

Submission in Response to the AEMC Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia, Second Draft Report 14 October 2008

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Australian Energy Market Commission
PO Box A2449
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Via email to
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1 Introduction and Scope

Kildonan UnitingCare (Kildonan) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia, Second Draft Report (Second Draft Report). Kildonan would like to support UnitingCare Wesley's submissions into this enquiry. This brief response to the Second Draft Report is based on Kildonan's work in the residential energy sector and focuses on consumer issues and protections in competitive markets. Specifically, it focuses on consumers and consumer protections that we believe have been inadequately addressed in the First and Second Draft Report and associated consultation processes.

Considerations Supporting this Submission

In order to have a competitive market there are two parts that need to work well together - firstly competition amongst retailers that drives prices to the most competitive and efficient level and secondly consumer choice that can shape the market into their best interests when it comes to price and product need. Furthermore the principles of competition policy as agreed to by governments in Australia include consumer protection.

The Compendium of National Competition Policy Agreements Second Edition June 1998 clearly states that the "*Governments have agreed to the principles for a national competition policy as outlined in the Hilmer Report*"¹. They set up SCO to manage this agenda and the Competition Principles Agreement 11 April 1995. Relevant matters to competition include²

¹ National Competition Council, *Compendium of National Competition Policy Agreements*, Second Edition, Commonwealth of Australia, June 1998. (p.11)

² National Competition Council, *Compendium of National Competition Policy Agreements*, Second Edition, Commonwealth of Australia, June 1998. (pp. 11-15)

- (e) social welfare and equity considerations, including community service obligations; and
- (h) the interests of consumers generally or of a class of consumers.

With the establishment of National Electricity Market the first objective amongst others was

- (i) *the ability for customers to chose which supplier, including generators, retailers and traders, they will trade with³*

AEMC objectives are even more consumer focused than the above

Australian Energy Market Commission Establishment Act 2004-sect 30
30 Objectives

In performing its functions-

- (a) the Panel must have regard to any relevant objectives set out in a National Energy Law; and
- (b) the Panel must seek to promote the interests of all consumers of electricity or natural gas while paying particular regard to benefiting small to medium consumers of electricity or natural gas.

2 Kildonan UnitingCare's Background

Kildonan is an agency of the UnitingCare Victoria and Tasmania Network. which, as part of the Uniting Church in Australia, operates the largest welfare network in Australia. Kildonan is based across five sites in the northern suburbs of Melbourne with 75 staff and over 80 volunteers, working to make a positive difference with children, young people, families and individuals, through the provision of effective community services and through addressing issues of social and economic hardship.

For over 127 years, the way in which Kildonan delivers care has evolved to reflect the diverse and changing needs of communities, families and individuals. Services are provided within four areas; family services, youth services, community services and social advocacy services. In 2006 two agencies, Hope Springs and Preston Creative Living Centre, merged with Kildonan and have increased the diversity of services offered through the inclusion of mental health, programs men's behaviour change, and pre-employment training opportunities.

Kildonan is committed to the development of innovative, evidence based proactive services and works with the utilities, insurance telecommunications and finance industries, advocating for sustainable solutions for low income and vulnerable consumers. Kildonan's work in developing consumer hardship policies and models has received two Prime Minister Business and Community Partnership Awards in recognition of the outcomes of these initiatives.

³ National Competition Council, *Compendium of National Competition Policy Agreements*, Second Edition, Commonwealth of Australia, June 1998. (p.60)

Kildonan is uniquely placed as an organisation with experience in developing programs that address fuel poverty. This experience has provided Kildonan with considerable understanding of energy efficiency issues affecting low income consumers. Our organisation has built on this understanding to develop cutting edge programs in partnership with business, thereby delivering programs to consumers in hardship that produce sustainable outcomes for consumers and business.

Of particular relevance, Kildonan UnitingCare has a team of industry funded energy auditors who work directly with consumers across Victoria. Based on the success of this work Kildonan is currently finalising partnerships with interstate community organisations to build energy efficiency capacity in the wider community sector and for low income households.

