20 December 2018

Michael Drake
A/g Director
Electricity Markets Branch
2 Lonsdale Street Melbourne 3000
Australian Competition & Consumer Commission

By email: Electricity Monitoring@accc.gov.au

Dear Mr Drake,

Submission to Discussion Paper on monitoring of electricity supply in the National Energy Market (NEM)

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 people who are marginalised and facing disadvantage. 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.

PIAC welcomes the opportunity to respond to the ACCC's discussion paper on monitoring of electricity supply in the National Energy Market (NEM). The ACCC's Retail pricing inquiry (REPI) represented a crucial opportunity to highlight a range of structural failures and inefficiencies within the NEM, providing a basis from which to significantly improving outcomes consumers. PIAC commends the ACCC on the comprehensive analysis undertaken as part of the REPI process and strongly supports using this work as the foundation for the ongoing monitoring role of the ACCC. We note with concern governments' inconsistent response to the comprehensive range of recommendations contained in the REPI final report, and encourage the ACCC to also consider its ongoing monitoring as a means not only to analyse the impact of those recommendations which have been implemented, but also to further develop and promote those which have not.

Ongoing monitoring role of the ACCC

The discussion paper notes that a range of National and jurisdictional agencies undertake monitoring and regulatory functions to varying degrees, and suggests that there is potential for overlap and duplication as a result. PIAC is equally minded to avoid unnecessary duplication, but is of the view that existing market monitoring or evaluation undertaken by other agencies or regulatory bodies in no way negates the value of ongoing monitoring and investigation from the ACCC.

REPI illustrated the importance of the information gathering powers of the ACCC and the necessary additional detail and nuance that this adds to understanding of the operation of the NEM and outcomes for consumers. This is particularly relevant in assessing the efficiency of retail and wholesale electricity markets and the interactions between them. There are instances (for example in relation to retail bill and price information) where analysis by the ACCC presents a new level of accuracy and insight which is not possible under other monitoring frameworks, and which is vital in understanding how consumers are actually being impacted by the operation of the retail market.

Level 5, 175 Liverpool St
Sydney NSW 2000
Phone: 61 2 8898 6500
Fax: 61 2 8898 6555
www.piac.asn.au
ABN: 77 002 773 524

Particularly in this time of significant change, some overlapping with existing frameworks is preferable to potentially leaving crucial gaps in the range of monitoring undertaken.

Accordingly, we encourage the ACCC to continue the analysis undertaken in the REPI, use it as a start point for ongoing monitoring, and take the opportunity to evolve and augment this approach.

In relation to the issues raised in the Discussion Paper, PIAC highlights the following.

