Submission to

National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014

Draft Determination

Consumer Action Law Centre
Consumer Utilities Advocacy Centre

September 2014

The Consumer Action Law Centre (**Consumer Action**) and the Consumer Utility Advocacy Centre (CUAC) welcome the opportunity to comment on the Australian Energy Market Commission's (**AEMC**) *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014 Draft Determination* (**Draft Determination**) which is as a result of a rule change proposed jointly by our two organisations.

We look forward to ongoing discussions in relation to unilateral variations under fixed term contracts and a focus on how to ensure a fairer market for consumers.

Draft Determination

CUAC and Consumer Action are pleased that the AEMC – and other bodies, such as the AER, ERAA, and consumer advocates – recognise that there is a problem in energy contracts worth addressing.

The AEMC's Draft Determination finds the issues that require a regulatory response are narrower than those raised in CUAC and Consumer Action's rule change request; specifically, that the key issue raised by the rule change request is that some consumers may be entering contracts unaware that prices may vary.

The Commission considers CUAC and Consumer Action's suggested changes to be disproportionate responses to the issues identified, and likely to restrict consumer choice, inhibit retailers' ability to innovate, adversely affect competition in retail energy markets, and result in poorer outcomes for consumers (including higher prices).

Instead, the AEMC propose to provide greater transparency for consumers in relation to how prices may vary when they sign up to a new contract. Specifically, the AEMC propose to amend the rules to require retailers to:

- disclose the possibility of price variation when obtaining explicit informed consent to enter a market contract; and
- provide information about when retailers will notify consumers of variations during a market contract as part of product disclosure information required upon entry.

CUAC and Consumer Action reject the AEMC's conclusions and consider the Draft Determination and proposed rule a manifestly inadequate response to the issues raised in the Rule Change Application and subsequent submissions.

We have identified ten significant problems with the Draft Determination and associated materials:

1. Lack of response to the economic analysis and advice provided as part of the evidence base for the Rule Change Application;
2. Selective analysis of consumer research findings;
3. An absence of acknowledgement of the insights of behavioural economics into consumer behaviour or any analysis of the issues raised;

4. Failure to demonstrate why consumers are better at managing risks compared to energy retailers;
5. Lack of any modelling of alleged "premium" that retailers would charge if the proposed rule was made;
6. Little consideration given to alternative scenarios, such as banning exit fees;
7. Limited attempt to establish the presence or absence of price-baiting as a market practice;
8. An apparent unwillingness to consider international experiences and evidence to inform the draft determination;
9. Failure to reduce uncertainty with the application of unfair contract term laws for energy consumers; and
10. Willingness to accept retailer assertions about limiting contracts, with no clear supporting evidence base.

1. Response to the economic analysis

A key feature of the Rule Change Application was the economic analysis undertaken by Dr Rhonda Smith.

This analysis was provided as evidence to support the proposed Rule Change and argued that the ability of energy providers to unilaterally change prices can incentivise retailers to initially set prices below the competitive level to attract customers, knowing that they can raise prices once a customer has signed up (refer also section 7 on price baiting). The analysis observed that, should retailers be banned from changing prices during a fixed-period contract, energy retailers would be less likely to set prices below competitive levels to attract customers and increase prices afterward. The analysis also observed that retailers would be required to take greater steps to manage their risk exposure to cost increases (refer also section 4 on risk management).

Dr Smith argued that, with the simplification to contracts that the proposed Rule would achieve, consumers may be more likely to switch retailers as search costs are reduced (no need to check terms and conditions for price variation clauses) and trust would improve. This would also improve the perception of fairness in energy markets and build confidence in a competitive market.

The Draft Determination did not provide any substantive analysis or critique of Dr Smith's work. It also did not include any discussion of the need to improve trust and perceptions of fairness in the energy retail market. Recent research by CHOICE found that only 9 per cent of Australians have confidence that the advice of energy retailers is in their best interests.[1] This should be a significant concern to a regulator charged with promoting the long-term interests of consumers.

[1] See CHOICE, Consumer Pulse Report, August 2014: http://www.choice.com.au/media-and-news/consumer-news/news/choice-cost-of-living-report-highlights-tough-times-for-many.aspx.

2. Analysis of consumer research findings

The proponents commend the AEMC for the extensive research it commissioned from Newgate Research[2] into consumer views and preferences, There are, however, several problems with the analysis of the results.

Firstly, the quantitative research shows that a plurality of residential consumers across the NEM – 43 per cent – believe that the rate paid per unit of energy consumed on an energy contract is fixed. In addition, most consumers in the qualitative survey also thought being on a contract for a specified period of time meant the rate per unit would be fixed.

