Submission by the South Australian Farmers' Federation (SAFF)

in response to

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

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Summary

In summary SAFF believes the current structure for the deregulated electricity market has been based on overseas models that do not consider Australia's unique market composition, its geographical spread, population, population density and the infrastructure required to provide services.

The model applied is considered to be inefficient, costly and not in the best interests of consumers in the State in general and for regional users in particular.

SAFF feels that cost increases above inflation indicates that deregulation has not been of any benefit to consumers, only to governments who have now defrayed the costs of subsidising power to consumers by passing this onto the power retailers initially and ultimately onto consumers.

In the opinion of SAFF full price deregulation would see significant price increases which would not be in the best interests of all consumers. It is our opinion that a review of the structure of the industry and the ways in which power can be best distributed to consumers at sustainable prices would be a more beneficial exercise.

Recommendation

The State Government immediately initiate an independent review of the structure of the electricity industry and the ways in which power can best be distributed to consumers at sustainable prices.

Introduction

The South Australian Farmers Federation is the State's principal farmer organisation with a proud history of representation and support for farmers dating back more than 100 years. The SAFF represent industries which have helped to build South Australia, and will continue to play a key role in its future.

Agriculture and Horticulture contribute more than $5 billion annually to Gross State Production and account for around 55% of the State's export revenue. The Centre for International Economics has forecast that over the next decade these industries have the potential to contribute an additional $1.0 billion to the State economy.

In this submission the SAFF view is constructed from its own experiences in the deregulated market and the experiences of its members.

The members of SAFF are primarily based in regional areas and face challenges of distance, isolation and infrastructure inadequacy that in some cases can restrict any advantages that may exist in the current deregulated market.

It is SAFF's view that the current retail market in South Australia is not a truly competitive market, nor is it robust enough to develop into a competitive market, from a consumer's point of view.

SAFF has dealt with two different electricity retailers to offer our members deals which would save them money on their electricity bills since the market competition was introduced, and whilst there were some advantages to members there were also costs. As time has gone on we have found these initial advantages have been largely eroded and at this time cannot find an ethical supplier who can provide a tangible benefit to our members.

When the market was first deregulated SAFF wrote some 1480 contracts with the initial retailer. This equates to actual electricity users many operating with multiple contracts due to the way they use electricity in bores, dams, sheds and irrigation. After three years our supplier's deals were not as beneficial, so SAFF moved to another supplier. Since that time we have written 60 contracts for 19 farmers. Not a great take up of offers from a base of around 2800 users of electricity.

1. Market Structure

Structural Conditions

SAFF believes that the structural conditions of the Energy retailing market actually preclude true market competition.

Australia as a whole has a population density significantly smaller than other continents such as Europe and North America and therefore has a completely different market structure. With 60% of the population centred around Sydney, Melbourne, Brisbane, Perth and Adelaide there is a real concentration in a small area with the rest of the population being sparsely spread out through the rest of the country. This leads to large infrastructure costs that we deem to be uneconomical in the medium to longer term.

Country	Land Mass	Population	Density
Australia	7,741,220	21,260,000	2.75
USA	24,709,000	523,736,000	21.2
Europe	10,180,000	712,000,000	69.94
United Kingdom	244,820	60,587,300	247.48
South Australia	984,377	1,584,500	1.61
Adelaide	615	1,146,119	1863.61
Victoria	237,629	5,205,200	21.9
Melbourne	8,831	3,806,092	430.99

Facts extracted from wikipedia

SAFF recognises that the Victorian review of the electricity market has been undertaken but feels that this review could well yield different results to South Australia and that the results of that review should in no way influence the review in South Australia. The Victorian population density is closer to that of North America which has implications on infrastructure and its cost to retailers and their ability to spread costs over a larger relative population base. Ultimately this affects the charges applied to consumers in the state.

Clearly with such a large density of people in one area of South Australia and such a low density of people in the regional areas the infrastructure itself is a barrier to true competition throughout the state.

This is born out of experience where our members cannot get a competitive deal on gas supplies. Our current retailer provided a member with a gas deal which they could not fill due to the incredible entry costs. In fact it was so prohibitive that the member is back with the original supplier, the retailer out of pocket due to paying out the contract so as to honour their agreement.

So while city dwellers can access gas deals the regional areas are at a significant disadvantage and in our experience often are charged government mandated rates. The costs of gas provision in these areas are therefore unlikely to be competitive – ever in the South Australian context.

Barriers to entry

There are significant barriers to competition in Australia and in particular to South Australia.

These include:

- The infrastructure
- Population density
- An effective duopoly
- An inability of operators to offer true discounts or deals

With market size restricted due to the size of the South Australian population itself and the infrastructure issues related to the size of the state there are significant entry costs for a new entrant in the system.

SAFF also believe that the maintenance and upgrade costs in the future will also be prohibitive and may in fact rise as technology and resources are committed to industry and growth.