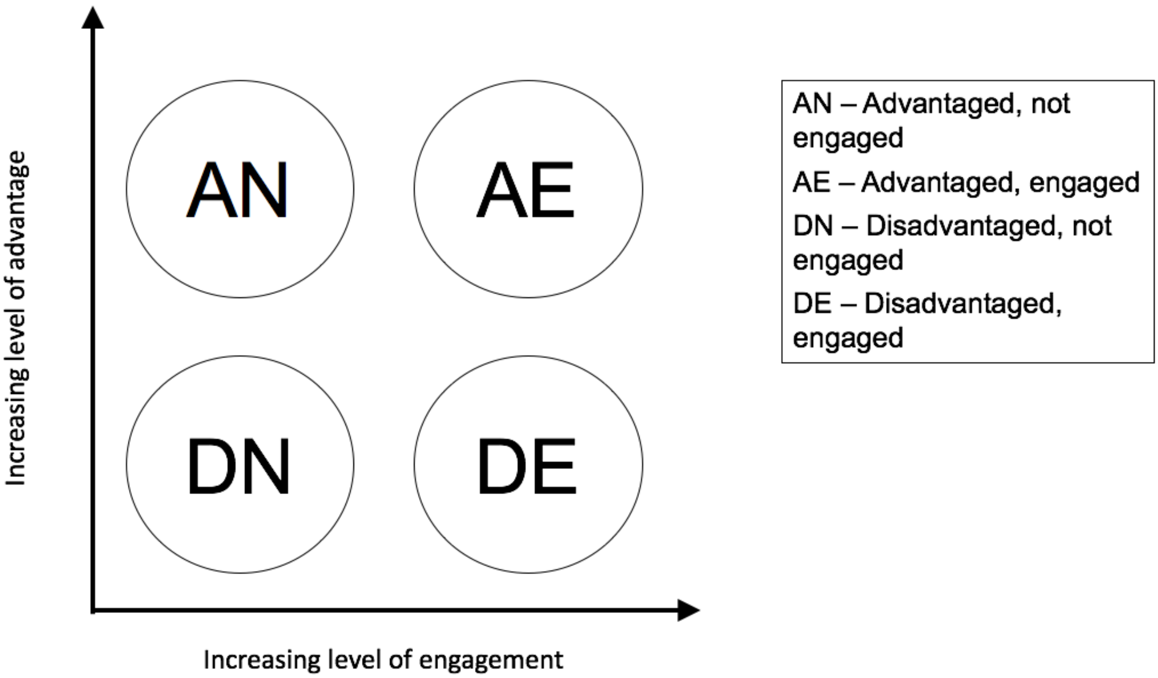
Analytical framework

PIAC broadly concurs with the frameworks identified in the discussion paper. The essential service nature of electricity means that a distributional or equity framework must be the overarching consideration, yet there is a need to utilise legal and market failure frameworks in order to inform a comprehensive analysis. Accordingly, PIAC highlights the following in relation to the frameworks presented in the discussion paper.

1. Consideration of issues through a market failure framework must include a qualitative dimension, and recognise that a competitive market (particularly in relation to the delivery of an essential service) is a means to an end (delivering more efficient outcomes), not an end or good in and of itself. Accordingly, market failure may not be indicated by simple metrics related to the number of market participants and market participant or customer 'activity'. In this context, PIAC specifically notes:
    - That barriers to entry may be indicated not only by the impact on potential number of market participants, but on their scope to make an impact on market outcomes and the behaviour of other participants.
    - That information asymmetry and a lack of transparency may be inherent to the operation of some markets, and render them less amenable to efficiency improvements. Where a competitive market framework can be relatively efficient and effective in the wholesale energy market (where the market participants are largely equally informed, empowered and have a transparent view of the operation of the market), the inherent information asymmetry between retail businesses and consumers, and the lack of transparency in the retail market, are fundamental. These failures are inherent to the nature of the retail market, and may suggest that any reliance upon a market framework with no price regulation to deliver such an essential service is not appropriate.
2. Consideration of issues through a legal framework should evaluate compliance with the spirit and intent of legislation, not merely the narrow, 'black-letter' interpretation of the law.
3. Consideration of issues through a distributional or equity framework is fundamental, particularly in relation to the operation of the retail market. Electricity is an essential service and fair and equitable outcomes for all consumers must be a primary guiding principle. PIAC is concerned that the Discussion Paper repeats the mistake of considering distributional and equity issues as only being relevant in relation to hardship or vulnerable consumers. Electricity is an essential service for all consumers and the National Electricity Retail Law (NERL) and National Energy Objective (NEO) do not make a distinction between the long-term interests of some consumers over others. In any case, all consumers are, to different degrees, at risk of hardship or disadvantage.

Consumer outcome framework

PIAC considers that, in relation to the operation of the retail market, the 3 frameworks highlighted in the Discussion Paper, should also be viewed through the lens of the outcomes for consumers, and how they are currently determined as an interaction between their level of engagement and their level of potential 'advantage', expressed in 4 broad cohorts.



Advantaged/able, not engaged (AN)
This consumer cohort is disengaged from the energy market. They are likely to be experiencing higher bills through suboptimal retail contracts (standing offers or market offers with expired benefits), but their potential socio-economic advantage means that they are not considered a priority in assessment of the competitive market and consumer outcomes. They are considered to be able to deal with the impacts of their lack of engagement. Increasingly however, evidence is showing that even consumers in middle incomes (for example), are struggling with the cost of energy and are experiencing negative impacts as a result the failure of the market to provide efficiently priced energy for those who don't engagement with the market[1].

PIAC contends that the structure of the market framework and consumer protections are still relevant to the outcomes for this cohort, notwithstanding their current level of potential socio-economic advantage. Importantly, in relation to distributional equity, PIAC highlights the danger in making potentially normative judgements regarding this group's ability to engage in the market, and the implication that poor outcomes for this group are not an indicator of the failure of the market to deliver an essential service. Monitoring engagement, contract types, and actual bill outcomes will be key indicators for this cohort.

