be required - thus highlighting how extraordinarily small consumer responses are relative to price changes”.<sup>6</sup>

These findings highlight the importance of the current standing offers in providing consumers with pricing stability, confidence that offers are reasonable and limit the significant potential that exist for profiteering or price gouging in the energy market where competition is ineffective or non-existent (a particular issue for non-metropolitan and low density communities this will be discussed later).

If the AEMC suggests that there is to be an end to the standing offers it must develop and implement a process that provides the mechanism for third parties to scrutinize the fairness and reasonableness of price being offered in the market.

This would ensure that customers have confidence in the market and affirm that pricing is fair and reasonable or in extreme cases where retailer behavior is an abuse of market power or as a result of market failure.

**SVdP recommend:** If the AEMC propose an end to standing offers it must recommend the development and oversee the implementation of a process that provides the mechanism for third parties to scrutinize the fairness and reasonableness of all tariffs being offered in the market. This is critical given the demand elasticities and the essential nature of energy.

### **Standing offer and Retailer of Last Resort Tariff (ROLR)**

The standing offer also provides another critical function as it is the ROLR tariff in the Victorian retail energy market.

As such removing the current standing offer would strip away the current RoLR tariff and create further issues leaving regulators or government to develop and implement a specific ROLR tariff to deal with a ROLR event. This issue has been identified by the Victorian Essential Service Commission (ESC)

“As stated in the draft decision paper, the Commission considers that use of the standing offer terms and conditions applicable under the safety net provisions of the Electricity Industry Act and the Gas Industry Act satisfies the key elements of the RoLR pricing criteria – that administration costs should be minimised, a standard contract is in place

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%20Domestic%20Electricity%20Demand%20Elasticities.pdf)

<sup>3</sup> National Institute of Economic and Industry Research, *The Price Elasticity of Demand for Electricity in NEM regions*, prepared for National Electricity Market Management Company, June 2002

<sup>4</sup> National Institute of Economic and Industry Research, *op. cit.*, p. 3

<sup>5</sup> National Institute of Economic and Industry Research, *op. cit.*, p. 4

<sup>6</sup> Langmore M & Dufty G, *Domestic electricity Demand Elasticities, Issues for the Victorian energy market*, June 2004, page 11



that protects consumer interests, there is a high degree of regulatory certainty, and implementation should be possible within existing system capabilities. In particular, the Commission considers that use of standard terms and conditions will reduce the cost of the RoLR scheme because these terms and conditions are contained in local retailers' existing standing offer and deemed contracts. It will also ensure that most customers – those who have chosen not to change retailer or enter into a market contract with their local retailer – will continue to be supplied on terms and conditions that are familiar to them.

The Commission further considers that relevant customers of a failed retailer may be in a vulnerable position with respect to terms and conditions because they are allocated to the RoLR rather than exercising an active choice. The application of standing offer terms and conditions provides the necessary protection for RoLR customers without placing them on more advantageous terms and conditions than similar customers served by other retailers. The Commission confirms its draft decision.

### ***Final decision***

The standing offer terms and conditions that apply under the Electricity Industry Act and the Gas Industry Act, including the provisions of the Energy Retail Code, will form the basis of the terms and conditions for the provision of RoLR services to relevant customers. Any departure from these terms and conditions will require the Commission's approval."<sup>7</sup>

**SVdP recommend:** That if the AEMC deem though this review that the standing offers are to be phased out the AEMC must adequately deal with the issues associated with the need for ROLR tariffs and associated terms and conditions.

**Standing offers and the role in the market:** Role of standing offers in informing and supporting consumer to make informed choices in the market cannot be underestimated. SVdP believe that this is the catalyst and hence the reason why the Victorian retail energy market is viewed as the most competitive market in the world. SVdP believes that if the standing of were to be withdrawn there would be a significant slow down of customer willingness to seek or respond to market offers.

In addition the price to beat, which is securitized by the regulators and government provides customers with comfort that there are being offered a fair and reasonable price and terms and condition, providing confidence in the market. Ensuring order and facilitating informed choice and a key factor in a mature market.

