



public interest
ADVOCACY CENTRE LTD

The next piece of the puzzle:

**PIAC submission to the Australian Energy Market
Commission's Approach Paper: *2014 Retail
Competition Review***

28 February 2014

Oliver Derum, Acting Senior Policy Officer

Energy + Water Consumers' Advocacy Program

Introduction

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights; and
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from Trade & Investment NSW for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

Energy + Water Consumers' Advocacy Program

This program was established at PIAC as the Utilities Consumers' Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- St Vincent de Paul (NSW);
- Ethnic Communities Council NSW;
- Rural and remote consumers;
- Retirement Villages Residents Association;
- Physical Disability Council NSW; and
- Affiliated Residential Park Residents Association.

1. The current review

PIAC thanks the Australian Energy Market Commission (AEMC) for the opportunity to provide comment on its *Approach Paper – 2014 Retail Competition Review* (the Approach Paper). The Approach Paper is designed to provide clarity to stakeholders about how the AEMC will ‘gather and analyse evidence on the state of competition in NEM [National Energy Market] jurisdictions’.¹

The current review is the first the AEMC has undertaken to examine the state of retail competition across the NEM. The AEMC has previously assessed retail competition in single jurisdictions, including in NSW in 2013. Under the Australian Energy Market Agreement (AEMA), made between State and Territory Energy Ministers through the Standing Council on Energy (SCE), jurisdictions agree to remove retail price regulation following a finding from the AEMC that effective retail competition exists in that State or Territory.² In December 2012, SCE (then SCER) Ministers agreed to change the approach of assessing competition from jurisdiction by jurisdiction to an annual assessment across the NEM.³ The new approach takes effect from this review.

PIAC’s comments in this submission relate to a number of aspects of the effectiveness of competition in the retail energy market for small consumers.⁴ These issues include:

- the importance of assessing competition in rural areas as well as major capital cities;
- whether retailers in a particular area are offering a variety of tariff shapes, allowing customers to potentially benefit from choosing an offer that is best for them;
- the retail component of prices, including retail profit margins and the ‘high and unexplained’⁵ retail costs in Victoria;
- a low ability of suppliers to enter the market possibly indicating that the price is close to the efficient level and that the market is delivering benefit to consumers; and
- customer satisfaction and complaints.

In addition to these comments, this submission emphasises the key role that future annual AEMC competition reviews will make in tracking the on-going progress and evolution of the market. PIAC has previously argued that if price regulation is removed in NSW, a series of triggers for re-regulation should be introduced.⁶ This would occur where it could be demonstrated that the competitive market was not benefitting consumers or was producing other negative outcomes. PIAC believes that if appropriately designed, the AEMC’s annual market assessment could provide the indicators for the activation of those triggers. PIAC also believes that all market participants, their representatives and policy makers will benefit from comprehensive and on-going assessment of the energy market. In undertaking this function, PIAC submits that the AEMC should follow the example of work currently being undertaken by consumer representatives from the St Vincent de Paul Society, in collaboration with Alvis Consulting.

¹ AEMC, *Approach Paper: 2014 Retail Competition Review*, 2014, 1.

² Standing Council on Energy, *Australian Energy Market Agreement* (as amended), 2013, cl 14.11.

³ Macfarlane, I, *Terms of Reference: AEMC reporting on the state of retail energy market competition across the NEM*, 2014, 2.

⁴ This review focuses on small customers, not making a distinction to residential and small business customers (AEMC, above n 1, 8)

⁵ Dufty, G, and Mauseth Johnston, M, *The National Energy Market – Is the Devil in the retail? Observations from the Vinnies’ tariff-tracking project*, 2013, 5. Available at:

www.vinnies.org.au/icms_docs/178601_National_Energy_Market_-_Is_there_devil_in_the_retail.pdf

⁶ PIAC, *Where to and how?*, 2013, 7. Available at: www.piac.asn.au/publication/2013/08/where-and-how.

PIAC notes that the Approach Paper ‘applies solely to the 2014 review’ and that the AEMC will consult later in the year to refine its approach to future reviews.⁷ A number of PIAC’s comments relate to the approach to assessing competition as much as the current state of competition itself. Nonetheless, PIAC believes that it is appropriate to make these comments at this stage, as part of the first NEM-wide competition review. PIAC also notes that the schedule for this review ‘does not provide sufficient time for the AEMC to consult with stakeholders on a draft report’.⁸ Accordingly, PIAC takes this sole opportunity to provide comment on this review.