There is no recognition by the AEMC that the research shows consumers' broad expectations are that prices within contracts remain fixed. To the extent that consumers' expectations are addressed, the AEMC appears to consider it problematic not that the market doesn't follow consumers' expectations, but that consumers' expectations don't follow the market.

That consumers, when pressed, allow that they only "hope" prices will be fixed but anticipate that "typical behaviour from energy companies" (p.13) will dash these hopes should be seen as an indictment of current practices, not as proof of consumer understanding. Proposing to solve this clear disconnection between consumer expectations and electricity market practice by providing consumers with more information via an education approach is a curious decision.

Secondly, the Draft Determination, with reference to Newgate's research, considered that consumers did not find the problem of non-fixed prices to be particularly important. Given that Newgate's research found consumers were generally frustrated with and distrustful of energy retailers, this is unsurprising: when the overall attitude toward retailers is this bad, it's rare for single issues to stand out. Simply because fixed pricing did not rank highly on the list of consumers' concerns does not mean it is an issue consumers are not concerned about. A change in one aspect of the relationship between consumers and their retailer could have a significantly positive impact across the board.

It is disappointing that the consumer research did not seek to test the findings of CUAC's 2012 research, which specifically asked consumers about their attitudes toward energy retailers changing prices within contracts and proposals to change this.[3] The results of CUAC's survey, which show that 86% of respondents find changing prices during contracts is unfair and 94% would support regulations to prevent this, remain the best source of information on consumer attitudes toward this specific issue.

Thirdly, it appears that in its analysis of the Newgate consumer research, the Commission has relied heavily on the finding that "almost half of residential and small business customers say they prefer the type of contract this request would have stopped retailers from offering".[4]

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[2] Newgate Research (2014) Consumer Research on Retailer Price Variations in Market Retail Contracts

[3] CUAC (2012) Fixing up fixed term contracts for energy consumers

[4] See AEMC, Letter to the Editor – Retailer Price Variations, http://www.aemc.gov.au/News-Center/What-s-New/Announcements/Letter-to-the-editor-%E2%80%93-Retailer-Price-Variations-i

The relevant question from the research asked whether consumers would prefer a fixed period contract with a relatively large discount from the regulated tariff, or whether they'd prefer a fixed period contract with small or no discounts from the regulated tariff that had a variable price.

There are a number of problems with this question and the Commission's reliance on it. The question refers to a 'regulated tariff'. In Victoria, and indeed a number of the NECF jurisdictions, there is no longer a regulated tariff. It is therefore hard to see how a respondent is to make sense of this question; at the very least, it doesn't tell a policy maker much about the impact of the proposed rule change. The Newgate research report also noted that the qualitative sample found this question "somewhat difficult to absorb". As such, caution should be taken placing too much reliance on the quantitative sample's response to the question. Around 25 per cent of respondents answered 'something else' or 'don't know', which indicates that there may well have been confusion.

The Commission also appeared to rely on findings that:

- Consumers are generally satisfied with their retailer;
- Low numbers of consumers responded to price variations in their fixed period market contracts with negative emotions; and
- Most consumers see price variations during fixed periods as being less important that issues such as improved information.

In relation to the first finding, we submit that consumer satisfaction is not a good indicator of effective competition. Satisfaction could simply be an indicator of a consumer view that all retailers are the same, or that there is no difference between the retailers treatment of customers or offers available. Indeed, the Newgate research included a finding that many consumers thought all energy companies offer virtually the same price. A much more useful indicator is consumer trust and confidence. As cited earlier, recent research by CHOICE finds only 9 per cent of Australians have confidence that the advice of energy retailers is in their best interests. In relation to the next two findings, it is equally legitimate to conclude that these indicate helplessness or a lack of control when it comes to energy contract terms and conditions. It is perhaps a rational response not to feel 'negative' emotions when you believe there is nothing you can do about the issue.

There were also a number of important findings of the Newgate research that appear to have been discounted by the Commission in its Draft Determination. Interestingly, both the qualitative and the quantitative research results suggest that many consumers are not aware whether they are actually on a contract. There was also significant confusion about the term 'fixed' and what is actually fixed in an energy contract – the rate per unit of energy used, discounts off the price paid, both or neither, with one in five unsure. These findings indicate that consumer views about terms and conditions should be treated with caution – such a significant lack of basic understanding suggests that views about the details of contracts are unlikely to be robust.

