

Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

Submitted online: <https://engage.vic.gov.au/assessing-energy-retail-markets-competitiveness-and-efficiency>

30 March 2020

Dear Sir/Madam,

Framework and Approach: Assessing the Competitiveness and Efficiency of the Victorian Energy Retail Market

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Essential Services Commission's ('ESC') Framework and Approach Paper on *Assessing the Competitiveness and Efficiency of the Victorian Energy Retail Market* ('the Framework and Approach').

The AEC is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

Following the release of the *Independent Bipartisan Review of Electricity and Gas Retail Markets* ('Thwaites Review'), the Victorian retail energy market has changed significantly. Various regulatory reforms have been implemented in response to the recommendations that Thwaites put forward, such as the Victorian Default Offer, new contracting obligations and enhanced information disclosure. This Framework and Approach serves as a way for the ESC to assess whether these reforms have improved the state of competition in the retail market to deliver better outcomes for customers.

The AEC supports the need to monitor and review the operation of the competitive retail markets, and considers with some minor amendments, the ESC's proposed Framework and Approach will enable a comprehensive periodical assessment to be undertaken to highlight the benefits of competition to Victorian energy consumers.

This submission provides some high level comments on the ESC's proposed framework and approach. We hold some concerns with the methodology put forward, as there appears to be inconsistencies in the ESC seeking a *scientific* market analysis via subjective customer experiences. Furthermore, the AEC would like the ESC to provide greater clarity on its determination of the *objective* of the market, and how it plans to capture the customer experiences (given the huge diversity of customers).

Methodology

Approach to Analysis

The standard methodological approach for analysing competitive markets is the Structure, Conduct and Performance framework ('SCP framework'). The Framework and Approach notes that the SCP framework 'has been applied across many markets for decades', including by the Australian Energy Market Commission ('AEMC') in its annual Retail Energy Competition Reviews since 2014, and is a 'rational and structured framework for considering markets'.¹ Despite this description, and the ESC

¹ Essential Services Commission, 'Assessing the competitiveness and efficiency of the Victorian energy retail market' ('Framework and Approach'), 17 December 2019, p4.

being required to have regard to the AEMC's approach, the ESC has chosen an alternative approach to analyse the Victorian retail energy market.

While the AEC recognises that no framework is watertight, further detail is required as to how the ESC's preferred systems thinking approach will deliver an objective and justifiable assessment of competition as opposed to the well understood and accepted SCP framework. Of challenge to the ESC's preferred approach will be the weight it provides each element of its assessment framework. For example, the use of customer experiences and stories are welcomed, however they create objectivity challenges. The AEC would prefer customer experiences be used to complement better defined metrics, such as reiterating or challenging the ESC's findings, rather than driving the findings themselves.

The Framework and Approach highlights this challenge, when it notes that it must avoid 'assuming consumers will make the best decision based on clear and accurate information presented to them. In imperfect markets, consumers have various preferences, biases and external factors that impact their decision-making'.² Identifying the best decision creates its own challenges, and the AEC would be concerned if the ESC suggested that a customer not making a rational decision in itself was a feature of an uncompetitive market.

The AEC does not oppose including customer experiences in the market analysis, but believes they could be incorporated into the SCP framework, or a version of this framework as suggested by the ESC. That is, simply because there might be limitations within the SCP framework, that does not mean it could not be refocused to capture the elements sought. The AEC suggests a reasonable approach might be to first analyse the retail market through the SCP framework and then seek customer experiences to see where their stories align and/or diverge from the theory.

Representing the Customer Experience

As energy is an essential service, the customer demographic is extremely broad and diverse. By logical extension, any representation of the customer experience must capture this diversity to be considered accurate. The AEC has some concerns that the Framework and Approach has developed a pre-conceived view of what customers will have their experience represented. For example, the paper states that 'it will be important to understand the reasons why the customer experience is falling short of what is desired. In order to do this the commission will actively seek quantitative and qualitative data to assist us in gaining this understanding'.³ On face value, this statement appears to suggest that the ESC will actively seek out customers with an unfavourable experience over those who are happy or not dissatisfied with the retail market.