The standing offers in Victoria are not a price cap but a regulated price to beat that is offered to customers that are not offered or refuse to take up a contestable offer. Furthermore this price to be is only a requirement that applies to the incumbent, first tier retailers AGL, TRU, ORIGIN and not any of the second tier retailer.

Even then they do not stop companies offering higher prices if the market will stand it for example all the green energy contracts which are by far the most popular are paying

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<sup>7</sup> Essential Services Commission, Final Decision – Energy Retailer of Last Resort, Feb 2006 (p 20)



premiums in excess of the cap (up to 20% above the price cap) this also applies to some contracts in off peak areas.

Furthermore in the case of the Energy One RoLR event in June 2007 suggestion that this company was unable to pass through volatility in generation costs is nonsense as this could easily be achieved through insertion of terms and condition in the energy contract allowing pass through of these charges.

**SVdP recommend:** The AEMC investigate and detail where and how the retail regulatory framework or excludes higher offers than the standing offer or where it excludes the pass through of cost associated with volatility in the market or unexpected events.

**Standing offers, network pricing and customer segmentation:**

SVdP argues that there are in fact eight (8) distinct energy markets within Victoria five (5) electricity markets and three (3) gas markets. This is reflected through the 8 various standing offers that not only reflect reflects different network changes but also act as the RoLR tariff in each case.

This situation implies that there are eight geographical markets as such it is critical that the AEMC in any review ascertain the various market behaviors and activities based on these eight (8) networks.

**SVdP recommend:** That the AEMC evaluate the effectiveness of competition relative to the eight (8) distribution areas and associated retail standing charges that are offered in these networks.

**Market acquisition and market distortions:** For retailers acquisition of customers is generally achieved through door knocking activities. This highlights market distortions that favor those customers that reside in high density areas. This has two outcomes places incumbent retailers who "patch" was in the higher density areas are a greater risk of losing customers than incumbent retailers who customer base is more diverse.

Conversely it also serves to protect retailers with a geospatially diverse customer base as the cost to acquire from competitors is prohibitive. This serves to further highlight that the market should be viewed as 8 distinct markets. SVdP have been lead to believe that there are signs of scaling down of retailers use of door knocking services which is an indication of decline in competition in the energy market.

**SVdP recommend:** AEMC explore the acquisition strategies that facilitate market churn and the applicability of the strategies to all Victorian energy retail customers with the view to identify market distortion, exclusions and customer red lining.

The AEMC review the use of door knocking as a means to facilitate market churn with a view to ascertain if the market activity is in decline.

**Market segmentation and exclusions:** There has also been anecdotal evidence of market segmentation and distortions occurring including in the private retail market, metro vs non metro, fuel mix - dual fuel households, tariff mix peak rate vs off peak, volume large versus small volume. This is a particular issue if door knockers are being used as though discreet questioning they have the ability to exclude customers this has potential as doorknocker are often paid on commission and the potential for the commission payment to effectively exclude offer to various customers for example if they are being paid on energy volume



rather than customer number. In this case they would spend time acquiring larger volume customers and less time on smaller volume customers.

**SVdP recommend:** AEMC explore other factors that result in market exclusion including tariff type, fuel source, fuel mix, sales commission on customer acquisition strategies and customer consumption profiles.

**Future issues:** The review must also be mindful that any decision that is made is consistent with future issues and impacts that may occur of review and impacts on market in the future for example access to water, interval meter roll out, carbon trading, climate volatility and so on.

**SVdP recommend:** The in any recommendation made by the AEMC due recognition and reference is provided to the significant changes that will present themselves in the energy retail market in the next few years. This should include potential risk as well as opportunities.

For further information contact Gavin Dufty, Manager Policy and Research St Vincent de Paul Society Victoria phone (03) 9895 5816





## **Appendix 1: Role of the St Vincent de Paul Society in Victoria**

### **ST VINCENT DE PAUL SOCIETY VICTORIA INC.**

The St Vincent de Paul Society Victoria Inc. consists of over 7,000 members and volunteers outreaching to the most vulnerable in our community through:

#### **HOME VISITATION**

Forming local groups, known as 'conferences', members of the St Vincent de Paul Society visit people in their homes, hospitals or prisons, offering practical support and extending the hand of friendship. Support can take the form of food, material aid, budget and utility bill advice and advocacy.

