

14 November 2017



Dr Peter Boxall
Chair
Independent Pricing and Regulatory Tribunal
PO Box K35, Haymarket Post Shop
NSW 1240

Dear Dr Boxall,

Draft Report – 2017 NSW retail electricity market monitoring

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon disadvantaged and marginalised people. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training. The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers, developing policy and advocating in energy and water markets.

Retail electricity prices across NEM states have steadily increased in real terms since deregulation of the retail electricity market began in the 1990s.¹ On the back of this, the price rises from 1 July 2017 will further burden consumers – particularly low income and vulnerable consumers, for whom any increase to cost of living is of significant detriment.

PIAC supports continued monitoring of retail electricity prices and welcomes the opportunity to provide input to the Independent Pricing and Regulatory Tribunal's (IPART) draft report.

Effectiveness of retail competition

IPART notes that where competition is

sufficient to ensure that electricity retailers could not set price above the costs of supply without the risk of losing customers to their rivals ... [then] allowing retailers to set prices is likely to result in better outcomes for customers than regulation, because they have better information than a regulator about the costs of supplying electricity to their customers.²

In general, PIAC agrees with this view, but stresses that competition must be sufficiently robust so that setting inefficiently high prices results in retailers losing customers to others that make better offers.

¹ Carbon + Energy Markets, *Australia's retail electricity markets: who is serving whom?*, 2016.

² IPART, *Review of the performance and competitiveness of the retail electricity market in NSW – draft report*, Oct 2017, pg. 1.

Given the findings of reports examining the profit margins that electricity retailers appear to be earning, such as those by CME³ and the Grattan Institute⁴, PIAC questions whether this condition is met in NSW.

A competitive market is not an end of itself. Instead, the goal must always be to achieve acceptable consumer outcomes, and a competitive market is just one of a number of ways to achieve this. Arguably, for example, the outcome of more affordable energy is being better achieved in the ACT and Tasmania, which lack competition altogether, than in NSW. Victoria, on the other hand, has more affordable (or at least less unaffordable) energy than NSW due to lower network costs, yet has the highest retail margins in the entire NEM, suggesting less effective retail competition.

In particular, PIAC advocates for a state where access to essential energy services is no longer a source of hardship or distress for consumers.

Consumers and the changing energy market

Until this decade, energy consumers could very broadly be categorised into 'haves' and 'have nots'; they could either afford energy, and had some tools to limit their usage if they so desired, or they could not.

Since then, deregulation, the emergence of competition, innovation (particularly in relation to behind-the-meter technology), and the escalation of energy prices have created the need for consumers to be thought of differently to just these two cohorts. In addition to social advantage, a consumer's level of engagement with the energy market now has a material impact on their energy outcomes.

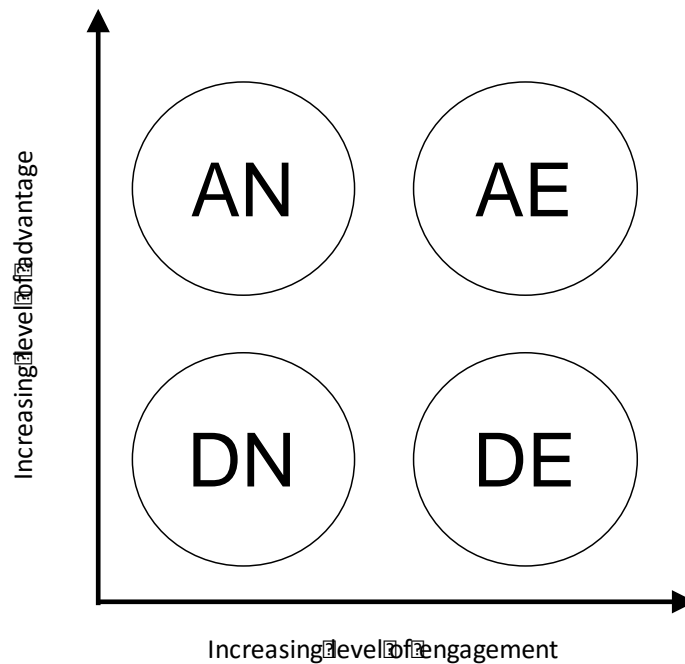
An engaged consumer may be able to minimise their energy bills through a combination of moving between retailers (retail churn), behind-the-meter technologies, and ongoing engagement in the form of paying their bills on time to access discounts. Conversely, a consumer that is not engaged, or is financially disadvantaged, is likely to consume more energy from the grid, which is purchased from a retailer to whom they pay a higher price by not accessing the cheapest deals.

