

Dr Patrick Walsh
Chairperson
Essential Services Commission of South Australia
GPO Box 2605
Adelaide SA 5001

Marjorie Black House
47 King William Rd
Unley SA 5061

P. 08 8305 4222
F. 08 8272 9500
E. sacoss@sacoss.org.au
www.sacoss.org.au

ABN 93 197 662 296

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Dear Dr Walsh,

RE: ESCOSA's 2010 Review of Retail Electricity Standing Contract Price Path: Draft Inquiry Report & Draft Price Determination.

SACOSS welcomes the opportunity to provide a short submission to the Draft Inquiry Report and Draft Price Determination. This letter will not revisit SACOSS's perspectives on the details of the methodology used to set the initial building block elements or comment on the proposed price path in detail.

We believe there is a more fundamental issue at stake. It is SACOSS's view that the Commission has erred in assuming that:

"...there does not appear to be any special characteristics of standing contract customers which might justify stronger price protection under the standing contract."

This is an unacceptable premise on which to base the price path process given that ESCOSA does has evidence of a sizeable group of vulnerable, older customers that has never considered changing retailers. The consequent 'loosening' of price caps in order to foster more competition places this substantial group of consumers at risk of being unable to afford an essential service.

SACOSS believes it is appropriate to revisit "why the standing contract is important?" In our submission to the review of the RPP methodology in December 2009¹ we stated:

SACOSS has considered the contents of the Discussion Paper and the options presented, and has prepared the following response based on reflection of our basic principles for Essential Services:

- *All South Australians are entitled to reasonable access to sufficient quantities of essential services to maintain a healthy life.*
- *Reasonable access is to be considered in terms of unit prices, any other fees and charges as well as the terms and conditions of access imposed from time to time by private operators or government regulators.*

¹ A copy is available here: www.escosa.sa.gov.au/library/091207-EnergyRetailPriceMethodologyReviewSubmission-SACOSS.pdf

From a SACOSS perspective, the relevant questions stem from the role of the standing contract. The price setting essentially sets the 'price to beat' for market based contract offers and also defines arrangements for a form of 'universal access' in relation to the terms and conditions of contract – the non-price aspects. On this basis, the key question for SACOSS in response to this paper is: which of the options presented is likely to lead to a more affordable 'ceiling price'?

Our submission to the methodology review then went on to make the following statements in this regard:

According to the [methodology consultation] paper (with emphasis added to the salient points):

*... effective competition takes time to evolve, and transitional regulation of retail prices was imposed by the South Australian Government to **protect vulnerable customers** and ensure small consumers had **access to a basic standard of service at a reasonable price.*** (p17)

*... it is the Commission's view that the purpose of the standing contract price, for the regulatory period 2011 to 2013 for both electricity and gas, is to **provide price protection** for those South Australian customers who are, for whatever reason, unable or unwilling to participate in the energy retail market; while at the same time allowing for price flexibility to enable appropriate responses to significant changes in input costs. This approach will permit energy retailers to compete in the market and deliver to consumers the benefits of competition while at the same time protecting those who pay the standing contract price.* (p29)

Based on the view that the purpose of the Standing Contract price is to provide price protection for those unable or unwilling to participate in the energy retail market, it would be useful to understand the characteristics of the consumers who remain on the Standing Contract. Unfortunately little is published about these consumers.

Intuitively, it seems likely that those remaining on the Standing Contract have not moved house since the introduction of FRC in 2003. This is because the practice appears to be that when a customer moves house, the Standing Contract is not explicitly marketed, the preference being to highlight the benefits of Market Contracts. It is therefore likely that this cohort represents a significant proportion of the aged and low-income population.

The Commission's response to these issues appears in section 2.13 *The nature of standing contract customers* at page A-23 of the DRAFT Inquiry Report and Price Determination. The Commission states:

The Commission has sought to better understand the nature of electricity standing contract customers, to ascertain whether or not there are any special characteristics of this group of customers ... The Commission has examined this issue through a review of data obtained from previous SA energy customer surveys and from information provided by AGL SA ... There is no evidence to suggest that standing contract customers consist of a disproportionate number of vulnerable customers.

This is then qualified with a footnote (note 37, pA-24):

The Commission does not suggest that these outcomes have a high degree of statistical validity. It can, however, be more confident there is no evidence to suggest that there is a statistically valid difference between the characteristics of a standing contract customer and those of a market contract customer, given the results of the survey.

The ESCOSA Draft also re-states results from a commissioned survey from 2006 which states that 34% of standing contract customers receive the energy concession compared to 44% of market contract customers.

At page A-26 the Commission concludes:

This information suggests that there does not appear to be any special characteristics of standing contract customers which might justify stronger price protection under the standing contract.

This is contrary to the view expressed by SACOSS and held by many of our stakeholder members. SACOSS reiterates its previous concerns regarding a lack of understanding of consumer behaviour in relation to housing status and also in relation to metropolitan (Adelaide and the major country centres) and non-metropolitan locations. The December 2009 SACOSS submission to the Review of Retail Price Setting Methodology explained this further. The customer choice data provided in ESCOSA's publications consistently:

- fails to discern metro vs non-metro (for example MacGregor Tan's focus groups have drawn on major country centres not non-metro);
- fails to differentiate those who have moved house and those who have not (moving house and staying with AGL but only being offered a market contract should not constitute a consumer exercising 'choice' to leave the standing contract); and,
- regularly aggregates small business and residential into the number of customers on standing contracts.

