

19 February 2018

By email: info@esb.org.au

Energy Security Board
c/- COAG Energy Council Secretariat
Department of the Environment and Energy
GPO Box 787
CANBERRA ACT 2601

Dear Energy Security Board,

National Energy Guarantee: Draft Design Consultation Paper

Consumer Action welcomes the opportunity to provide a brief submission in response to the Energy Security Board's (ESB) Draft Design Consultation Paper: National Energy Guarantee (**Consultation Paper**).

In summary:

- we support the incorporation of an effective emissions reduction mechanism in energy regulation—it is essential that the mechanism creates 'additional' emissions reductions that would not have occurred in the absence of the scheme;
- we question whether the reliability guarantee is necessary, or at least how the additional cost of any increase in reliability is going to be balanced with affordability; and
- we contest an underlying assumption in the Consultation Paper that a competitive retail market will ensure additional costs created by the National Energy Guarantee (NEG) will be tempered by effective competition.

On this latter point, energy policy at both the state (Victorian) and federal level has historically relied far too heavily on rational choice theory, factoring in a degree of consumer engagement that has proven to be unrealistic. While the practical, cognitive and behavioural reasons for this are complex (and can sometimes seem counter-intuitive), the salient fact is that people generally do not engage proactively with the energy market—even when it would seem in their interests to do so. This situation is not going to change; it is an expression of fundamental human nature and must be accepted as a basic fact of the market.

In designing the NEG, we implore the ESB to take account of this consumer inertia in the retail market—and consider how people experiencing vulnerability or on low-incomes may be affected by the policy settings of the NEG. The NEG must be made to work for the benefit of consumers in an

environment where many, (perhaps most), do not engage. Any system built on the assumption that consumers will engage—and which relies upon that engagement to operate effectively—is doomed to failure. Such a system will inevitably result in perverse outcomes, where those who can least afford it pay the most. We have seen such a situation evolve over the course of the National Energy Market (NEM), and in Victoria, where full price deregulation has existed the longest, it is arguably at its most acute. The NEG must work to avoid mistakes that were made in devising the NEM, and not over-estimate the degree to which people are willing to engage with the energy market.

Our further comments are set out below.

About our organisation

Consumer Action is an independent, not-for profit consumer organisation with deep expertise in consumer and consumer credit law, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice and representation, and policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just market place for all Australians.

1. Emissions requirement

Consumer Action strongly supports the electricity system taking steps to reduce carbon emissions. In 2012, Consumer Action published a report 'A policy trilemma: creating an affordable, secure and sustainable energy market'.¹ We are pleased that policy makers are now adopting the language of our report, recognising that it is in the consumer interest to reduce the environmental impact of the energy sector.

However, particularly given energy is an essential service, ensuring costs incurred from mechanisms like an emissions requirement are fair and proportionate is very important. We are concerned that the Consultation Paper only discusses affordability in terms of policy certainty reducing the risk premium on new investments. There is a marked absence of any discussion about the equity implications of additional costs on energy bills, or the role competition needs to play to ensure increases are kept in check.

We welcome the discussion at part 3.5 of the Consultation Paper on the interaction of an emissions requirement with voluntary 'green' programs. Consumer Action considers that addressing additionality should be a key feature of the design of the emissions requirement of the NEG. Additionality is important to ensure that the requirement does not pay for emissions reductions

¹ Consumer Action and Foundation for Effective Markets and Governance, *A Policy Trilemma: Creating an Affordable, Secure and Sustainable Energy Market*, November 2012.



that would have occurred anyway. This is essential not only for the integrity of the NEG, but for community confidence in energy policy.

2. Reliability requirement

Consumer Action is concerned to ensure that the reliability requirement does not unduly add costs to energy bills. It is important to note that the electricity system is not designed to be perfectly reliable. The trade-off between reliability and cost means a government decision to increase reliability standards may require substantial new investment that affects customer bills. The assessment of reliability in both the generation and network sectors should be based on an assessment of what consumers are willing to pay for.

Reliability in the NEM is already very high, and the Consultation Paper gives no thought to the impact the proposed mechanism will have on household bills. If affordability is genuinely a key concern of the NEG, then it must be weighed against the proposal for a reliability requirement—and the reliability standard to be set—which will have a material impact on bills.

We note the argument that renewable energy makes the system less reliable because these sources aren't as dispatchable. It is not clear to us that the NEG's approach to reliability, a contracting requirement imposed on retailers, is the most cost-effective way to deal with the concern. While demand response can be incorporated in to the NEG, it seems that 'competitive pressure' is the driver to ensure that retailers chose a cost-effective measure. The next section contests the assumption that where market participants are given obligations, competitive pressures alone are enough to ensure minimal costs are passed on to customers.

