



Power Transformed

Unlocking effective competition and trust in the transforming energy market



July 2016

Acknowledgements

Consumer Action would like to thank the people who assisted us in the production of this report.

Our sincerest thanks go to the members of the Demand-side Energy Reference Group, whose discussions and advice directly informed the development of this report. We thank Ben Burge, Ian Clyde, Mark Feather, Michelle Groves, Gabrielle Kuiper, Chris Murphy, Tim Nelson, Larissa Nicholls, Lara Olsen, Melissa O'Neill, Stuart Richardson, Rosemary Sinclair, Paul Smith, Chris Spangaro, Yolande Strengers, Dean Van Gerrevink, Tony Wood and David Young for the contribution of their time, ideas and advice. We also thank Ross Wyatt for his skilful facilitation of Reference Group meetings.

We also warmly thank Philip Cullum and Gabrielle Kuiper for peer reviewing this work.

We especially wish to thank Andrew Reeves for his wisdom and guidance in chairing the Demand-side Energy Reference Group, and contributing his expertise to the development of this report.

Disclaimer

This project was funded by Energy Consumers Australia (www.energyconsumersaustralia.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 Energy Consumers Australia.

Chair's foreword



“...it is inevitable that consumers will make decisions that are less than optimum and, in some cases, to their detriment.”

The rapid development of new technology in electricity supply is disrupting the traditional means of delivery of this essential service. As in other sectors, the consumer is at the heart of these changes and consumer choice will, as never before, determine the service and mix of technology to meet each need.

But such a shift involves risk for the consumer and for the community. With imperfect information systems it is inevitable that consumers will make decisions that are less than optimum and, in some cases, to their detriment. There is consequently a risk of over-reaction by consumers choosing not to participate, or by policy makers creating barriers to technological transformation to avoid harm. There is the prospect though, of a longer term harm as a result of continuing investment in redundant systems, or by over-investment in new systems and early redundancy of existing and useful facilities.

The challenge for policy makers is to facilitate innovation while maintaining the community's confidence in the long term benefits of change. Effective competition is central to the drive for greater efficiency, but competition can only be effective if consumers are confident and actively engaged. Maintaining the confidence of the community includes identification of the risks and instituting appropriate protection measures.

Research on the implications of the electricity transformation has until recently focussed largely on the technical, environmental and economic aspects of these changes.

“This Report represents the first documentation of consumer issues and strategies in the evolving energy market.”

There has been little research that addresses the transformation from a consumer perspective. The Consumer Action Law Centre has recognised the complexity of these issues and, as a leading advocate, initiated public consideration of the consumer implications through its 2014 study *Smart Moves for a Smart Market*.

In recognition of the need for a broad perspective to advance this work, Consumer Action proposed a Reference Group of thought-leaders in government, sectors of the supply industry and consumer advocates to explore these issues. The Reference Group held a series of workshops, canvassing contributions from leading experts in the financial services and telecommunications sectors that had experienced, or are experiencing, similar challenges. In addition, discussions were informed by the insight that behavioural economics is bringing on how consumers make decisions on complex matters, and how policy makers and regulators may influence outcomes.

Each of the Reference Group members volunteered their valuable time because of the importance of the timing and scope of the research. At the commencement of the project there was little attention to the consumer implications, but this has now changed and this work will be of considerable interest to policy makers. This Report represents the first documentation of consumer issues and strategies in the evolving energy market. It does not provide all the answers we need for a full regulatory and policy response to the issues faced by consumers in the new market, but it does provide a foundation to start this important work. And importantly, it provides a blueprint for whole-of-sector collaboration as we work together to take this important work forward.



Andrew Reeves

Chair, Demand-side Energy Reference Group

Executive Summary

Australia's Energy Market Challenge

Australia's energy market is rapidly evolving. Deregulation and reform to increase competition have given consumers more choice and created the platform for innovation. At the same time, rising energy prices over recent years have given people the impetus to look for new solutions and plummeting technology costs have unleashed the opportunity for people to choose cheaper, more personalised and more innovative energy products and services.

Like many markets before it—including entertainment, accommodation and telecommunications—transformation in the energy market will provide people with the opportunity to find products and services that better meet their personal preferences and needs, allowing them to benefit from lower costs, higher utility or both. Effective competition and meaningful choice is good for consumers, and many people will find better deals and greater satisfaction.

With this evolution, the role of the energy consumer is fundamentally shifting. Consumers will need to navigate an array of choices and a web of relationships to source the supply and demand technologies and services that best suit their needs.

However, this is likely to create real challenges for many people. It is well established that 'human decision-making markedly deteriorates as the amount or complexity of information increases.'¹ Rather than assessing all available information against their needs and making decisions in response to price signals that leave them better off, consumers use shortcuts and rules of thumb to make decisions. In cases of extreme complexity or choice, they frequently even fail to make a decision at all.²

¹ Stenner, K., Frederiks, E., Hobman E.V., and Meikle, S. (2015). *Australian Consumers' Likely Response to Cost-Reflective Electricity Pricing*. CSIRO, Australia. Page 16.

² Frederiks, E.R., Stenner, K. and Hobman, E.V. (2015). *Household Energy Use: Applying behavioural economics to understand consumer decision-making and behaviour*. *Renewable and Sustainable Energy Reviews* 41, 1385-1394.

The challenge Australia's energy market now faces is that effective competition, innovation and market efficiency require informed consumer participation, but evidence shows that consumers are not engaged in the energy market³ and don't make the decisions expected of them.⁴

To unlock the full potential of recent energy market reforms, consumer benefit must be prioritised to build their trust and engagement. The foundation of further market reform must be:

How can we enable good consumer outcomes in the transforming electricity market for effective competition and innovation?

The Demand-side Energy Reference Group

Addressing the challenge requires a concerted whole-of-market response at the structural, regulatory and product level. Consumer Action therefore established the Demand-side Energy Reference Group (**Reference Group**) of leaders from across the energy sector in early 2015.

The Reference Group worked with Consumer Action to explore the role of, and implications for, consumers in a transforming energy market. Together, we considered responses that could enable better consumer outcomes and build their trust in the energy sector, as a precondition for market benefit and effective competition. For the membership and methodology of the Reference Group, see the Appendix to this report (page 39).

The positions put forward in this report were informed by discussions of the Demand-side Energy Reference Group. They do not, however, necessarily reflect the views of Reference Group members or their organisations.

Confident Consumer Participation and Trust

Innovation and competitive markets 'increase the prosperity and welfare of Australian consumers'⁵ whose long-term interests remain at the heart of competition policy and reform. For competition to thrive, and deliver efficient costs, consumers need to be willing to participate, perceiving the benefits of participation to outweigh the costs. Effective consumer participation is therefore based on trust that the market will deliver the outcomes they expect in terms of service, quality and price.

People 'use trust as a simple decision-making heuristic when assessing risk and making cost-benefit appraisals'.⁶ As the complexity of the market increases, people's reliance on heuristics (or decision-making shortcuts) becomes more prevalent. Strong levels of trust are therefore critical to consumer participation and effective competition.

Trust in the energy market, or individual energy companies, will influence how people respond to the risks of the new energy market⁷— willingness to participate will increase with greater trust that the company will deliver the expected outcome or has the consumer's best interests at heart.

³ In a recent survey, Accenture found that only 9% of consumers trust their energy provider. Accenture (2014). *The Balance of Power: Why Australian utilities need to defend, delight and disrupt*.

⁴ Frederiks, E.R., Stenner, K. and Hobman, E.V. (2015). *Household Energy Use: Applying behavioural economics to understand consumer decision-making and behaviour*. Renewable and Sustainable Energy Reviews 41, 1385-1394.

⁵ Australian Competition and Consumer Commission. <https://www.accc.gov.au/about-us/australian-competition-consumer-commission/about-the-accc> (viewed 10 December 2015)

⁶ Frederiks, E.R., Stenner, K. and Hobman, E.V. (2015). *Household Energy Use: Applying behavioural economics to understand consumer decision-making and behaviour*. Renewable and Sustainable Energy Reviews 41, 1385-1394.

⁷ Frederiks, E.R., Stenner, K. and Hobman, E.V. (2015). *Household Energy Use: Applying behavioural economics to understand consumer decision-making and behaviour*. Renewable and Sustainable Energy Reviews 41, 1385-1394.

Trust must therefore be at the core of efforts to enable good consumer outcomes in Australia's transforming energy market, and the foundation for effective competition and innovation.

Unnecessary consumer detriment will undermine this trust. The innovative products and services available in Australia's energy market are already creating challenges as new business models push the boundaries of the existing market, and consumers carry the burden of risk—Consumer Action is already witnessing a rise in complaints about solar sales and installations (Case Study 3, page 21). In a significantly more diverse and innovative energy market, the potential for detriment is increased, as consumers face more novel products and choices, and the risks that come with them.

Consumer detriment may arise for a wide range of reasons, from minor disputes, through to significant technical failures or exclusion from the market.⁸ However, not all detriment is equal and not all require treatment. In fact, sometimes detriment can be a catalyst for innovation and better consumer outcomes. The market itself is self-correcting. Those businesses and models that do not deliver good consumer outcomes will fail in time, but there is the risk of harm and damage to trust that may be avoided with foresight.

Some detriment may create barriers and poor outcomes for people trying to engage with the new energy market. This detriment (Table E1) can be attributed to three key sources:

- variability in regulatory requirements as new business models enter the market (e.g. some consumer protections which apply to conventional services do not currently apply to emerging services);
- information asymmetries (there are greater unknowns with new technologies); and
- a legacy of reliance on disclosure, even though it is acknowledged that greater disclosure of complex information does not assist consumers to make better decisions.

If addressed, more effective competition would be unlocked through the confident participation of consumers.

Building Trust in Australia's Energy Market

Capturing the benefit of innovation and increased competition relies on confident consumer participation, and building consumer trust. In achieving this, policy-makers, regulators and energy businesses will need to weigh up competing interests and navigate an array of trade-offs to find practical responses that achieve the goal of facilitating strong innovation while appropriately supporting consumers.

Trade-offs that are already impacting on decision-making in the energy market include:

- **The Opportunity Trade-off:** balancing unlocking immediate opportunity with managing risk to consumers and the market
- **The Temporal Trade-off:** balancing the interest of consumers today with the interest of future consumers
- **The Individuality Trade-off:** balancing benefits to individuals with benefits to society
- **The Delivery Trade-off:** balancing the rate of change to achieve greater economic efficiency with meaningful consumer engagement and equitable social outcomes.

Building consumer trust through good practice and good intent is in the best interests of market participants – who will benefit from greater consumer engagement and loyalty – and the operation of the market itself, which will become more efficient as consumers become more engaged and better informed. It is therefore fundamental to the strong operation of an innovative Australian energy market that the needs of consumers are prioritised.

⁸ Westmore, T. and Berry, L. (2014). *Emerging Energy Services – Issues for Consumers: awareness, engagement and protection*.

Table E1: Potential detriment for consumers in the new energy market

Detriment	Example
1. Lack of access to basic consumer protections	Many new products and services may fall outside of the current regulatory framework, and protections that ensure a right to supply, hardship arrangements and access to Ombudsman schemes may not apply
2. Buck-passing and blame shifting	When disputes arise in new products and services which may require a network of relationships to deliver, the potential for buck-passing and blame shifting between parties is high
3. Mis-selling	As products get more complex, some companies may turn to sales tactics relying on product complexity to mask inappropriate or unsuitable products and services
4. Poor decision-making	Consumers may find it difficult to make decisions in their own interests when the number of choices, and complexity of those choices, increases
5. Long lock-in contracts	Long lock-in contracts (e.g. 15 years for a solar lease) reduce consumer choice and flexibility
6. Complex financing tools	New financing arrangements for products and services (e.g. solar leases and power purchase agreements) are complex and may include unclear costs and inconsistent regulatory oversight
7. Inability to access the new market	Some consumers may face systemic barriers to participation in the new, personalised electricity market; this may include those with low incomes, poor literacy skills, language barriers and renters
8. Difficulty comparing products and services	Bundled products and services which are increasingly marketed to individuals based on their personal usage profiles may become difficult to compare where inclusions, exclusions and terminology differ
9. Market failure due to segmentation	Downward pressure on energy prices through mass market competition may be undermined in a market where retailers can increasingly identify and target active, affluent households with individual deals
10. Exclusion through complexity	People who could benefit from switching to new products and services may not engage if information and price signals are too complex, or the reason for participating is not clear
11. Hardship in off-grid scenarios	Off-grid households may experience reduced supply or loss of supply if they fall into hardship, or during a dispute with their technology provider
12. Reduced choice in off-grid communities	Consumers in off-grid communities may have reduced ability to choose their preferred electricity provider and may face higher costs where retail competition is reduced

Different people will have different needs in the new energy market. Strong innovation policy may be sufficient to support some, while others may be more reliant on effective competition, clear education campaigns, or more traditional essential service regulation to continue to get fair and affordable energy supply in a decentralised and tech-heavy energy market.

To support the needs of all consumers, it is therefore important to:

- Provide meaningful information and choices which take into account real consumer decision-making biases;
- Ensure the adequacy of consumer protections across all products and services; and
- Share the benefits of energy market innovation across the whole community, including the vulnerable demographics who may face barriers to accessing new products and services.