3. *Behavioural economics*

In the Rule Change Application and our submission to the Commission's consultation paper on the Rule Change, we referenced findings from the discipline of behavioural economics. We put the case that rules designed to empower consumers (such as the proposed rule) risk having no effect in the absence of due consideration to the significant body of work on real-world consumer behaviour. We also arranged for an expert in behavioural research, Dr Paul Harrison, to present to the Commission at its public forum on the proposed rule change in May 2014.

It is disappointing that the Commission has, at least in its published Draft Determination, given no consideration to this relevant field and its ability to inform robust analysis and decision making. We again refer to statements from other regulators, such as the Chairman of the Australian Securities & Investments Commission, who states that regulators should be considering behavioural science 'to better understand how consumers really behave'.[5] We also reiterate that the Office of Best Practice Regulation has provided guidance to policy makers and regulators about influencing consumer behaviour through regulatory design.[6]

The Commission's preferred rule, primarily to provide more information to consumers, suggests limited understanding of how consumers make decisions. We submit that unless relevant information is provided to consumers in marketing and advertising it matters very little that further information is provided at the decision point where 'explicit informed consent' is required. At this stage of the choice chain, consumers generally display automation, and the consent process is often little more than a 'tick a box' exercise online or giving assent via a phone call. Even financial institutions have acknowledged that providing more information and incentives to consumers will not necessarily influence their behaviour, or help them make decisions in their own interests.[7]

The common experience of consumer-market interactions is that contracts represent binding agreements between parties that are, in the vast majority of situations, unalterable. Challenging this cultural conditioning requires conscious effort and is difficult to grasp. Where consumers are confused, uncertain, or simply do not consider the matter, they will assume contracts to be fixed – unalterable – across all relevant characteristics.

4. *Risk management*

The Draft Determination acknowledges that CUAC and Consumer Action's proposed rule would require retailers to manage more risks on behalf of consumers (p. 50). It also notes

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[5] Greg Medcraf, 'Speech—Regulating for Real Consumers', ASIC Annual Forum, March 2014, available at: https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-Forum-2014--Opening-address--24March2014.pdf/$file/ASIC-Forum-2014--Opening-address--24March2014.pdf

[6] Office of Best Practice Regulation, 'Influencing Consumer Behaviour: Improving Regulatory Design', December 2012, available at: http://ris.dpmc.gov.au/2012/12/18/obpr-research-paper-influencing-consumer-behaviour-improving-regulatory-design/

[7] See, for example, CitiBank, 'Evidence versus Emotions: how do we really make decisions?', available at: http://www.citi.com.au/citigroup/pdf/Citi_Fin_Report_full_document.pdf

that retailers have a better ability to manage changes in network prices and government policy costs than consumers.

However, the Commission has not explained why consumers should bear these risks, while stating that the retailers have a limited ability to predict or control these risks. We submit that a key role of retailers is to manage risk associated with the energy market on behalf of their customers. It would make sense that a retailer offering greatest stability and price guarantees over a given period would attract and retain a solid customer base. Those that cannot will exit the market.

The Commission's suggestion that only efficient risks are passed on is overly optimistic. The proportion of energy consumers who have never switched or rarely switch, and the magnitude of potential benefits of switching these consumers forego,[8] suggest that inefficient costs could be passed on fairly easily to a significant proportion of consumers.

We also reiterate that the proposed rule would not have prevented retailers from passing on risk to consumers through contractual arrangements. We feel that the Commission may have overlooked the fact that the proposed rule does not inhibit a retailer from offering variable price market contracts. It does, however, prevent such contracts operating for a fixed term. Retailers would be free to offer a variable price market contract on an 'evergreen' arrangement, free from fixed terms or exit penalties. Given this flexibility, there should be no cause for concern about retailers being unable to manage risks.

5. Failure to undertake modelling of alleged "premium"

The Draft Determination states that the Commission investigated the level of price premiums that are priced into current fully fixed-price market contracts offered by retailers. The Commission states that the premium paid for fixed-priced offers over the cheapest market offers varied significantly, and ranged between 9.7 per cent and 20.4 per cent (p. 50).

While the Commission acknowledges that these percentages may not actually reflect the risk involved for retailers in offering these contracts due to the low level of competition in the provision of these contracts, these percentages in fact cannot represent any risk premium. This is because the comparison point is not the entry price for a fully-fixed offer versus a variable price offer. Rather, the comparison should be the total amount paid by a consumer on a fully-fixed offer and a consumer on a variable offer over the term of the contract. This would therefore include price increases imposed by the retailer on the variable offer. In the absence of the necessary analysis, the Commission's stated variations cannot be relied on.

