Retail markets and consumer participation

Presentation to the AEMC's public forum on Strategic Priorities for Energy Market Development

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Good morning

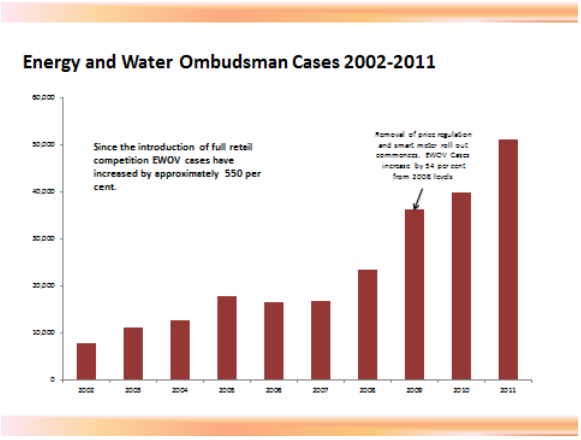
It was with great pleasure that I accepted the AEMC's invitation to come and address this forum today. For one thing, I was delighted that the AEMC had sought the perspective of consumers as well as industry at this national forum on the important topic of energy retail market development. However, I was also pleased about the timing of this event and the opportunity that it provides to examine the issue of energy market reform in a thorough and objective manner that avoids some of the excesses of the highly politicised debate on the issues that is played out daily in Australia's major newspapers.

Before addressing the substance of the issues at hand, I will take a moment to quickly tell you a little about the organisation for which I work. The Consumer Utilities Advocacy Centre was established in 2002 by the Victorian government to represent the interests of Victorian energy and water consumers in policy and regulatory processes. We are Australia's only consumer organisation focused specifically on the energy and water sectors, and consequently we have developed an in-depth knowledge of the interests, experiences and needs of energy and water consumers. Our mandate is to represent all Victorian consumers. However, our focus is very much on the residential sector and our policy analysis always has regard to the needs of the most vulnerable community members.

Given that we represent the *Victorian* consumer interest, we like to think we have a fair bit of knowledge and experience about the pointy end of energy market reform. Victoria was the first Australian state to introduce full retail competition and subsequently remove price regulation in the retail market in 2009 in accordance with the Australian Energy Market Agreement. Additionally, Victoria is the only state to have required the roll out of smart meters to all homes and businesses across the state. This will enable the introduction of a range of innovations to retail electricity markets including:

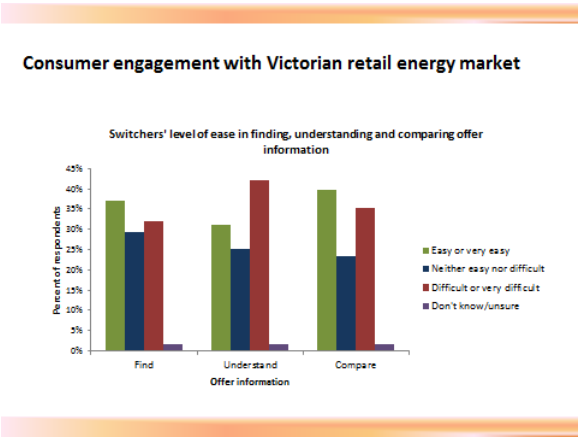
- time variant or 'flexible' pricing;
- interactive consumer interfaces providing data about power consumption and cost directly to consumers in real time; and
- the possibility of improved network management through techniques such as direct load control.

Broadly speaking, these reforms, the liberalising of retail energy markets and the introduction of technology to enable greater demand side participation, are the main features of what are consistently identified as the strategic priorities for energy retail market development in Australia. It is of great advantage to Australia as a whole that Victoria has undertaken these reforms as it provides a unique ability to analyse the outcomes and learn from any mistakes that may have been made in their implementation. By analysing the Victorian experience we can better assess the desirability of these priorities and whether they are, in fact, what is needed to better meet the needs of energy consumers and the economy. Let's now have a look at some of the impacts reforms in Victoria.

