



## **Comment**

# **on the Phase Out of Retail Price Regulation for Electricity and Natural Gas - Draft Effective Competition Criteria**

**September 06**

### **INTRODUCTION**

ACTCOSS acknowledges that Canberra is built on the traditional lands of the Ngunnawal people. We pay our respects to their elders and recognise the displacement and disadvantage they have suffered since European settlement. ACTCOSS celebrates the Ngunnawal's living culture and valuable contribution to the ACT community.

The ACT Council of Social Service Inc. (ACTCOSS) is the peak representative body for not-for-profit community organisations, people living with disadvantage, and low-income citizens of the Territory. ACTCOSS is a member of the nationwide COSS network, made up of each of the state Councils and the national body, the Australian Council of Social Service (ACOSS).

ACTCOSS' objectives are representation of people living with disadvantage, the promotion of equitable social policy, and the development of a dynamic, collaborative and sustainable community sector.

The membership of the Council includes the majority of community based service providers in the social welfare area, a range of community associations and networks, self-help and consumer groups and interested individuals.

ACTCOSS receives funding from the Community Services Program (CSP) which is funded by the ACT Government.

ACTCOSS advises that this document may be publicly distributed, including by placing a copy on our website.

## Introduction

The Ministerial Council on Energy Standing Committee of Officials (MCE SCO) asks for comment on the level of *effective* competition that should exist to enable the lifting of regulated retail pricing for electricity and gas.

ACTCOSS has been a participant in the jurisdictional and national discussions on full retail competition (FRC) since the late 1990s, and was opposed to the introduction of FRC on the grounds that it offered no improvements in services or pricing for low income households or consumers experiencing financial hardship or other forms of disadvantage. To date, we have seen nothing in the Australian or international experience that changes that perspective; indeed, some of the issues now being raised in terms of demand side responses to generation and transmission concerns only heightens our anxiety that an essential service is being priced out of the reach of many small consumers.

In 2005, the Independent Competition and Consumer Commission (ICRC) in the ACT was given a reference by the then Treasurer, Ted Quinlan, to determine whether the transitional, regulated pricing structures introduced at the commencement of FRC in Canberra should be retained. One of the parameters for that review was the extent to which there was effective competition in the ACT retail electricity market<sup>1</sup>. ACTCOSS, and other social welfare groups, took the position that this was not an issue as we felt that there was no evidence of real competition: there was still a monopoly in distribution, and the churn in the ACT market had mostly been bundling of services from the former monopoly supplier of electricity, water and gas. The newer entrants into the ACT market, Country Energy and Energy Australia, represented only 2 of the 15 electricity retailers licensed in Canberra and their market share was quite small. With no looming threat forcing a change in the prices offered to consumers, and no new entrants trying to take profit from the head room built into the regulated pricing, we were confident that the transitional tariff would be retained.

ACTCOSS was very concerned that the ICRC produced a draft report in early 2006 stating that they have found "*potential*" competition existed, and that this was sufficient to support the removal of the transitional tariff. There were some legislative barriers to some of the protections ACTEW AGL said it would put in place to protect low income households, which would provide a 12 month phase out period. This was to enable the ACT Government to make necessary changes and to provide a fail-safe mechanism to protect against future market failures.

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<sup>1</sup> The gas market in the ACT was not part of this review. All future references to energy in this submission are generally applicable to principles for pricing electricity and gas to protect low income and disadvantaged consumers.

What none of the discussion has centred on to ACTCOSS' satisfaction has been the turn-about in the national approach to the provision of essential services to low income households and consumers experiencing disadvantage. For decades private and state housing providers have built housing that was inadequate for the various Australian climates, and solved those construction shortfalls with electric heating and cooling. We have also increased the usage of heated water within the home, for legitimate public health and safety reasons. Yet the construction of the energy markets through reference to the Hilmer report of 1992 has not explored nor addressed the inequity in the market, assuming all energy consumers are informed, in control of their usage and able to pay market price for the convenience of a warm home and hot water.

ACTCOSS will examine the various questions posed by the MCE SCO in its discussion paper, but believes that some fundamental issues have been ignored in the development of the energy markets. Of primary interest to this organisation is the ability of small, residential consumers to have guaranteed access to a safe, reliable and affordable amount of electricity and gas, or their environmentally sound substitutes, to ensure that they maintain the best health and wellbeing achievable. The households of most concern to us are those affected by poverty, including those whose incomes are consumed by the costs of ill health or disability.