6. Consideration of alternative scenarios

Chapter 7 of the Draft Determination discusses a number of alternative rules proposed in our Rule Change Application. However, there were a number of other alternatives that arose during the consultation. These include, for example, the banning of exit fees. Other

[8] See e.g. St Vincent de Paul's 'Tariff Tracker' series of reports for potential savings from switching.

alternatives include requiring prices in a fixed-period market contract to be fixed for a period of time, for example, 12 or 18 months.[9]

We note that a number of jurisdictions have further regulated exit fees or required retailers to make offers without exit fees. For example, in South Australia all energy retailers must offer at least one market contract with no exit fees. The economic analysis in support of the Rule Change Application also considered a scenario where unilateral price variations are allowed, but exit fees are eliminated. This was not a preferred option, but it was considered in-depth. The Commission did note this alternative in chapter 5 (page 30). It is disappointing therefore that the Draft Determination did not include any detailed analysis of the effects of this alternative.

We reiterate the concern noted in our letter to the Commission of 26 June 2014. That is, there is a real possibility that we will end up with a marketplace where retail contracts include jurisdictional differences for price notification procedures, the application of exit fees, and other responses to consumer detriment, because the existing rule is considered inadequate. This will add to the cost of retailing and will ultimately be a cost borne by consumers. It is disappointing that the Commission has not acknowledged or engaged with this risk.

7. Price-baiting

The Draft Determination states that there is insufficient evidence to conclude that retailers are engaging in widespread price baiting practices. The Commission has not, to our knowledge, asked retailers for the history of price increases and their timing for market contracts offered to consumers. Without this information, it is impossible to say there is no evidence of price baiting.

We note that the Commission refers to existing prohibitions around misleading conduct and price baiting in the Australian Consumer Law (ACL). In relation to price baiting, our concern is different to the prohibition in the ACL. The ACL prohibits bait advertising which involves the advertising goods or services at a specified price if there are reasonable grounds for believing that the person will not be able to offer reasonable quantities of the goods or services at that price for a reasonable period, having regard to the advertisement and the nature of the market. A person who offers goods or services at a specified price must also do so for a reasonable period and in reasonable quantities, having regard to the advertisement and the nature of the market. Our concern is not that the initial contract is unavailable. The concern is that the price is changed soon after sign up – the ACL prohibition on bait advertising is not relevant to this practice.

In relation to misleading consumers, we note that should retailers disclose clearly that they will change the price, then it is unlikely to be misleading. While we are concerned that aspects of retailers' marketing and communications of contract terms are misleading, this is not the sole concern – it is the strategy of using contract terms to the detriment of consumers.

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[9] This was proposed by the Essential Services Commission Victoria in a 2011 consultation paper on this issue.

8. International experience

The Commission posits that it is not required to consider international consumer protections as part of its assessment of the consumer protections test. The Commission has a significant policy making role, and it would be expected to seek out and consider international examples of good and bad practice in the matter under consideration. The Commission does state (page 11) that it has considered the development of consumer protections relevant to the rule change request in a range of international jurisdictions, including the UK. Despite this statement, the Draft Determination does not include any analysis of the experience of the UK market and how any consideration of that market has informed the Commission's thinking. It is therefore difficult to engage with a finding that does not provide an insight into acceptance or rejection of possible responses as attempted in other markets.

One example of relevant international practice, from research carried out in 2011 research for the UK Office of Gas and Electricity Markets (Ofgem), found that,

> *"[s]ince energy is essential and not a discretionary purchase, poor quality communication can lead to what psychologists call "learned helplessness" (first described by Seligman, 1967), that is, consumers feel that their attempts to get better value are not getting them anywhere and so they disengage; they stop trying to influence the situation and become passive."* [10]

This insight challenges the Draft Determination's supposition that, simply because few consumers actively react to price rises during fixed period contracts, those customers are not troubled by those changes.

CUAC and Consumer Action are not suggesting that the Australian energy market mirror the reforms of the UK. As noted in our submission to the Commission's consultation paper, the UK reforms were far reaching and, in addition to requiring fixed-term contracts to come with a fixed price, it limited contracts to four core tariffs, banned tiered tariffs and restricted discounting[11]

While it is not clear from the Draft Determination, it appears that the Commission may have rejected our rule change on the basis that the Ofgem reforms have yet to result in improved consumer engagement and competition, and that this is evidenced by Ofgem's referral of the market to that country's Competition and Market Authority (CMA) for a full investigation.[12] In doing so, the Commission appears to have discounted the significant amount of analysis that was undertaken during the Ofgem Retail Market Review (and referred to in our submission to the Commission's consultation paper).