SACOSS also feels that the Commission's view is not necessarily supported by the findings of ESCOSA's most recently released customer survey by consultants Colmar Brunton². The Survey identified a cohort of 22% of those surveyed that were classified under the consultant's 'behaviour stage profiling' as *Residents who had never considered changing providers*. To quote the Executive Summary of the report (p22 of 344) with emphasis added;

Residents who had never considered changing providers

22% of residents had never considered changing providers. While residents who had never considered changing providers were not differentiated by gender, they did tend to be older with 47% aged over 65 years including a significantly high incidence of being aged 75 years and older (24%). Aligned with this older age profile, residents who had never considered changing providers were more likely to be retired (51%), less likely to have children in the home (24%) and to have lower household incomes with a significantly high incidence of having incomes of \$25,000 and under per year (35%). This group also tended to have achieved lower levels of education with a significantly large proportion with high school as their highest academic achievement (58%).

² Available from www.escosa.sa.gov.au/projects/154/customer-survey-monitoring-the-development-of-energy-retail-competition-in-sa-and-consumer-preference-for-market-contract-information.aspx

35% of this group had only electricity which is similar to residents generally. They did, however, have a higher incidence of receiving a State Government Energy concession (48%). This group had a significantly lower incidence of being confident that they would know how to change energy providers if they wanted to (61%). While 32% of this group indicated that nothing would increase their confidence to change providers, 27% would need to know that they could get a better rate, price or deal.

The consultants also profiled other cohorts who had not changed their electricity provider (although this is not the same as being on the standing contract, as many market contracts are also held by AGL SA). These other groups had either thought about it or sought more information and chose not to switch. The combined size of these groups was a similar 22%.

It was also of interest to read that the cohort profiled as ‘residents who had sought information but not changed providers’;

“... had a significantly high incidence of having achieved an undergraduate or tertiary degree (44%). A significantly large proportion of this group had gross household incomes of more than \$100,000 per year (25%).”³

The Commission might choose to consider whether this group and those discussed previously have ‘averaged out’ in previous work.

In summary, the Colmar Brunton survey analysis suggests the existence of a substantial subset of those on standing contracts who are older, poorer and less well educated than other consumers. This is certainly an indicator that there is a sizeable group of vulnerable customers that are ‘stuck’ to the standing contract. It is also in direct contradiction of the Commission’s stated view⁴ that:

“... there does not appear to be any special characteristics of standing contract customers which might justify stronger price protection under the standing contract.”

The DRAFT Inquiry Report and Price Determination references the Colmar Brunton work at page A-52 and refers to this group as “sticky residential customers who are less amenable to churn”. The report goes on to say:

“... it is difficult for the commission to ascertain whether or not the majority of residential customers on a standing contract are made up of these “sticky customers”

The “sticky customers” are then only discussed in the context of whether AGL SA’s forecasts of churn are reasonable, not whether or not the Commission intends to overcome these difficulties. This is a disappointing approach to the interests of consumers.

In relation to the balance of the ESCOSA document, SACOSS notes that elements of its June 2010 submission have been considered.

Regarding wholesale energy costs, SACOSS would like to reiterate its stated concern to AGL SA’s ‘stand alone cost approach’ and notes ESCOSA’s commitment to investigate the

³ Colmar Brunton p24

⁴ Draft Determination page A-26

implications of extending the analysis to the total customer load (page A-69). SACOSS will monitor the results of this investigation with interest.

Regarding retail operating costs (ROC), SACOSS reiterates that the arguments presented for an increase in ROC are unconvincing. At page A-96 the Commission states its view that the AGL SA proposed ROC is 'reasonable' considering their consultant's analysis of benchmarks in other jurisdictions.

SACOSS can only say that this is the sort of self-fulfilling regulatory approach that has undermined the credibility of energy market regulation for years. No doubt some other entity will now cite the ESCOSA decision as justification in a future decision elsewhere. Despite pages of discussion it would appear that AGL SA has simply been given the benefit of the doubt. There is no efficiency dividend for consumers.

In conclusion, SACOSS feels that, on review of the DRAFT Inquiry Report & Draft Price Determination, AGL has been given a generous opportunity to set an increased standing contract price by being given the benefit of the doubt whenever the Commission has been unable to unequivocally refute a proposal. The Commission has set the scene for allowing such an approach by stating that

" ... there does not appear to be any special characteristics of standing contract customers which might justify stronger price protection under the standing contract."

SACOSS feels that this is not a defensible position given the evidence of vulnerability of a cohort of 'sticky customers' and that this process will lead to a very poor outcome for a substantial group of consumers. Industry stakeholders have repeatedly called for the removal of price controls in SA, as has been recommended by the AEMC. The DRAFT determination by the Commission is a very close approximation of exactly that.

SACOSS believes this process should proceed with great caution.

Sincerely,

A handwritten signature in black ink, appearing to read 'Ross Womersley', with a large, sweeping flourish at the end.

Ross Womersley
Executive Director

This project was funded by the Consumer Advocacy Panel (www.advocacypanel.com.au) as part of its grants process for consumer advocacy projects and research projects for the benefit of consumers of electricity and natural gas.

The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel or the Australian Energy Market Commission.