Disadvantaged/vulnerable, not engaged (DN)
This consumer cohort, who most closely match those often referred to as 'vulnerable consumers', consistently have the worst outcomes. The combination of energy market disengagement and relative socio-economic disadvantage means that these consumers are less able to take advantage of cheaper, conditionally-discounted market contracts from energy retailers, or other tools for reducing energy costs such as energy efficiency and embedded generation. Market frameworks should support them having the opportunity to benefit from engagement where possible, but it is critical that supporting frameworks must not require them to be engaged in order to access an essential service at a fair price. Most importantly, the goal should be to improve the relative level of 'advantage' (that is move people from the DN cohort to the AN cohort), while giving them the opportunity to move to the AE cohort but not obliging them

1 Choice, *Consumer Pulse Report: July 2016*, pp 8-9

to do so. While monitoring engagement will be important for this group, the most fundamental measures will relate to the overall affordability and their actual bill outcomes, and includer consideration of the supporting measures such as concessions frameworks.

Advantaged/able, engaged (AE)
This consumer cohort are the only consumers able to operate as the current framework intends, and therefore only ones broadly getting good outcomes today. The combination of energy market engagement and relative socio-economic advantage means these consumers are more likely to be on favourable retail energy contracts, and choose (and can afford) to be adopters of energy technology such as solar PV, energy storage and demand management systems. Competitive opportunities for these consumers should be encouraged, while recognising they are, by and large, the least at risk of disadvantage. PIAC considers all consumers should have the opportunity – but not an obligation – to move into this cohort. Importantly, the positive outcomes achieved by this cohort, are to some extent cross subsidised by the higher prices paid by those groups who are not engaged and able to negotiate better deals, particularly where 'loss-leading' contracts are involved. In this context key analysis for this group will involve actual bill outcomes, along with monitoring of acquisition and win-back costs, as well as engagement activity and contract types.

Disadvantaged/vulnerable, engaged (DE)
While this cohort requires similar support to the DN cohort, their potential and preference for engagement means that they are able to ameliorate some impacts of disadvantage through more active participation in the energy market. This group is often cited as demonstration that the market can achieve positive outcomes for more vulnerable consumers. However, PIAC's recent report on disconnections demonstrates that the constant requirement to remain informed and engaged is a significant burden for a cohort that is often burdened by compounding and overlapping vulnerabilities[2]. Further, their potential disadvantage (even something as simple and fundamental as being a renter) means that the potential benefits of their engagement are limited, while they bear the full impact of the risk of non-engagement (in the form of unaffordable costs).

Accordingly, the goal for this group should be ensuring that the framework provides the same protections of access to a fair price, while giving them the choice and opportunities to benefit from competition in the same way that the AE cohort has. It is important that these consumers do not continue to be burdened with the risk of not engaging (and the ongoing cost of engagement), and that they have the protection of a fair price for an essential service. Key monitoring for this group will include actual bill data, to match with household income, along with usage, engagement statistics and contract types as well as acquisition and retention costs.

The REPI as a foundation for ongoing work

In relation to the discussion papers focus, PIAC recommends that in addition to the assessment measures employed in the REPI, the ACCC augment ongoing monitoring with a range of additional measures outlined below.

Retail electricity prices

Actual final bill data
While the unit cost analysis undertaken in the REPI provides a crucial perspective on the prices that different cohorts of consumers are paying, actual final bill data for those same cohorts is a necessary reference point that links to the range of other available data, and that provides important context in a form that is both relevant and comprehensible to consumers. Further, it is the dollar quantum of bills and the relevant proportion of household disposable income which

[2] PIAC & UMR, *Close to the Edge: A qualitative and quantitative study*, November 2018, pp 12-20

are crucial measures of affordability, and potential indicators of vulnerability, that are most useful in relation to assessing market outcomes for consumers.

The important work undertaken in the REPI, breaking down consumer cohorts and monitoring the unit price they pay, was valuable, but presents a picture with significant gaps. This analysis should be repeated, but presented in conjunction with the final bill and usage data from which it is derived, giving a more complete view of what consumers are actually paying for their essential electricity services. PIAC would welcome the opportunity to work with the ACCC in informing the most practicable and valuable means of presenting this data.

Market offer data

While data suggests that many consumers have access to significant headline discounts, it is necessary to better understand what impact this is actually having on consumers, and what outcomes market offers are actually delivering for them. Accordingly, the analysis undertaken in the REPI should be augmented by:

- monitoring the extent to which the conditions of these offers are being met, and discounts actually realised by consumers.

  Data on market offers assumes that the full benefits of the headline discounts accrue to consumers, but we know that many consumers are struggling with affordability and often unable to pay on time, which effectively renders them 'standing offer' customers in all but name. Retailer data on how many market offer customers met/did not meet the conditional requirements of their offer, would provide greater clarity of actual consumer outcomes, and help understand the effectiveness and impact of consumer engagement.