PIAC considers that aspects of engagement and advantage are far from mutually inclusive, hence consumers should be thought of in four cohorts for the purpose of understanding and measuring market outcomes, such as those sought through consumer protections and promoting competition for all consumers.

³ Carbon + Energy Markets, *Australia's retail electricity markets*, 2016.

⁴ Tony Wood and David Blowers, "Price Shock: is the retail electricity market failing consumers?" *Grattan Institute Report No. 2017-04*, 2017, pg. 3.

Figure 1: Current consumer cohorts



The four cohorts are:

- **Advantaged/able, not engaged (AN)** – This consumer cohort is disengaged from the energy market. While they do experience the detriment of disengagement through suboptimal retail contracts, their relative social advantage means that they are usually able to absorb the financial detriment associated with these contracts. On the other hand, while these consumers are more able to absorb the detriment associated with their lack of engagement, currently they are effectively being punished with inefficiently high bills in a way their engaged counterparts are not. Many are also at risk of falling into the DN cohort if their circumstances change, and consumer protections need to cater to this risk.
- **Disadvantaged/vulnerable, not engaged (DN)** – This consumer cohort is likely to have the worst energy outcomes. The combination of energy market disengagement and relative social disadvantage means that these consumers are unable and/or unlikely to take advantage of new energy technology or beneficial market contracts from energy retailers. They may use large volumes of high-priced energy that they are unable to afford.

Competition frameworks should support them having the opportunity to benefit from engagement, but it is critical that supporting frameworks, including protections and concessions, should not require them to be engaged or assume that is an option for them. The goal should be to move people from the DN cohort to the AN cohort, while giving them the opportunity to move to the AE (or at least the DE) cohort but not obliging them to do so.

- **Advantaged/able, engaged (AE)** – This energy consumer cohort is the only one broadly getting good outcomes from competition today. The combination of energy market engagement and relative social advantage means these consumers choose, and can afford, to be adopters of energy technology such as solar PV, energy storage and demand management systems. Furthermore, their engagement with energy means they are likely to be on retail energy market contracts that give them the best deal and enable them to most

effectively use this technology. Competitive opportunities for these consumers should be encouraged, while recognising they are, by and large, least at risk of disadvantage.

- **Disadvantaged/vulnerable, engaged (DE)** – While this cohort still requires similar support to the DN cohort, their willingness to engage means they are able to ameliorate some impacts of social disadvantage through engagement with the energy market if the opportunity exists. The energy market today, however, does not present such opportunities to these consumers; the nature of pay-on-time discounts means that they are less likely to access the best retail offers, and the higher prevalence of renters, lower income groups higher-density living in this cohort limits their capacity to reduce energy consumption through building efficiently, appliance efficiency and rooftop solar.

The goal for this group should be giving them opportunities to benefit from competition and innovation in the same way that the AE cohort have, while affording them the protections available to the DN cohort.

Barriers to effective consumer engagement

A lack of information makes it difficult for consumers to manage their energy use and costs, and shop around for the best retail deal for them. The complexity of the retail energy market has consistently mitigated against informed choices by consumers and resulted in what has been called a 'confusopoly'. For many consumers, the inability to effectively engage with the market means many consumers default to very expensive energy contracts with high retail margins.

Because of this, PIAC strongly supports IPART's draft recommendation to promote and improve the AER's Energy Made Easy website. However, this alone will not solve the problem. It is one of many steps needed to address the more fundamental issue that access to a comparator website cannot fix: many consumers are unable to receive a fair and reasonable offer for their energy needs.

Retail price deregulation has required consumers to become, and remain, engaged in the electricity market in order to pay a reasonable price for their electricity. PIAC supports allowing engaged consumers to make full use of competitive market offers, and new technologies to derive the most benefit for their electricity services. Indeed, there are many consumers who are willing and able to do this, and PIAC supports making it easier for them.

