The power of choice?

Presentation by David Stanford to the Public Forum on the Australian Energy Market Commission's Directions Paper: *The power of choice – giving consumers options in the way that they use electricity*.

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Good morning

First of all I would like to thank the AEMC for inviting me to address this forum. At CUAC we are of the view that the outcomes of the demand side participation review offer substantial opportunity to improve the functioning of our energy markets. Additionally, there is substantial opportunity to increase the engagement of the demand side in Australian energy markets and both new and existing technologies present exciting opportunities. However, we caution that success is not simple and the approach to designing and implementing any market reforms will be fundamental to their success.

As you are aware, I work for an organisation called the Consumer Utilities Advocacy Centre or CUAC for short. **[SLIDE 2]** We were established by the Victorian government in 2002 as a vehicle for providing consumer input to ongoing energy and water market reform processes. We are Australia's only consumer organisation focused specifically on the energy and water sectors, and consequently we have developed an in-depth knowledge of the interests, experiences and needs of energy and water consumers. Our mandate is to represent all Victorian consumers. However, our focus is very much on the residential sector and our policy development always has regard to the needs of the most vulnerable community members.

In a review such as the DSP review, obviously incorporating the perspective of the demand side, consumers, is fundamental to achieving effective policy and regulatory outcomes. The success of energy reform, particularly as it relates to

customer participation and engagement, requires community involvement in the decision making process and community acceptance of the outcome. One does not need to search very hard for examples of where this has not occurred and the outcomes have, therefore, been poor.

The mandatory roll out of smart meters in Victoria is one example. This initiative, that was intended among other things to stimulate greater DSP, has been troubled from the start. In my view this is because it failed to incorporate a broad range of perspectives, including the views of the community, into the decision making process. The result has been widespread consumer antipathy to the new technology and the likelihood of cost increases resulting from meter refusals and policy uncertainty. Additionally, the likelihood of achieving the best policy outcomes on this issue in other jurisdictions is reduced. Nonetheless, the Victorian Government has certainly changed its approach to decision making on smart meters. Consumer views have become central to the process and policy outcomes are improving as a result. This change in approach to incorporate consumer views will not just help overcome the issue of community acceptance but it will also deliver policy outcomes that are more closely aligned with the public interest rather than any sectional interest. I should note that in CUAC's view the future success of the smart meter roll out will be dependent on:

- clear and accurate information to consumers devoid of "spin";
- the ability of consumers to access and engage with tangible benefits from the program; and
- appropriate policies to ensure that negative consumer impacts are appropriately accounted for and managed.

Happily, the Victorian Government has made clear commitments in relation to these issues and we look forward to working with them to ensure success.

This brings me to the issues raised in the AEMC's DSP 3 Directions Paper in relation to consumer participation, which is why I have been asked to present here today. The Directions Paper raises a number of really important issues that are fundamental to determining the appropriate response to ensuring consumer participation in a market with greater levels of DSP and DSP related services. The opening point in Chapter 4 of the directions paper that states

"consumers generally expect affordable, safe and reliable electricity services" is key to understanding the challenges associated with consumer participation and DSP. This is because, at present, this is all that most consumers want. Most have not really considered either the possibility that the energy market may offer them something more than this basic service level or that their own behaviour may have an impact on the continuing ability to deliver this outcome. Therefore, there is a tremendous challenge in raising the capacity of most consumers to a) understand the issues and the possibilities and b) to make consumption decisions that are both in their own interest and that of ensuring ongoing availability of affordable, safe and reliable supplies.

This is underscored by the research findings highlighted in the directions paper that illustrate:

- the low level of consumer interest in electricity;
- the lack of understanding of electricity pricing; and
- consumer desire for simple relevant and consistent information that is tailored to their personal needs and situation.

I will turn now to some recent research conducted by CUAC into the Victorian retail energy market that should further illuminate some of the issues. CUAC recently undertook research into Victoria's competitive retail market for energy and released the associated report *Improving energy market competition through consumer participation.* **[Slide 3]** As most of you would be aware, Victoria has removed retail price regulation and has a rate of retail customer churn that is one of the highest in the world. However, we were concerned that the actual market may not be meeting original expectations and that the consumer participation that was evidenced by the churn rates may not in fact be effective consumer participation. That is, while consumer participation may be occurring in a way, consumers are not necessarily making informed choices in their own interest.

From a survey of Victorian consumers we found that, in a nutshell, there was widespread uncertainty about how prices were set in the market and there were relatively low levels of understanding of energy offers and how to compare them. Furthermore, the research highlighted serious problems with the quality of information used by consumers in switching decisions, including

that provided online and by salespeople. Here are some extracts from the research findings:

- Despite the fact that retail prices have been deregulated for some time, 22 per cent of survey respondents thought that the government was responsible for energy price setting, and a further 33 per cent weren't sure. [**Slide 4]**
- 42 per cent of consumers indicated that they found it difficult to understand energy offers. Furthermore, over 30 per cent of consumers found it difficult to find and compare energy offers. **[Slide 5]**
- 37 per cent of consumers who had not changed energy providers indicated that the reasons were that it was "too hard to choose", "not worth the effort", or they "could not be bothered".