When the market was first deregulated SAFF wrote some 1480 contracts with the initial retailer. This equates to 1003 actual electricity users, many operating with multiple contracts due to the way they use electricity in bores, dams, sheds and irrigation. After three years our suppliers deals were not as beneficial, so SAFF moved to another supplier. Since that time we have written 60 contracts for 19 farmers. Not a great take up of offers from a base of around 2800 users of electricity. Currently we have no retailer offering our members any deals other than the standard government regulated rates.

Since the market began a number of smaller operators have been swallowed up by the two larger operators, AGL and Origin. Neither of these operators offer consumers any real savings apart from a few insignificant lifestyle choices such as magazines or football club membership etc.
It would appear to the SAFF in fact that only large corporate consumers and businesses are able to receive any real and meaningful savings on their power bills

SAFF can no longer offer any deal to its members, our original provider has been taken over by AGL, our last provider has withdrawn all deals due to losses incurred in providing service. These were withdrawn last year with new innovative deals expected at the beginning of this year, 2008. To date nothing as eventuated and in SAFF's opinion any real savings are unlikely.

To date we have found no other retailer who can offer significant deals to our member base.

Barriers to expansion

There are significant barriers to expansion. South Australian consumers appear to be some of the hottest prospects for taking up electricity deals of all types. Whether this was a result of clever marketing on behalf of the retailers and the state government or due to consumers scared they will miss out on any savings with the hype over the changes to the system the SAFF is unsure. With a large proportion of the users taking initial offers there is only a small market segment left to attract.

This means that any new entrants will not have a market base big enough to make coming into the market worthwhile or profitable. SAFF expects that once contracts entered into at the beginning of the competitive market place expire the only real options available will be from the two major players, AGL and Origin who will have no need to offer discounts or real savings to entice consumers.

Infrastructure costs and the cost of power in peak times also provide a significant real cost to providers and make any competitive pricing virtually impossible. These costs will be too high to allow providers to spread their risk over the small base of users that would be available to them.

Access to gas

Access to gas services exist in the state but are provided currently by the two major players in the industry. Our providers in the past have found gas provision in the city to be possible but in regional areas to be impossible to provide at any really competitive price due to the huge costs levied against them for access. From their perspective the initial costs were far too high to spread over the user base to make it worthwhile to enter the market in any form. Even charging the full regulated rate wasn't considered profitable due to the wholesale costs associated with the provision of service.

Overall SAFF believe that population density, infrastructure cost, population size and the effective duopoly that exists all contribute to an environment that will impede the implementation of true competition now and in the future.

The only way SAFF can see this changing is through significant technological advances that significantly reduce the cost of power consumption reduce the resources needed to generate power and overcome the infrastructure costs inherent in the State. At this time we are not aware of any advance that would meet these criteria or even have a possibility of allowing competition to truly flourish.

2. Retailer Rivalry

Competition

Retailer rivalry existed in the early stages of the competitive process but we believe this has now developed into a duopoly system where competition will not be necessary and we don't see that this will change.

From our experiences there is no true competition in the market, this is even less the case in regional areas. We can't see this situation changing in the future and in fact expect the average consumer to be worse off as retailers start to recoup infrastructure costs in an attempt to increase profits for shareholders.

Regulated price

While the regulated price has maintained a price ceiling and protection for users it is our experience that retailers now in real terms charge this ceiling with no real discounts. In fact with retail prices to the consumer rising by 25 -30% we feel consumers are worse off than prior to the market being deregulated. During the period from December 2003 to December 2007 inflation has risen by 11.56% (source ABS CPI statistics). Clearly electricity price increases are significantly higher than inflation. There is little or no tariff innovation.

Our members have found deals offered while sounding realistic often use a number of techniques to reduce the actual attractiveness of rate reduction, these include:

- Changing tariff steps
- late payment penalties
- meter alteration at client cost
- changes in peak and off peak times reducing the off peak period
- Different contract periods
- Pressure on telephone marketing
- Interstate firms marketing with SA in their trading name to give the impression of being a local firm
- Prohibitive exit costs

Our members have often rung us confused stressed and annoyed at how marketers have approached them. In a number of cases after analysing the deal and the power usage of the members the deals contributed no real savings and increased the risk of inflated costs if a member's power usage increased above current levels, largely due to the step structure of the deal. Given the weather patterns especially the consistent heat we have experienced the power usage of many users having increased which would exacerbate this situation.

In the opinion of SAFF price regulation is necessary to protect regional and other disadvantaged groups. With electricity price rises in excess of the inflation rate under a regulated system SAFF feels that the impact of deregulating the rates would be negative to regional users of electricity.

Mis-selling

As outlined above the use of aggressive telephone and door to door marketing, misleading names and difficult to understand structures all lead to mis-selling in our view. The operators we have dealt with on the whole were ethical in their conduct although there were a couple of issues with several members where meter change over costs were not explained clearly. The details were in the contract but the sales pitch outlining the benefits of the deal failed to inform of these costs clearly. Once identified this was corrected and our sales staff made this clear to members.