However, this must not be a pre-requisite to receive a fair and reasonable offer. Many consumers are unable to benefit from the Energy Made Easy website due to language, numeracy, energy literacy and/or technological barriers, let alone other priorities and issues that relate to their personal circumstance.

The onus should not be on already disadvantaged consumers, who are often the least likely to effectively engage with the complexities of the competitive retail market, and for whom higher energy costs have the most consequence,⁵ to be engaged to compare numerous offers.

Improving consumer outcomes with protections in retail prices and offers

In addition to options to strengthen the current regulatory framework, PIAC considers that regulation of electricity prices is an option that should be considered if market approaches do not deliver consumer benefits.

PIAC appreciates that regulation is a significant intervention in a market. However, it can take a number of forms, which are more flexible, and lower in risk, than the traditional approach of a

⁵ NCOSS, *Turning off The Lights: The Cost of Living in NSW, June 2017, 2017*, pg. 29.

single government- or regulator-determined price applied to all consumers (often at the expense of a consumer's ability to choose between different providers and offers).

For instance, it may include one or more of:

- setting a ceiling for the price that retailers can offer to all consumers. This price ceiling would necessarily be higher than an efficient cost of supplying electricity, to allow retail innovation and competition through retail offers below this level and/or additional features such as solar feed-in tariffs, but low enough to limit price-gouging of disengaged consumers.
- providing a social tariff to low-income and other disadvantaged consumers, set at or even below the purely efficient cost of supplying electricity.
- more prescription to allow for more consistent comparison of offers from the same retailer and between different retailers, such as common price structures, terminology and conditions around available discounts. Excessive prescription in price structure can, however, have perverse consequences of placing upward pressure on prices, as has been observed in the UK, so care needs to be taken in pursuing this option.
- more transparency in the cost breakdown of the retail component of the bill which can help highlight where excessive profits are being made from consumers.
- limitation on the use of pay-on-time discounting, which results in greater price dispersion to the detriment of already disadvantaged consumers who cannot pay their bills on time. Pay on time discounts are at best an inflated, non-cost reflective late payment fee in disguise, and at worst a pricing strategy that seeks to recovers the costs of hardship obligations from the same consumers they are intended to protect.
- restrictions on anti-competitive practices such as 'win-back' marketing which is discussed later in this submission.

Price sensitivity vs price responsiveness

IPART have stated that

price discrimination often increases efficiency in markets compared to all units being sold at the same price at a constant mark up to the marginal costs of supply to recover fixed costs. By recovering fixed or sunk costs from less price sensitive customers (who will consume the good anyway), businesses can offer lower prices to more price sensitive customers to compete for their business.⁶

PIAC disagrees with this assessment in the context of the retail electricity market.

There is an important distinction to be made here between customers who are price sensitive and those who are price responsive. In economic theory, these two concepts are often one and the same and used interchangeably, but this is simply not the case in the reality of an electricity market.

As noted earlier, there are many barriers to consumers being fully engaged with the electricity market – in particular vulnerable and low-income consumers. In addition, there are barriers

⁶ IPART, *Review of the performance and competitiveness of the retail electricity market in NSW – draft report*, Oct 2017, pg. 35.

which may prevent consumers also being able to change their energy consumption. This may include factors such as being unable to afford more efficient appliances, their tenancy status preventing them from installing behind the meter devices or improving building energy efficiency, or medical and family circumstance preventing them from changing their energy usage.

This means that many consumers who are very price sensitive (for whom a relatively small increase in the unit cost of energy may have a relatively large impact on their quality of life) cannot be price responsive (they are unable to respond to this price signal by moving to a different offer or changing their energy consumption).

Considering that greater price dispersion in energy in NSW occurs to the detriment of already disadvantaged consumers, PIAC disagrees strongly with any unqualified assessment that price variation should be seen as a sign of an effective retail market in NSW.

PIAC recommends that IPART considers the impact of price dispersion in terms of the outcomes for each of the four cohorts of consumers identified earlier in this submission.

Much needed protections for embedded network residents

PIAC strongly supports IPART's recommendation regarding protections for consumers in caravan or residential parks. PIAC has been active in advocating to address these issues along with other groups through processes such as the AEMC's review of regulatory arrangements for embedded networks as well as through the AER's issues paper on access to dispute resolution services for exempt customers.