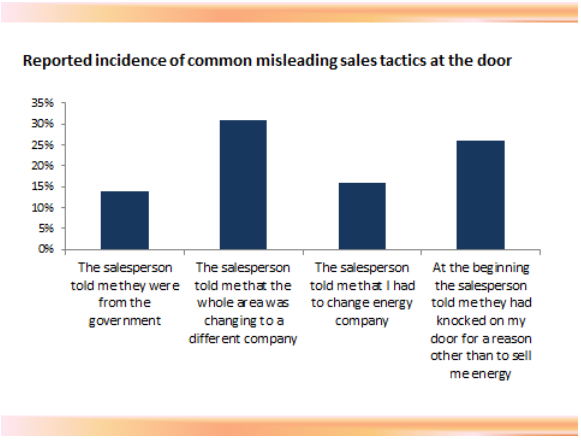


This slide shows the number of cases received by the Energy and Water Ombudsman (Victoria) (EWOV) annually since the introduction of full retail competition in 2002. It shows a remarkable increase of 550 per cent since that time. In 2009, the year of price deregulation and the start of the roll out of smart meters, EWOV case numbers increased by 54 per cent on the previous year. While not wanting to automatically conflate correlation with causation, I would suggest that these figures show a significant increase in consumer problems that are directly associated with the progressive liberalisation of the retail energy market in Victoria.

The trend highlighted in the of EWOV cases certainly tallies fairly well with our own research into Victoria's retail market that shows that many consumers still find it difficult to make effective market choices and are confronted with consistently inaccurate or unreliable information upon which to make choice.



Take the above chart for example from our research on *Improving energy market competition through consumer participation*. According to our data, after several years of price deregulation, over 30 per cent of consumers still find it difficult to find, compare and understand energy offers. Similarly, other parts of our research indicate that there is still a level of uncertainty among Victorian consumers over the market governance arrangements, with a significant number of consumers still thinking that the government is responsible for setting prices.



Our research has also highlighted a range of problems with the quality of information in the Victorian market upon which consumers often base their decisions. The chart above highlights the reported incidence of misleading sales tactics used by door to door energy sellers from a consumer survey we conducted. If consumers are relying upon this type information to make their market choices and select the right offer, then it is likely that the choices being made are not necessarily the best, or even just better, options. Similarly, our mystery shopper analysis of privately operated price comparison or switching services showed significant problems in information quality and transparency with the presence of inaccurate information a feature of a number of sites.

A comparable market to Victoria is that of the UK where a range of research, including the recent Retail Markets Review by Ofgem, highlights ongoing and systemic consumer problems that have not diminished despite the relative maturity of their deregulated market. The above slide highlights a research finding from paper by Catherine Waddams-Price that indicates that quality of consumer decision making in that market yielded similar outcomes to what would occur if consumers were to randomly select energy offers.

In summary, these examples from liberalised markets show some of the pitfalls of competition and price deregulation. It is likely that smart meter enabled retail products and services, such as time variant pricing, will add to this complexity and compound some of the demonstrated problems in retail energy markets.

This brings me back to the question of the strategic priorities for energy market development. Victoria's experience in pursuing retail market reform shows that we need to seek a broader set of strategic objectives for energy market development than the simple headline objectives of removing retail price regulation and introducing pricing that reflects the costs of energy production and delivery production at the time it is consumed. While these may be important objectives, they cannot by themselves deliver the retail energy market that Australian consumers either want or need. Instead, I would highlight an additional set of objectives that should necessarily sit alongside these commonly cited priorities.

Changing the culture of energy market institutions and participants to place the long term interest of consumers as the central objective of reforms and market conduct is certainly an important priority. While consumer complaints continue to pile up, while consumers continue to express frustration with the quality of service they receive and while misleading conduct is a feature of energy marketing we cannot say with conviction that we are delivering an energy market that is achieving this overarching national energy objective. What is more, I have not seen serious commitment from any energy industry player to address ongoing problems with the quality of customer service that seems to continue to deteriorate annually as evidenced by regular releases of ombudsman data and comparative performance data from regulators. This needs to be addressed urgently to ensure that consumers can have confidence in our market structures. I would also stress that improvements in this area are not only based on regulation and its enforcement. A culture of best practice services must also be a feature of any change.