Energy businesses and governance institutions are best placed to develop the initiatives and interventions that best fit their business practices or jurisdictions, while providing improved consumer outcomes. However principles are required to guide these developments, to ensure that enabling better consumer outcomes and trust are embedded in the development of products, services and regulations.

Based on the evidence of consumer experience, decision-making biases and responses to complexity in other markets presented in this report, there are three simple principles that are required to guide all further market reform and innovation:

UNLOCKING EFFECTIVE COMPETITION

PRINCIPLE 1: It should be easy for people to engage to make effective decisions

PRINCIPLE 2: Appropriate consumer protections are applied to all energy products and services

PRINCIPLE 3: The benefits of the transforming energy market should be shared across the whole community

These principles provide a competitively neutral, balanced and fair platform to underpin further development of Australia's energy market, ensuring consumers can make good decisions, get the expected outcomes and trust their rights when things go wrong. They must be adopted widely across the energy market, to ensure the success of energy market reforms and underpin effective competition.

While giving effect to the principles must primarily be the responsibility of energy businesses and governance institutions, the experience of the Demand-side Energy Reference Group is that there are strong benefits to taking a whole-of-sector approach that considers the expertise and perspectives of a range of different market participants, including consumers. New approaches that enable better consumer and market outcomes, regardless of the trajectory of innovation or the ultimate regulatory structure, are needed. These 'no-regrets' solutions will be critical to efficient competition in the evolving energy market.

From a consumer perspective, no-regrets initiatives that could be adopted in the short to medium-term include:

1. Testing the need for, and form of, market interventions against real consumer decision-making.
2. Ensuring adequate access to justice by expanding the jurisdiction of energy Ombudsman schemes.
3. Requiring energy service providers to identify the consumer's purpose in acquiring a service, to ensure it is appropriate.
4. Identifying programs to assist vulnerable demographics access new products and services.
5. Targeting concessions to address need rather than tying them to specific supply arrangements.

1. Consumers in a Complex Market

Australia's energy market is rapidly evolving. Low trust in the energy market and rising energy prices over recent years have driven people to look for new solutions, while plummeting technology costs have unleashed the opportunity for people to choose cheaper, more personalised and more innovative energy products and services. A greater focus on reducing energy consumption and energy emissions to address climate change has also driven some people to seek out cleaner energy options.

At the same time, deregulation and reform to increase competition have given consumers more choice and created the platform for innovation. Together with the restructuring of Australia's economy, these dynamics have unlocked unprecedented innovation and the greatest disruption to the electricity supply industry in its history.

Like many markets before it—including entertainment, accommodation and telecommunications⁹—the transforming energy market will provide people with the opportunity to find products and services that better meet their personal preferences and needs, allowing them to benefit from lower costs, higher utility or both. Effective competition and meaningful choice is good for consumers, and many people will find better deals and greater satisfaction in this market.

With this evolution, the role of the energy consumer is fundamentally shifting. Households have traditionally been the end of a vertical supply chain—the new market puts the emphasis on people to be energy managers in their own right. Consumers will navigate an array of choices and a web of relationships to source the supply and demand technologies and services that best suit their needs. Increasing choice however, will create new challenges for people, whose need for secure, reliable and affordable energy is essential to health, wellbeing, economic participation and social inclusion.

New challenges are also arising for the energy market itself. Rapid transformation has introduced significant uncertainty about consumption patterns and the future mix of generation technologies. For example, detailed modelling of the 2050 Australian energy market published in 2013 by the CSIRO assumed storage

⁹ Notable examples include iTunes, Spotify, AirBnB, smart phones and Uber.

costs would fall by 50% from 2010 levels by 2030.¹⁰ Prices in fact decreased by 50% in the following two years alone, driven largely by the release of Tesla's low-cost Powerwall.¹¹ It seems the only things that *are* certain in the new market are that there will be more choice, more market participants and less predictability.

There is, however, another certainty in this market of shifting dynamics. It is well established that 'human decision-making markedly deteriorates as the amount or complexity of information increases.'¹² Rather than assessing all available information against their needs and making decisions in response to price signals that leave them better off, consumers use shortcuts and rules of thumb to make decisions. In cases of extreme complexity or choice, they frequently fail to make a decision at all, even if it would materially benefit them to do so.¹³ In the face of a rapid expansion of choices and complexity in energy products and services, it is certain that consumers will not behave as rational economic entities. Rather, they will engage sporadically as life events or bill shock compel them and will use shortcuts to decide between products or services that may (but are not guaranteed to) meet their needs.

It is vital to effective consumer participation and competition that consumers are able to easily engage to get the services they desire, and trust that the market will deliver the outcome they expect. While consumers have always been the end point of the energy supply chain, consumer engagement has not always been a priority of the energy market.

The challenge Australia's energy market now faces is that effective competition, innovation and market efficiency require informed consumer participation, but evidence shows that consumers don't trust, and are not engaged in, the energy market.¹⁴ Moreover, people don't make the decisions expected of them, almost always preferring the status quo¹⁵ and feeling that choices in the energy market are too confusing, too much 'hassle' or not genuine as the products all seem the same.¹⁶ This creates an inertia within the energy market which is hard to overcome.

To unlock the full potential of recent energy market reforms, consumer benefit must be prioritised to build their trust and engagement.

There will not be a silver bullet that can deliver rapid and effective transformation with optimal outcomes for all market participants. Addressing the challenge will require a concerted whole-of-market response at the structural, regulatory and product level.

Throughout this, policy-makers will need to navigate an array of trade-offs between competing objectives to guide the transition in the short-term, and the structure of the future market in the long-term interests of consumers. Trade-offs include:

- **The Opportunity Trade-off:** unlocking opportunity vs managing risk
- **The Temporal Trade-off:** the interest of customers today vs the interest of future customers

¹⁰ CSIRO (2013). *Change and Choice: The Future Grid Forum's analysis of Australia's potential electricity scenarios to 2050*.

¹¹ Parkinson, G (2015). *Tesla already forcing down battery storage prices in Australia*. RenewEconomy, 9 June 2015.

<http://reneweconomy.com.au/2015/tesla-already-forcing-down-battery-storage-prices-in-australia-57681>

¹² Stenner, K., Frederiks, E., Hobman E.V., and Meikle, S. (2015). *Australian Consumers' Likely Response to Cost-Reflective Electricity Pricing*. CSIRO, Australia. Page 16.

¹³ Frederiks, E.R., Stenner, K. and Hobman, E.V. (2015). *Household Energy Use: Applying behavioural economics to understand consumer decision-making and behaviour*. Renewable and Sustainable Energy Reviews 41, 1385-1394.

¹⁴ In a recent survey, Accenture found that only 9% of consumers trust their energy provider. On average consumers only engage with their provider for 12 minutes a year and over half have not engaged with their provider at all for over a year. Approximately 70% of customer interactions at the time were negative. Accenture (2014). *The Balance of Power: Why Australian utilities need to defend, delight and disrupt*.

¹⁵ Frederiks, E.R., Stenner, K. and Hobman, E.V. (2015). *Household Energy Use: Applying behavioural economics to understand consumer decision-making and behaviour*. Renewable and Sustainable Energy Reviews 41, 1385-1394.

¹⁶ Ben-David, R. (2015). *If the retail energy market is competitive then is Lara Bingle a Russian Cosmonaut?* <http://www.esc.vic.gov.au/wp-content/uploads/esc/fc947897-7d4f-4772-97c9-959e3baad0db.pdf>

- **The Individuality Trade-off:** a market to benefit individuals vs a market to benefit society
- **The Delivery Trade-off:** achieving rapid economic efficiency vs achieving meaningful consumer engagement or equitable social outcomes.

This report highlights the role of consumers in the current market transformation, using evidence of their behaviour in complex markets to identify principles for fostering the trust necessary to underpin effective competition in a modern Australian electricity market.

1.1. Purpose and Scope

Power Transformed addresses the fundamental question:

How can we enable good consumer outcomes in the transforming electricity market for effective competition and innovation?

In the context of the challenge the energy market faces, 'good consumer outcomes' include:

- Ensuring safe and fair products and services;
- Providing simple, clear and consistent information;
- Providing easy and equitable access to services;
- Providing free and simple dispute resolution processes; and
- Ensuring that the efficiency from innovation benefits consumers.

Enabling good consumer outcomes will require action at many levels, and this will take time. However, while broader reform challenges will need to be addressed through a 'top-down' assessment of the regulatory structures required to support effective competition in the new energy market, energy policy-makers need to provide a pathway in the short-term towards better consumer outcomes and more effective competition. This report looks specifically at this shorter-term 'bottom-up' challenge.

By assessing the implications of electricity market transformation for consumers, and the risks of consumer detriment, we have identified key policy principles that will foster good outcomes for consumers and build trust and efficient competition in Australia's energy market (see Chapter 4).

1.2. The Demand-side Energy Reference Group

Addressing the complex challenge of consumer trust and participation in the new market requires a whole-of-sector response. Consumer Action therefore established the Demand-side Energy Reference Group (**Reference Group**) of leaders from across the energy sector in early 2015.

The Reference Group worked with Consumer Action to explore the role of, and implications for, consumers in a transforming energy market. The Reference Group considered responses that could enable better consumer outcomes and build their trust in the energy sector, as a precondition for market benefit and effective competition. For the membership and methodology of the Reference Group, see the Appendix to this report (page 39).

The positions put forward in this report were informed by discussions of the Demand-side Energy Reference Group. They do not, however, necessarily reflect the views of Reference Group members or their organisations.

2. The Market Challenge

2.1. Australia's Energy Market

Australia's energy market was established to provide Australians with reliable, low cost energy from our abundant fossil fuel resources. Energy was consumed by households and businesses at the end of one-way transmission and distribution networks, often over long distances from where it was generated. This model was the foundation for the growth of Australia's manufacturing industry, and has provided households with relatively cheap, secure and reliable electricity for decades.

We are now seeing a profound disruption to the traditional energy market model. This disruption is challenging the regulatory structures of the National Electricity Market, which were designed for a very different market.

More specifically, greater innovation and competition is generating myriad new energy technologies, for both consumers' energy supply and demand. These new technologies and business models don't fit neatly into the existing regulatory or legislative structures. They create both challenges *to* the regulatory framework (e.g. by pushing the boundaries of what we define as an energy supplier), and challenges *within* the regulatory system (by creating new products that don't fit within current regulatory frameworks). What's more, the rate of change in the market as innovation gathers pace is outstripping the regulatory system's ability to keep up. The needs of market operators in this new paradigm have changed, and the traditional market structures need to change to deliver.

At the same time, the *Power of Choice* reforms¹⁷ have started to put the emphasis on consumers to drive energy market evolution. Consumers will increasingly have to decide between an array of novel products and services to find those that best meet their needs, thereby delivering efficient market outcomes. Good market outcomes are dependent on informed and active consumer participation.

Finding a balance between supporting innovation and supporting consumers in a changing market place with new risks will need an assessment of the appropriate regulatory and governance structures to deliver a fair

¹⁷ Australian Energy Market Commission. <http://www.aemc.gov.au/Major-Pages/Power-of-choice> (viewed 25 May 2016).

and innovative energy market in the long-term interests of consumers. Regulatory reform and renewal is likely, and will understandably take time.

However in the interim, innovation will continue and accelerate. New products and services bring new risks and new potential for poor consumer outcomes. Building informed consumer choice and participation to unlock efficient market outcomes depends on consumers being able to trust the market from the outset. The challenge is to build consumer trust through the transformation.

2.2. The Importance of Trust

Innovation and competitive markets ‘increase the prosperity and welfare of Australian consumers’¹⁸ whose long-term interests remain at the heart of competition policy and reform. For competition to thrive, and deliver efficient costs, consumers need to be willing to participate, perceiving the benefits of participation to outweigh the costs. Effective consumer participation is therefore based on trust that the market will deliver the outcomes they expect in terms of service, quality and price.

People ‘use trust as a simple decision-making heuristic when assessing risk and making cost-benefit appraisals’.¹⁹ As the complexity of the market increases, people’s reliance on heuristics (or decision-making shortcuts) becomes more prevalent. Strong levels of trust are therefore critical to consumer participation and effective competition.

Conversely, if trust in a market is eroded, competition suffers. For example, energy customer churn driven through dissatisfaction (a lack of trust) is costly and inefficient, requiring significant investment to win back customers or attract new customers to replace them. Churn through willing selection of a product that better suits your needs or willingness to pay, however, is efficient and drives cost-effective innovation. As noted by Ross Gittins:

“Market economies run best on widespread trust: mutual trust between... businesses and their customers. Allow declining standards of behaviour to erode trust and the economy suffers. Customers become harder to persuade, argue more with counter staff, are surlier with call-centre staff and more inclined to take their business elsewhere. They resist ‘upselling’. With less trust you waste a lot of money on increased security in its many forms. And governments react by multiplying laws and legal requirements.”²⁰

Ultimately, trust consists of two simple elements:

1. The competence to deliver; and
2. Good intent (or having values that are aligned with the consumer’s).²¹

In the energy market, consumers simply want ‘their energy supplier to deliver predictable outcomes and to serve their best interests’.²² Trust in the energy market, or individual energy companies, will influence how people respond to the real or perceived risks of the new energy market²³—people’s willingness to participate will increase with greater trust that the company will deliver the expected outcome or has the consumer’s best interests at heart.