We attach our comment on the ICRC Draft Decision on the Transitional Franchise Tariff for your information.

## What makes a market in energy?

The MCE has asked for comment upon the following criteria.

- Independent rivalry in the market
- Ability of suppliers to enter the market
- The exercise of market choice by consumers
- Differentiated products and services
- Prices and profit margins
- Customer switching behaviour

In making its assessment, the MCE relies on the six indicators set out as criteria upon which to judge competition:

1. Customer experiences – for competition to be effective, customers must be aware of different retailers and perceive that they can make price comparisons – data compiled from customer surveys.
2. Customer switching – transfer rates can indicate customer interest and activity in the competitive market – available from market data.
3. Price and non-price offers – evidence that suppliers are actively competing by offering innovative products that meet customer needs – compiled from retailer surveys and ‘mystery shopper’ surveys.
4. Entry and exit of suppliers – number of competing suppliers and changes in the number of suppliers can indicate the degree of competition – available from market data.
5. Market share – market share and changes in market shares are an indicator of market structure and dynamics – available from market data.
6. Barriers to entry – the threat of new entry creates pressures to reduce prices and improve services – to be ascertained by analysis.

The discussion paper also talks about what weight should be given to these indicators. ACTCOSS is very concerned that this is covered by a caveat that states:

*In assessing whether competition is effective, the high level criteria have been classified into two classes of indicators:*

- *input related indicators, which deals with market structure; and*
- *output/outcome related indicators, which deal with the outcomes of introducing competition in the market.*

*In undertaking the effective competition assessment, the AEMC may place more weight upon indicators considered input related without compromising its holistic assessment.*

In ACTCOSS' reading of this statement it appears that the final decision is unduly influenced by the performance of upstream industries and the appearance of competition, rather than the actual outcomes for consumers. We find this an inappropriate concept to apply to a market, the purported existence of which is to provide goods and services to consumers. To put more weight on upstream industries and/or inputs would seem to indicate that we have a perfect Sir Humphrey market – one where the consumers are of little interest and their absence would allow everyone to get on with their jobs.

ACTCOSS raises this issue in light of our wish to emphasise the fact that the energy market is not uniform or simple. Even small end-users are not a uniform group, with a wide range of needs. ACTCOSS' specific concern is with those consumers who cannot:

1. Control their use of energy because of the age and condition of their accommodation;
2. Curtail their use of energy use because of health issues;
3. Access secure and affordable accommodation and are therefore subject to high entry costs each time they need to reconnect; or
4. Earn sufficient income to meet their need for appropriate accommodation, including the necessary essential services such as electricity, gas and water.

From this perspective, ACTCOSS believes that the following points need to be borne in mind when the MCESCO considers its final report on retail price controls.

### **Independent rivalry in the market**

Rivalry will be assessed on a jurisdictional basis; however this causes some concern. While the ACT is fairly spatially homogenous, there is still a substantial population group experiencing poverty and financial distress. As mentioned in ACTCOSS submission to the ICRC on the transitional tariff draft decision, there is no competition for the lower end of the retail energy market. Many low-consumption, low-income households are ineligible for the discounts offered through bundling, as they do not have a range of products, such as electricity, gas, internet and phone, to bundle. They may access other introductory discounts, however there has been some concern raised that these discounts may be illusory as the costs of the initial discount is recouped over the life of the contract. Again, ACTCOSS would point out that there are 15 licensees in the ACT, yet less than a third of them are actively seeking household customers, demonstrating that the presence of high numbers of licensed firms in a market is insufficient evidence of competitive activity.

### **Ability of suppliers to enter the market**

ACTCOSS understands that, while obtaining a licence to retail energy in Canberra is relatively cheap, the cost of IT upgrades and compliance with local regulations are seen as restricting new entrants. Entry to the market therefore incurs costs which will be reflected in pricing at some point.

Given the industry gaming on pricing that has been commented on in the past by regulators, it would seem that the ability of suppliers to enter a market needs to be re-focussed to ascertain what the price is to consumers of that ability.

### **The exercise of market choice by consumers**

ACTCOSS finds this a difficult area to assess, as most of the data on this aspect of FRC has been collected by the regulators, and it seems that little has been provided in recent times.

