

Stop blaming consumers for market failures

Dr Martin Gill

Electricity retailers continue to justify their poor behaviour by claiming consumers have a choice. This is untrue. As an essential service, consumers must purchase electricity. Consumer rights to access this essential service, at a sensible price, should be protected and not turned into a “game” with a few winners and many losers.

Introduction

Feedback left on one of Dr Gill’s recent articles stated:

“Of course consumers only benefit if they are engaged”

The statement is concerning because it suggests some consumers deserve to pay more. It lays the blame for poor outcomes on consumers rather than looking at the cause of the poor choices they are making.

The statement also accepts retailers have turned the sale of electricity into a game. In this new game retailers are free to use questionable tactics to mislead consumers into choosing energy options increasing their energy costs.

Some informed consumers may be avoiding the misleading tactics. Unfortunately analysis reveals a majority of consumers are unaware of the new rules in this energy game and ultimately pay more.

There is a more enlightened approach. This approach focusses on a positive outcome for consumers. Focussing on the outcome has the potential to fix Australia’s broken energy market.

Only engaged consumers benefit

Electricity is an essential service. Consumers should have the right to access this service at a sensible price. They should not be forced to pay more for failing to regularly review their energy decisions.

During the 2018 Ruby Hutchison Memorial Lecture Fiona Guthrie stated “we must stop blaming consumers for poor outcomes”. This is particularly true in the new competitive electricity market.

Only 10 years ago electricity prices were regulated and consumers were not required to make any decisions. Then the Australian Energy Market Commission (AEMC) introduced retail competition. Despite the huge impact this change inflicted on consumers the AEMC did not to provide any consumer education. History shows this lack of

consumer education ensured informed consumers were in short supply. Retailers capitalised on consumer vulnerability.

Without assistance, ill-prepared and uninformed consumers were thrown into the new competitive retail market. Retailers ‘explored regulatory boundaries’ occasionally forcing the ACCC to intervene levying fines for the (sometimes) misleading tactics used by the sales people they were employing.

During 2017 the Federal Government finally declared “enough”. They insisted retailers provide some basic consumer education. Retailers were forced to write to the many ill-prepared and uninformed customers explaining they could lower their energy costs. Unsurprisingly this simple consumer education program resulted in a jump in the number of ‘engaged’ consumers. Of concern is the consumer education was still woefully inadequate to provide the majority of consumers the knowledge to choose options lowering their energy costs.

It is a common theme. The AEMC continues to make major changes affecting the price consumers pay for electricity. These significant changes are not accompanied by the education programs required to ensure consumers have the knowledge, skills and tools to meaningfully compare available options. The majority of consumers end up paying more.

Example where competition increased prices

Retailers were forced to compete against each other with the one prepared to pay the highest price being awarded all the unengaged consumers. While this competition resulted in a higher sale price it was not in the interest of the consumers. The winning retailer recovered the high price they paid by putting all the ill-prepared and uninformed consumers on retail tariffs ensuring they paid more for their electricity.

What is the evidence engaged consumers benefit?

The comment makes a major assumption: “Engaged consumers benefit”

Market statistics only report the number of consumers voluntarily accepting retailer tariffs. Many use this figure to represent the number of ‘engaged consumers’. Unfortunately evidence clearly shows these engaged consumers do not necessarily lower their energy costs.

Many consumers on the subsidized NSW Solar Bonus Scheme incorrectly assumed changing retailer resulted in the loss of the subsidised feed in credit. They chose to stay with the default retailer and ended up paying more for their electricity. The statistics suggested these consumers were unengaged however that was not the case, with each having taken positive steps to lower their energy costs. The lack of consumer education was the problem.

As the NSW Solar Bonus Scheme drew to a close the NSW Government attempted to provide the necessary consumer education. This information highlighted they could lower their energy costs by choosing a different retail tariff. Unsurprisingly the consumer education program resulted in a jump in the number of ‘engaged’ consumers.

A new retail opportunity

One retailer saw a huge opportunity at the end of the NSW Solar Bonus Scheme. They contacted consumers offering a highly attractive special deal. This deal offered to double the standard feed-in credit. The special deal was made at a time the NSW Government was recommending consumers look at other tariffs or face a steep rise in their electricity costs. The retailer’s special deal was accepted by a large number of affected consumers.