Providers themselves however have a knack of outlining the positive parts of a deal and not the negative. Whilst this is the nature of sales, SAFF believe that in this market with its newness and complexity these techniques are misleading.

Given that all households, businesses, and government must use power to a reasonable level it is essential that users are given all information necessary to make an informed decision.

Again in a captive market serviced by a duopoly SAFF cannot see how a market can be truly competitive. We are even more concerned what this will mean for disadvantaged regional users should some form of government regulation be removed altogether.

Wholesale Electricity

Both of our retail providers to members have cited the cost of electricity during peak periods, especially if unpredicted (eg long heat waves) as being a primary reason as to why they cannot be competitive below government regulated rates. The system required for retailers to cover their exposure to fluctuating prices appears costly but more costly where unpredictable weather patterns increase power consumption well above expected levels.

The SAFF feels that the system as a whole needs to be reviewed so that the exorbitant infrastructure costs and the costs of wholesale power can be smoothed out to make the system workable.

Our view is that the current system is trying to make a power distribution work in a free market where the underlying small base of users and large costs prohibit a free market from being profitable. If costs of ongoing provision remain too high and the market is deregulated SAFF can only see prices becoming unsustainable. It would seem that overseas models have been applied to an economy that has totally different parameters, structure, market forces and barriers to entry. The Australian market is totally different from overseas markets and the South Australian market is totally different to markets on the East coast of Australia.

It is these differences that make the wholesale cost of electricity so high.

3. Customer Participation

Our members will only change providers if they are comfortable that:

- The deal provides a real saving in costs
- They consume enough electricity to be at the high end of the deal where benefits actually exist
- They are dealing with a reputable company
- Power supply will not be affected during peak times
- The deal structure suits seasonal use
- The deal is available in regional areas
- The length of contract
- Exit costs are non existent or small
- The benefits of the deal are cash savings instead of lifestyle benefits

We have seen no real competition between providers in the city and even less in regional areas. All of the deals seem to be similar and we have found in our own experience deals while honoured for existing contracts have been withdrawn for new contracts and the rates offered are at government rates with few lifestyle rewards offered. Even previous lifestyle programs have been withdrawn.

The electricity industry is similar to the telephone industry in relation to the variations in deals and how benefits can vary depending on how users use the services themselves. The major differences in the industries however relates to the number of providers, cost increases (retail prices for electricity have risen by 25 – 30% for retail customers since inception) and the necessity to use electricity for essential uses in the home and business where phone use can be more discretionary. This means that the electricity market has significant real differences to the telephone industry that preclude cost savings and therefore lower prices to consumers.

It’s a fact that where a market can grow and truly innovative products are provided the infrastructure cost can be offset against more users. The market responds with lower prices and improved services – eg telephone industry.

But even here there will be provision issues for regional areas without some form of government legislation.

Our concern is that the captive market in electricity, the limit to innovation, the time and effort involved in new service provision will continue to see no real innovation in deals and continuous price increases to users as a whole and to regional users in particular.

Information

Information provided by retailers we have found differs significantly.

Anecdotal evidence from calls to our office concerning our retailers offers and the offers of other retailers indicate that whilst most deals have common elements and provide all mandated information the actual deal itself can be less than clear. There are often no comparison tables to government rates and the tariff steps, and other costs that enable users to clearly identify the benefits and disadvantages of a deal.

Users often have difficulty in assessing the relative benefits of a number of deals.

4. Equitable Access

As outlined in other areas SAFF believes regional areas are currently disadvantaged by having no ability for real savings and some cases access to alternative gas services due to the wholesale cost restrictions that exist.

It is our concern that now the market is settling into an effective duopoly that regional consumers may be further disadvantaged by a lack of choice and spiralling costs associated with future infrastructure recovery by retailers trying to improve their share value.

SAFF do not believe there is any incentive for any retailer to entice users into the market. While the market theory outlined in the statement of approach documents provided by the AEMC asks questions about customer access we believe this is misleading.

All households, business and government will continue to access power sources for survival and living. Therefore rather than talking about customer access we believe it is more relevant to talk about access to power at a reasonable cost which is now essential to survival.

SAFF’s concern in this area is that people who need to use power to operate their businesses or in fact to survive may find themselves without the financial capacity to pay for what they need. Farmers have experienced rising costs in fuel supplies and at the same time have been in drought conditions for a significant time thus reducing their incomes. If electricity prices keep rising they may be excluded from the market financially leading to a loss of business and maybe livelihood.

Other sectors of the community may also be affected, regional centres, low income earners and the aged sections of the community. Any loss or reduction in the use of power during hot or cold spells may lead to increased health issues and possibly could be life threatening.

Our concern is that restrictions on access to power are related to financial capacity rather than information provision.