These findings were complemented with other research findings in relation to online price comparison and energy information services. We found that while some savings would usually be made through the use of such services, the offer information provided by all of the services reviewed (both regulator and privately operated) was either incomplete, out of date, incorrect, or some combination of these. Survey respondents also reported high levels of misleading marketing conduct among door to door sales people. For example, of the survey respondents:

- 14 per cent reported that the last salesperson they saw told them they were a representative of the Government;
- 16 per cent reported being told they had to change energy company;
- 26 per cent said that the salesperson had come for a reason other than to sell energy; and
- 31 per cent reported that the salesperson told them that the whole neighbourhood was changing energy provider.

These findings in the Victorian market are not incompatible with experience in other energy markets. One study from the UK market, for example, found that the quality of customer switching decisions in that market were virtually the same as if customers had selected an offer at random. **[Slide 6]** The problems with the effectiveness of consumer participation in the UK retail market have also been highlighted by Ofgem in their retail markets review. Both the UK

Government and Ofgem have started to introduce some fairly fundamental reforms to increase the effectiveness of consumer participation.

So what does all of this tell us and how is it of relevance to consumer participation in relation to DSP?

First it tells us that simply establishing a market for something won't result in effective consumer participation. In the case of the Victorian retail market many consumers simply do not seem to be particularly interested in the products and are not necessarily making effective choices. What the data does suggest is that Victorian consumers are switching suppliers at a relatively high rate.

Second, complexity and constraints on consumer capacity is a major factor in both consumer inclination and willingness to participate in markets. This point is illustrated particularly well in a classic study of consumer behaviour when confronted with multiple choices of jams. **[Slide 7]** Customers were far more engaged and likely to make a choice when confronted with a smaller selection of jams rather than a diverse selection. This finding seems to hold in energy markets and it is this finding that provides the basis for the question mark in the title of my presentation. There needs to be an acknowledgement of the limits of choice.

Third, the market will not necessarily be effective at providing information that is accurate, in the consumer interest and that supports effective decision making.

Consequently, the design of the market, the information or choice architecture of that market and the engagement of consumers will be important factors in its success or otherwise. This certainly applies to an energy market characterised by greater levels of DSP and DSP related services.

In designing an energy market with greater availability of DSP related services, a balance has to be struck between complexity and innovation. In designing features of the market, policy makers should seek to encourage a market which is sufficiently simple for consumers to make effective choices and not be overwhelmed by complexity to the point where they are disinclined to participate. The seeming inability of competitive retail energy markets to do

this without some form of regulatory intervention suggests to me that there is likely to be a role for government in setting the parameters of choice in an energy market that features greater accessibility to DSP related services.

The choice or information architecture is also important. In a relatively simple competitive retail market model that does not, as yet, feature time of use pricing or other products such as load control or smart technologies in home, information providers and marketers are failing to provide accurate information to consumers about the products on offer and which products may suit a particular consumer's needs. How will this be corrected in a more complex market featuring some of the tools and services intended to encourage DSP? It would seem that the incentives for the provision of disinformation, particularly in the presence of commission based sales, are still too great and the quality of information is therefore compromised. Effective consumer participation will only be achieved if this can be overcome.

Additionally, thought now needs to be given to the broad approach to ensuring that the capacity of consumers to participate in new market arrangements is sufficient. CUAC has often highlighted the need to conduct further education and awareness raising in the community around energy issues. We certainly see the benefits in developing a government funded broad based community education program on energy and the energy market. This should not only seek to raise consumer awareness of energy issues but also seek to make sense of the disparate and varied current information and education resources available in order to provide greater consistency

In relation to the specific questions posed in the chapter on consumer participation I would like to make some very brief points in the time remaining.

First, CUAC sees value in a centralised hub or portal for consumers to access consumption data. We see this as improving the information architecture by:

- providing a one stop shop for consumers.
- providing consumption data that is unadulterated with marketing messages and is independent of any market participant; and

- allowing consumption data to be effectively coupled with any information and education initiatives on energy that may be relevant to a particular consumer at a particular time.

Second, on the question regarding the costs of consumption decisions, we see a role for both education and technology. Education can play a role in increasing consumer understanding of the impacts their approach to energy use has on costs. Technology, in home devices for example, offer the potential to provide consumers with much more tangible signals and information on the costs of their consumption decisions. With appropriate protections in place, we see these technologies as playing a useful role in the market of the future.

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