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Australian Energy Market Commission
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Dear Commissioners

Power of Choice—giving consumers options in the way they use electricity: Draft Report

We welcome the opportunity to respond to the Australian Energy Market Commission's (the **Commission**) Draft Report on its Power of Choice Review (the **Draft Report**).

In summary, we have significant concerns that the Commission has not adequately considered many of the practical implications of proceeding with its recommendations, particularly as to how consumers will respond to the changing, more complex energy market that the implementation of the recommendations will ultimately produce. While we welcome efforts by the Commission to take steps to protect vulnerable consumers and to improve information provision to consumers, we believe much more policy work must be done to ensure consumers are able to effectively exercise choice and engage with the "options" that electricity markets will deliver.

To be clear, Consumer Action does support action to address the problem of peak demand. We agree that peak demand, and inefficient use of the electricity system, is an acute problem that deserves attention. We also agree that efforts should focus on ensuring that the demand side of the market is more effectively able to participate and relieve this problem. However, our message is that, in doing so, the Commission needs to more closely consider expert evidence about the actual behaviour of consumers in markets, particularly in essential service markets, and should also consider the policy tools needed to inhibit harm caused by behavioural biases and increasing complexity for consumers. As noted further below, the Productivity Commission has highlighted these as key challenges requiring consumer policy responses.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal assistance, litigation services and financial counselling to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

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Consumer behaviour

In our initial submission to the Commission's Issues Paper for this review, we provided significant information about consumer behaviour and the lessons for policy development from the field of behavioural economics.¹ In its Directions Paper, the Commission did not accept this information and maintained that consumers will always make the best decision from their viewpoint. In doing so, the Commission ignored significant evidence of consumers departing from the rational choice in a systematic and predictable way.²

We note that the Productivity Commission takes a different view and has found that there is a need for policy to take account of the results of behavioural economics.³ The Australian Treasury has also acknowledged that actual consumer behaviour matters, and that consideration should be given to whether consumer biases are capable of causing detriment in the development of consumer policy. In its publication, *Consumer Policy In Australia: A companion to the OECD Consumer Policy Toolkit*, it advises consideration of consumer behavioural biases and asks the following questions:⁴

- is there evidence that consumer behaviour is responsible for, or contributing to the problem?
- are consumers making quick buying decisions or eliminating options as a result of too many product offerings, or due to the complexity in comparing options?
- are consumers making decisions based on inertia (selecting the default choice and failing to choose) or are their decisions heavily influenced by the manner in which the options are presented to them (for instance, claims made on packaging or in advertising)?

While we acknowledge that detriment caused by consumer behavioural biases are not the key focus of the current review, we are concerned that implementation of the Commission's package of recommendations may contribute to further consumer detriment arising from behavioural biases and increased complexity.

As noted in our initial submission to this review, it is our view that consumer behavioural biases not only represent an issue for consumers, but also for the effective functioning of markets. One common behavioural bias is heuristics or "rules of thumb", which may operate to impede effective decision-making. Heuristics recognises that people commonly do not make decisions in a considered or calculated fashion, but instead rely on mental shortcuts. This can mean that choices regarding energy options may be made by consumers that do not accord with their preferences, contrary to the position advocated by the Commission.

¹ See, Consumer Action, *Submission to AEMC Power of Choice Issues Paper*, August 2011, available at: <http://aemc.gov.au/Media/docs/Consumer%20Action%20Law%20Centre-ee5953b4-fa7d-4af2-8082-143a6782dcfd-0.PDF>.

² AEMC, *Directions Paper, Power of Choice Review*, March 2012, page 29.

³ Productivity Commission, *Review of Australia's Consumer Policy Framework—Volume 2*, April 2008, page 374.

⁴ Australian Government, *Consumer Policy in Australia: A companion to the OECD Consumer Policy Toolkit*, March 2011, available at: http://www.consumerlaw.gov.au/content/consumer_policy/downloads/Companion_to_OECD_Toolkit.pdf, page 15.

Eldar Shafir has explained this argument:⁵

To the extent that consumers find themselves in situations that are unfamiliar, distracting, tense or even stigmatizing (say, applying for a loan), all of which tend to consume cognitive resources, less resources will remain available to process information that is relevant to the decision at hand. As a result, decisions may become even more dependent on situational cues and irrelevant considerations.

Economist Herbert Smith has succinctly expressed the problem of information overload: a 'wealth of information creates a poverty of inattention'.⁶

This consequent impact on the functioning of markets is an issue that has been recently identified in relation to telecommunications markets. In its recent inquiry, *Reconnecting the Customer*, the Australian Communications and Media Authority stated:⁷

Being unable to easily choose a product suitable for their needs is a key consumer problem. However, there is also an adverse impact on the functioning of the market—a consumer who cannot assess the range of products available is not likely to choose the service provider that best meets their needs.