What this data does not show is the extent to which consumers were conscious of making a choice between competing retailers, and how they informed themselves of the merits of the various offers. At present, there is, for example, little data on switching behaviour, although Andrea Sharam from Swinburne University and the Energy Advocacy Group in Victoria<sup>2</sup> has presented some material which indicated that consumers were not well informed, but tended to rely on the assertions of retail sale staff.

There is also a lack of any accessible data on consumers, their energy use patterns or what constitutes a base level of energy use to maintain good health and public safety. ACTCOSS believes that groups such as the EAG in Victoria have a long history in consumer advocacy and could provide guidance as to the various gaps in consumer energy data that could assist market analysis.

***ACTCOSS asks that the MCE SCO undertakes to increase the amount of consumer-based energy research undertaken and to ensure that the results of that research are held in a publicly accessible archive to assist utilities policy and advocacy groups to analyse the development of the market.***

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<sup>2</sup> Sharam, Andrea. "Changing Energy Retail Project Report". A research report funded by the Consumers Utilities Advocacy Centre, May 2005.

## Differentiated products and services

ACTCOSS made the point to the ICRC in the attached submission that:

*ACTCOSS does not see bundling of existing products, even when offered by a new entrant, as a range of products. That does not mean that ACTCOSS believes that the offers interstate should be extended into the ACT. We do not, for example, want to see Qantas Frequent Flyer points attached to utilities bills through credit card debit schemes. The ESC found that there was a range of incentives offered in Victoria under competitive contracts, including:*

- *Brand alliance with non-energy products (including football teams);*
- *Dual Fuel Billing;*
- *Fixed Pricing;*
- *Green Energy;*
- *Competitions; and*
- *Product and Service Vouchers.*

*There is also a product from TruEnergy that is targeted specifically at consumers on rebates and concessions. (p.12 of attachment)*

ACTCOSS also notes elsewhere in that submission that in New South Wales there are companies that offer discounts if a customer enters a contract with a specific credit card provider and uses this credit facility for billing. This arrangement may also attract loyalty points for unrelated goods and services. We would see this particular product offering as being financially risky for low income households, who may be attracted to the concept of using credit to pay for essential services. Such offerings, as we also state in that submission, can confuse the consumer protection issues around utilities by removing vulnerable consumers from the protection of bodies like the ACT's Essential Services Consumer Council because the debt is transferred to a credit provider and is separated from their energy use.

The alternative "products" that have been discussed at several National Electricity market discussions ACTCOSS has attended have been demand-management tools set out as retail product alternatives, such as providing a "product" that can be turned off to assist with peak load management, "brown outs" and remote load management – again, turning off appliances remotely when power companies are experiencing peak load.

ACTCOSS does not believe any of these "products" should be substituted for what households should already have access to: safe, reliable, affordable energy that meets their needs. Any discussion of reducing the current reliability, safety and ease of use is really seeking to create an underclass of consumers.

## **Prices and profit margins**

ACTCOSS does not seek to enter a discussion about what is a fair return on the investments made at each tier of the energy industries. What we are concerned with is the amount of gouging that is possible in the various consumer segments. For example, without a high income, consumers do not have a large number of services to bundle. In the ACT, for example, low income households may not have access to gas or internet services, and may be using prepaid mobile phones as a way of managing their communications costs. As demonstrated in the South Australian research, "Powering Poverty" by the Western Region Energy Action Group<sup>3</sup>, most low income households are very aware of their energy use and are considered to be *under*-consuming electricity. They are often not able to access reduced tariffs provided to high-end users.

ACTCOSS believes that the lack of tariffs that provide an affordable base level of energy for all households means that low-consumption households are paying more for their energy when compared to high-end users. While price and profit margins are being used as a measure of competition, the MCE SCO is ignoring the needs of consumers for an affordably priced essential service.

## **Customer switching behaviour**

As outlined above, ACTCOSS has no recent data on customer switching that would allow further comment than that offered in the attached submission to the ICRC. It is possible that additional households have left the monopoly supplier, ACTEW AGL, for Energy Australia, or that Country Energy has secured more small business clients. ACTCOSS still contends that any switching is, as Sharam points out, a response to marketing and not an analysis by informed consumers about the energy products and packaging that meets their needs.

ACTCOSS is concerned that there is insufficient quantitative and qualitative data about switching behaviour, particularly among household consumers.

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<sup>3</sup> Paul Laris & Associates, "Powering Poverty", Western Region Energy Action Group, South Australia. July 2004.