The AEC would welcome the opportunity to work collaboratively with the ESC to develop a consumer engagement approach that delivers an accurate and representative assessment of experiences in the market.

Expectations of the Victorian Retail Market

Mixed Messaging

The Framework and Approach contains mixed messages on the ESC's expectations of competitive markets that deliver an essential service. The summary section states that 'as energy is an essential service, it is imperative that all customers experience positive outcomes' while the focus section is

² Id at 28.

³ Id at 30.

more circumspect: ‘a market to deliver for all consumers is unattainable’.⁴ The AEC would encourage an approach consistent with the second line of thought, recognising that no retailer, whether it be government, private or community owned, can deliver perfect customer outcomes.

Vulnerable Customers

When the customer experience does fall short of expectation, the competitive market provides a customer with the choice to switch to a better provider. For vulnerable customers, where market engagement is not practical or challenging, retailers have systems in place to provide financial support. In light of recent events, namely the bushfires and COVID-19, retailers have taken (and are still taking) additional steps to support customers experiencing vulnerability. At the same time, achieving a holistic response to ameliorating vulnerability requires a whole-of-society approach. The Australian Energy Regulator recognised this in its most recent report, *exploring regulatory approaches to consumer vulnerability*, whereby it noted that ‘fair, affordable energy supply ... is not just the responsibility of regulators and industry, but government and civil society’.⁵ It then goes on to suggest that regulators, like the ESC, need to ‘help ensure structural issues of poverty, disadvantage and financial stress are properly addressed by government’.⁶ The AEC believes there is a need then for discussions about vulnerability to be broadened to encompass other stakeholders, as well as industry. This challenge is also relevant when considering affordability in an evolving market.

Measuring Innovation and Trust

The Framework and Approach identifies two metrics for measuring competition in the retail market: innovation and customer trust. It states that the retail market has low levels of each and this is a major reason why competition cannot be considered effective. Consequently, enhancing competition requires higher levels of innovation and customer trust.

While the AEC agrees that innovation is critical to a competitive market, it is not clear from the paper how the ESC intends to measure innovation. This is problematic because, as Catherine Price explains, ‘innovations are by definition difficult to predict ... one great strength of competition over regulation is that the market will produce innovation which regulators cannot identify, let alone introduce’.⁷ Price’s sentiment is particularly relevant in the Victorian context given the plethora of retail regulations that have been introduced over the past two years. The ESC does ask itself to consider ‘whether the regulatory framework is fostering or hindering innovation’,⁸ however the AEC notes that the regulator undertaking a review of its own regulations may lead to perceptions of confirmation bias, which the Framework and Approach has said it wants to avoid.⁹

Notwithstanding these limitations, the AEC and its members would be willing to assist the ESC in highlighting examples of genuine innovation that have led to positive customer outcomes, as well as cases where regulation has stifled innovation. Given that the regulator and industry hold the most intimate knowledge of the retail regulatory regime, a collaborative approach is likely to produce the most detailed understanding of the relationship between regulation and innovation. It should also ensure that the different challenges large and small retailers face with regulation is properly captured.

⁴ Id at 4, 35.

⁵ Consumer Policy Research Centre, ‘Exploring regulatory approaches to consumer vulnerability’, 1 November 2019, Australian Energy Regulator, p9.

⁶ Ibid.

⁷ Catherine Price, ‘Assessing the competitiveness and efficiency of the Victorian energy retail market’, Centre for Competition Policy, p4.

⁸ Framework and Approach at 5.

⁹ Id at 30.

The AEC is less optimistic about the possibility of accurately calculating ‘trust’ in the market. While it makes sense to give weight to customer perspectives, the problem of which customer perspectives are given weight again resurfaces. This dilemma presented itself in the AEMC’s decision to regulate conditional discounting. The AEMC moved to limit the practice of conditional discounts even though ‘many customers have been satisfied with their current conditional discount arrangements’.¹⁰ The AEC did not oppose this decision, but noted that engaged customers might be worse off as a result. We are concerned a similar situation will arise if the ESC interprets ‘trust’ to mean that customers should be allowed to disengage and receive the same outcomes as engaged customers. This would ultimately render innovation meaningless.