Barriers to entry for new retailers

While IPART's analysis shows that independent rivalry (the market share of second-tier retailers) has been improving in recent years, PIAC notes that it still remains relatively low. As a result, 87% of NSW customers are still supplied by the "Big 3" retailers.

An issue PIAC is particularly concerned about 'win-back' marketing, which is prevalent among the "Big 3". This practice limits the ability of smaller retailers to grow their market share and, indeed, even enter the market.

Customer 'win-back' is the practice of an incumbent retailer, on becoming aware that another retailer has acquired their customer through market customer transfer processes, contacting that customer and offering to match or better the deal offered by the new retailer. This typically occurs during the cooling off period on the new contract, so there is no penalty for the consumer cancelling the new contract.

On the surface, 'win-back' seems to offer an immediate benefit to the customer in question, in the form of a cheaper energy contract. However, the practice appears to drive up the cost of customer acquisition for new retailers, making it hard for them obtain a viable market share, or deterring them from entering the market altogether. At the same time, the cost of customer retention for the incumbent retailer is relatively low.

Further, 'win-back' marketing has the hallmarks of anticompetitive behaviour, as it is possible only because the incumbent retailer is privy to information that the customer has initiated a change of retailer – no other retailer has access to this information.

PIAC is concerned that this limits the ability of new retailers to enter the market, resulting in less effective competition in the longer term.

The practice also only favours consumers who are engaged and penalises those who are disengaged by placing them on more expensive offers.

Retailer support for hardship customers

In their August 2017 *Consumer Pulse* report, Choice reported that “energy prices remain the number one worry for Australians” with 82% of households concerned about their electricity bills.⁷ Furthermore, the Council of Social Services of NSW (NCOSS) recently reported that eight, 13 and 20 per cent of the low-income consumers they surveyed were unaware of payment extension options, payment plans and hardship programs respectively.⁸ The combination of community concern and the lack of knowledge about support programs highlights the need for retailers to identify customers who are at risk of hardship and provide access to appropriate support mechanisms as early as possible.

It is encouraging, therefore, to see that many retailers are advising hardship program customers of cheaper tariff plans that are available, and some are proactively moving these customers to cheaper plans.

However, retailers and IPART must be mindful that limiting this activity to customers on a hardship program means waiting until consumers have unmanageable debt due to their inability to pay successive bills and may cause avoidable hardship and distress.

To avoid such an outcome, PIAC is of the view that retailers should identify and contact potential hardship customers before they are in unmanageable debt. These consumers could include those who have recently been on hardship programs but not currently on them, those who have sought an extension on their bill payments and those who have received concessions such as from the NSW Government. This would allow consumers who are at risk of hardship to be supported as early as possible, so reducing the need for more drastic action, in particular disconnection.

In addition to existing or traditionally identified hardship customers, retailers should be aware of new potential hardship groups.

For many households, winter energy bills are the highest of the year. After the price increases announced for July 2017, the following electricity bills for many NSW households were their highest yet. Due to other cost of living pressures – most notably housing costs – many households will be less able to absorb this increase than they have been at other times.

As a result, high numbers of consumers who have not previously identified as ‘hardship customers’ may experience payment difficulty for the first time. This cohort may include families on middle incomes, people experiencing mortgage stress, and self-funded retirees. In many cases, these customers are unaware of their entitlement to retailer hardship support. They are disinclined to seek support, due to the stigma associated with seeking assistance, until the problem is exacerbated by accumulated debt and/or forgone expenditure on other essential products and services.

Retailers need to be aware of the increasing prevalence of hardship among these groups. PIAC would welcome moves to assist these customers as early as possible rather than waiting until

⁷ Choice, *Consumer Pulse*, August 2017 < <https://www.choice.com.au/about-us/media-releases/2017/august/consumer-pulse> >

⁸ NCOSS, *Turning off The Lights: The Cost of Living in NSW, June 2017*, 2017, pg. 31.

they have accumulated an unmanageable level of debt and endured otherwise avoidable financial hardship and stress.

Further engagement

PIAC would welcome the opportunity meet with IPART and other stakeholders to discuss these issues in more depth.

Yours sincerely,

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