¹⁸ Australian Competition and Consumer Commission. <https://www.accc.gov.au/about-us/australian-competition-consumer-commission/about-the-accc> (viewed 10 December 2015).

¹⁹ Frederiks, E.R., Stenner, K. and Hobman, E.V. (2015). *Household Energy Use: Applying behavioural economics to understand consumer decision-making and behaviour*. *Renewable and Sustainable Energy Reviews* 41, 1385-1394.

²⁰ Gittins, R (2016). *We all pay the price when businesses break our trust*. The Canberra Times, 22 March 2016.

<http://www.canberratimes.com.au/comment/we-all-pay-the-price-when-businesses-break-our-trust-20160321-gnnyho.html>

²¹ Greenberg, M.R. (2014). *Energy policy and research: The underappreciation of trust*. *Energy Research and Social Science* 1, 152-160. Ernst and Young (2013). *In Utilities we Trust? How can energy providers win back the trust of their customers?*

²² Ernst and Young (2013). *In Utilities we Trust? How can energy providers win back the trust of their customers?*

²³ Frederiks, E.R., Stenner, K. and Hobman, E.V. (2015). *Household Energy Use: Applying behavioural economics to understand consumer decision-making and behaviour*. *Renewable and Sustainable Energy Reviews* 41, 1385-1394.

Trust must therefore be at the core of efforts to enable good consumer outcomes in Australia's transforming energy market, and the foundation for effective competition and innovation.

2.3. Consumer Trust in Transforming Markets

The energy market is not the first market in Australia to grapple with digital disruption, rapid transformation or complexity.

In recent years Australia's telecommunications industry has undergone significant change as smart phones, online services and demand for mobile data have become the norm. The resulting complexity of products and services has undoubtedly provided consumers with beneficial choice, and many have found products and services that better suit their lifestyles. However, increasing complexity also eroded consumer trust in the market, as people found it difficult to understand the products they were signing up to. In response to this challenge, the telecommunications sector has already undergone significant reform to prioritise good consumer outcomes (Case Study 1, page 17).

Innovation and complexity in the financial services market also makes it challenging for consumers to navigate in search of products or services that meet their needs. Successive reviews in the financial services sector have sought ways to deal with this complexity and make the sector more trustworthy for consumers (Case Study 2, page 19). The recent Murray Financial Systems Inquiry recognised the significant potential for consumer detriment in this complex market, including fair treatment of consumers as a key theme in the Inquiry report and recommendations:

*"Fair treatment occurs where participants act with integrity, honesty, transparency and non-discrimination. A market economy operates more effectively where participants enter into transactions with confidence they will be treated fairly... This includes providing consumers with clear information about risks; competent, good-quality [services] that takes account of their circumstances; and access to timely and low-cost alternative dispute resolution and an effective judicial system."*²⁴

2.4. Consumer Trust in the Energy Market

The disruption of the energy market is not as far progressed as that experienced by the telecommunications sector, and the complexity of products and services is yet to reach that of some financial services. However, mass-scale energy market disruption and complexity in products and services (or the relationships required to engage and maintain them) is underway. This has the potential to create challenges and poor outcomes for consumers, undermining trust and the benefits of innovation.

For example, the mandated rollout of smart meters in Victoria undermined consumer trust in the energy market which has had flow on implications for adoption of smart meters in other States. The rollout introduced a relatively complex new product into all Victorian households, which they were required to pay for without understanding the benefits.²⁵ The benefit smart meters can unlock for consumers was not explained to households ahead of or during the rollout, nor were the material benefits for households realised following it. To date, the benefits have primarily flowed to industry.²⁶ As a result, consumers don't trust smart meters, and they have become unpopular. Some consumers, albeit a small proportion, have even

²⁴ Commonwealth of Australia (2014). *Financial System Inquiry Final Report*. <http://fsi.gov.au/publications/final-report/> Page 6.

²⁵ Meter costs were presented as a line item in electricity bills.

²⁶ Victorian Auditor General's Office (2015). *Realising the Benefits of Smart Meters*. <http://www.audit.vic.gov.au/publications/20150916-Smart-Meters/20150916-Smart-Meters.pdf>

refused to have a meter installed. Uptake of time of use pricing, which smart metering facilitates, has also been extremely low, despite the benefits to some customers.²⁷

Subsequent political concern about risks to consumers from energy market reform has further limited the pace of innovation, with the Victorian government recently announcing that cost-reflective network tariffs may only be 'opt-in' in Victoria.²⁸ This means that consumers will need to choose such a tariff by making an active choice of a new plan through their retailer. The concern with mandating cost-reflective network tariffs, even though they may encourage innovation to support household adaptation, was that forcing a price change on households would result in challenges similar to those experienced during the mandated smart meter rollout.

The energy market can learn from past experiences and those of other transforming markets to enable good outcomes for Australian households, by building trust with consumers and helping them participate with confidence in the evolving energy market.

The reality is however that the innovative products and services available in Australia's energy market are already creating challenges. New business models are pushing the boundaries of existing market structures and regulatory frameworks, or resorting to sales tactics for quick wins that the established energy market has voluntarily withdrawn from as they undermine consumer trust (Case Study 3, page 21).

In a significantly more diverse and innovative energy market, the potential for detriment is increased, as consumers face more novel products and choices, and the risks that come with them.

In the traditional market, consumer detriment has typically been limited to whether retailers offer a fair price for energy, whether a consumer can afford their supply and how simple it is to resolve a dispute—the National Energy Customer Framework (**NECF**)²⁹ and the Energy Retail Code Victoria³⁰ seek to address the problems with varying degrees of success.³¹

The issues become more complex in the emerging electricity market. The new market relies on effective consumer choice driving efficiency, competition and more diverse electricity services. With consumer engagement and trust in the energy market already very low,³² it is important that people are able to find good outcomes in the new market and build their trust in energy providers, regardless of the products and services which make up their energy supply or consumption patterns.

Detriment may arise in a wide variety of forms, from minor disputes, through to significant technical failures or exclusion from the market. It can also arise as a result of regulatory settings or policy changes that change the viability of investments.³³

²⁷ After two years of offering time of use pricing, only 6000, or 0.02% of Victorian households had switched to this tariff structure.

²⁸ Letter from the Honourable Lily D'Ambrosio, 21 December 2015. Letter available at:

<https://www.aer.gov.au/system/files/Victorian%20Energy%20Minister%20-%20Distribution%20network%20pricing%20arrangements%20-%2021%20December%202015.pdf>

²⁹ The National Energy Customer Framework comprises the National Energy Retail Law, the National Energy Retail Regulations and the National Energy Retail Rules. For more information:

<http://www.industry.gov.au/Energy/EnergyMarkets/Pages/NationalEnergyCustomerFramework.aspx>

³⁰ *Energy Retail Code (Version 11)* January 2015.

³¹ For a critique on whether competitive markets and consumer protections have provided good consumer outcomes in Victoria, see Ben-David, R. (2015) *If the retail energy market is competitive then is Lara Bingle a Russian Cosmonaut?* <http://www.esc.vic.gov.au/wp-content/uploads/esc/fc/fc947897-7d4f-4772-97c9-959e3baad0db.pdf>

³² Accenture (2014). *The Balance of Power: Why Australian utilities need to defend, delight and disrupt.*

³³ Westmore, T. and Berry, L. (2014). *Emerging Energy Services – Issues for Consumers: awareness, engagement and protection.*

Not all detriment is equal and not all requires treatment. In fact, sometimes detriment can be a catalyst for innovation and better consumer outcomes.

There is, however, some detriment that may create avoidable barriers and poor outcomes for people trying to engage with the new energy market. This detriment arises through variability in regulatory requirements as new business models enter the market, information asymmetries and a legacy of reliance on disclosure. If addressed, more effective competition would be unlocked through the 'confident participation of consumers in markets' (Table 1).³⁴

Table 1: Potential detriment for consumers in the new energy market

Detriment	Example
1. Lack of access to basic consumer protections	Many new products and services may fall outside of the current regulatory framework, and protections that ensure a right to supply, hardship arrangements and access to Ombudsman schemes may not apply
2. Buck-passing and blame shifting	When disputes arise in new products and services which may require a network of relationships to deliver, the potential for buck-passing and blame shifting between parties is high
3. Mis-selling	As products get more complex, some companies may turn to sales tactics relying on product complexity to mask inappropriate or unsuitable products and services
4. Poor decision-making	Consumers may find it difficult to make decisions in their own interests when the number and complexity of choices increases
5. Long lock-in contracts	Long lock-in contracts (e.g. 15 years for a solar lease) reduce consumer choice and flexibility
6. Complex financing tools	New financing arrangements for products and services (e.g. solar leases and power purchase agreements) are complex and may include unclear costs and inconsistent regulatory oversight
7. Inability to access the new market	Some consumers may face systemic barriers to participation in the new, personalised electricity market; this may include those with low incomes, poor literacy skills, language barriers and renters
8. Difficulty comparing products and services	Bundled products and services which are increasingly marketed to individuals based on their personal usage profiles may become difficult to compare where inclusions, exclusions and terminology differ
9. Market failure due to segmentation	Downward pressure on energy prices through mass market competition may be undermined in a market where retailers can increasingly identify and target active, affluent households with individual deals
10. Exclusion through complexity	People who could benefit from switching to new products and services may not engage if information and price signals are too complex, or the reason for participating is not clear
11. Hardship in off-grid scenarios	Off-grid households may experience reduced supply or loss of supply if they fall into hardship, or during a dispute with their technology provider
12. Reduced choice in off-grid communities	Consumers in off-grid communities may have reduced ability to choose their preferred electricity provider and may face higher costs where retail competition is reduced

³⁴ Productivity Commission (2008). *Review of Australia's Consumer Policy Framework*. Productivity Commission Inquiry Report, No. 45.



Case study 1: Good consumer outcomes in the telecommunications sector

Complaints about telecommunications services reached record highs in Australia between 2009 and 2011. During that period, the Telecommunications Industry Ombudsman (TIO) received almost 200,000 new complaints each year, covering issues such as customer service, billing and complaint handling. While consumers were generally satisfied with the quality and reliability of communications services, they were very dissatisfied with the customer care being provided by telecommunications companies.

In response, the Australian Communications and Media Authority (ACMA) launched the 'Reconnecting the Customer' Inquiry³⁵ with the purpose of materially improving outcomes for consumers. The ACMA drew on behavioural research, finding that:

- Telecommunications customers are overloaded with more information than they can process;
- Consumers are susceptible to advertising that focuses on more obvious product features rather than more complex ones;
- Attractive handset features displace thought about factors that are important over the life of a contract, including cost over the contract, realistic assessment of likely usage, and consequences of exceeding a plan 'cap';
- This increases the likelihood that a consumer will make a choice that turns out to be a poor one in hindsight, for example when they experience 'bill shock'.³⁶

³⁵ http://www.acma.gov.au/webwr/_assets/main/lib310013/rtc_final_report.pdf

³⁶ http://www.acma.gov.au/webwr/_assets/main/lib310013/behavioural_econ-cust_complaints_report.pdf

“...complexity in marketing and pricing of products was driving consumer complaints”

The Inquiry found that complexity in marketing and pricing of products was driving consumer complaints, and that customer confusion and ‘bill shock’ provided opportunities for ‘up selling’—the practice of responding to a consumer enquiry or complaint about unexpectedly high expenditure by shifting them on to a higher priced plan.

Based on these findings, the ACMA made a number of recommendations including:

- Improved advertising practices, including prohibiting use of confusing terms like ‘cap’;
- Improved product disclosure, particularly ‘critical information summaries’; and
- Requiring providers to offer expenditure management tools, such as real time information alerting consumers to usage thresholds.

The industry was subsequently charged with amending the Telecommunications Consumer Protection Code to implement these recommendations. The code was approved by the ACMA in 2012.

The reforms drove the telecommunication industry to shift their competitive focus from complexity to simplicity. In relation to data usage for example, providers stopped separating data quotas into on- and off-peak quotas, moved away from ‘excess data’ charges to issuing extra data packs when you exceed your mobile limit, and began charging for data per-kb rather than per-MB. These practices all benefited consumers by removing hidden ‘nasties’.

In response, complaint numbers have dropped significantly. In 2014/15, there were 124,417 new complaints to the TIO, the lowest number since 2007-08. While this is still a high volume of complaints and more can always be done, the reforms did deliver better outcomes for consumers which has allowed better trust in the industry.



Case study 2: Good consumer outcomes in the financial services sector

“Knowing how to manage your money is one of the most important skills in everyday life”. So said then Parliamentary Secretary to the Treasurer when launching the National Financial Literacy Strategy in 2014. However, the significant financial losses experienced by many Australians—be it the investors behind investment collapses like Storm and Westpoint, or the customers of high-risk payday lenders or consumer lease providers—suggests that financial literacy is either still low in Australia or does not adequately protect everyday Australians.