#### **SOUP VANS**

The Society has four soup van services based in Collingwood, Fitzroy, Footscray and Moe. Staffed by volunteers, the vans travel the streets, visit boarding houses, refuges, squats and hospitals in metropolitan Melbourne and Moe providing soup, sandwiches, tea and coffee to people they meet.

#### **VINNIES CENTRES**

Vinnies Centres provide quality furniture, clothing and household items to people in need. Stocks are available to people being supported by conference members free of charge but are also available to the general public at a low-cost. Profits from the sale of stock in shops go towards providing resources and support to people in need.

#### **COMPEER**

Compeer aims to provide friendship, advocacy and support for people living with a mental illness.

#### **MIGRANT & REFUGEE**

The Migrant & Refugee program provides a range of services to support and assist refugees to rebuild their lives in a new country.

#### **OVERSEAS DEVELOPMENT**

Overseas Development provides strong commitment and support people in developing countries, fostering links and cultural exchange.

#### **TERTIARY EDUCATIONAL SPONSORSHIP**

The Tertiary Educational Sponsorship program assists young rural students who would like to study beyond secondary college but, due to finances or distances, are unable to continue their studies. A one-off grant is provided to students meeting the criteria which assist them with accommodation or tertiary education related costs.



## **ST VINCENT DE PAUL AGED CARE & COMMUNITY SERVICES**

St Vincent de Paul Society Aged Care & Community Services provide a range of professional services and support to marginalised people. These services are funded jointly between government and the Society:

### **AGED CARE SERVICES**

The Society provides care and accommodation for elderly citizens through its various hostels and nursing homes.

#### **Low Care Facilities**

Bailly House:	North Melbourne	41 beds
May Noonan Hostel:	Terang	40 beds
O'Mara House:	Traralgon	49 beds
Rosalie House:	Geelong	32 beds
St Anne's Hostel:	Westmeadows	30 beds
Vincenpaul Hostel:	Box Hill	53 beds
Vincenpaul House:	Geelong	59 beds

#### **High Care Facility**

St Vincent de Paul Nursing Home	Box Hill	30 beds
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#### **Independent Living Units**

Independent Living Units:	Bendigo	30 units
Independent Living Units:	Ballarat	3 units
Independent Living Units:	Maryborough	6 units
Independent Living Units:	Mildura	14 units

#### **Day Therapy Centre**

St Vincent de Paul Day Therapy Centre	Box Hill	90 clients per week
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## **COMMUNITY SERVICES**

The Society provides a range of accommodation and support services to people who are experiencing homelessness; providing help with issues such as general health concerns, drug and alcohol abuse, unemployment, education and training options and social exclusion and isolation. marginalised and homeless within the Victorian community. A family violence service in regional Victoria and a supported employment service for people with a disability in Mornington further diversify our services.

### **Accommodation Services**

- ***Ozanam House***  
A 63-bed facility offering 60-beds for crisis accommodation for homeless men; 3-beds are contracted to St Vincent's Hospital for homeless people exiting their emergency department.
- ***Quin House***  
A 10-bed residence for homeless men who have undertaken alcohol and drug detoxification/rehabilitation programs.
- ***Transitional Housing Management***  
Provides interim housing and support services for people who are homeless or experiencing a housing crisis situation.





## Support Services

- **Adult Outreach Services**  
Provides case management assistance and housing to homeless and marginalised people throughout Melbourne.
- **Marian Community**  
Provides support and temporary housing for women and their children escaping family violence.
- **Ozanam Community Centre**  
Provides support to people who are homeless or at risk of becoming homeless, through material aid, housing support, onsite health services, skills development and community development.
- **Ozanam Enterprises**  
Provides supported employment for people with disabilities. Over 60 people with a range of disabilities are involved in full and part-time supported employment and work skills training.
- **OzLink Personal Support Program**  
Provides participants with “time out” from the pressures of looking for work, to focus on and address issues that affect their ability to look for work. Ozlink is funded to support 60 participants per year.
- **Youth Support Services**  
Provides case management assistance and stable housing for homeless young people in Melbourne, with the aim of providing safety and security so that they may rebuild their lives.