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Dear Sir/Madam

### **Draft Effective Competition Criteria – Consultation Paper**

The Public Interest Advocacy Centre (PIAC) welcomes the opportunity to contribute to the Ministerial Council on Energy's *Phase Out of Retail Price Regulation for Electricity and Natural Gas – Draft Effective Competition Criteria* (the ***Consultation Paper***).

For customers who are unable to participate in the competitive retail market, retail price caps play an important role in ensuring access to competitively priced electricity. In the years since full retail contestability was introduced to New South Wales we have observed the uneven development of the contestable energy retail market, which sees some consumers benefiting financially from competitive offers while other remain locked out of the market due to geographic, tenancy, consumption or credit profiles. PIAC therefore lends its full support to the analytical assessment of the effectiveness of retail competition in the energy market.

We make the initial observation that the task of the AEMC in the assessment process will not result in a simple assertion of whether or not competition is effective. Rather, we perceive that the task will identify where in the marketplace, and to what degree, competition is effective as well as where it remains ineffective. The qualitative analysis of the counterfactual (ineffective competition) will be invaluable to ensure consumer protection measures develop in line with the maturing market.

The *Consultation Paper* proposes that an effectively competitive market is one in which 'the ability of market participants to exercise market power to the detriment of competition and consumers is constrained due to the actions of other market participants'. We note that as a market for an essential service, residential consumers are ultimately not able to absent themselves from the retail energy market. Barriers to exiting the market are therefore an important consideration in the market place as, by definition, the market power of supplier participants is heightened at the outset. Market participants, retailers to the residential mass market, may have their market power constrained by the presence of competing retailers. However, if consumers don't benefit from the exchange then can the market said to be effectively competitive? For example, evidence from the United Kingdom suggests that

incumbent retailers are able to retain large numbers of their customer base at inflated prices, while remaining fully exposed to competitive pressures.<sup>1</sup> It is not sufficient to rely on rivalry between firms to constrain market power. Rather, effective competition should see rivalry between firms erode market power and improve on the price and product delivered to consumers.

PIAC concurs with the view expressed in the *Consultation Paper* that an effectively competitive energy market will not necessarily reflect a perfectly competitive market. The energy market will remain an administered market with substantial intervention to ensure, among other factors, security of energy supply, access and affordability and consumer protections that enable consumers to activate competition. The energy marketplace will always reflect the public policy imperatives of energy supply.

PIAC is primarily concerned to ensure that the AEMC's analysis across the indicators looks at the specific experiences of a range of vulnerable customer classes. The proposed 'market outcome' indicators are useful to understand the experiences of consumers generally in the marketplace, however customers including tenants, low consumption households, pensioners and other low-income households have unique needs within the marketplace. For example tenants may be well aware of the capacity to switch but they may be restricted to products with costly exit fees. Similarly households with a poor credit rating may be limited in the product offerings that they are able to access. For example, research from the United Kingdom suggests a large number of low-income households end up with contracts for pre-payment meters carrying significantly higher energy costs.<sup>2</sup>

In the various review of retail competition, data has routinely been presented on 'small customer' switches. However, PIAC has pointed out the 'small customers' captures everyone consuming below 160MWh per year. When the average household consumes less than 10MWh per year, the figures reported for small customers cannot reflect well the experience of the average residential household and say little about the experiences of vulnerable households.

Vulnerable customers stand to risk the greatest economic loss in the absence of retail price regulation. PIAC and its stakeholders are concerned to ensure that the experience of these customer classes in the marketplace is well understood. We therefore recommend that the criteria commit the AEMC to reporting on the experiences of classes of vulnerable consumers within each of the 'market outcome' indicators.

The *Consultation Paper* proposes weighting the assessment in favour of the 'market structure' indicators. PIAC does not agree with the reasons given in support of this option. The *Consultation Paper* states that there is no clarity or general agreement about how to determine the 'right' level of market outcomes such as churn or prices, so they should not be relied on as the core indicators of competitiveness. We note that there is similar uncertainty and lack of clarity about the 'right' level for market structure indicators. For example, there is no consensus on the right number of market participants, the correct degree of horizontal/vertical integration and the suitable amount of market power for incumbents. Both market structure and market

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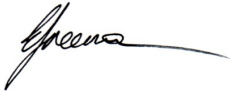
<sup>1</sup> Monica Giulietti, Catherine Waddams Price, and Michael Waterson, (2005) *Consumer Choice and Competition Policy: A study of UK energy markets*, The Economic Journal, 115 (October), 949–968

<sup>2</sup> Beth Keehn (ed) *Life Lines: Affordable Utilities*, Published by the National Consumer Council, September 2004

outcome indicators suffer from the same absence of firm benchmarks to assess the state of the market.

PIAC also rejects the view that there is necessary a linear relationship between the market structure and the outcomes for *all* consumers in the marketplace. The ultimate goal of assessing the effectiveness of competition is to identify the market's readiness for the weakening of price regulation. Given that the contestable market has not and will not develop evenly across the customer base, a high consideration needs to be given to market outcomes as they are delivered for classes of customers. Preferential treatment of the market structure indicators fails to consider the experience of classes of consumers in the marketplace. In our view, the two sets of indicators need to be viewed together on an equal footing to understand when and where competition is working in the retail energy market. We therefore recommend that market structure and market outcome indicators be given equal weighting by the AEMC.

Yours sincerely  
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