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[10] Lawes Consulting, 2011, Retail Market Review: Energy bills, annual statements and price rise notifications; advice on layout and the use of language, p. 3

[11] See Ofgem, 'Simpler, clearer, fair', available at: https://www.ofgem.gov.uk/simpler-clearer-fairer/simpler-choices

[12] See Ofgem, 'Ofgem refers energy market for full competition investigation', available at: https://www.ofgem.gov.uk/news/ofgem-refers-energy-market-full-competition-investigation

However, it is by no means clear that the change to fixed-term contracts in the UK has not improved consumer understanding and engagement with contracts, as there is as yet no analysis of the impact of the Ofgem retail market reforms. Indeed, this uncertainty appears to be a key driver of the referral to the CMA.

We also note that as part of the CMA's investigation, which has just begun, it has released an issues statement.[13] That statement identifies a key 'theory of harm', being:

> *"Energy suppliers face weak incentives to compete on price and non-price factors in retail markets, due in particular to inactive customers, supplier behaviour and/or regulatory interventions."*

It is instructive that regulators in the UK appear to have grasped the nub of the problem and are willing to undertake required analyses (both the problem, and the impact of reforms), rather than propose 'informational' fixes for which there is no evidence of success. We reiterate that the experiences of the UK and other international jurisdictions warrant deeper consideration and offer salient insights to inform decisions made in our own energy markets.

9. Unfair contract term laws

The Commission notes that there is uncertainty with the application of the unfair contract terms provisions in the ACL to energy market contracts. It does not, however, acknowledge that this uncertainty creates costs – particularly for consumers who bear risks associated with unilateral price variations.

The Commission suggests that the unfair term provisions should be first tested by the courts. This ignores that there is a dearth of litigation in relation to the unfair term provisions, with only one case ever taken by the ACCC. This, we note, was a policy intention – the law was designed to be self-enforcing and not rely on the courts. It is the uncertainty about the interaction of the Retail Law, the NERR, and the ACL which means that the unfair terms provisions are not self-enforcing in relation to energy contracts, creating additional costs.

The Commission had the opportunity to reduce uncertainty and these costs by making the proposed rule and effectively clarifying that unilateral price variation clauses are unfair. While it may not have regulatory power in relation the ACL or the Retail Law, the Commission could have also expressed a view about the application of unfair contract term laws to energy market contracts. It could do this jointly with the ACCC. This sort of regulatory guidance can be very influential on consumer contracts, and we note that it is this sort of regulatory guidance that has had practical impacts on other areas of consumer contracts.[14] We urge the Commission to reconsider and offer regulatory guidance to reduce uncertainty and consumer costs.

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[13] Competition and Markets Authority, Energy Market Investigation—statement of issues, June 2014, available at: https://assets.digital.cabinet-office.gov.uk/media/53cfc72640f0b60b9f000003/Energy_Issues_Statement.pdf.

[14] See eg https://www.accc.gov.au/publications/unfair-contract-terms

10. Retailer assertions about limiting contracts

The Commission states that the proposed rule would limit the ability of retailers to develop a range of contracts that meet consumers' different preferences. We note that while there is some innovation in energy offers (particularly about consumption information, and contracts without a fixed period), there is no significant innovation that benefits consumers in relation to the terms and conditions of fixed period contracts. Indeed, as was submitted in our Rule Change Application and our joint submission to the consultation paper, it is the terms of such contracts that are reducing consumer empowerment and engagement with the market.

As noted above, the proposed rule would not limit retailers in areas other than fixed-term contracts. Retailers would still be free to offer variable price market contracts on an 'evergreen' arrangement, free from fixed terms or exit penalties. Claims of undue limitation in contract structure or innovation appear to have little basis in evidence.

It is instructive that the section of the Draft Determination on the impact of the proposed rule on retail competition (part 7.3.3) includes no discussion of competition on the demand side, nor consumer empowerment as a means to improve the effectiveness of competition. This is a significant deficiency. As noted above, we are concerned that the Commission's analysis of whether price variations cause consumer disengagement (part 5.3.1) has not considered the evidence from studies of consumer behaviour and includes insufficient evidence to draw conclusions.

CONCLUDING REMARKS

The proponents welcome and acknowledge the efforts of Commission staff in the process to date, and the ability to engage in robust discussions about both process and content. While the content of this submission is indeed critical, we encourage the Commission to consider our response to the Draft Determination in the spirit in which it is intended. That is, we intend it to be a constructive critique with a view to improving the level of analysis before any final decision is made. We also intend it to underscore that we think there are significant problems with consumer engagement with energy contracts, particularly fixed-period market contracts, and that narrow constructions of the issue will not address the problems. Consumer advocates will continue to highlight problems with energy marketing, contractual terms, product design and distribution, to enable consumers to make informed choices and participate effectively in the market.