The 1997 Wallis Inquiry into the finance sector based consumer regulation around disclosure rather than regulating products themselves. However, the subsequent 2015 Murray Inquiry³⁷ found that this disclosure-based framework had bred a culture of legal compliance, rather than a focus on how best to inform consumers. This has resulted in lengthy and complex documents, rather than short, targeted documents that highlight product features, risks and rewards.

The Murray Inquiry also noted a number of factors that prevented disclosure from enabling informed consumer decision making, including:

- Disengagement – many consumers are disengaged from their financial affairs and decisions, due to time or motivation, and do not read disclosure documents;

³⁷ Commonwealth of Australia (2014). Financial System Inquiry, Final Report. <http://fsi.gov.au/publications/final-report/>

- Complexity – disclosure documents are typically long and complex for most consumers containing large amounts of information that most consumers consider irrelevant. This makes it difficult for consumers to compare products, understand risks and make informed decisions.
- Consumer behaviour — research in behavioural economics shows consumers have cognitive biases that can lead to poor financial decisions.

The Inquiry recognised the significant losses to consumers if they make a poor choice in the financial sector and the further harm that can be caused by the time it takes to legislate new consumer protections for high-risk products. The Inquiry recommended a number of reforms to better protect consumers, including broad and responsive powers for the regulator, the Australian Securities & Investments Commission (ASIC).

These new powers include:

- Product intervention powers to prescribe marketing terminology for complex products;
- A power to temporarily ban products where there is significant likelihood of detriment to consumers.

New obligations to ensure the safety of financial products were also recommended by the Inquiry. These place obligations on product manufacturers and distributors to consider a range of factors when designing products and distribution strategies. The Federal Government has announced that it will publicly consult on the implementation of these recommendations in 2016.

There is still a long way to go to build consumer trust in the financial services sector, as evidenced by recent calls for bank directors to be legally responsible for poor corporate culture³⁸ and a Royal Commission into the banking sector.³⁹ However the Murray Inquiry proposals would provide a strong foundation for improving consumer outcomes in a complex market.

“There is still a long way to go to build consumer trust in the financial services sector...”

³⁸ Scandals put spotlight on bank ethics and culture. Australian Financial Review, 6 April 2016. Page 1.

³⁹ For and against a Royal Commission in banks. The Sydney Morning Herald, 15 April 2016. <http://www.smh.com.au/business/banking-and-finance/for-and-against-a-royal-commission-into-banks-20160412-go4ed1.html>



Case study 3: Poor consumer outcomes in the solar sector

The Consumer Action Law Centre receives approximately 5000 calls to our legal advice line every year. During 2016, we have received a high volume of complaints about unsolicited solar sales and poor installation which have created poor outcomes for our clients.

For example, in February 2016, we received a call from a client who is on WorkCover and her husband is a recipient of the disability support pension. They were approached by a solar sales company and purchased a 15 kW solar panel system for \$27,485. An electrician later attended the property to install the system, however the first solar contribution didn't appear on our client's bill until eight months after installation, and this contribution was only \$1.53.

Our client tried to resolve the matter with the seller of the system, but they referred her to the subcontracted installer of the system. The installer referred our client back to the solar sales company which by then was entering into administration.

Our client contacted another installer to look into the problem, who identified that the system was wired incorrectly. The second installer fixed the problem and the output significantly increased. Consumer Action assisted the client to seek compensation for the cost of repair plus the lost solar contribution through the Victorian Civil and Administrative Appeals Tribunal.

Prior to the hearing, a lengthy defence was filed by the opposing party raising a broad range of issues that had not previously been raised. The client eventually chose not to proceed and the complaint was withdrawn.

In another case in April 2016, a salesperson attended our clients' home to provide a quote. Our clients, who are both disability support pensioners, were concerned that they could not afford the solar system on offer, but the salesperson made representations that they would no longer receive energy bills if they installed solar panels, and they could pay with third-party finance.

“If we are unsuccessful, the clients are at risk of losing their house”

The salesman subsequently completed the contracts without our clients' knowledge, and falsely indicated that one of them was employed on the finance application. In addition, our clients were not told about the cooling-off period on unsolicited sales, and when the panels were delivered, our clients assumed that they had no option but to proceed with the contract despite misgivings about whether they could afford it.

Once the finance company discovered that the applicant was not employed, finance was rejected.

The panels had by then been fully installed, although our clients had no capacity to pay for them. The solar company subsequently engaged debt collectors to recoup the money they claim they are owed, and were ultimately successful in obtaining default judgement against our clients in March 2016. Consumer Action is assisting the client. If we are unsuccessful, the clients are at risk of losing their house to repay debt on solar panels which should never have been incurred.

3. Building Trust in Australia's Energy Market

3.1. Confident Consumer Participation

'Competitive markets increase the prosperity and welfare of Australian consumers.'⁴⁰ This central tenet has underpinned competition reform in Australia over the last 30 years, and has led to deregulation, privatisation and growth across many areas of the economy. People undoubtedly benefit from lower prices and choice unlocked by effective competition. However competitive markets also introduce new risks for consumers who need to negotiate the purchase of products and services from companies, often at a significant information or market-power disadvantage. Consumer policy acknowledges this trade-off and provides the legal framework that aims to enable 'the confident participation of consumers in markets in which both consumers and suppliers trade fairly and in good faith'.⁴¹

Confident consumer participation relies on consumers' belief that that a company or market has their best interests at heart (good intent) and the competence to deliver good outcomes (see Chapter 2). Ultimately, the competence to deliver comes down to individual companies' practices and is an opportunity for competitive advantage. Good intent, on the other hand, is a matter for the whole market.

Ensuring companies have good intent in competitive markets by preventing poor conduct is at the heart of consumer policy. Policy-makers, rule-makers and regulators have a fundamental role to play in setting the goal posts for good intent, especially in the face of rapid innovation. This 'market-making' regulation will enable 'proper competition and choice'.⁴² Primary responsibility for delivering on good intent lies with energy businesses.

⁴⁰ Australian Competition and Consumer Commission. <https://www.accc.gov.au/about-us/australian-competition-consumer-commission/about-the-acc> (viewed 10 December 2015).

⁴¹ Productivity Commission (2008). *Review of Australia's Consumer Policy Framework*. Productivity Commission Inquiry Report, No. 45, 30 April 2008.

⁴² National Consumer Council (2005). *Consumers and Regulation*. https://web.archive.org/web/20060522100650/http://www.ncc.org.uk/regulation/consumers_and_regulation.pdf. Page 5.

In the energy market, consumer policy has focused on social justice and fair treatment, recognising that energy is an essential service that underpins people's health and wellbeing. Regulatory frameworks, such as the NECF⁴³ and Energy Retail Code Victoria,⁴⁴ has traditionally been 'lifeline regulation',⁴⁵ focusing on what is required to support those in financial hardship. This includes imposing limitations on disconnections, setting minimum terms and conditions, providing marketing rules to ensure consumers receive appropriate information before they enter into an energy contract, and providing access to Ombudsman schemes.

Energy-specific lifeline regulation is still necessary in the new energy market. The Productivity Commission found that the generic consumer law will not provide adequate consumer protections where:

- The risk of consumer detriment is relatively high and/or the detriment suffered if things go wrong is potentially significant or irremediable; and/or
- The suitability and quality of services is hard to gauge before or even after purchase.⁴⁶

New energy services are likely to meet these criteria. However, existing energy consumer protections will need to adapt to ensure competitive neutrality between technologies and services, as well as consistent consumer support.

Aside from regulation, we also now have the benefit of insight on real consumer-decision making from the field of behavioural psychology, which can help to enhance and complement a 21st century consumer protection regime.

For example, there is ample evidence that people find it difficult to manage large volumes of information and complex choices, and sometimes do not act as 'rationally' as policy makers and regulators might expect.⁴⁷ This insight could be used to inform initiatives or regulations that make it easier for people to make choices between products.

The level of support that people require to confidently participate in the new market will vary. Strong innovation policy may be sufficient to support some consumers, while others may be more reliant on effective competition, clear education campaigns, or more traditional essential service regulation to continue to get fair and affordable energy supply in a decentralised and tech-heavy energy market.

The level of support required may also shift as individuals' and households' circumstances change. A sudden accident may put a tech-savvy early adopter with complex financial products supporting an off-grid system into hardship. A new baby may change a family's usage profile, such that the previous cost-saving tariff may become a considerably more expensive option. Some people with the agency to adopt new technologies may opt not to, simply as a result of choice overload or apathy.

The energy sector will need to find a balance between the flexibility to innovate and the right level of regulation to support all customers and prevent poor conduct.

⁴³ The NECF is a set of national laws, rules and regulations that govern the sale and supply of energy. They include the National Energy Retail Law (Schedule to the *National Energy Retail Law (South Australia) Act 2011*), the National Energy Retail Rules, and the National Energy Retail regulations. The NECF currently applies in the ACT, Tasmania, South Australia, New South Wales, and Queensland.

⁴⁴ The Energy Retail Code Victoria (version 11) is made by the Essential Services Commission pursuant to the *Electricity Industry Act 2000* (Vic), the *Gas Industry Act 2011* (Vic) and the *Essential Services Commission Act 2001* (Vic). The principal acts also contain various consumer protections.

⁴⁵ National Consumer Council (2005). *Consumers and Regulation*.

https://web.archive.org/web/20060522100650/http://www.ncc.org.uk/regulation/consumers_and_regulation.pdf. Page 5.

⁴⁶ Productivity Commission (2008). *Review of Australia's Consumer Policy Framework*. Productivity Commission Inquiry Report, No. 45, 30 April 2008.

⁴⁷ Frederiks, E.R., Stenner, K. and Hobman, E.V. (2015). *Household Energy Use: Applying behavioural economics to understand consumer decision-making and behaviour*. *Renewable and Sustainable Energy Reviews* 41, 1385-1394.

Building trust in the Australian energy market through demonstrating good intent requires three areas of focus:

1. Providing support for informed consumer decision-making in a complex market;
2. Ensuring an adequate safety net in the event that things go wrong; and
3. Sharing the benefits of energy market innovation across the whole community.

3.2. Supporting Informed Decision-Making

All consumer decision-making is underpinned by information on the choices available and the relative attributes of those choices. However, as the number of choices or the amount of information increases, decision-making deteriorates.⁴⁸ That is, people's decisions become less likely to be in their own interests.

Heavy reliance on disclosure alone to underpin informed decision-making in a rapidly changing and diversifying market is therefore unlikely to support effective choice and effective competition.

For example, modern online purchases disclose information about products via lengthy lists of terms and conditions. Often, users have to 'click through' to see the full terms which are not displayed automatically. Surveys reveal that they are rarely, if ever, fully read (if read at all). For online software packages (e.g. many entertainment packages or smart phone apps) most consumers only spend six seconds reading the terms and conditions.⁴⁹ Disclosure of important product attributes in this way is therefore unlikely to be improving informed choice.

In addition, people's reliance on short-cuts and heuristics to process information makes disclosure alone insufficient. Essentially, when "the decision environment is complex relative to their mental and computational capabilities",⁵⁰ consumers base decisions on approximate measures, because to sort through all of the information and make an 'informed' decision is not deemed worth the effort. So strong is our innate drive to find decision-making short-cuts that even placement of information on a screen can influence people's decisions—we are all wired with a visual 'middle bias' that makes us much more likely to choose options that appear in the centre of a digital screen.⁵¹

The importance of better considering how people use information to make decisions is being increasingly recognised by Australia's policy-makers. Australia's recent Competition Policy Review recognised that:⁵²

"Insights from psychology and behavioural economics suggest that consumers can have behavioural traits that prevent them from making good use of even well-presented information. Governments should take account of these findings to ensure that consumers are able to enjoy the full benefits of competition and choice."

Australia's Office of Best Practice Regulation has published a useful guide for policy makers of common behavioural factors that affect consumer choice (Table 2, page 26). These factors can be used to improve the design of initiatives or regulations to help consumers better assess relevant information, or 'nudge' them towards making a desirable choice. Recognising the importance of this body of knowledge, in late 2015 the Turnbull Government established the Behavioural Economics Team of the Australian Government.⁵³

⁴⁸ Schwartz, B (2004) *The Paradox of Choice – why More is Less*.

⁴⁹ Sauro, J (2011). *Do users read licence agreements?* Measuring U, 23 January 2011. <http://temp.measuringu.com/blog/eula/>

⁵⁰ Xavier, P (2011). *Behavioural economics and customer complaints in communication markets*.

⁵¹ Benartzi, S (2015). *The Smarter Screen: Surprising ways to influence and improve online behaviour*. Page 67.

⁵² Commonwealth of Australia (2015). *Competition Policy Review: Final report*. Page 53.

⁵³ Ryan, S (2015). *Designing effective and innovative public policy in a complex environment*. Speech delivered to ANU Crawford School, HC Coombs Policy Forum Public Policy Conference, 23 November 2015. <http://scottryan.com.au/media/speech-anu-crawford-school-hc-coombs-policy-forum-public-policy-conference>

Table 2: Behavioural factors affecting choice

The behavioural factors which affect choice⁵⁴ can broadly be categorised as follows:

Loss aversion: people would rather not lose than win.