- Monitoring the number of consumers (potentially within each market offer discount % band) whose benefit period has expired.

  Data on the number of customers on market offers suggests that a minority of consumers remain on standing offers, implying that the market is 'working effectively' for most (engagement is increasing and improving consumer outcomes). However, figures in the REPI on length of time since consumers last 'switch', in conjunction with the common practice of long term or evergreen contracts with benefit periods that expire after 6-12 months, suggests that the number of consumers actually receiving their headline contract benefits may be significantly smaller. Better data on which consumers are on market offers, who are no longer within the benefit period they signed on to (and may effectively be on standing offer conditions) would present a more reflective picture of consumer outcomes within the market, and be valuable in relation to the value and impact of a default market offer.

- Monitoring the number of consumers (by retailer) who are on offers which are not publicly available.

  Greater visibility of the extent of 'off-market' offers is valuable in determining the extent and impact of internal 'cross subsidy' that retailers engage in. Opaque price dispersion, where some consumers are offered better terms than others (through no externally discernible criteria) is a fundamental failure of the market and potentially a source of significant inequity. Information on how many consumers on 'off market' offers are receiving discounts beyond those that are publicly advertised, and what those offers entail, is vital to gaining a more complete picture of the operation of the retail market and how this impacts upon the outcomes for different consumer groups (in this case, those who are engaged as opposed to those who are not). This understanding of selective retail marketing is key to understanding whether already vulnerable consumers are further disadvantaged by retailers marketing strategies such as winback marketing.

- Monitoring the internal dispersion of offers in individual retailers.

While the REPI undertook to analyse the dispersion of market offers across jurisdictional markets, this picture is incomplete without an internal dispersion analysis of each of the retailers, or as a minimum, retailers broken down by type (tier 1, tier 2 and tier 3). This data is crucial to analysis of the equity of outcomes for consumers, highlighting potential cross-subsidisation of consumers, and determining the efficiency of retail offers and the retail market as a whole. Such analysis will also be helpful in informing the implementation and monitoring of the default market offer.

Customer Acquisition and retention costs

PIAC supports the analysis undertaken in the REPI, and the separate consideration of retail costs to serve and costs of customer acquisition and retention (CARC). However, ongoing monitoring presents the opportunity to improve the depth of this analysis to provide a clearer picture of the extent of these costs, where and how they are being incurred and how they are impacting different consumer cohorts. Accordingly, the analysis undertaken in the REPI should be augmented by:

- Monitoring of acquired customer CARC expressed as the extent of 'cross subsidy'.

  CARC are essentially related to decisions made by retailers to 'buy' certain customers, with the cost of doing so imposed upon the remainder of customers. This is a significant source of cost to all consumers and exacerbates inequity through price dispersion in a non-transparent way. Figures on 'switch rates', such as those collected by IPART[3] indicate that less than 20% of customers are switching only once a year (and likely to be the consumers that retailers are working to acquire and retain). Determining the extent of customers driving CARC (the % of customers for each retailer, retail type, jurisdiction), the cost related to acquiring and retaining them, and expressing that cost as an additional amount averaged over the remaining customers, would provide a valuable picture of the scope and impact of this behaviour. While the REPI analysed the averaged CARC over all customers as well as acquired customers, this is the inverse of how the costs are actually distributed - it is actually a cost incurred for acquired customers but paid by the majority remainder.

- Monitoring the main types of CARC costs by retailer/retailer type (tier 1, tier 2 and tier 3).

  While it is often asserted that CARC is a normal cost of business for a retailer, there is currently neither transparency of how these costs are incurred nor how they are exposed to any drivers for efficiency. Where network inputs and even the wholesale price contribution to the retail bill are relatively transparent and subject to market or regulatory efficiency, CARC are opaque. If future work is required to limit certain acquisition activity (as suggested by IPART [4]in its most recent review of retail competition in NSW, for example) then a more detailed understanding of the extent and impact of acquisition and retention activity, is crucial.

- Monitoring the charges and commissions for comparison sites and other acquisition agents.

  These costs have become a de-facto fourth layer in the supply chain (in addition to wholesale, retail and network), over which there is no transparency. Gaining a more accurate picture of how many consumers are being targeted and the range of costs involved will be a key part of determining the actual extent of costs that this activity is adding to the system.

[3] IPART, *review of the performance and competitiveness in the NSW retail energy market, from July 1 2017 to 30 June 2018*. November 2018. Pp. 92-96

[4] Ibid

- Monitoring change in CARC figures over time and tracking these figures against the number of competitors, relative market share of competitors, and the number and proportion of customers switching or 'churning' annually.

