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Australian Energy Market Commission
By email to submissions@aemc.gov.au

AEMC Retail Competition Review – CUAC Response to Draft Report

The Consumer Utilities Advocacy Centre Ltd (CUAC) appreciates the opportunity to respond to the Australian Energy Market Commission's First Draft Report *Review of the Effectiveness of Competition in Gas and Electricity Retail Markets in Victoria* (the Draft Report).

CUAC is an independent advocacy organisation, established to represent the interests of Victorian consumers, particularly low-income, disadvantaged, rural and regional and Indigenous consumers, in policy and regulatory decisions on electricity, gas and water. This submission has been made with the interests of those consumers in mind.

CUAC has serious concerns about the Commission's findings in the Draft Report. In summary, they are:

- A consumer apparently has only to answer the door to a door-knocker to be defined as an 'informed and active consumer' by the Commission, even though informed and active consumers are deemed integral to effective competition. The analysis has ignored evidence of widespread marketing problems, the nature of consumers' vulnerability in the market, and what are clear market failures.
- The Commission has relied too heavily on the customer survey to assess the experience of consumers in the market, and has ignored the concerns raised by consumer groups, particularly in relation to marketing misconduct.
- We strongly disagree with the notion that the consumer's transaction costs of switching are significantly reduced by retailer's direct marketing strategy. Door-knocking only reduces the transaction costs for signing up for that one product – it does not equate to or replace real product comparison.
- Too great a weight has been placed on supply-side criteria - issues relating to information asymmetry and transaction costs have not been sufficiently well researched to enable the Commission to make a sound finding that competition is effective
 - An important omission is the lack of research as to whether consumers have actually benefited from switching decisions.

- The obligation to supply is fundamental to ensuring all Victorians have access to energy. We do not support the notion of tying the obligation to a product without government oversight; for retailers to choose that product risks the consumers most at risk of losing access paying the highest price for energy.
- We would strongly encourage the Commission to consult directly with consumer groups in considering any amendments to the regulatory framework dealing with to ensure that its deliberations take into account the significant body of work and expertise on these issues.
- That the analysis failed to take into account the short-term development of the market fatally undermines the finding of the Draft Report, particularly since
 - the roll-out of advanced metering infrastructure (AMI) will enable new and more complex products
 - the introduction of emissions trading and associated climate change policies will place upward pressure on prices and impose greater expectations on consumers to understand their usage.

The following outlines CUAC's concerns in detail, and is aligned with the relevant sections of the Report.

4 Retailing energy in Victoria

We are concerned that the Commission's analysis is too sanguine in its assessment of the level of competition. In considering market concentration it is true that new retailers have made inroads into the Victorian market since the last review of full retail competition (FRC) in 2004. However, the fact remains that the three host retailers retain around 80% of electricity customers and nearly 90% of gas customers. That is still a sizeable market share, and one that creates significant market power.

4.2.4 Awareness of FRC

The tenor of the report seems to suggest that the Commission's analysis is weighted toward a judgement that competition is effective. An example is the question asked in the customer survey about whether customers valued the opportunity to choose their retailer. This is clearly a value-laden question – indeed it's very difficult to see how respondents could respond other than in the affirmative - which adds nothing to the overall analysis, but is used by the Commission to demonstrate that “a necessary pre-condition for competition to be driven the demand side is met” (p 44), a conclusion that is dubious at best.

The Commission ignores the fact that a significant portion of customers – half of gas customers and a third of electricity customers – still cannot name another retailer. The fact that the number has risen since the last survey is essentially irrelevant: the crux of the issue is that there remains a poor awareness of the market.

5.1.3 Retailer rivalry

CUAC and other consumer groups pointed to the role of the standing offer to provide a price reference for consumers. In the Draft Report, the retailers also acknowledge that the standing offer forms a benchmark against which market offers can be compared, and that different pricing structures had been rejected by consumers (p 61) – from the example provided, we

think it safe to assume that those different tariffs increased consumers' transactions costs and so customers rejected them.