Reference point: people may evaluate changes relative to some reference point, rather than objectively. Examples include:

- Priming – people’s behaviour may be impacted if they are first exposed to certain sensations.
- Anchoring – people use an initial reference point in estimating values.
- Salience – consumers are drawn to what seems relevant to them.

The implications of loss aversion, reference point and time inconsistency:

- Default choice – consumers may ‘go-with-the-flow’.
- Endowment effect – consumers may disproportionately value what they possess.
- Status quo bias – consumers may be averse to change.

Time inconsistency: people change their minds over time. Examples include:

- Hyperbolic discounting – people may change their valuation of goods and services over time.
- Procrastination – important decisions may be delayed.

Social factors: choice can be impacted by the choice of others, including through:

- Social norms – people are influenced by the actions of those around them.
- Ego – consumers behave in a way that supports the impression of a positive self-image.
- Messenger – consumers are influenced by who communicates information.

Additional factors, including:

- Mental accounting – consumers may be inconsistent in valuing money.
- Heuristics – people may use mental short-cuts when making choices.
- Affect – emotions can be powerful in shaping consumer behaviour

Despite our increasing understanding of human decision-making, energy market reforms often still assume that consumers will respond to price signals to balance their utility against cost, with the resulting energy use describing their willingness to pay. Cost-reflective network pricing relies on this principle to underpin efficient network investment and workable competition. In reality, while overall cost of the bill may be a driver at times (and particularly when the bill arrives), most people do not make decisions about how and when to use energy based on a price signal. Instead, they use energy to facilitate their lifestyle, or as required by greater needs (e.g. families with young children have little ability to respond to price signals because of their hectic schedules and energy use is based more around the needs of the children⁵⁵).

A recent study by CSIRO further highlights how real decision-making influences people’s interest in cost-reflective network tariffs (Case Study 4, page 27). Consumers in almost all cases would prefer to stay with flat rate tariffs, regardless of whether there would be benefits to them in switching to a cost-reflective tariff.⁵⁶

Insights from behavioural economics are not the silver bullet that creates perfect consumer engagement. They do, however, provide useful tools to assist market and policy development better targeted for consumer participation, which creates a more effective platform for competition. To date, this potential is untapped in the Australian energy market.

⁵⁴ <http://ris.dpmc.gov.au/2012/12/18/obpr-research-paper-influencing-consumer-behaviour-improving-regulatory-design/>

⁵⁵ Nicholls and Strengers (2014). *Changing Demand: Flexibility of energy practices in households with children*.

⁵⁶ Stenner, K., Frederiks, E., Hobman E.V., and Meikle, S. (2015). *Australian Consumers’ Likely Response to Cost-Reflective Electricity Pricing*. CSIRO, Australia.



Case study 4: Consumer attitudes to cost-reflective network pricing

A recent study by CSIRO⁵⁷ assessed the likelihood of success of Australia's introduction of cost-reflective network pricing based on the acceptance and likely uptake of a range of tariff structures by real consumers. The study asked over 1100 Australian households about how likely they were to choose the tariff structure if it was offered to them, covering six distinct tariff structures: time of use, critical peak pricing, critical peak rebates, real-time and capacity pricing, plus the normal flat-rate tariff. Participants were also asked about their likelihood of choosing tariffs if offered a 'risk reliever', including a money back guarantee or a free automation device that would help them respond to price signals.

The research found that all forms of cost-reflective pricing were less attractive to consumers than traditional flat-rate tariffs. Consumers were least accepting of the most complicated and novel tariffs (real-time pricing and especially capacity pricing) due to higher perceived risk. More predictable (and therefore trustworthy) forms of cost-reflective pricing – including time of use pricing, critical peak pricing and critical peak rebates – were more appealing, however were still not as attractive as flat-rate tariffs. Risk relievers boosted people's interest, particularly the offer of a money back guarantee if the tariff worked out to not be suitable for the household, but not enough to make any of the cost-reflective tariff structures as appealing as the status quo.

Consumers' preferences roughly related to how hard the structure is to understand and respond to. CSIRO concludes that 'the greatest barrier to uptake... appears to be consumers' aversion to making any kind of choice, i.e. their aversion to giving up the status quo (which we know is only magnified as the decision-making environment grows more complex).'

⁵⁷ Stenner, K., Frederiks, E., Hobman E.V., and Meikle, S. (2015). Australian Consumers' Likely Response to Cost-Reflective Electricity Pricing. CSIRO, Australia.

3.3. Ensuring an Adequate Safety Net

A fundamental plank of providing a trusted market is ensuring that consumers can rely on their rights when things go wrong. Energy-specific consumer protections have long been in place to provide this confidence for people in a competitive market for an essential service where disconnection can have harmful effects, billing is lumpy and therefore more likely to lead to financial stress, and prices and products can be complex.⁵⁸

The NECF provides these protections in the current market. However, new energy suppliers (such as those that retail solar power purchase arrangements) have been granted exemptions from the full suite of NECF protections that apply to incumbent retailers and distributors.⁵⁹ Energy-specific consumer protections are, however, still necessary in the future energy market, where energy is more essential than ever.

For example, as bundled services (i.e. combining solar panels, battery storage and a retail contract) become more common it will be increasingly difficult for people to compare costs and offers between providers. In addition, it will be difficult for people to trust their rights if different elements of the bundle have differing obligations for hardship provisions or dispute resolution. At the same time, people who cannot afford the capital cost of these 'add-on' services will become increasingly excluded from innovative products and services, potentially experiencing higher prices as other users decrease their use of traditional grid infrastructure.⁶⁰ Energy protections can mitigate the impacts of these.

There is also a range of new products and services entering the energy market which go beyond the simple sale of electrons, and therefore challenge the existing regulatory frameworks which relies upon there being 'the sale and supply of electricity'. Battery storage, for example, could be considered either demand management or a supply

Case Study 5: Australian Competition and Consumer Commission v AGL South Australia Pty Ltd [2014] FCA 1369

The case concerned the marketing practices of energy retailer, AGL, and the way that discounts off its energy plans were marketed.

After many consumers signed up to the energy plans, AGL raised the price of the tariff the discounts were based on. The ACCC alleged that communications to customers about these price rises were misleading. There were two communications to two separate groups of customers.

For the first, the Court found misleading conduct because the communication stated that the consumers' discount remained (it did not, because it was effectively lost through the price rise). In relation to the second communication, however, the Court did not find any misleading conduct. That was because there was nothing in that letter stating that the discount would continue.

The ACCC argued that AGL had an obligation to disclose that the discounts would effectively be lost at the time of the increase, but the Court did not agree. The Court found that as the ACCC had provided no basis for concluding that customers had an interest in being informed of the impact of the changes on their discount, there was no 'reasonable expectation for disclosure'.

⁵⁸ Productivity Commission (2008). *Review of Australia's Consumer Policy Framework*. Productivity Commission Inquiry Report, No. 45, 30 April 2008.

⁵⁹ Australian Energy Regulator. <https://www.aer.gov.au/retail-markets/retail-exemptions> (viewed on 25 May 2016).

⁶⁰ It is important to note that effective cost-reflective pricing has the potential to mitigate this 'death spiral' effect. However while cost-reflective network pricing is required of electricity distribution businesses in Australia from 2017, there are signs that its uptake may be low. Notably, the Victorian Government recently announced that cost-reflective network tariffs may only be offered as a voluntary product in Victoria from their commencement. Under these circumstances it is unlikely that many households will choose to adopt them, particularly if they are likely to be financially worse off. The potential for the 'death spiral' effect of electricity pricing therefore remains.

technology, and its treatment within current frameworks is therefore unclear. There is also a range of energy management technologies entering the market that do not fall within the jurisdiction of energy regulations despite their purpose being to influence energy supply and consumption.

Providing an adequate safety net therefore requires consideration of both energy-specific protections and generic consumer protections, provided by the Australian Consumer Law (**ACL**).

The generic consumer protections provided by the ACL include:

- National laws covering a number of sales practices;
- A system of consumer protections and remedies in relation to defective goods and services (the 'consumer guarantees');
- Unfair contract term protections; and
- A harmonised national product safety and enforcement system.

The Australian Competition and Consumer Commission (**ACCC**) actively monitors conduct and enforces the law where it is breached. The ACL does, however, have limitations—it too does not adequately assist effective decision-making, and it contains uncertainties and gaps that make enforcement difficult.

For example, the ACL's prohibitions against misleading and deceptive conduct and unconscionable conduct are powerful protections that benefit consumers in their commercial dealings, but they do not ensure consumer choices are good ones. The prohibition on misleading and deceptive conduct does not actively require traders to impart clear messages to Australian consumers, and unconscionable conduct is challenging to define, which limits effective compliance by industry. As one judge recently said:

"any agonised search for definition [of unconscionable conduct], for distilled epitomes or for short hands of broad social norms and general principles will lead to disappointment, to a sense of futility, and to the likelihood of error".⁶¹

In other jurisdictions, protections aimed at supporting consumers in competitive markets are drawn in more modern (and economic) terms. For example, prohibitions on unfair trading in the EU cover 'conduct that distorts the economic behaviour of the average consumer' or 'significantly impairs the average consumer's freedom of choice or conduct'.⁶² It also covers practices which 'omit or hide material information, or provides it in an unclear, unintelligible, ambiguous or untimely manner'. Such analysis can bring into consideration consumers' behavioural biases that might be exploited by traders. The recent Federal Court decision of *ACCC v AGL* demonstrates the ACL's limitations (Case Study 5, page 28).

Australia's energy regulations build on the ACL to provide assistance to consumers through explicit informed consent provisions, limitations on disconnection and support for those experiencing financial difficulty, marketing rules and access to Ombudsman schemes.

There is increasing recognition of the need to go further than just 'protecting' consumers in complex markets. Recent reviews in markets such as financial services have placed a stronger focus on fairness for consumers, recognising the limits of disclosure and information-based remedies. David Murray's Financial System Inquiry found that fairness must be central to the regulatory framework:

⁶¹ *Paciocco v Australian and New Zealand Banking Group Ltd* [2015] FCAFC 50 at [304].

⁶² European Commission (2005). *Unfair commercial practices directive* http://ec.europa.eu/consumers/consumer_rights/unfair-trade/unfair-practices/index_en.htm (viewed 4 April 2016).

“...consumers should be treated fairly and financial products and services should perform in the way consumers are led to believe they will. Consumers have a responsibility to accept their financial decisions, including market losses, when they have been treated fairly. However, financial system participants, in dealing with consumers, should have regard to consumer behavioural biases and information imbalances.”⁶³

Fairness is also a major focus of Ofgem, where new principles-based regulation has been introduced into the retail market to give energy companies the flexibility to innovate while still providing safeguards that ensure consumer interests are protected (for more detail on the Ofgem principles, see page 33).

Fairness in the application of consumer protections would go a long way to helping consumers trust the energy market when things go wrong. At present however, protections apply inconsistently, making the market difficult to navigate confidently, especially in novel situations with new products and services.

For example, while battery storage may now make up part of a bundled retail product, under current practices the battery element of the bundle would not be required to come with hardship provisions and the consumer has no right to access energy Ombudsman schemes in the event of a dispute regarding the battery (even though both rights are part of the underlying retail contract). These inconsistencies will need to be addressed to underpin trust and effective competition.

3.4. Sharing the Benefits of the Transforming Energy Market

The transforming energy market will provide opportunity and benefits to many Australian energy consumers in the form of lower costs, better service, reduced environmental footprint or higher satisfaction. The benefits will not, however, fall evenly across the community. Those with the resources to invest will get better deals, while those that cannot risk being left behind.

For example, solar panels are now relatively cheap for many Australian households, and solar financing agreements are reducing the upfront costs even further. However the cost of panels is still prohibitive for the vast majority of the most vulnerable households, who might benefit most from generating their own electricity and reducing their energy bills. In addition, many low-income consumers are renting their homes, creating further barriers to solar installation and the uptake of other energy products and services that affect the household fabric.

All consumers should be able to benefit from the new energy market. Building community trust will therefore require addressing the barriers to access, providing vulnerable and disadvantaged consumers with reasonable access to the products and services that may improve the affordability of their energy supply, and to fair pricing structures.

Challenges to vulnerable people reaping the benefits of innovation may be individual (e.g. a consumer's lack of English language skills), demographic (e.g. low income earners) or structural (e.g. flat rate network tariffs which create cross-subsidies between high and low energy users).

Attempting to address structural barriers to fair market outcomes has been the focus of the Australian energy market in recent times, with the introduction of cost-reflective network tariffs. This reform may be a good initiative to share the benefits of market transformation across the community as, managed carefully, it will reduce the wealth transfer between low and high energy users.

⁶³ Commonwealth of Australia (2014). *Financial System Inquiry Final Report*.