3 Kildonan UnitingCare Responses to the AEMC Review

(i) Lowered Competition due to Industry Vertical Integration in South Australia

Lack of competition in the wholesale energy market and market dominance by a few players across the wholesale and retail sectors in South Australia (jointly referred to as 'vertical integration') will impede true market competition. Policies aimed at increasing competition that ignore these factors will not be effective and will worsen the range of choice and equity for consumers. Therefore the proposed changes fail by four of the AEMC's own criteria for the assessment of competition:

- Independent rivalry within the market;
- Ability of suppliers to enter the market;
- The exercise of market choice by customers; and
- Differentiated products and services.

There is documented concern ^[1] that the vertically integrated nature of the South Australian wholesale market and the associated lack of competition may increase prices to consumers as they did in Victoria. In fact, concerns about retailers being 'squeezed out' may be the result of the vertically integrated nature of the larger retailers, an issue requiring further attention and investigation by AEMC.

^[1] Gans J. S. & Wolak F. A., A Comparison of Ex Ante versus Ex post Vertical Market Power: Evidence from the Electricity Supply Industry. October 8, 2008. www.mbs.edu/jgans & www.stanford.edu/~wplak

Recommendation 1

That independent research is conducted into the vertically integrated nature of South Australian wholesale markets and the implications for consumers. This should take into account UnitingCare Wesley's concerns as well as the experience in Victoria about price increases emerging from the market power of vertically integrated electricity companies. This research also needs to take into account concerns by small not vertically integrated retailers.

(ii) The Current System is Working, Which is not an Argument to Change It

The AEMC's own conclusion is that the current regulatory regime for gas and electricity markets in South Australia is working in terms of facilitating competition. Therefore it is unclear why a change is being proposed. In fact, we argue that competition will be drastically reduced with the proposed changes. [See Point (i) above].

To elaborate, competition under a regulatory environment has already delivered positive outcomes for consumers according to AEMC. According to its Second Draft Report:⁴ *'The First Final Report indicates that competition is effective in keeping market contract prices in line with real costs of supply, and margins at or below competitive levels'*. We cannot agree with the sentence that follows (in sequence if not in logic): *'In these circumstances price regulation is unnecessary and costly'*. That is, we contend that if price regulation and a competitive market work well together there is no need to change it.

Recommendation 2

That current price regulation mechanisms in the South Australian energy market are retained.

(iii) Retail Suppliers are Favoured at the Expense of Consumers

The proposed changes favour the suppliers over small and medium sized consumers, impeding true consumer choice in the process, especially in terms of access to information.

⁴ AEMC 2008, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia*, Second Draft Report, 14 October 2008, Sydney (p.5)

It is stated in the Second Draft Report that: *'Because regulators have imperfect information, regulated prices will generally either be set too low, deterring investment and innovation, or too high, to the detriment of consumers'*.⁵ However, the same could be argued about energy consumers in that they too have imperfect information yet they are expected to make important choices to obtain market contracts under the proposed changes. Following this logic further, the players with the most perfect information in this market are the big industry players and, in particular, the leading player. This market advantage is set to entrench industry dominance and facilitate an imbalance of power between them and the consumers. To thus allow one or a few large players to steer the market and set the prices appears to be both anti-competitive and inequitable.

Recommendation 3

Suggest instead put this below: 'That independent research be conducted and published into the effects of projected price changes following any removal of price regulation on consumers.'

(iv) Facilitation of Future Price Rises to Cause Consumer Hardship

The regulatory facilitation of energy price rises will disadvantage consumers and lead to widespread energy-related hardship.

AEMC in its Second Draft Report states that regulation has actually held prices down for consumers but that the market requires price increases. For example:

*.....the regulation of standing contract prices has prevented retailers from passing through rising costs. Price regulation has also eroded margins, thus impeding competitive activity.*⁶

and

*Even if increased flexibility to pass through cost increases could be introduced into the regulatory arrangements, retaining direct price regulation by the regulator in a rapidly changing and uncertain future regulatory environment is likely to harm the viability of existing retailers, discourage entry and impede the effectiveness of energy retail competition*⁷.