2. Assessing competition in regional areas

In its submissions to the AEMC’s 2013 review of the effectiveness of competition in NSW, PIAC argued that consumers in rural and regional areas, especially those covered by the Essential Energy network area, experience lower levels of competition than their counterparts in cities such as Sydney and Newcastle and the surrounding suburbs.⁹ In light of this, PIAC argued for a separate examination of the competition in each NSW network area.¹⁰

The AEMC chose not to follow this recommendation, stating in its Draft Report that:

the costs and conditions of operating a retail business are sufficiently similar across the three distribution areas that they do not constitute separate markets for the purposes of assessing the effectiveness of competition.¹¹

PIAC, therefore, welcomes the AEMC’s statement that it ‘will analyse regional areas separately in each state to determine whether there are any systemic differences from urban areas’.¹² PIAC submits that consumers in rural and regional areas experience lower levels of competition than their counterparts in urban areas. Previous analysis by PIAC has suggested that rural and regional consumers have access to a lower number of different offers than their counterparts in the suburbs of major cities.¹³ PIAC also considers that lower population density and higher energy prices make regional areas less attractive markets for new retailers to enter.

However, as well as collecting data that allows the AEMC to examine whether there are systemic differences between urban and regional areas, PIAC recommends that the AEMC assess whether there are differences between different rural areas. Regional Australia is highly diverse. As part of assessing competition across the NEM, it is important that the AEMC understand the nuances within these areas, rather than simply how they differ from major cities.

⁷ AEMC, above n 1, 1.

⁸ Ibid, 3.

⁹ PIAC, above n 6, 10.

¹⁰ Ibid.

¹¹ AEMC, *Review of Competition in the Retail and Electricity and Natural Gas Markets in New South Wales: Draft Report*, 2013, 14

¹² AEMC, above n 1, 9

¹³ PIAC, above n 6, 10. See also: Schetzer, L, *Choice? What Choice?*, 2011, Sydney: PIAC. Available at: www.piac.asn.au/publication/2011/06/choice-what-choice

Recommendation 1

PIAC recommends that the AEMC examine competition in a variety of rural and regional areas and analyse differences between these areas, as well as comparing competition to that in major cities.

3. Tariff shapes and product diversity

PIAC submits that a key aspect of a mature and effectively competitive retail electricity market is a diversity of product offerings from suppliers. In a truly competitive market, retailers can be expected to offer a variety of different products as part of their efforts to attract and retain customers. This product diversity, in turn, allows consumers to choose an option that best suits their circumstances.

A recent report on the NEM retail market by the St Vincent de Paul Society and Alvis Consulting found that 'Victorian households have the most tariff shapes (irrespective of metering type) to choose between'.¹⁴ The report attributes this to a number of factors. Victoria has removed electricity price regulation and has five network areas. As a result, 'there is not a single incumbent retailer that other retailers can "copy"'.¹⁵ This means that each retailer determines its own standing offer, which becomes the basis for the discounts they offer under market contracts.¹⁶ The report found that NSW and South Australia had the next highest level of variation, with the two being very similar.¹⁷

PIAC takes the view that the level of product diversity in NSW (and other jurisdictions) should increase as the market matures. This should happen regardless of whether price regulation is removed, but PIAC would expect even greater product diversity to be evident in the market if the NSW Government (or any other) did choose to deregulate prices. Accordingly, PIAC welcomes the AEMC's intention to 'test whether retailers are competing by offering different products and services that meet the needs of their customers'.¹⁸ However, PIAC wishes to emphasise that this is a key indicator in which change over time, as much as a single finding, will indicate the presence (or absence) of effective competition in the retail energy market. Monitoring the retail market over time is discussed in more detail in Section 7, below.

4. Retail costs and profit margins

In its submissions to the AEMC's review of the effectiveness of competition in NSW, PIAC argued for a trigger for the reintroduction of energy price regulation (if such regulation is removed) based on retailer profit margins.¹⁹ In its Final Report for that review, the AEMC stated that while profit margins provide an indicator of competition and may be considered, they are 'not, in themselves, determinative'.²⁰

PIAC maintains that retailer profit margins are a useful indicator of the effectiveness of competition. In particular, as noted by the Approach Paper, 'where profit margins are persistently very high, retailers may be earning profits in excess of the efficient cost of supply'.²¹ PIAC also

¹⁴ Dufty, G, and Mauseth Johnston, M, above n 5, 11.

¹⁵ Ibid.

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ AEMC, above n 1, 11.

¹⁹ PIAC, above n 6, 9.

²⁰ AEMC, *Review of Competition in the Retail Electricity and Natural Gas markets in New South Wales: Final Report*, 2013, 9.

²¹ AEMC, above n 1, 11.

accepts that there are potential difficulties in determining retailer profit margins. Nonetheless, PIAC supports the AEMC's efforts to examine retailer costs and recommends that efforts be made to determine whether retail costs are above efficient levels.