## **Additional areas of concern**

As mentioned above, ACTCOSS sees the lack of reliable, independent information and research on consumer behaviour as a major impediment to appropriate decision making about energy industries at this time. We also believe that there are a range of issues that have been ignored in the rush to assess the “market” from the perspective of industry, without recognising that there is a significant number of Australian households who do not have the resources to participate in a market for their essential services. We would like to have the MCE-SCO comment on the following issues and the approach they feel is needed to address the more obvious market failures for low income and disadvantaged households.

### ***The need for an accessible, understandable price comparison tools, like those available overseas***

There is a comparison tool available on one energy retailer’s site in Australia, but it does not provide the level of ease of use or details about the product offerings that are necessary for an informed choice.

### ***Inequity of introduction of FRC for low-end consumers***

The settlement of accounts and transfers within the National Electricity Market demonstrate that the efficiencies that should exist in the upstream industries are not yet achieved. Yet consumers are being asked to forego price controls because there is an emphasis on the sector that deals directly with them, and no overview of how energy industries interact. There is also concern that the vertical integration of companies may impact negatively on household consumers, among others.

### ***Lack of competition for low income consumers***

As discussed, there is no rush to sign up low income households and there is a lack of demand-side assistance for these users.

### ***Lack of incentive for consumers to control use while the standing charges still form such a large component of the energy bill***

The energy industries have argued against lowering of standing charges under regulation, and there is no reason to believe that de-regulation will not lead to increased dependence on these charges. This means that any jurisdictional programs to curb usage will have little effect. The high level of standing charges also reduces the utility of concessions and CSOs, which are often payable against consumption, not the up front charges.

***Lack of clarity about the funding for CSO's in the post-regulated energy market***

ACTCOSS is very concerned, as pointed out in the attached submission to the ICRC, that the ESCC faces de-funding after the removal of jurisdictional licensing. The ESCC provides a safety net for consumers who have failed in the "market", and who need the support and protection of their community from the harsher elements of a market economy. ACTCOSS would want to see an analysis of providing ongoing funds for concessions and bodies like the ESCC in any report on competition, in recognition of the complete lack of a market for low income households who struggle to pay their utilities bills.

***The lack of enforcement of current regulatory requirements***

ACTCOSS does not believe that the current level of compliance from utilities demonstrates that they understand the diversity of consumers or their obligations as suppliers of essential services. One example that ACTCOSS has raised in the past with the ICRC was the request in 2004 by ACTEW for price compensation to provide filtration plant to the ACT water supply post the 2003 bushfires. The risk of catastrophic fires had been predicted by ACTEW in its 1999 application for a price increase, and a capital works component had been allowed in the pricing decision. The works were not carried out, and ACTEW again asked for funding for those works in 2004. ACTEW received a one line, very mild caution that its future works would be scrutinised in the 2004 determination.

In the compliance report for 2004-05<sup>4</sup> the ICRC noted that some of the data it needed to assess compliance with regulatory directions had not been collected. Compensation was also not paid for failures under certain performance standards (see table 2.2) to attend in certain cases, yet there was no admonishment. There was also an admission that annual reports were insufficient evidence that ring-fencing provisions were being adhered to.

ACTCOSS believes that an improved enforcement regime is required.

ACTCOSS therefore asks that the MCE SCO adopt a consumer focus for its decisions on the operation of the energy markets, and not solely look at the inputs to the market to determine efficiency. Our major concerns, as outlined in this comment, are for:

- improved consumer usage data;

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<sup>4</sup> ICRC, "Licensed Electricity, Gas and Water and Sewerage Utilities Compliance Report for 2004-05" Report 4 of 2006 February 2006

- major improvements to energy efficiency in current and future housing stock,
- retention and financial sustainability of consumer protection mechanisms, like the ESCC, and the concessions and community service obligation regimes that support households experiencing disadvantage;
- ensuring that the new “products’ offered to low income and low-use households are not a reduction in service or a second class “product”;
- ensuring that other product offerings do not cause or exacerbate hardship by bundling non-like products;
- that there is a useful, accessible comparison tool made available, via the web and other formats, which enable easy and meaningful comparison of tariff offerings;
- recognition that FRC is not a panacea for consumers experiencing disadvantage and that there must always be safety nets and hardship relief services available; and
- enforcement of existing regulatory requirements to a high degree, to ensure that consumers remain a prime focus of energy retail policy.

Thank you for the opportunity to comment on the MCE-SCO’s review of draft effective competition criteria.