A second key priority for energy market development from our perspective relates to the empowerment of individual consumers. Much is made of the power of choice in energy markets and consumers driving outcomes through the selection of energy products that match their budgets and interests. While not dismissing the possibility that we may achieve such an outcome at some point in the future, we only have to look at experiences in the UK and in Victoria to see that it is not achieved simply by removing price controls or introducing time variant pricing. What actually needs to occur is an extensive and well-designed effort to engage with consumers about changes to energy markets, about why particular changes are taking place and about how they can take advantage of the changes in their own interest. Effective information and education for consumers is one important approach to achieving this consumer empowerment.

Keeping it simple

People are more likely to purchase gourmet jams or chocolates...when offered a limited array of 6 choices rather than a more extensive array of 24 or 30 choices.

Source: *When choice is demotivating: Can one desire too much of a good thing?*, Sheena Iyengar and Mark Lepper

However, information is not in itself a sufficient condition for an empowered consumer. In addition to providing information to consumers there is also the need to create a market environment that facilitates easy and effective consumer choices. I have included the slide above that highlights a finding of one of the major pieces of research on this issue. When provided with a display of jams or chocolates, consumers were much more likely to make a purchase when confronted with a tightly limited array of options rather than abundant choice. The lessons from this and a significant body of recent research is that when considering energy market reform options we also need to consider what has been termed the "choice architecture" that accompanies the reform. In the Victorian retail energy market, I would suggest that plentiful choice of what appear to most consumers to be essentially homogenous products serves to discourage participation, increase consumer confusion and undermine the effectiveness of consumer choice. Significant additional work is required to assess how, in price deregulated markets with the additional complexity of time variant prices and other innovations, consumers will be easily able to identify a product that best matches their circumstances. I would stress that a seemingly limitless choice of homogenous products hawked through door to door sales is not the answer to this.

The answer lies, I believe, in enhancements to retail market design including the innovative design of retail market rules and regulation. The UK is currently addressing this issue through a variety of approaches to mandating certain supplier behaviour including regulatory efforts to improve offer comparability. I also understand the Government there has recently signed an MOU with energy suppliers that require the supplier to periodically notify customers of the best available offer for them. While this may or may not be appropriate for the Australian context, it is indicative of the types of things that may need to be considered as additional layers of complexity are applied to Australian retail energy markets.

While noting the importance of consumer empowerment, we must also acknowledge that there will be consumers who, for whatever reason, will be unable to make effective choices in a highly complex market. This is a feature of markets which people must necessarily participate in. It is for this reason that we must also consider approaches to ensuring that these consumers are not disadvantaged

through energy market reform. Consumer protection regulation plays an important part in serving the needs of these consumers and I would argue that there is still scope for further improvements to consumer protection regimes in Australian energy markets. However, approaches to providing additional support to these consumers - resourcing to allow for advice from a trusted counsellor perhaps to ensure they get the right mix of services - may be necessary and should be further considered as market reform progresses.

In a conversation yesterday, someone suggested to me that energy market reform in Australia in many ways is over the easy part. The last ten years has seen reforms at a national level to many of the upper levels of the supply chain. While not discounting the challenges associated with this reform, it was suggested that greater challenges lie ahead as the energy market develops further and policy and regulatory attention necessarily turns to the consumer facing parts of the market. I tend to agree with this assessment. Retail market deregulation and the introduction of smart meters are just two examples of where governments and market participants have to pay much closer attention to the social aspect of reform processes in addition to the consideration of the economic and business aspects that have traditionally been the focus. This should be kept front of mind as the strategic priorities for energy market development are advanced through forums such as this and ongoing policy and regulatory processes. Acknowledging the social impact of energy reform processes is an important first step in cementing the long term interests of consumers at the centre of future developments.

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