In particular, PIAC takes the view that retailer costs in Victoria must be the subject of particular attention. Without price regulation, it is difficult to isolate the wholesale and retail components of energy prices. However, research suggests that these costs appear to be increasing as the market develops.²² The Approach Paper notes that retail market costs in Victoria are high, with the difference with other jurisdictions 'appear[ing] to be larger than expected'.²³ The St Vincent de Paul Society has gone further, stating that 'various analyses continue to show high and unexplained retail costs' in Victoria.²⁴

PIAC is concerned that as the competitive retail market develops, retailers will continue to put ever-greater effort into gaining and retaining customers. The cost of larger marketing departments, more market research and staff to design new products will ultimately be passed on through final retail prices. While retailer effort to attract new customers may appear to be a sign of a competitive market, increased costs will deliver poorer outcomes for consumers. Consumers should not be asked to pay higher than efficient costs for essential services in order to fund increased retailer activity and operations. If this is occurring, the market is failing to deliver an efficient outcome and, in PIAC's view, effective competition cannot be said to exist.

As generation and network costs remain stable or decrease, it is important that these reductions in price are passed through to consumers. By tracking these price movements, and the movements in other cost components, such as green schemes, the AEMC should be able to determine whether increases in retail costs are working to cancel out lower costs in other areas of the energy price cost stack.

Recommendation 2

PIAC recommends that the AEMC examine retailer costs and profit margins, to determine whether the market is working to minimise retail costs and deliver competitive prices for residential consumers.

5. Ease of entry into the market for suppliers

The Approach Paper notes that 'an effectively competitive market will generally have no significant barriers to entry, exit or expansion'.²⁵ PIAC agrees that for competition amongst suppliers to benefit consumers, there should be minimal impediments to new suppliers entering the market.

However, PIAC does not believe that a low likelihood of retailers generating significant profit should be considered a barrier to entry. PIAC takes the view that the lower profit margins are, the closer the price is to the level of efficient costs. Ultimately, the reason competition exists in markets is the belief that it will drive prices down to the true cost of production and provide benefits to consumers.

In addition, PIAC notes that policy measures designed to encourage competition often seek to do this by increasing prices for consumers. For example, PIAC was critical of the decision of the

²² Dufty, G, and Mauseth Johnston, M, above n 5, 17

²³ AEMC, above n 1, 11.

²⁴ Dufty, G, and Mauseth Johnston, M, above n 5, 17.

²⁵ AEMC, above n 1, 10.

NSW Independent Pricing and Regulatory Tribunal (IPART) to include an extra customer acquisition and retention charge in regulated electricity prices for 2013-14. PIAC took issue with IPART's decision to insert extra 'head-room' in the regulated price in order to attract new market entrants. IPART argued that when new suppliers entered the market, the extra competition would drive prices back down to efficient levels. However, this extra cost was included in final prices for consumers, who were asked to pay high prices in exchange for the possibility of lower prices in the future.

PIAC is a supporter of vibrant competition in the market, as this will benefit consumers. However, where that competition drives prices towards the true cost of supply, profit margins may become thin and entry into the market difficult for new suppliers. Where the market has already reached this stage of development, PIAC is unsure if new market entrants will benefit consumers. To address this issue, PIAC recommends that the AEMC undertake an analysis of the optimal level of suppliers in the retail market.

Recommendation 3

PIAC recommends that the AEMC undertake analysis to determine the optimum number of suppliers in the retail energy market.

6. Complaints and the consumer experience

The Approach Paper states that the AEMC intends to use customer complaints to test consumer satisfaction with retailers, noting that 'in effectively competitive markets, customers are generally satisfied with the range of products available to them and the choices that they make'.²⁶

PIAC submits that by this measure, the competitiveness of NSW retail energy markets has decreased in recent times. Recent figures from IPART show that complaints to electricity and gas retailers increased by 79% and 54%, respectively, last financial year compared to the year before (see Table 1 and Table 2, below).

TABLE 1: Complaints to NSW electricity retailers from small retail customers²⁷

	2011/12	2012/13	Percentage increase
Number of complaints related to marketing	7,193	10,268	43%
Number of complaints related to billing	25,482	45,156	77%
Number of complaints about other matters	18,417	36,158	96%
Total number of complaints	51,092	91,582	79%
Total complaints as a percentage of customers	1.6%	2.8%	75%

²⁶ Ibid, 11.

²⁷ IPART, *Customer service performance of electricity retail suppliers: 1 July 2008 to 30 June 2013*, 2013, 10.

