Retail Advisory Group

Improving transparency of consumers' electricity charges

Agenda paper

18 September 2013

1 Recommendation

1.1.1 It is recommended the Retail Advisory Group (RAG):

a) approve the publication of the summary of submissions on the improving transparency of consumers' charges issues paper, attached as Appendix A

b) discuss the main themes arising from submissions, set out in section 4

c) provide feedback on the problem definition and the reasons for undertaking further work on this project, set out in section 5

d) provide feedback on the approach for further work, set out in section 6

e) provide feedback on the discussion of how the project fits into the Authority's work programme, set out in section 7

f) note the next steps for completing the project, set out in section 8.

2 Introduction

2.1.1 The Electricity Authority (Authority) requested the RAG to review the transparency of information on consumers' electricity charges. The objective of this project is to promote competition by ensuring consumers have timely access to sufficient information to make informed choices about their electricity supply.

2.1.2 On 9 July 2013, the RAG published an issues paper seeking input to assist its understanding of any problems or issues relating to the availability of information about consumers' electricity charges, and feedback on preliminary options.[1]

3 Submissions received

3.1.1 There were 16 submissions on the issues paper from the parties listed in table 1.[2] A draft summary of submissions on the issues paper is attached as Appendix A.

Table 1 Submissions on RAG issues paper – Improving transparency of consumers' electricity charges

Retailers/Generators	Networks	Consumers	Other
Contact Energy Genesis Energy Mercury Energy Meridian Energy Powershop TrustPower	Orion Powerco PwC (on behalf of 22 electricity distribution businesses) Vector Wellington Electricity Lines Ltd.	Counties Power Consumer Trust Energy Trusts of New Zealand Inc. Major Electricity Users' Group (MEUG) Top Energy Consumer Trust	Energy Efficiency and Conservation Authority (EECA)

1 The discussion paper is available at http://www.ea.govt.nz/our-work/consultations/advisory-group/rag-transparency-consumer-charges/.

2 Submissions are available on the Authority's website at: http://www.ea.govt.nz/our-work/consultations/advisory-group/rag-transparency-consumer-charges/submissions/

4 Main themes in submissions

4.1.1 Submitters expressed mixed views about whether there is a benefit for retail competition from improving transparency of charging information.

4.1.2 Submitters that supported improving transparency cited potential benefits of:

a) enabling consumers to make more informed choices about their retailer, thereby promoting competition

b) assisting consumers make better choices about their energy use and energy saving investments

c) providing greater transparency around price changes, and price trends over time

d) bringing electricity retailing into line with other industries, including service providers such as telecommunications.

4.1.3 Those that did not support improving transparency submitted:

a) there is no evidence of a problem to be solved or of the role of transparency in addressing the issues stated in the issues paper

b) some consumers either actively do not want more information, or become confused by greater detail

c) mandatory disclosure would risk stifling innovation and would undermine the competitive advantage of those currently providing charging breakdowns

d) it would be complex to provide a breakdown of charges in a number of situations, and may not be feasible for grid-exit pricing (GXP) based networks

e) it would be costly for retailers to implement the disclosure requirements, and these costs would ultimately be passed through to consumers (this contrasts with the views of some supporters, who thought the costs would be minimal)

f) future technological changes and developments will continue to improve the quality and timeliness of information that is provided to consumers.

4.1.4 The main themes in submissions are discussed further below.

4.2 Clarifying the problem definition and the role of transparency

4.2.1 A number of submitters were not convinced that improving transparency will be valued by consumers or will improve retail competition. Some submitters were concerned at the lack of evidence of a problem, and suggested that the Authority should survey consumers directly about their information needs, preferences and willingness to pay for more detailed information.

4.2.2 Some submitters recognised that there are consumers who consider that the availability of charging information is a problem, but submitters had different views on the value of improving transparency and the types of information that should be available. A number of submitters did not consider that improving the transparency of information would assist consumers understand price changes or more easily compare retailers.