So “Did these now engaged consumers benefit?” Absolutely NOT. The attractive feed in credit hid other higher fees. These higher fees ensured the majority of NSW solar customer choosing this special deal increased their electricity costs by \$200 a year compared to doing nothing. They were now ‘engaged’, but paying more.

Limited Benefit Periods

Another common tactic used by retailers involves limiting how long ‘engaged’ consumers receive special discounts. The retailer then quietly shifts these ‘engaged’ consumers onto tariffs where they end up paying more for their electricity.

Positively the Federal Government now requires retailers inform consumers when the terms of the contract change. Negatively these contract renewal notices are still not required to highlight what has changed.

For example Dr Gill reviewed a tariff renewal notice sent by a retailer. The notice failed to mention the tariff fundamentally changed how electricity use would be charged. The change increased electricity costs by 30%. The consumer was ‘engaged’ but paid considerably more for their electricity.

It is acknowledged these are only examples where retailers are taking advantage of consumers. More detailed analysis is required to determine the state of the market.

Failing to measure outcomes

The AEMC created the contestable energy market promising it would lower energy costs. Like most Government departments they are required to produce annual reports showing how successful they have been.

The AEMC report lists the number of different retailers, the range of tariffs being offered by these retailers and counts the number of consumers who have chosen a retail offer. All these figures **fail to measure the promised outcome of lower electricity prices.**

The AEMC have successfully created a competitive retail market which fails to deliver lower electricity prices.

The AEMC report estimates the annual cost on offered retail tariffs. This analysis confirms the fears of many consumers, choosing the wrong tariff increases electricity costs. Price diversity does not show the market is delivering promised lower electricity prices.

Consider if the AEMC listed how many consumers are choosing the cheaper tariffs. It could then show an outcome, how much consumers ARE SAVING.

While the AEMC refuses to publish this information there is at least one available measure. The Thwaites review found the average Victorian consumer is paying 21% more than the cheapest available tariff.

The Victorian electricity market is claimed to be a successful example of Australia's competitive energy market. Victoria has one of the highest levels of reported consumer engagement - globally. Despite this global high, the statistic shows **consumers are choosing the wrong tariffs.**

This probably explains why the AEMC chooses to report meaningless measures of market activity rather than acknowledge the competitive market is failing to deliver their promise of lower electricity prices.

Are some consumers paying less?

The AEMC's annual report into the competitive retail electricity market shows it is possible for consumers to select retail tariffs increasing their energy costs. For example tariffs using large (meaningless) discounts which actually increase consumer electricity costs. The Thwaites analysis showing the average Victorian consumer is paying 21% more than necessary for electricity confirms many consumers are on these tariffs.

It is assumed a minority of sufficiently well informed and actively engaged consumers are probably making 'wise energy choices'. These well informed actively engaged consumers review their retail tariff several times a year so end up paying less than the majority of consumers. A critical question is "Do they pay less than if there was no competition?"

The ACCC's investigation into Retail Electricity Prices examines retail operating costs since the introduction of retail competition. The following figure is taken from their Preliminary Report:



The ACCC analysis shows far from lowering costs the introduction of retail competition has doubled retailer operating costs (in real terms). The retail price increase was (partially) attributed to large advertising

budgets and the cost of special offers used to lure new customers (with suggestions of higher profitability also mentioned). Higher retail costs are passed on to consumers through higher energy costs (The Thwaites review has a similar conclusion).

Focussing on the outcome suggests some consumers are paying less than others, but eventually all consumers end up paying more. So can anything be done to fix Australia's broken energy market?

Regulators continue to play "Whack a Mole"

To date interventions in the broken energy market can accurately be described as ineffective. They are regulatory band-aids applied as a political response to adverse publicity.

For example the proposal hoping to limit retailer use of discounts. Current rules mean discounts are completely meaningless. The rules allow retailers to use large discounts to advertise energy plans designed to increase consumer electricity costs. While the rule change may stop retailers using discounts to mislead consumers it will only encourage their marketing departments to explore new areas of consumer deception.

A different approach was suggested by Fiona Guthrie during her 2018 Ruby Hutchison Memorial Lecture:

"Retailers must be made responsible for consumer outcomes"

The statement emphasises the importance of the outcome. The significance of focussing on the outcome can be highlighted by comparing two recent attempts to address poor retailer behaviour.