However, the introduction of cost-reflective tariffs also provides a good example of the trade-off between consumer understanding and rapid innovation. While cost-reflective tariffs may be beneficial to many vulnerable energy consumers, their complexity makes them difficult to understand⁶⁴ and the current practice of quarterly billing creates significant challenges for making sure the price signal they create is visible to the consumer. There is also significant uncertainty about how cost-reflective tariffs from distributors will be passed on by energy retailers so that the signal is visible and effective to drive change.

Ensuring that consumers can reap the benefits of these tariffs will require genuine collaboration between electricity retailers and distributors, together with strong engagement so that consumers are adequately informed about tariff changes, and understand the benefits. Behavioural insights have a role to play in effective communication with consumers about this important reform in order to build their trust.

The tension created by this trade-off is playing out within the National Electricity Market (**NEM**), even as the preparation for and implementation of the new tariffs occurs. NEM jurisdictions are required to introduce these complex new tariffs by 2017,⁶⁵ while the Victorian Government has ruled that cost-reflective network tariffs may only be 'opt-in' in Victoria while more effort is put into consumer engagement around this initiative.

Similar tensions have been experienced in other countries in the introduction of cost-reflectivity in the energy market. For example, Ofgem has announced that they will move to more flexible, principles-based regulation.⁶⁶ This followed a finding by the UK's Competitive Markets Authority that Ofgem's earlier attempts to provide simplicity by prescribing that energy retailers could only offer four tariffs in the retail market was stifling competition.⁶⁷ Ofgem's measures are described further in Chapter 4.

Beyond cost-reflectivity, there is much that could be done to improve vulnerable people's access to new products and services. For example, currently hardship programs help ensure that people experiencing financial difficulty can maintain access to retail energy supply. However these hardship provisions do not extend to new products and services, such as solar products with a financial contract. Expanded hardship provisions may allow more Australians to access the new products and services that suit their needs.

In addition, impartial energy advice programs, like the former federal Home Energy Saver Scheme, coupled with government funding mechanisms, could increase vulnerable people's awareness of, and access to, useful energy products and services.

In a fair and trustworthy energy market, people need to feel that they can access the products and services that best meet their needs. Not all people will ever be able to access all products and services, but systemic barriers must be removed so that the benefits of innovation are reasonably capable of being shared by all.

⁶⁴ Most Australian distribution businesses have proposed a Maximum Monthly Demand tariff to provide the cost-reflective signal to consumers. Under this model, the flexible part of the tariff would be adjusted monthly, based on the maximum demand of a household during peak periods in the previous month, and would be combined with a fixed charge to make up the household's total distribution charges. The charges would be passed on via the retail bill, which in the NEM is usually sent quarterly.

⁶⁵ Australian Energy Market Commission (2014). *National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014 No.9*. <http://www.aemc.gov.au/getattachment/528077f0-3be3-45e5-bf0b-02b76437ccb4/Final-rule.aspx>

⁶⁶ Ofgem, *The Future of Retail Market Regulation*. <https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/future-retail-market-regulation>

⁶⁷ In March 2016, the Competition and Markets Authority found that Ofgem's 'Simpler Choices' limit on retail tariff offers had an 'adverse effect on competition' by 'reducing retail suppliers' ability to innovate in designing tariff structures to meet customer demand, in particular, over the long term, and by softening competition'. Competition and Markets Authority (2016). *Energy Market Investigation: Provisional decision on remedies*. <https://assets.digital.cabinet-office.gov.uk/media/5706757340f0b6038800003b/Provisional-decision-on-remedies-EMI.pdf> Page 111.

4. Unlocking Effective Competition

4.1. Building Trust in Innovative Energy Markets

Increasing competition and choice in the energy market is undoubtedly good for consumers. It will provide more opportunities to find products and services that meet people's individual needs and preferences, and done well, will drive efficient allocation of costs across the market.

However the new energy market also brings risks and challenges for consumers, who will be faced with more choices, more information and more complex products and services. Challenges will arise through poor decision-making and behavioural biases, inconsistent protections and barriers to access for vulnerable demographics. These consumer challenges introduce risk to realising the benefit of energy market reforms, in a market where consumers are increasingly expected to be in the driver's seat.

Capturing the benefit of innovation and increased competition relies on confident consumer participation, and building consumer trust. In achieving this, tensions will need to be balanced to achieve good outcomes for both consumers and the market. Innovation should be encouraged at the same time as consumers are supported to confidently engage.

Trade-offs that are already impacting on decision-making in the energy market include:

- **The Opportunity Trade-off:** balancing unlocking immediate opportunity with managing risk to consumers and the market
- **The Temporal Trade-off:** balancing the interest of consumers today with the interest of future consumers
- **The Individuality Trade-off:** balancing benefits to individuals with benefits to society
- **The Delivery Trade-off:** balancing the rate of change to achieve greater economic efficiency with meaningful consumer engagement and equitable social outcomes.

Ultimately, navigating these trade-offs will require a comprehensive review of whether the current regulatory frameworks are best able to deliver the needs of both consumers and the industry in the new energy market. However innovation in the energy market will continue regardless, and there is a shorter-term role for both

policy-makers and market participants in ensuring we are on the right track for navigating those trade-offs and building consumer trust.

Building consumer trust through good practice and good intent is in the best interests of market participants – who will benefit from greater consumer engagement and loyalty – and the operation of the market itself, which will become more efficient the better informed and engaged consumers become. It is therefore fundamental to the strong operation of an innovative Australian energy market that the needs of consumers are prioritised.

While Australia may be leading the world in uptake of rooftop solar systems,⁶⁸ there is still much that we can learn from other countries' approaches to balancing the consumer interest and consumer decision-making biases with the need for strong innovation.

For example, in the US almost two-thirds of domestic solar systems are financed by a solar lease or solar Power Purchase Agreement (**PPA**). In Arizona, these complex products led to high numbers of consumer complaints, including that consumers didn't save as much as was initially promised by the provider, consumers didn't understand the metering arrangements on which they were being paid/billed, and consumers didn't realise the duration of the lease agreement they were signing.⁶⁹ In response, the Arizona Senate introduced a new law, which establishes clear protections for consumers who are entering financing arrangements for solar.⁷⁰ The law still allows for innovative financing mechanisms to be offered, but simply requires that they disclose the total cost of the system over the life of the agreement, including the number of payments and payment amounts, and the rates (or projected rates) that savings estimates have been calculated from, including clear disclosure that rates may change outside of the control of the equipment provider.

Similarly, Ofgem, has taken a strong focus on providing flexibility for the energy market to innovate, while ensuring that consumer interests are protected. It is assisting consumers to participate in the market by embedding 'fair treatment of consumers in every level of [energy supply] organisation[s]'⁷¹ through principles-based regulation. Ofgem introduced binding Standards of Conduct for UK energy providers in 2013, requiring licensed entities to treat customers fairly, as defined by:⁷²

- **Behaviour:** suppliers must behave and carry out any actions in a fair, honest, transparent, appropriate and professional manner.
- **Information:** suppliers must provide information (whether in writing or orally) which is complete, accurate and not misleading; communicated in plain and intelligible language; relates to products and services that are appropriate to the customer at whom it is directed; and fair both in terms of content and how it is presented.
- **Process:** suppliers must make it easy for consumers to contact them; act promptly and courteously to put things right when they make a mistake; and ensure that customer service arrangements and processes are complete, thorough, fit for purpose and transparent.

⁶⁸ The Conversation (2016). *Factcheck Q&A: is Australia the world leader in solar power?* Published 28 March 2016. Available at: <http://theconversation.com/factcheck-qanda-is-australia-the-world-leader-in-household-solar-power-56670>

⁶⁹ Tucson Electric Power Company and UNS Electric, Inc. Joint Response to Request for Comments on Solar Industry Issues in the *Matter of the Commission's Inquiry into Solar Distributed Generation Business Models and Practices and Their Impacts on Public Service Corporations and Their Ratepayers* (Docket No. E-00000J-14-0415) February 13 2015, 1-2; and Grand Canyon State Electric Cooperative Association, on behalf of its Arizona cooperative members, Response in the *Matter of the Commission's Inquiry into Solar Distributed Generation Business Models and Practices and Their Impacts on Public Service Corporations and Their Ratepayers* (Docket No. E-00000J-14-0415), February 13 2015, 2.

⁷⁰ Arizona Senate (2015). *Distributed energy generation systems: disclosure*. Bill SB 1465. First Regular Session 2015.

⁷¹ Ofgem, *Fairer Treatment*, <https://www.ofgem.gov.uk/simpler-clearer-fairer/fairer-treatment> (viewed 4 April 2016).

⁷² Ofgem (2013). *New standards of conduct for suppliers – domestic customers*, <https://www.ofgem.gov.uk/publications-and-updates/new-standards-conduct-suppliers-domestic-consumers> (viewed 4 April 2016).

As these are enforceable licence conditions, Ofgem has the power to undertake investigations and enforcement activity where it believes the Standards of Conduct have been breached, and fairness has not been central to a supplier's conduct. At present, the Standards only apply to licensed entities and it is unclear how they would be extended to apply to alternative business models.

The work of improving consumer outcomes and trust should not be the sole responsibility of regulators and regulatory systems however. In a more flexible energy market, the onus must be on businesses to operate with good intent and the competence to deliver, with regulators only stepping in to enforce clear standards where they have been breached.

The market has already taken the lead on many initiatives to provide consumers with a better experience. There are a growing number of commercial products and services available which aim to provide products and services that consumers may like, from Powershop's unit pricing model⁷³ to automatic switching sites, like the UK's Flipper.⁷⁴

In addition, voluntary initiatives are helping to ensure that industry is policing its own conduct in some situations. For example, the Solar Retailer Code of Conduct allows leading Australian solar energy companies to 'show their commitment to responsible sales and marketing activities, and solar industry best practice.'⁷⁵ Amongst other things, signatories to the Code commit to providing the total cost of a solar financing agreement (e.g. solar lease or PPA) as well as the component costs to help consumers make more informed decisions about complex financial products.

A similar voluntary code exists for Australian energy price comparator sites.⁷⁶ Energy consumers worldwide are becoming more familiar and comfortable with price comparator sites, themselves another example of market-based initiatives to help consumers better navigate a complex market. To be effective and retain consumer trust, however, these services need to facilitate honest, like-for-like comparisons, be transparent about commercial relationships, and clearly disclose who and what is being compared.⁷⁷

Ultimately, energy businesses and the structures that guide their conduct need to strive to provide an energy market that builds consumer trust through supporting confident consumer participation, providing an adequate safety net and ensuring that all members of the community can benefit from energy market transformation (Chapter 3).

4.2. Building Trust in Australia's Energy Market

Policy-makers, regulators and energy businesses will need to weigh up competing interests and navigate an array of trade-offs to find practical responses that achieve the goal of facilitating strong innovation while appropriately supporting consumers.

Energy businesses and governance institutions are best placed to develop the initiatives and interventions that best fit their business practices or jurisdictions, while providing improved consumer outcomes. However principles are required to guide these developments, to ensure that enabling better consumer outcomes and trust are embedded in the development of products, services and regulations.

⁷³ Powershop, <http://www.powershop.com.au> (viewed 9 June 2016).

⁷⁴ Flipper, <http://flipper.community/about> (viewed 9 June 2016).

⁷⁵ Clean Energy Council, *Solar Retailer Code of Conduct* <https://www.solaraccreditation.com.au/retailers.html>

⁷⁶ Consumer Utilities Advocacy Centre (2015). *Energy Comparator Code of Conduct* <http://www.cuac.org.au/consumer-and-community-resources/energy-comparator-code-of-conduct>

⁷⁷ Australian Competition and Consumer Commission (2015), *Comparator websites: A guide for comparator website operators and suppliers*. <https://www.accc.gov.au/publications/comparator-websites-a-guide-for-comparator-website-operators-and-suppliers>

Principles provide flexibility and resilience in the face of technological and service changes compared to prescriptive and inflexible regulation. In addition, principles can be implemented through targeted policies and programs within different sectors of the energy market as required to give them effect.

Based on the evidence of consumer experience, decision-making biases and responses to complexity in other markets and jurisdictions presented in this report, there are three simple principles that are required to guide all further market reform and innovation (Figure 3).