⁵ AEMC 2008, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia*, Second Draft Report, 14 October 2008, Sydney (p6)

⁶ AEMC 2008, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia*, Second Draft Report, 14 October 2008, Sydney (pviii)

⁷ AEMC 2008, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia*, Second Draft Report, 14 October 2008, Sydney (pix)

Without taking full account of the influence of vertically integrated companies (see above) and their market power over the smaller retailers, AEMC apparently believes that keeping prices low is an issue of regulatory inflexibility and that enabling prices increases necessarily leads to market competition. However, this appears to be based on faith rather than evidence.

To reiterate our argument, it will not be in the best interests of consumers, especially small to medium consumers of electricity and gas, to have price increases, especially if those prices are far from competitive or transparent due to the vertical integrated nature of the South Australian electricity industry. In fact, the evidence is that smaller energy retailers have left the market in the past due to vertical integration and access to reasonably priced hedging.

Recommendation 4

That independent research be conducted and published into the effects of the removal of price caps, particularly in relation to retaining or increasing consumer benefits at the current level.'

(v) Inadequate Consumer Protection

From Kildonan UnitingCare's experience, the proposed consumer protections will not prevent disconnection of low income consumers, or restrict escalating debt, especially in the face of projected price rises.

Rising energy costs will inevitably place many South Australian families in greater poverty and without access or ability to maintain basic energy necessities. In order to ameliorate some of the energy-related hardship for consumers, we suggest that South Australia considers and adopts the suite of consumer protection frameworks operational in Victoria as an example of best practise for minimum benchmark consumer protection.

Recommendation 5

That South Australia adopts the consumer protection framework operational in Victoria as best practice CSO. This consumer protection framework includes but is not limited to, all the concessions under Department of Human Services including Utility Relief Grant Scheme and Home Wise, The Energy Retail Code consumer protections, Wrongful Disconnection legislation and retailer mandatory hardship policies.

(vi) Disadvantage and Lack of Choice for People on Low Incomes, in Regional Areas and with Poor Literacy

While there is evidence of active consumer choice in the electricity market, this is limited to consumers with higher income and a tertiary education.

AEMC commissioned Mc Gregor Tan Research⁸ to carry out quantitative and qualitative research on consumer behaviour including the exercise of market choice by consumers, consumer switching behaviour and customer satisfaction. The report found that 82 per cent of people are aware that they can choose their electricity retailer. Specifically, just over 84 per cent of city people, of working age, not on a concession, and higher income indicated they could choose their retailer now.⁹ However, importantly, the opposite was true of consumers in regional areas and on a low income. Eighteen per cent of people living in regional South Australia or on low income believed they had to purchase electricity from their current retailer.¹⁰

Even though numbers are very small (13 per cent) consumers with higher income, and a tertiary education were more likely to have approached a company for an offer.¹¹ While there is active consumer choice in the electricity market this appears limited to educated, high income, working age, city dwellers who are able to understand and negotiate contracts on favourable terms. What then of the majority of customers (over 87%) who do not have the same advantages?

According to ABS data^[3], a large proportion of the Australian population has poor literacy, which will affect capacity for consumers to analyse energy offers from retailers. For example, the majority of the Australian population falls within level one and two of the document literacy scale (understanding every day documentation), problem solving and numeracy scale. Evidently many people in the community encounter difficulties with each of the above categories in their everyday lives and will therefore have trouble understanding and comparing the utility contracts that are marketed.

See Recommendation 2 above.