The AEC considers that trust in itself is not an accurate measure of the effectiveness of a competitive market. In practice, customers themselves might covet trust, but if challenged, the AEC expects most customers would prefer lower prices, or easier access to better offers over an increase in trust in their retailer. In this regard, performing industry benchmarking might be useful to see how trust and customer engagement intersect in other retail sectors.

To that end, unless the ESC’s proposed consumer testing suggests otherwise, the AEC considers that a more appropriate metric of competitiveness could be a consumer’s knowledge of, and ability to, benefit from the retail market. Practically, if a representative customer is aware that different offers exist, and the market enables them to make a rational decision (based on their desires or circumstances), it could be said that the market is functioning, *prima facie*. Merely because the customer does not wish to engage in the market, or is unable to engage in the market, does not in itself suggest that a market is not competitive, but rather that consumer protections are required to ensure these customers are not unduly disadvantaged by the operation of the competitive market.

As noted by the AEC in multiple submissions to ESC consultations in recent years, the competitive market is not a one-size-fits-all approach. Customers should be able to benefit from their engagement, but at the same time, customers should not be unfairly disadvantaged if they choose not to engage. The AEC considers that the Framework and Approach does not adequately highlight that customers in a competitive market should be able to make choices that benefit them.

Other Considerations

COVID-19

At the time of writing, the Federal and Victorian Government, along with other states, have implemented various measures to contain the spread of COVID-19. These measures will have a major impact on businesses and workers alike. Workers will increasingly work from home, increasing their daytime electricity usage, while others may be stood down by their employers, and potentially face difficulties paying their bills. The AEC is already working with its retail members, along with other stakeholders such as government and consumer groups, to implement a coordinated response to this. However, given the extraordinary circumstances, an increase in the number of customers reporting and experiencing vulnerability is likely to occur. These externalities diminish the ability of retailers to continue to evolve their operations, and circumstances such as the COVID-19 pandemic will clearly take precedence over product development and innovation. The AEC considers that the ESC should take these factors into account in its assessment of the competitive market.

¹⁰ Australian Energy Market Commission, ‘Draft Rule Determination: National Energy Retail Amendment (Regulating Conditional Discounting) Rule’, 21 November 2019, p21.

Environmental Considerations

The energy sector has undergone substantial changes in the past decade, and will continue to do so, as it transitions towards a cleaner future. These changes are in response to government policies on climate change as well as the declining costs of renewable generation. For retailers, they must manage the increased risk of fluctuating wholesale prices as new, intermittent generation enters the market, but also customer trends towards wanting to use clean energy. Recent surveys from consumer groups, such as Energy Consumers Australia, have shown that clean energy is now a customer consideration when engaging in the market. The AEC encourages this to be recognised in the Framework and Approach.

In this regard, the ESC should consider analysing the impact of these changes to the market, and provide recommendations to ensure these changes deliver the best outcomes for energy consumers in the longer term. The most prominent example in Victoria is the dramatic increase of rooftop solar in recent years. Declining prices for solar panels, increasing energy bills, and government subsidies is expected to inject more than 600,000 new systems into the market. This will undoubtedly impact the outcomes faced by consumers, both those with solar installed and those without. The AEC considers that this change might require reforms to enhance the customer benefits, including changes to network tariff structures and feed-in tariff arrangements. This could include asking what type of customers are benefiting, any impacts on vulnerable customers and whether it reflects the needs of customers as highlighted in its customer testing.

The AEC looks forward to continuing working with the ESC as it undertakes its competition review. A collaborative approach between all stakeholders is the best way to ensure that this review paints a holistic and comprehensive picture of competition in the Victorian retail energy market.

Any questions about this submission should be addressed to Rhys Thomas, by email to Rhys.Thomas@energycouncil.com.au or by telephone on (03) 9205 3111.

Yours sincerely,



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