Consumers suffer from 'disclosure fatigue' and when the decision making environment is complex will be more likely to take short cuts such as following rules of thumb rather than assessing and comparing products. This can present an incentive for service providers to take advantage of consumer bias by increasing the complexity of consumer choice and presenting information in a way that will appeal to the rule of thumb approach.

The complexity of market choice for consumers, and the consequent detriment, was a key driver for the *Reconnecting the Customer Inquiry*, which was largely instigated because of an exponential increase in complaints to ombudsman services about telecommunications services.

In our view, consumer detriment arising from complexity is likely to become worse in energy markets following the implementation of the Draft Report's recommendations. In particular, the recommendations relating to more flexible pricing options, competitive metering services, new market participants and consumer information may mean that the market is far more confusing for consumers, resulting in consumer detriment and inefficient market outcomes. We strongly encourage the Commission to consider the implications of increasing complexity in its final report, and make recommendations to mitigate negative consequences.

Levels of consumer engagement

The Commission, in the Draft Report, states that:

⁵ Eldar Shafir, *A Behavioural Background for Economic Policy*, paper presented to the Productivity Commission's roundtable on Behavioural Economics and Public Policy, August 2007, page 12,

⁶ Herbert Simon, 'Designing Organisations for an Information Rich World', in Martin Greenberger, *Computers, Communication and the Public Interest*, 1971.

⁷ Australian Communications and Media Authority, *Reconnecting the Customer—Final Report*, September 2011, available: http://www.acma.gov.au/webwr/assets/main/lib310013/rtc_final_report.pdf, page 87.

Traditionally, consumers have been relatively passive participants in the energy market. This situation has changed in recent times, with consumers becoming increasingly interested in managing their electricity usage and costs.

While this may be so in a broad view of the situation, the Commission has not provided any evidence that consumers have confidence to better manage electricity and costs. Without such evidence, and given the extent of consumer confusion evident in complaints to our centre, we're not convinced that consumers are not still placed as passive participants in the market.

Even if consumers are interested in managing their electricity usage and costs, we reiterate that complexity, behavioural influences, and market power can operate to reduce a consumer's desire to engage. We have already discussed complexity above, but there are additional behavioural influences when it comes to energy services, particularly heating and cooling, which are significant contributors to energy consumption. Another well-understood behavioural bias involves hyperbolic discounting. This bias posits that 'people care about now', which can explain a wide range of human behaviour, such as succumbing to addiction, procrastination and impulse buying. Applied to energy, this is likely to mean that consumers will decide to use the air conditioner in peak times (even if they are aware that it costs more and rationally would prefer that they did not), and will disregard the significance of the large bill that will follow some time later.

In retail markets, there are also a range of market practices that inhibit consumer engagement:

- Firstly, most marketing in energy sales is through door-to-door sales. In our view, door-to-door sales do not support competition, and in fact stifles it. Competition can occur when a consumer reviews a range of products, considers their features and costs and makes an informed decision about what is right for them. At the doorstep, a consumer has no chance to consider other products or their own electricity consumption patterns, and is unlikely to be able to compare the offer with their current plan. Door-to-door sales do not promote informed decisions—rather it encourages ill-considered, rash purchases where consumers might end up paying more for electricity.
- Secondly, for those that do try and shop around, marketing can be at best confusing and at worst misleading. Energy retailers commonly market based on percentage savings, which raises the question—a saving from what? The saving is generally from that energy retailer's standard rate, and most consumers aren't likely to be on that rate. There is a further problem for low and fixed in come households—many discounts come with fine print that often includes a requirement to pay on time. For the consumer who finds this hard to manage, the discount evaporates.
- Thirdly, once a consumer chooses a new energy deal, there is nothing stopping a retailer increasing the price throughout the contract. Terms of fixed term contracts commonly provide retailers with the ability to pass on cost increases, which can make household budgeting difficult and any savings very short lived.

In our view, these sorts of retail practices make it less likely that consumers will engage in the energy market, as the costs and time of doing so may not be recovered where there is poor marketing, or where deals can quickly change. We encourage the Commission to consider, in its final report, recommending changes to the regulation of certain retail market practices that inhibit consumer engagement in the market.

New energy market participants

The Commission proposes that its recommendations will result in more parties providing "DSP energy services". As noted above, we are concerned that additional market participants will increase confusion among consumers. Nevertheless, we strongly support the Commission's proposal that the NECF is clarified so that consumer protections apply to these parties. In particular, these protections should include dispute resolution requirements (such as membership with ombudsman schemes) and protections around disconnection and hardship. We are concerned about some "DSP energy services" that impact ongoing access to energy, such those that might allow for supply capacity control. Supply capacity control might operate to limit access to energy for credit management purposes, effectively contracting a consumer out of their hardship rights pursuant to the NECF.⁸

New pricing options

We understand that the Commission, like many regulators, governments and industry participants, is committed to pursuing time of use pricing for residential households. In our submission to the Directions Paper, we outlined our concerns about the effectiveness of this policy. We won't repeat those concerns here. However, we will re-make the point that unregulated time of use pricing is likely to be the most significant driver of increased complexity for residential energy consumers.