TABLE 2: Complaints to NSW gas retailers from small retail customers²⁸

	2011/12	2012/13	Percentage increase
Number of complaints related to marketing	1,130	1,576	39%
Number of complaints related to billing	9,369	13,485	44%
Number of complaints about other matters	6,867	11,758	71%
Total number of complaints	17,366	26,819	54%
Total complaints as a percentage of customers	1.5%	2.3%	53%

PIAC is concerned by these sharp increases in customer complaints. PIAC submits that if similar increases are seen in the next figures, this may call into question the capacity of the market to deliver benefits to consumers without stricter regulatory oversight. PIAC takes the view that such an increase would suggest that the competitive market is not exerting sufficient pressure on retailers to minimise customer complaints (and, thereby, reduce the risk of dissatisfied customers changing to a different supplier).

PIAC, therefore, recommends that in order to assess the effectiveness of competition in the market, the AEMC must build a picture of complaint data across the NEM. PIAC understands that the Australian Energy Regulator (AER) compiles this data for jurisdictions that have implemented the National Energy Customer Framework (NECF). The AEMC should, therefore, build on this data until all NEM jurisdictions have implemented the NECF, at which point the AER's data would serve this purpose. PIAC submits that seeing the data tracked as part of annual competition reviews would also encourage retailers to minimise complaints.

Recommendation 4

PIAC recommends that the AEMC compile and analyse customer complaint data across the NEM as part of its current review of the effectiveness of competition.

7. The importance of measuring results over time

The AEMC's annual reviews of the effectiveness of competition will serve two important purposes. Firstly, they will provide an annual snapshot of the retail market across the NEM. Secondly, if conducted in the right manner, they will provide insight into the on-going development and evolution of the competitive retail market across the NEM. Such on-going monitoring is currently being undertaken by the St Vincent De Paul Society, in conjunction with Alviss consulting.²⁹

PIAC takes the view that the second of these functions is potentially more important. PIAC argues that effective competition in a market benefits consumers by moving prices towards efficient levels over time and placing downward pressure on prices. As such, the movement of price from year to year is an important indicator of the on-going effectiveness of competition. Similarly, retailer outcomes (such as profit margins) and the number of suppliers in the market

²⁸ IPART, *Customer service performance of gas retail suppliers: 1 July 2008 to 30 June 2013*, 2013, 14.

²⁹ For more information on the project, including all publications, is available at: http://www.vinnies.org.au/page/Our_Impact/Incomes_Support_Cost_of_Living/Energy/, as at 7 February 2014.

give a more illustrative picture when examined over a number of years. In short, on-going monitoring of the market will illustrate its development and evolution as opposed to a snapshot at a single point in time.

On-going monitoring of the effectiveness of competition could also form part of a framework for the possible re-introduction of price regulation. PIAC has previously argued for the introduction of such a framework, if price regulation is removed in NSW.³⁰ The AEMC also supports the creation of reserve powers if price regulation is removed. In the Draft Report for its review of competition in NSW, the AEMC stated that:

A reserve power to reregulate prices should be retained if price caps were removed in NSW. This would allow the Government to respond quickly to reintroduce price regulation if competition becomes less effective.³¹

PIAC, therefore, recommends that the AEMC undertake the current review in a manner that would support the use of the review's findings as part of a framework for exercise of reserve powers to regulate electricity prices. PIAC acknowledges that the AEMC intends to consult on the shape of future reviews of the effectiveness of competition. Nonetheless, PIAC expects the AEMC to consider the future use of the data that is collected in the current and first year of NEM reviews.

As noted above, the St Vincent de Paul Society and Alviss consulting have been monitoring the movement of electricity prices in various Australian jurisdictions for some years. PIAC considers this work to be of a very high standard, and argues that work of this quality enhances the energy policy debate as well as outcomes for consumers

Recommendation 5

PIAC recommends that the AEMC undertake its current review of retain competition in the NEM in a manner that would support the use of its findings in any future framework for the reintroduction of price regulation in a NEM jurisdiction.

8. Conclusion

Once again, PIAC thanks the AEMC for the opportunity to provide comment on its proposed approach to the first review of retail competition across the NEM. These reviews will give consumers and their representatives valuable information about the current state of the energy market and its development over time.

PIAC submits that the current review should examine competition by electricity network area in NSW. PIAC considers that product diversity is an important indicator of competition. PIAC shares the concerns of other consumer organisations about unexplained increases in retail costs, and encourages the AEMC to examine this issue as part of its current and future reviews of competition. In addition, PIAC argues that if prices are close to efficient levels, there may be little incentive for new suppliers to enter the market. While a high number of suppliers in competition with each other could be expected to benefit consumers, price is ultimately the key concern of most households.

³⁰ PIAC, above n 6, 6.

³¹ AEMC, above n 11, 113.

Regarding the current state of competition in the retail market, PIAC submits that increases in customer complaints suggest significant room for improvement. The figures support the case that the market is not currently exerting enough pressure on retailers to minimise complaints at the risk of losing customers.