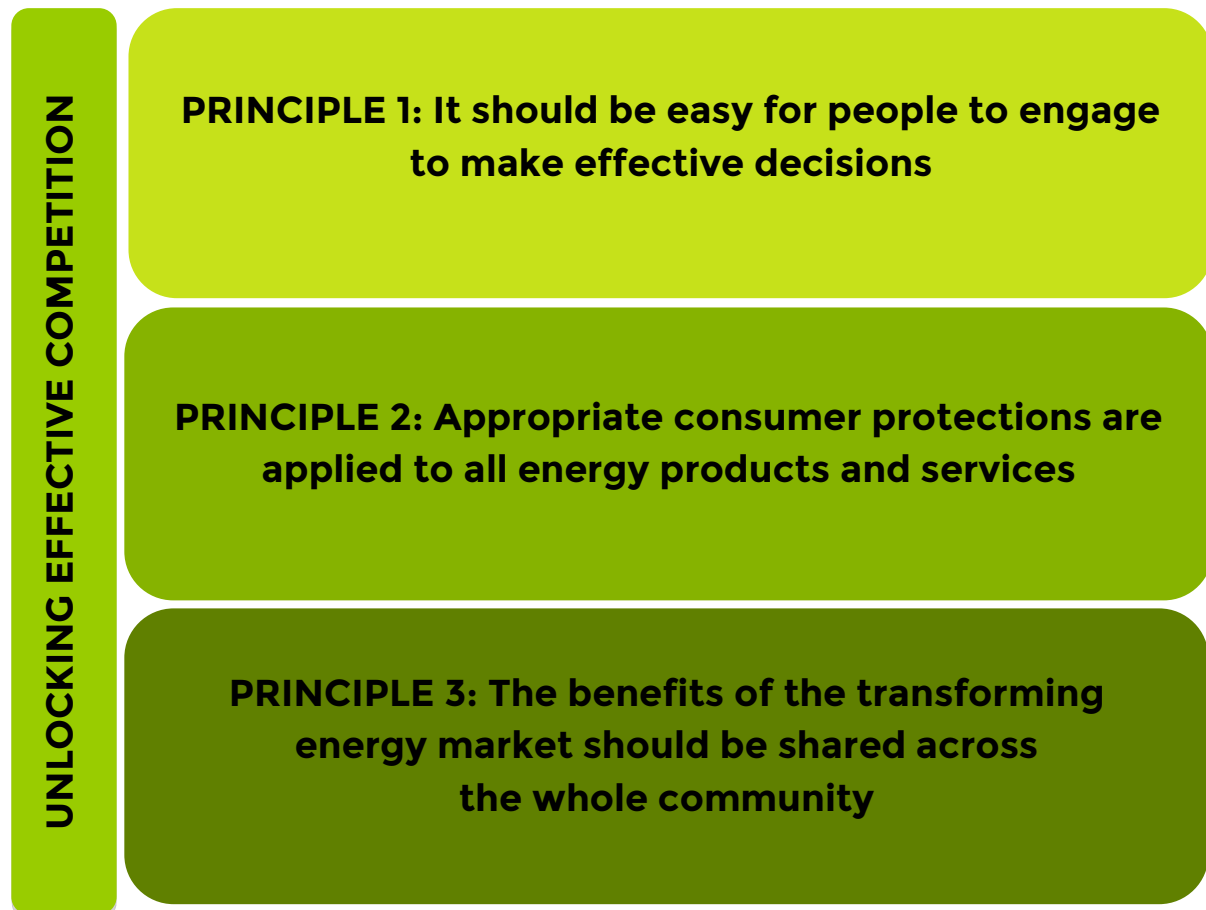


Figure 3: Principles to enable good consumer outcomes and build trust in the energy market

These principles provide a competitively neutral, balanced and fair platform to underpin further development of Australia's energy market, ensuring consumers can make good decisions, get the expected outcomes and trust their rights when things go wrong. They must be adopted widely across the energy market, to ensure the success of energy market reforms and underpin strong competition.

Giving effect to the principles must primarily be the responsibility of energy governance institutions, energy market bodies and energy businesses themselves. Different organisations or businesses may interpret them differently, depending on their needs, priorities and objectives. For example, Principle 1 could be interpreted to mean that products are simplified (either voluntarily or mandatorily) or that new tools are developed to navigate complexity. Both of these responses are valid.

The experience of the Demand-side Energy Reference Group is that there are strong benefits to taking a whole-of-sector approach that considers the expertise and perspectives of a range of different market participants, including consumers. New approaches that enable better consumer and market outcomes, regardless of the trajectory of innovation or the ultimate regulatory structure, are needed. These ‘no-regrets’ solutions will be critical to efficient competition in the evolving energy market.

From a consumer perspective, no-regrets initiatives that could be adopted in the short to medium-term include:

1. Testing the need for, and form of, market interventions against real consumer decision-making

Behavioural insights show that consumers usually assess information and make decisions very differently to the way that traditional economics might predict. Developing new energy market policies and rules and assuming that they will address the underlying need of consumers can lead to very poor consumer outcomes.

New energy market interventions could be more effective if behavioural insights were used to identify the driving cause of consumer issues, and to design measures to effectively address them. This concept underpinned the analysis of high levels of consumer complaints and barriers to effective competition in the telecommunications market during the Reconnecting the Customer Inquiry,⁷⁸ and directly led to the development of consumer-friendly solutions, such as text message data usage alerts that are now mandatory across the industry.

This initiative would give effect to Principle 1.

2. Ensuring adequate access to justice by expanding the jurisdiction of energy Ombudsman schemes

As new energy products and services arise, they challenge the efficacy of traditional energy consumer protections which do not always apply to innovative business models. This creates risk for consumers who may not understand what protections apply in the event of a dispute, but also undermines effective dispute resolution as it is unclear to the consumer which dispute resolution avenues are available to them. Furthermore, a lack of consistency in dispute resolution requirements for energy service companies creates a competitive advantage for some businesses.

Expanding the jurisdiction of energy Ombudsman schemes to cover disputes arising from any energy service,⁷⁹ regardless of whether the relevant consumer protections are provided by energy-specific frameworks or more general consumer protections, would ensure that consumers could access free, independent and fair dispute resolution for comparable energy services. It would also provide competitive neutrality within the market as a basis for fair innovation.

This initiative would give effect to Principle 2.

3. Requiring energy service providers to identify the consumer’s purpose in acquiring a service, to ensure it is appropriate

The Australian Consumer Law (**ACL**) includes a ‘fitness for purpose’ consumer guarantee that requires businesses to guarantee that products and services ‘are fit for any purpose that the consumer made known to the business before buying (either expressly or by implication), or the purpose for which the business said it would be fit’.⁸⁰ If a business fails to meet this guarantee, the consumer is entitled to a remedy. This protection may provide confidence to energy consumers who are engaging with novel energy services that

⁷⁸ Xavier, P (2011). *Behavioural economics and customer complaints in communication markets*.

⁷⁹ ‘Energy service’ is taken to mean any entity providing ongoing energy supply or management services via a contractual arrangement.

⁸⁰ Australian Consumer Law (Clth), s55 and s61.

they can trust the service to meet their needs, and that a safety net exists if it does not. However the guarantee only applies if the consumer discloses their purpose for purchasing a particular product or service.

Requiring energy service providers to identify a customer's purpose for engaging the service, and note it in contractual documentation, would ensure that this provision applies to energy services. It would allow consumers to rely on the ACL during dispute resolution and would also help to prevent mis-selling of services by energy companies.

Similarly, testing new products and services against real consumer decision-making biases makes good business sense, and would provide an easier-to-navigate market place for consumers by providing products that they understand. This was recognised by David Murray, who proposed a 'product design and distribution obligation' for financial services in the Financial Systems Inquiry, to ensure that products actually deliver the purpose they were designed to meet.⁸¹

This initiative would give effect to Principles 1 and 2.

4. Identifying programs to assist people in vulnerable situations to access new products and services

New energy products and services will not be equally available to all Australian energy consumers. While this is a normal dynamic in competitive markets, and is based on geography, wealth and other factors, there are some energy consumers who could particularly benefit from the increase in energy affordability brought by alternative energy supply or management technologies.

Programs already exist that assist vulnerable demographics overcome barriers to accessing other important appliances and services. These programs include the No Interest Loans Scheme that provides small interest-free loans for essential goods and services,⁸² and StepUP loans that provide low-interest loans for personal or household purposes.⁸³ Advice services exist that are targeted at those who are vulnerable, such as the National Debt Helpline. New initiatives also include a partnership between the Clean Energy Finance Corporation and St George Community Housing in New South Wales that provides energy efficiency and solar upgrades for community housing to lower electricity bills.⁸⁴

A review that identifies similar avenues for accessing energy supply or management technologies that can improve affordability for low-income households would ensure that the benefits of energy market transformation can be shared across the community.

This initiative would give effect to Principle 3.

5. Targeting concessions to address need

Current energy concession frameworks are tied to traditional energy retail supply, giving people with low-incomes a discount on their energy bills. These programs are critical in improving the affordability of energy supply. However, as new energy products and services become more commonplace in the market, new supply arrangements may evolve which are more suitable for a low-income consumer's needs and which may assist them to improve the affordability of their energy use. In addition, as more energy consumers use them to reduce their reliance on the traditional energy grid, the underlying cost of grid energy may increase, rendering the traditional concessions less effective.

⁸¹ Commonwealth of Australia (2014). *Financial System Inquiry, Final Report*. Recommendation 21. <http://fsi.gov.au/publications/final-report/executive-summary/#recommendations>

⁸² Good Shepherd Microfinance, *The No Interest Loans Scheme*. <http://nils.com.au> (viewed 9 June 2016).

⁸³ Good Shepherd Microfinance, *StepUP low interest loans*. <http://goodshepherdmicrofinance.org.au/services/stepup-low-interest-loans> (viewed 9 June 2016).

⁸⁴ Clean Energy Finance Corporation (2015). *New finance gives NSW community housing a clean energy boost*. https://www.cleanenergyfinancecorp.com.au/media/107497/cfc-factsheet_sgcommunityhousing_lr.pdf

Targeting concessions to address need rather than tying them to specific supply or contractual arrangements may be one avenue by which low-income consumers can overcome barriers to accessing new energy products and services.

This initiative would give effect to Principle 3.

4.3. Reviewing regulatory frameworks

In addition to adopting the three principles presented in Figure 3 in all further energy market reform, there is a broader need to comprehensively review energy-specific regulatory frameworks to ensure that they are appropriate for the transforming energy market. Such a review should consider:

- Whether additional protections are required for those households that go 'off grid'. For example, strengthened informed consent arrangements may be necessary or even a right to revert to the grid should the choice be regretted;
- Whether protections relating to financial difficulty remain adequate, particularly as new energy services become the predominant source of supply for many households;
- Whether marketing protections need to be strengthened, for example, to protect the high risk of detriment associated with high-cost or long-term supply arrangements; and
- Whether there need to be strengthened suitability requirements, so that providers ensure products and services are suitable for households' energy needs.

This review should consider the opportunity to take a principles-based approach, so that suppliers are required to embed the fair treatment of consumers in every level of their organisation. Such an approach, supported by effective monitoring and compliance arrangements, might be a more flexible way to ensure businesses maintain consumer trust and deliver good consumer outcomes.

Appendix:

The Demand-side Energy Reference Group

In July 2014, Consumer Action published *Smart Moves for a Smart Market*, an in-depth research report on the emerging demand-side energy market and the opportunities and challenges it was likely to create for consumers.⁸⁵ The report, and subsequent discussions with stakeholders, highlighted the need for a concerted whole-of-sector approach to identifying critical barriers to efficient competition and innovation caused by low consumer engagement in the rapidly evolving energy market.

In response, Consumer Action convened the Demand-side Energy Reference Group (**Reference Group**) in early 2015. The Reference Group is a collaborative forum across the energy sector to discuss how to enable good consumer outcomes and build consumer trust in the energy market in the face of increasing complexity to ensure innovation is effective and market efficiencies are realised.

1.1. Methodology

From March 2015 to May 2016, the Reference Group met on six occasions to consider the implications for consumers of the rapidly evolving Australian energy market, and the resultant impact on effective competition and innovation.

The Reference Group process over the 14 months was as follows:

- Agreeing the market challenge
- Understanding future energy consumers
- Identifying potential detriment
- Identifying potential responses

A synopsis of each step is provided below.

⁸⁵ Consumer Action Law Centre (2014). *Smart Moves for a Smart Market: Simple steps to ensure consumer protections keep pace with innovation in a hi-tech energy market*. <http://consumeraction.org.au/wp-content/uploads/2014/08/Smart-Moves-for-a-Smart-Market-eVersion.pdf>

1.2. Membership

Name	Organisation	Term
Independent Chair		
Andrew Reeves	Andrew Reeves Consulting	March 2015 – May 2016
Members		
Gerard Brody	Consumer Action Law Centre	March 2015 – May 2016
Ben Burge	Powershop	March – December 2015
Chris Murphy	Powershop	January – May 2016
Ian Clyde	Essential Services Commission Victoria	March – December 2015
David Young	Essential Services Commission Victoria	January – May 2016
Mark Feather	Department of Economic Development, Jobs, Transport and Resources	March 2015 – May 2016
Michelle Groves	Australian Energy Regulator	March 2015 – May 2016
Gabrielle Kuiper	Public Interest Advocacy Centre	March – August 2015
Tim Nelson	AGL Energy	March 2015 – May 2016
Lara Olsen	Citipower/Powercor	March – December 2015
Melissa O'Neill	Citipower/Powercor	January – May 2016
Stuart Richardson	Department of Industry, Innovation and Science	March 2015 – May 2016
Rosemary Sinclair	Energy Consumers Australia	August 2015 – May 2016
Paul Smith	Australian Energy Market Commission	March – December 2015
Chris Spangaro	Australian Energy Market Commission	December 2015 – May 2016
Yolande Strengers	RMIT	March – December 2015
Larissa Nicholls	RMIT	January – May 2016
Dean Van Gerrevink	Vector Advanced Metering	March – December 2015
Tony Wood	Grattan Institute	March 2015 – May 2016

1.3. Agreeing the market challenge

In its inaugural meeting, the Reference Group discussed the diverse challenges faced by the market as it evolves, including the technical and economic implications, and the impact on regulatory frameworks.