(vii) Retailer Information and Consumer Enlightenment and Choice

The marketing of products by retailers does not necessarily facilitate or guarantee consumer choice. Indeed, it may serve to obfuscate the nature of products, especially as companies seeking customers have a vested interest in presenting information with a slant that presents their offers in the best light. This is a particularly serious problem for the many people with poor literacy in the Australian population (see above). Unfortunately, in the prevailing market it does appear that ostensible consumer choice based on access to full information is left to and driven by 'interested' and partial retailers.

⁸ Mc Gregor Tan research, *Review of the Effectiveness of Competition in electricity and Gas retail Markets Project No: 8448, June 2008.*

⁹ Mc Gregor Tan research, *Review of the Effectiveness of Competition in electricity and Gas retail Markets Project No: 8448, June 2008 (p21)*

¹⁰ Mc Gregor Tan research, *Review of the Effectiveness of Competition in electricity and Gas retail Markets Project No: 8448, June 2008 (p22)*

¹¹ Mc Gregor Tan research, *Review of the Effectiveness of Competition in electricity and Gas retail Markets Project No: 8448, June 2008 (p30)*

^[3] 4228.0, ABS Adult Literacy and Life Skills Survey, Summary Results, Australia, 2006 (Reissue)

Drawing on information in the Mc Gregor Tan Research report already noted, South Australian energy customers who did not change retailers were marginally more satisfied than those who did change – which challenges the belief that changing retailers automatically implies greater satisfaction.

To elaborate, the AEMC states that there was high satisfaction amongst consumers of 81 per cent regarding their ability to choose retailers. However when we look at the breakdown in consumer satisfaction^[5] 38 per cent were very satisfied, 29 per cent were quite satisfied and 17 per cent were neither satisfied or dissatisfied. If we remove the neutral consumers we have 67 per cent satisfaction rate with current market transfer arrangements. This is in contrast to 69 per cent satisfaction rate with consumers who did not change retailers.

Most customers who switched did so because of an approach by a retailer. In its appendix to the first draft report AEMC accepts this approach and it's impact on consumer choice in a competitive market i.e.:

In an environment where customers perceive the cost of searching for information to be relatively high compared to the benefit they could obtain from switching retailer, direct selling is likely to be the most efficient way for retailers to improve competitive outcomes for customers (p. 100)

By providing information directly to customers, retailers can differentiate their service offerings from those of their rivals, while at the same time minimising the search and transaction costs incurred by customers. This form of marketing can ameliorate any perceived impediments that may otherwise discourage consumers from exercising choice (p. 103).

This is in direct contrast to the views some consumers expressed in the qualitative study in section 5 about *pressure to sign, confusion in decision making and complaints about marketing practices*¹².

When consumers are approached by a retailer they are approached to buy their product and we would not expect that the sales person would/could discuss other (perhaps better) offers by rival retailers with the consumer. This type of passive choice is certainly not conducive to a competitive market. In fact it is 'retailer driven' choice. Thus AEMC needs to investigate further how low income regional and consumers with literacy difficulties (the majority of the population) can actively access market offers and easily shop around for the best offers. Otherwise dependence on retailer information dissemination militates against a competitive market that consumers 'drive' and that works in their best interests.

Mc Gregor Tan research, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets*, Project No: 8448 June 2008 (p46)

¹² Mc Gregor Tan research, *Review of the Effectiveness of Competition in electricity and Gas retail Markets Project No: 8448, June 2008 Section 5 Analysis General (p149)*

As noted above, in order to have a competitive market there are two necessary components - firstly true competition amongst retailers that drives prices to the most competitive and efficient level and secondly consumer choice that can shape the market into their best interests when it comes to price and product need. We argue that current regulation serves to keep energy prices down, while facilitating competition. True consumer choice is the other component necessary for a competitive environment, however for the reasons given above a retailer driven market under the proposed changes will militate against this.

Recommendation 6

That the AEMC delay any implementation of the removal of price caps until research is carried out into optimal ways to support a competitive market that includes and is driven by consumer choice.

Recommendation 7

That the AEMC commissions independent research on how low income, regional customers, people with literacy difficulties and people in the general population can be supported in understanding and strategically choosing market offers.

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