In its analysis, however, the Commission appears to be criticising that role as stifling innovation and dampening competition. CUAC strongly disagrees with that assessment: first, the notion of 'innovation' in regard to electricity and gas is severely limited, given the nature of the product. Apart from dual fuel and green energy, product innovation simply means different ways of billing customers for the same good. As noted later in the report, dual fuel was only cited as a reason for switching by 10% of households and only 3% of business customers (p 97).

Second, products that increase the transaction costs to consumers, by reducing their ability to compare offers, undermine competition – indeed a major recommendation arising from the last review of FRC was for government to act to reduce those transaction costs, recognising the risk to consumers and the effective working of the market of confusion. The Commission's analysis does not address that risk at all, a significant omission.

5.3 Marketing practices

The customer survey results that only 10% of electricity and 6% of gas customers had contacted a retailer over the past 5 years bears out CUAC's experience – as we noted in our submission to the AEMC Issues Paper, the most effective marketing strategy for retailers is without doubt doorknocking, demonstrating that there remains a significant degree of customer inertia in the marketplace. Consumers are not actively seeking to change retailers, but will consider so doing when approached.

We strongly disagree with the notion that the consumer's transaction costs of switching are significantly reduced by retailer's direct marketing strategy (p 42). Door-knocking only reduces the transaction costs for choosing that one product – it does not equate to or replace real product comparison.

This review has provided consumer groups with the opportunity to undertake research in relation to marketing practices. That research, undertaken by Footscray Community Legal Centre, Financial and Consumer Rights Council (FCRC) and the forthcoming report by Consumer Action Law Centre and FCRC indicates systemic problems in the way energy is promoted to consumers.

It is clear from that body of research that

- customers are not making choices that are in their best interests, and in fact are signing onto products that reduce their surplus as a result of switching; and
- there is evidence of significant misleading and unconscionable conduct.

CUAC was therefore extremely disappointed with the Commission's decision to overlook these problems, which point not only to supply-side market failures, but also clearly demonstrate that information asymmetries remain a major problem.

CUAC and other consumer organisations recommended that the AEMC undertake more detailed research to assess whether customers had indeed switched to better offers. We remain of the opinion that without that data, it is very difficult to assess accurately how well consumers are faring in the market. The responses in the customer survey that customers believe the contract to which they had switched meets their expectations are not supported by

anecdotal evidence, or by research in other jurisdictions (e.g. Wilson and Waddam-Price, 2006).

The treatment of complaints and enquiries data in relation to marketing is also of concern. Apart from the comparison with the Telecommunications Industry Ombudsman and the implicit (and wildly inaccurate) assumption that telecommunications has some form of 'average' number of complaints, we do not understand why the reference to the UK experience, where regulation has resulted in a significant drop in complaints from levels comparable to Victoria, was only referred to in a footnote in the Draft Report. This again seems to indicate the Commission is focusing on analysis that supports the view that competition is effective.

Provision of information

In defining 'effective competition', the Commission states that for competition to be effective, one of three characteristics a retail energy market must have is "Informed and active consumers seeking to obtain energy products, prices and other terms and conditions of supply which best meet their needs" (p. 26).

The Commission's analysis overlooks the fact that the Victorian regulations mandating product information disclosure rely heavily on the customer taking the initiative to find that information – Product Information Statements are available online, but there is no requirement for a retailer to offer that information to a consumer or to tell a customer it exists. The customer survey found that customers rely primarily on the retailer for information – at point of sale, the customer is not going to receive any information except about the product on offer. That situation does not equate to an 'informed and active consumer'.

The Commission dismissed the evidence supplied by Footscray Legal Centre that found that 45 of 65 respondents did not receive information about the offers being made. That research however clearly demonstrates the shortfall of the regulation in place, which fails if customers are unaware of their rights to request and receive information.

6 Customer participation and experience

CUAC believes that customer participation is a crucial pre-requisite of an effectively competitive market. As we have noted earlier, we strongly disagree with the view (p. 86) that through their direct marketing to consumers, retailers are reducing transaction costs for a customer. In reality, information will only be provided for the product being offered to the consumer, which only reduces switching costs for that product, but that does not equate to an 'informed or active consumer' and does not promote competition.