The Reference Group discussed the fundamental role of consumers in the energy market, largely as a result of digital disruption and the *Power of Choice*⁸⁶ reforms. Acknowledging the very low levels of consumer trust and engagement in the current energy market, the Reference Group agreed that in addition to the technical and economic challenges facing Australia's energy market, there is a distinct consumer engagement challenge which poses a risk to efficient market operation.

The Reference Group agreed that the key consumer engagement challenge to address is:

How can we enable good consumer outcomes in the transforming electricity market for effective competition and innovation?

This question provided the scope for all further Reference Group discussions, and the *Power Transformed* report.

It was agreed that there are a number of tensions which could influence responses to this question. These include whether consumers are viewed as individuals or as a community, whether good outcomes are sought immediately or in the longer-term and the relative weighting of strong innovation to strong consumer protection.

⁸⁶ Australian Energy Market Commission, <http://www.aemc.gov.au/Major-Pages/Power-of-choice> (viewed 9 June 2016).

1.4. Understanding future consumers

To consider the challenge of how best to enable good consumer outcomes in the future energy market, the Reference Group needed a common understanding of what the future energy market, and therefore the consumer experience, may look like. We considered credible scenarios of the future energy market as a platform for understanding future energy consumers.

The CSIRO Future Grid Forum was established to 'develop and explore potential scenarios for Australia's energy future.'⁸⁷ The Forum developed four scenarios of future market development (Figure A1). The scenarios describe credible technological pathways for the development of Australia's energy market, but do not fully take into account the preferences and habits of real people.

1. Set and Forget	2. Leaving the Grid
<p>Sustained high retail prices, heightened awareness about the issue of peak demand, and new business opportunities lead residential, commercial and industrial customers to adopt peak demand management.</p> <p>But, recognising the busy lives of many customers, the demand management systems are designed to be on a 'set and forget' basis after customers have decided which level of demand management suits them.</p> <p>Measures include building large-appliance control (air-conditioning, pumps), on-site storage, specialised industrial demand reduction markets, and electric vehicle charge management, as well as advanced metering, and communication to enable these services.</p>	<p>The continued dominance of volume-based pricing encourages energy efficiency without accompanying reductions in peak demand growth. The subsequent declining network utilisation increases retail prices.</p> <p>New energy service companies sensing a market opportunity invite customers to leave the grid, offer an initially higher-cost solution but one that appeals to a sense of independence from the grid. Consumers have already become comfortable using small amounts of storage on-site and in their vehicles and a trickle of consumers takes up the offer.</p> <p>By the late 2030s, with reduced storage costs, disconnection becomes a mainstream option and the rate of disconnection accelerates.</p>
3. Rise of the Prosumer	4. Renewables Thrive
<p>Continued falling costs of solar photovoltaic panels and other on-site generation technologies, sustained high retail prices, and increasingly innovative financing and product packaging from energy services companies, leads to widespread adoption of on-site generation.</p> <p>Residential consumers in particular are empowered by their choice to become more actively engaged in their electricity supply and call themselves 'prosumers'. Electric vehicle adoption is also popular.</p>	<p>Confidence in the improving costs of renewable technologies, achieved by combined efforts from government and industry around the world, results in the introduction of a linearly phased 100 per cent renewable target by 2050 for <i>centralised</i> electricity generation.</p> <p>To shift demand and meet renewable supply gaps, storage technology is enabled to achieve the target and utility, network and consumer sites. Some customers maintain on-site back-up power (for example, diesel) for remote and uninterruptible power applications, offsetting their emissions by purchasing credits from other sectors, such as carbon forestry.</p>

Figure A1. The CSIRO Future Grid Forum scenarios⁸⁸

The preference of consumers for any one of these scenarios will be influenced by a range of factors, including wealth, home ownership, appetite for risk, literacy or life stage. They may also be based on poor information or marketing tactics by suppliers, leading people to choose products that are attractive, but not suitable to their needs.

As a consequence, the energy market of 2020, 2030 or 2050, is unlikely to be a homogenous display of a single scenario. Rather, the market will comprise a proportion of people exhibiting any one of these (or other) scenarios. The scenarios are therefore more accurately described as *segments* of the future market (with the exception of the Renewables Thrive scenario, which would not change the consumer experience from the current market and therefore does not create a market 'segment'). Each of these segments will include 'do-it-yourself' consumers as well as those who choose packaged services.

⁸⁷ CSIRO, <http://www.csiro.au/en/Research/EF/Areas/Electricity-grids-and-systems/Economic-modelling/Future-Grid-Forum> (viewed 9 June 2016).

⁸⁸ CSIRO (2013). *Change and choice: The Future Grid Forum's analysis of Australia's potential electricity scenarios to 2050*.

To appropriately capture credible projections of future consumers, the Future Grid Forum ‘segments’ require the addition of a new segment describing those consumers who stick with the status quo because they are unable to participate in the market or they simply don’t want to.

Further Reference Group discussions were therefore underpinned by consideration of four future consumer segments (Figure A2).

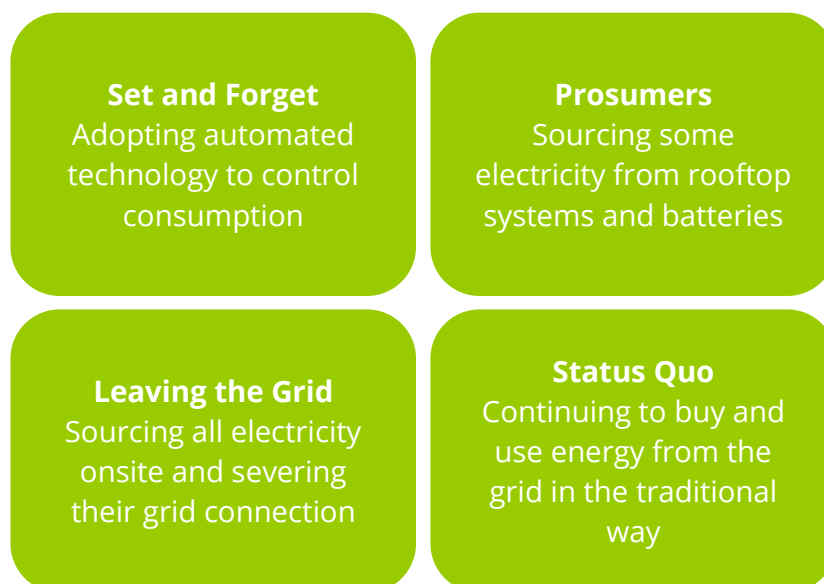


Figure A2. Consumer segments underpinning the Power Transformed project

1.5. Identifying potential detriment

Consumer detriment arises when market outcomes fall short of their potential, resulting in welfare losses for consumers. In general, the development of consumer policy involves identifying and measuring consumer detriment and then determining if market intervention is warranted.⁸⁹ While the aim is not to completely remove detriment, minimising unnecessary detriment to enable good consumer outcomes and build trust requires an understanding of the types of detriment that could arise, in order to be able to recognise and treat it where possible.

The four consumer segments were used to underpin an assessment of risks and detriment that consumers might face in the evolving energy market. Throughout this assessment it was acknowledged that it is overly simplistic to assume a particular type of person—wealthy or poor, sophisticated or naive—will rationally self-select or fall into the segment which best suits their needs. Rather, it was acknowledged that there is a range of potential consumer detriment associated with each segment.

Three categories of detriment were considered:

1. **Personal detriment:** the consumer is personally affected by product and service attributes that lead to poor outcomes. For example, door-to-door sales leads a consumer to sign up to a retail offer with high pay on time discounts, but the consumer is unable to pay on time.
2. **Class detriment:** particular groups of consumers experience detriment as a result of the way they are able to participate in the market. For example, low-income consumers may be unable to afford technologies.

⁸⁹ Australian Treasury (2011). *Consumer Policy in Australia: A companion to the OECD consumer policy toolkit*. http://consumerlaw.gov.au/files/2015/09/Companion_to_OECD_Toolkit.pdf

3. **Structural detriment:** detriment occurs to consumers through inefficiencies in the market. For example, inefficient price signals lead to installation of residential-scale battery storage when community-scale storage was more efficient.

The Reference Group's high level assessment resulted in identification of over 60 areas of potential detriment. Approximately 20 further areas of potential detriment were identified by Consumer Action's lawyers and financial counsellors, based on their experience with consumers engaging in complex markets. The complete list was rated for likelihood and severity of the detriment, giving an overall risk rating.

Not all potential detriment requires treatment however. Some potential detriment already has an effective treatment, some will be addressed by new energy market rules which have not yet come into force, and some should appropriately be faced by consumers in an innovative energy market. Others were identified as beyond the scope of the Reference Group.

As such, the following selection criteria were applied to the full list of potential detriment to filter out those which were less likely to create unnecessarily poor consumer outcomes:

1. Is the potential detriment specific to the energy market, or if broader (i.e. common to transforming markets), could the energy market lead development of an approach to foster consumer participation?
2. Is there currently no effective treatment for the potential detriment?
3. Does the potential detriment pose a high risk?
4. Does the potential detriment have an immediate impact on consumers?

Using this process, fourteen areas of potential consumer detriment were shortlisted for further analysis (Table A1).

Table A1. Shortlisted detriment

	Category	Detriment
1	Personal	Lack of access to traditional consumer protections that ensure a right to supply, hardship arrangements and dispute resolution when new participants may fall outside the current regulatory framework
2		Buck-passing and blame-shifting when disputes arise in a network of complex relationships
3		Mis-selling in the face of complexity, including through unsolicited sales tactics
4		Poor decision-making in the face of complex products
5		Long lock-in contracts reduce consumer choice and flexibility
6		Potential for off-grid households to experience reduced supply or loss of supply if in hardship or during a dispute, which will not be resolved swiftly through Civil and Administrative Appeals Tribunals
7		People in off-grid communities have reduced ability to choose products and services (and face higher prices?)
8		Poor decision-making due to unclear costs and inconsistent regulatory frameworks in complex financing arrangements
9		Inability to access new products and services due to cost or other systemic barrier
10		Inability to compare offers and get a fair price in a highly personalised market where offers are individualised
11		People who could benefit from switching to new products and services don't because the information and price signals are too complex, or because the reason for doing so isn't clear
12	Class	Cost of under-utilised assets disproportionately picked up by Status Quo customers
13		Inconsistent access to data, putting privacy at risk and creating unwelcome marketing while being difficult for the consumer to access
14	Structural	Inefficient network or personal investment increases cost (to individual or the economy)

Class and structural detriment was subsequently discarded from the analysis, as we focussed more closely on what could be done to address personal detriment for consumers, which are likely to have a greater impact on levels of trust and engagement. The final list are those areas of detriment that are most likely to undermine trust and confident consumer participation in the short to medium term (Table 1, page 16).

1.6. Identifying potential responses

Discussion of how to enable better consumer outcomes and build trust in the transforming energy market focussed on the 12 potential detriments as a proxy for the broader unforeseen detriment that consumers may face in a rapidly evolving energy market. The Reference Group workshopped strategies and measures that may be effective to maximise good consumer outcomes and build trust in an increasingly complex market.

The resulting list of measures spanned both targeted strategies and broad principles that could guide the development of targeted strategies to address the potential personal detriment. However, measures proposed fell into three broad themes:

1. Enhanced decision-making;
2. an adequate safety-net; and
3. access for vulnerable demographics.

The themes build on the evidence presented by guest experts who attended meetings over the Reference Group process. These experts, from both within and outside the energy market, presented on a range of subjects including the definition of 'consumer', human decision-making, the use of behavioural economics in regulated markets and vulnerability in the energy market. The three themes formed the basis of the policy principles presented in Figure 3 (page 35).

A recurring theme throughout the discussion of strategies to enable better consumer outcomes was the existence of a number of trade-offs that policy-makers, rule-makers and the industry will need to face when grappling with the evolution of the energy market (presented on pages 10 and 32). It was acknowledged on multiple occasions that decision-makers will need to be cognisant of these trade-offs in the development of responses to enhance consumer participation and trust in the energy market.

It was also acknowledged throughout Reference Group discussions that there are multiple approaches required to ensure the smooth operation of the new energy market, confident consumer participation and effective competition. Notably, the Reference Group process took a bottom-up approach of considering responses within the current regulatory framework that could remove barriers to consumer participation and improve consumer outcomes. The Reference Group agreed that a top-down approach is also required, which more comprehensively assesses the desired structure of the future market and the outcomes required of it, and the appropriate regulatory frameworks to deliver that.

In line with our bottom-up approach, the Reference Group considered the extent of essential service provisions in alternative energy supply models in more detail. This exercise highlighted inconsistencies in consumer protections that will require further consideration as the energy market evolves.

Consumer Action developed a list of proposals which may give effect to the proposed policy principles based on the Reference Group's discussion of targeted measures to improve consumer outcomes, the more detailed discussion of essential service provisions, and the lived experience of Consumer Action's clients. The proposals presented in this report (page 36) do not reflect the views of the Demand-side Energy Reference Group.



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