Consumer Action does welcome the Commission's efforts to protect vulnerable consumers from adverse impacts caused by a move to time of use pricing, and particularly supports the proposal for small to medium consumers to remain on flat tariffs rather than being required to move to time of use tariff mandatorily. In our view, especially to facilitate a managed transition to time of use pricing offers, we think this 'opt in' approach should apply to all residential consumers. Our concern is particularly that mandatory re-assignment will result in consumer confusion and backlash, and it is reasonable to expect the framework to be one that can allow a consumer to consciously make a decision to amend the terms of their existing retail contract. We note that the Victorian Government has proposed that this approach applies from 1 July 2013.⁹

We note, however, that this approach relies on consumers having the necessary information to be able to choose an electricity offer that suits their needs (discussed further below), and on robust compliance with rules that require explicit informed consent to enter into energy market contracts. We consistently receive complaints from consumers that marketers ignore directions not to engage with them,¹⁰ that key terms of contracts are not sufficiently explained prior to a sale (such as the right for a retailer to change the price throughout a fixed contract period), and that marketers target those that lack competence to understand what is being offered (such as the

⁸ Consumer Action, *Submission to the Essential Services Commission on Supply Capacity Control*, February 2011, available at: <http://www.esc.vic.gov.au/getattachment/d13c9b18-3efb-4a94-9809-822335ed1283/CALC-re-capacity-control-and-verifying-bills-issue.pdf>

⁹ Hon Michael O'Brien, Media release—Greater pricing choice for Victorian energy consumers, 26 September 2012, available at: <http://www.premier.vic.gov.au/media-centre/media-releases/4977-greater-pricing-choice-for-victorian-energy-consumers.html>.

¹⁰ Consumer Action, *Media Release: Do Not Knock Campaign lodges 100 complaints with ACCC*, June 2012, available at: <http://consumeraction.org.au/media-release-do-not-knock-campaign-lodges-100-door-to-door-selling-complaints-with-acc/>

elderly or those from non-English speaking backgrounds).¹¹ We encourage the Commission to consider how the rules might improve compliance with informed consent requirements, for example, whether there are specific marketing channels that should be further regulated (i.e. door-to-door sales) so that non-compliance with these rules is less likely.¹²

Access to consumption information


We welcome the Commission's recommendations with respect to access to consumption data and particularly that consumers should be able to access this data at no cost. However, we're concerned about how consumers are expected to interpret this data. Access to data alone is not sufficient—consumers need to know what their consumption data means in terms of the final price they will pay with respect to various energy offers in the marketplace, and the impact that changes to their consumption patterns would mean for the final bill. Without simple mechanisms to determine these matters, we're not convinced that access to consumption information will be useful for consumers in managing electricity use and prices.

We strongly support the proposal for an energy information hub, recently considered by the Department of Resources and Tourism,¹³ as well as Government-sponsored energy comparator sites, such as the AER's Energy Made Easy. We encourage the Commission to make stronger recommendations that will enable the linking of these services, so that a national one stop portal might be established, providing information about which energy deal is appropriate based on a consumer's historical consumption patterns.

Please contact me on 03 9670 5088 or at gerard@consumeraction.org.au if you would like to discuss these matters further/have any questions.

Yours sincerely

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¹¹ Footscray Community Legal Centre, *The African Consumer Experience of the Contestable Energy Market in the West of Melbourne*, March 2009, available at:

<http://www.esc.vic.gov.au/getattachment/94c82335-8fc7-4d6d-ac11-5d213bca2dbd/African-experience-of-Melbourne-Energy-Market-Marc.pdf>

¹² Recent research from the ACCC demonstrates how the industry's reliance on commission-based remuneration schemes drives aggressive sales behaviour and encourages agents to adopt tactics that are not fully compliant in order to secure more sales: Frost and Sullivan, *Research into the Door-to-door Sales Industry in Australia*, August 2012, available at:

<http://www.accc.gov.au/content/item.phtml?itemId=1070526&nodeId=9244ae9eca6a60727f3c75ff507124cc&fn=Research%20into%20the%20door%20to%20door%20sales%20industry%20in%20Australia%20%E2%80%93%20August%202012.pdf>.

¹³ Sapere Research Group, Scoping study for a consumer energy data access system (CEdata), August 2012, available at: <http://www.ret.gov.au/energy/Documents/energyMarket/CEdata-scoping-study.pdf>.