Similarly, we must challenge the notion that customers switch when presented with an 'attractive offer' (p. 92), which is not borne out by the research undertaken by consumer groups, that clearly demonstrate that customers sign onto offers in response to pressure and harassment from sales agents.

In assessing consumers' motivations for switching or not switching, CUAC believes that the Commission has not adequately addressed the interests of the significant number of consumers – around 40% - who choose not to switch, and the role of the standing offer in providing a safety net to those consumers.

6.2 Access to and understanding of contract information

CUAC strongly agrees that access to accurate and relevant information about the terms and conditions of energy contracts is necessary for the development of effective competition.

The customer survey and consumer submissions clearly demonstrate however that consumers are not sourcing such information, we believe because

- the regulatory obligations on a retailer to provide information to facilitate comparison depend on the customer requesting or seeking it, and therefore assume the customer knows that it exists; and
- Consumers perceive the transaction costs to outweigh the benefits to initiate a search. Retailers' rely on face to face contact to convey information so there is little in the public arena that would assist consumers or prompt switching.

CUAC does not share the Commission's confidence that this situation does not necessarily make competition ineffective – as we noted in our submission to the Issues Paper, the Government's decision to roll out AMI means we are likely to see more complex products emerge in the marketplace. Time of use tariffs may become common, requiring customers to understand how and when they consume in a way they have never had to before. Transaction costs will increase, not reduce.

7 Conditions for entry, expansion and exit

CUAC agrees with the Commission's assessment that the regulatory framework is not a barrier to effective competition. As the Commission notes, concerns about the costs imposed through meeting regulatory obligations in a number of jurisdictions is best dealt with in the processes underway in the MCE and Retail Policy Working Group.

CUAC also disagrees with the view that the Victorian framework imposes an undue burden on retailers – in fact, the regulatory regime has promoted competition, through ensuring consumers have confidence in the market.

7.2.2.1 Managing customers experiencing financial hardship

The timeframe to respond to the Draft Report precludes a detailed response on the efficacy of retailers' hardship programs, or their value to consumers. We would note that these programs have only been in place for a short time, so there is not much data available to assess them. However, we are sceptical of the claim that they present substantive obstacles to effective competition – the Commission should be aware that some of the second tier retailers did not engage actively in the processes of developing the regulatory framework, and are not well-versed in the policy development that led to that regulation.

We would strongly encourage the Commission to consult directly with consumer groups in considering any amendments to the regulatory framework dealing with hardship – there has been significant work done in Victoria by government, consumer groups, retailers, EWOV and the regulator on energy hardship, and the Commission should be careful to ensure that its deliberations take into account that body of work.

9 Equitable access to the benefits of competition

CUAC welcomes the Commission's discussion on those consumers who are less likely to benefit from competition. As noted above however, we would again strongly encourage the

Commission to consult directly with consumer groups in considering amendments to hardship policy obligations.

10 Moving Forward

CUAC's advocacy is based on the fact that energy is an essential service, and so access to affordable energy must remain a fundamental benchmark in the regulation of the market.

The obligation to supply is fundamental to ensuring all Victorians have access to energy. We are deeply concerned at the notion that the Commission seems to be considering its retention only as a transitional measure (p 147). We do not support the notion of tying the obligation to a product without some government oversight; for retailers to choose that product risks the consumers most at risk of losing access paying the highest price for energy.

What's missing from the Draft Report?

In our submission to the Issues Paper, CUAC encouraged the Commission to incorporate short-term developments into its analysis. In our view, its decision not to do so severely undermines the value of the Draft Report.

The Victorian market will change significantly following the AMI roll-out – the push for more complex tariffs is inevitable, requiring consumers to understand in detail the level and type of their consumption. The effect on competition of the AMI roll-out should have been incorporated actively into the Commission's assessment. In addition, the introduction of an emissions trading system will place upward pressure on prices – which are already under pressure from wholesale market constraints. What will be the impact on competition? Price increases in other jurisdictions should also have an effect on the level of competitive activity in the short-term.

Given the possible degree of change, we encourage the Commission to incorporate future trends into its analysis.

Please do not hesitate to contact me by phone on 03 9639 7600 or by email kerry.connors@cuac.org.au should you have any questions about the above.

Yours sincerely



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