3. False assumption about competitive pressures

In their April 2017 paper, *Exploring the drivers and barriers of consumer engagement in the Victorian retail energy market* the CSIRO found that:

Currently, there are more people not engaging in the market than there are those who are engaged. The reason for this can largely be attributed to the many barriers that exist to actively engage in the energy market. Most of these barriers are active for most consumers most (if not all) of the time. The end result is a context which is, to a large degree, antithetical to engagement.²

Further,

² Gardiner, John and Nilsson, Danie, *Exploring the drivers and barriers of consumer engagement in the Victorian retail energy market*, CSIRO, April 2017, p. 3. Available at: https://engage.vic.gov.au/application/files/4415/0252/0825/CSIRO_Energy_Market_Engagement_Report.pdf



This is the most basic and least tractable barrier to energy engagement: people simply do not care about energy for the vast majority of the time. People treat energy like oxygen—for almost everyone, it doesn't matter at all as long as it's available; as soon as it's not available, and [sic] it's a vital concern.³

It should also be noted that lack of consumer engagement in retail energy is not unique to Australia. A 2017 paper by the Centre for Competition Policy at the University of East Anglia, *Switching Energy Suppliers: It's Not All About the Money*, examined consumer behaviour in response to the The Big Switch (TBS)—the largest collective energy switching exercise ever conducted in the UK. Disappointingly, only just over a quarter of consumers took the small step necessary to accept a new offer, even when clearly presented with positive savings. The study found that:

A range of non-price factors—various sources of uncertainty, the non-monetary characteristics of different offers, concerns about the switching process and time pressures when the TBS occurred—are all associated with the switching decision.⁴

Ultimately, the paper concluded:

...the proportion of TBS participants still not switching suggests that relying on consumers to drive margins down to competitive levels is likely to prove disappointing. If even the well-educated, highly-engaged, savings-seeking TBS participants did not behave like the model consumers envisaged in an idealised homogenous product market, policy makers should lower their expectations about the power of consumer engagement to promote competition.⁵

In Victoria, the 2017 Independent Review into the Electricity and Gas Retail Markets in Victoria (**Independent Review**) found that:

The benefits promised when competition was implemented have not been realised and consumers are paying more for the same service. As an essential service, it is imperative that all consumers, including low income and vulnerable customers have access to affordable energy.⁶

As the ESB will be aware, the Independent Review's headline recommendation was for the implementation of a Basic Service Offer (**BSO**). The BSO would a retail price for energy to be set by the Essential Services Commission (**ESC**), which would strip out—or at least reduce—some retail elements comprising part of the typical cost stack for energy in Victoria (where the overall retail component commonly accounts for 30%-40% of the bill). All retailers would be required to offer a

³ Ibid, p. 4.

⁴ Deller, David et al. *Switching Energy Suppliers: It's Not All About The Money*, Centre for Competition Policy, University of East Anglia, 2017, p. 15. Available at: <http://competitionpolicy.ac.uk/documents/8158338/17199160/CCP+WP+17-5+complete.pdf/fdaaed88-56e5-44f9-98db-6cf161bfb0d4>.

⁵ Ibid.

⁶ Thwaites, John; Faulkner, Patricia and Mulder, Terry. *Independent Review into the Electricity and Gas Retail Markets in Victoria*, August 2017, p x. Available at: <https://engage.vic.gov.au/review-electricity-and-gas-retail-markets-victoria>.

BSO to all consumers. The Victorian State government is yet to respond to the Independent Review, and a BSO remains on the table.

That such an option should even be floated provides a strong indication of market dysfunction. The in-built assumption of a competitive retail market for energy—that consumers would navigate that market and effectively acquire the best deal available, keeping prices down—has simply not been borne out in practice.

As noted above, this issue is important in the context of the NEG because of the assumption implicit in the Consultation Paper that the costs of the emissions and reliability requirements will be tempered by the effectiveness of retail competition. We strongly contest that assumption and urge the ESB to take greater steps to address the effectiveness of retail competition throughout the NEM.

In particular, we are concerned about the cost impacts on some of the most disadvantaged consumers who are most vulnerable to the impact of climate change. These people should not bear an undue share of the cost of transitioning to a clean economy. While emissions reduction is urgent, the transition needs to be affordable, equitable and inclusive. Crucially, the degree of engagement that a consumer demonstrates (or the capacity they have to do so), should not determine the extent to which they ‘win’ or lose’ in the transitioning energy economy. Being a consumer is not a job—and it follows that no-one should be ‘punished’ for not engaging effectively enough with the market.

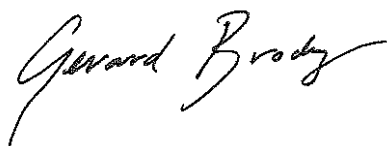
Consumer Action urges the ESB to consider means by which the NEG can deliver on emissions targets in an affordable, equitable and inclusive manner without relying on the chimera of consumer engagement to ensure a competitive retail energy market. In particular, we urge the ESB to:

- analyse how obligated parties pass on costs to consumers, including whether this is done in a regressive manner where more affluent consumers benefit at the expense of lower income consumers;
- consider how the NEG can better contribute to demand reduction for energy as an alternative to investing in new assets to meet current and future demand.

Please contact Zac Gillam, Senior Policy Officer at Consumer Action on 03 8554 6907 or at zac@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

CONSUMER ACTION LAW CENTRE



Gerard Brody
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