The Federal Government asked retailers to perform an activity. The activity it chose was to force retailers to write to unengaged consumers suggesting they may be able to lower their energy costs. Significantly there is no certainty of a positive consumer outcome.

Addressing the same problem the Victorian Government instead focussed on an outcome. It forced retailers to compensate unengaged consumers. This solution provided (at least) two very positive outcomes. The \$700 compensation payment makes consumers aware of how much extra they have been paying (this is not achieved by the Federal Government's activity). Also, going forward, retailers are going to hesitate before misleading Victorian

consumers, fearing they will again be forced to compensate consumers.

Application to other energy market providers

The focus on delivering desirable consumer outcomes is applicable across the energy industry.

Tariff Comparison Sites

The use of third party tariff comparison sites is increasing, but there are issues. Current providers do not compare all available tariffs. While this is typically made clear they fail to explain why. These sites only recommend tariffs from retailers prepared to pay to have their tariff listed on the site. These are rarely the cheapest tariff.

While not listing the cheapest tariff is undesirable there is a far more significantly issue. These third service tariff comparison services do not currently have to disclose the financial incentives they receive for recommending a tariff. Hidden financial incentives has been discussed extensively during the Banking Royal Commission. In the banking sector hidden commissions resulted in advice recommending products paying **the advisor** the highest commissions ahead of products of benefit to consumers.

The financial sector has moved to solve the problem by making financial advisors responsible for the outcome. They must now ensure their financial advice benefits consumers. Positively this has increased the number of independent financial advisors.

Applying similar rules to third party tariff comparison services suggests they be made responsible for their energy advice. Perhaps new rules should examine providing consumers with compensation should the recommended tariff result in the consumer paying more than the cheapest tariff. While likely to be unpopular with tariff comparison service providers the suggestion aligns with the compensation awarded to consumers by the Victorian Government.

Conclusion

Suggesting “of course only engaged consumers benefit” is unfair. Electricity is an essential service and consumers must purchase it. Market failure has turned electricity pricing into a ‘game’. This game is rigged to ensure the majority of consumers end up losing. The game is not in the long term interest of consumers.

The statement is also out of touch with recent analysis finding the small minority of winners are increasing costs for all consumers. This analysis reveals any consumer wins have now turned into losses as Australian electricity retailers increase their operating costs well above global averages.

The statement also accepts retailers are free to penalise unengaged consumers. It overlooks the evidence the competitive market was responsible for placing many of these consumers on higher electricity tariffs (in order to recover fees paid to access these unengaged consumers).

The competitive retail energy market is new. No consumer education has been provided leaving the majority of consumers ill-prepared and uninformed. They are then bombarded with misleading advertising (discounts) and biased tariff comparison services (hiding commission fees) leading to their poor energy choices.

Steps are finally being taken to address the huge imbalance between ill-prepared and uninformed consumers and electricity retailers, who for too long have been allowed to set the rules. Regulatory approaches attempting to limit one misleading retailer sales tactic ultimately turns into a game of “Whack a Mole” with their marketing departments developing new equally dubious tactics.

The alternative is to make retailers responsible for consumer outcomes, an approach already shown to deliver consumer benefits.

Fiona Guthrie’s Ruby Hutchinson’s Memorial Lecture should be compulsory viewing for all consumer advocates. The suggestion we stop blaming consumers for market failures provides a strong framework for positive market development. One in which all consumers win.

Comments or Questions?

The author is happy to receive comments or questions about this article. He can be contacted at martin@drmartingill.com.au

Citation

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References

[linkedin.com/in/drmartingill](https://www.linkedin.com/in/drmartingill)

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About Dr Martin Gill

Dr Martin Gill is an independent consultant specialising in the provision of consumer advice based on a deep understanding of the Australian energy industry and strong analytical skills. As a consultant he has prepared advice for consumer advocates, government regulators, electricity distributors, electricity retailers, asset operators and equipment vendors.

He currently represents the interests of consumers on a range of Standards Australia committees including metering, renewable power systems, battery storage and demand management.

Dr Gill is a metering expert. During the National Smart Metering Program he facilitated the development of a specification for Australian smart meters. Innovative metering products developed by his teams have been externally recognised with the Green Globe Award, NSW Government's Premier's Award and Best New Product by the Australian Electrical and Electronics Manufacturers Association.