<u>Embedded Networks</u>

Exempt selling and embedded network arrangements cover a significant, if unquantified, minority of consumers who by their very nature are disadvantaged by reduced access to choice, competition and the full scope of consumer protections available to others in the NEM. PIAC understands the significant complications involved in any monitoring of embedded networks; nonetheless, improving an understanding of the outcomes for consumers covered by these networks is increasingly vital. PIAC considers that ongoing monitoring by the ACCC should look to improve information on:

- The number of embedded networks and exempt sellers in operation
- The number of consumers currently covered by embedded networks and/or exempt seller arrangements
- The costs and margins charged in exempt selling and/or embedded network arrangements
- The costs, both to customers and network owners, of exiting embedded network arrangements
- The effectiveness of payment supports or retail assistance measures available to consumers in embedded network and/or exempt selling arrangements.

<u>Interaction of cost stack and energy retail charges</u>

There is a wide variation in the way retailers construct their pricing to consumers with differing balance between daily charges and usage charges. This variation provides scope for retail innovation and consumer choice, but which also increases the complexity of the retail market, potentially obscures visibility of price dispersion, and complicates analysis of the relationship between wholesale, network and other costs with the final prices paid by consumers.

While PIAC does not suggest that this variation is problematic in itself, ongoing monitoring presents an opportunity to gain a clearer picture of how it is employed, its impact upon consumers, and how it does or does not ensure that retail prices efficiently reflect changes in wholesale costs. Accordingly, ongoing analysis by the ACCC should:

- Monitor the spread of retail offers by proportion of fixed (daily charges) and variable (usage) charges, including steps in time-variant and block charges
- Monitor the average change in variable charges and track against the change in wholesale, network and other costs, on the basis that this charge should be the most responsive to changes in the wholesale price.

Wholesale market

PIAC supports the approach to analysis taken in the REPI process, and recommends it form the basis of ongoing monitoring of the interaction between wholesale and retail markets, and their impacts upon prices. The performance of wholesale markets, and by extension their interaction with and impact upon retail prices, cannot be assessed as simplistically as "if X indicator is above Y level, then there is effective competition." A suite of measures is required to accurately assess the overall performance of wholesale markets, including both quantitative and qualitative measures. Importantly, PIAC highlights the need to avoid considering any single indicator in isolation, but rather to analyse the suite of data as a whole.

<u>Wholesale Demand Response</u>

While the 'efficient' level of deployment of demand response (DR) in the NEM is not known, there has been widespread agreement among market institutions, as noted the Finkel inquiry and even within the REPI report, that wholesale DR will play a vital and significant part in the way the NEM balances supply and demand efficiently, and affordably. While some analysis of the availability and employment of DR is currently undertaken by the AER, PIAC understands that this work is not currently detailed enough to present the clear picture required to track progress in the utilisation of DR, and identify measures to hasten its most efficient level of deployment. PIAC sees further opportunities for the ACCC monitoring to improve this by:

- Monitoring the availability of DR opportunities for consumers in the retail market.

  Both in advance of any potential rule change implementing a wholesale DR mechanism, and in informing and monitoring its potential implementation, the ability for consumers to participate in DR will be an important metric in determining its impacts upon consumer outcomes, equity of access for different consumers, and the performance of retailers (and potentially aggregators) in facilitating efficiency in the wholesale market.

- Monitoring what DR is being deployed, where this is happening and what impact it had.
- Identifying where DR would have a significant impact, but is not currently being utilised.

  Key to determining the efficient level of DR utilisation in the NEM is identifying where the delivered cost of energy (indicated, for example, by wholesale spot prices) is materially higher than the price for which prospective DR providers could have realistically undertaken DR. For example, during periods where a peaking gas plant became the marginal generator, driving a sport price above $10,000/MWh, could demand response have been deployed at lower cost? Was there un-utilised DR available? What impact would that DR be likely to have had upon the wholesale price? These instances could be identified in monitoring the previous 6 months operation of the wholesale market, where certain conditions that indicate potential for the more efficient deployment of wholesale DR are met.

Continued engagement

PIAC would welcome the opportunity to meet with the ACCC and other stakeholders to discuss these issues, and looks forward to providing further detail on the issues explored in this submission. For further engagement please contact [redacted] or [redacted]

Yours sincerely,

[redacted]

[redacted]
Policy Officer, Energy and Water
Public Interest Advocacy Centre

[redacted]

[redacted]
Policy Team Leader, Energy and Water
Public Interest Advocacy Centre

[redacted]