4.2.3 In response to submitters' requests for greater evidence of a problem, this paper sets out a strengthened problem definition, which focuses more clearly on the drivers of consumer decision making, and the role of transparency of information in switching behaviour.

4.3 Risk of stifling innovation

4.3.1 A number of submitters expressed concern that a prescriptive approach to the disclosure of pricing information would stifle innovation. Others submitted that requiring consistency of information (for example, by way of a template) would minimise costs to retailers and have the benefit of enabling consumers to more easily compare the fixed and variable price components of different retailers.

4.3.2 This paper discusses other work underway by the Authority that will address some of the information needs of consumers, and explains how this project could concentrate on the remaining gaps in information, in a way that does not inhibit innovation.

4.4 Practical difficulties

4.4.1 Submitters advocated a range of different approaches to improving transparency of information, with some submitters raising concerns about the feasibility of some options, including the practical difficulties of providing more detailed information. Other submitters noted that some retailers (such as Meridian Energy and Genesis Energy) have managed to work through these issues and are currently providing detailed pricing information to their customers. Concerns were also expressed at the potential costs to retailers of providing pricing breakdowns.

4.4.2 The nature and scale of these costs will depend on the option that is pursued and how it is developed. More detail on costs could be sought on the more refined options that will be put forward in the next round of consultation.

4.5 Technological changes and developments

4.5.1 A number of submitters noted that future technological changes and developments will continue to improve the quality and timeliness of information that is provided to consumers and, therefore, there is no need for the Authority to intervene to improve transparency of information.

4.5.2 However, these developments may not meet the needs of all consumers, and may only provide pricing information about consumers' current retailer, rather than other retailers a consumer might want to compare prices with. The next discussion paper could consider the various channels for providing information to consumers and the relative merits of each.

5 Role of transparency in promoting competition

5.1.1 The objective of this project is to promote competition by ensuring consumers have timely access to sufficient information to make informed choices about their electricity supply.

5.1.2 Consumer choice is a key element of competition. However, in order for the gains from competition to be realised, consumers need to exercise this choice and make active decisions to switch retailer when there are benefits available (whether savings or more valued service levels).

5.1.3 The availability of sufficient information has implications for the ability of consumers to make decisions about their retailer, including whether they are aware they could get a better deal, can understand what other offers are available and have sufficient motivation to act on the information they obtain. Therefore, ensuring that sufficient information (about charges) is available should have ongoing dynamic competitive benefits, by improving the ability of consumers to compare and switch retailers and encouraging greater retail competition.

5.2 The availability of information affects consumer decisions about comparing and switching retailers

5.2.1 The Authority's most recent survey of the impacts of the What's My Number campaign show that 82 per cent of consumers are aware that they can switch retailer, that 73% believe that it is worthwhile to do so, and 70% consider that it is easy to switch. However, the Authority has also estimated that consumers could collectively have saved $295 million if they had all switched to the cheapest retailer in their region in 2012.

5.2.2 This raises the question of why consumers are not obtaining these savings by exercising their ability to compare and switch retailers? Despite awareness and understanding, it appears the motivation from the potential savings is insufficient to prompt many customers to act.

5.2.3 The issues paper suggested a number of reasons why electricity is different from other residential consumer goods and services and, therefore, why consumers may want more transparent pricing information:

a) **Retail competition was introduced in 1999, meaning that consumers have had choice for a relatively short period.** Consumers may not be comfortable with comparing pricing for a product that until relatively recently (compared to banking or insurance products) were provided by a single supplier. Further the electricity sector is regarded as complex, possibly resulting in a perception by consumers that they may not be getting a fair deal.

b) **There are no full substitutes**. Although other energy sources can meet some household energy needs (such as space heating, hot water heating and cooking), electricity is generally still required for lighting and appliances.

c) **Ex-post charging** means consumers will often not know how their use of household items affects their consumption.

5.2.4 Submitters' responses to this characterisation were divided. In relation to the latter point, Mercury Energy submitted that technological developments will improve the timeliness of usage information and granularity of appliance-specific information over time. Contact Energy submitted that the introduction of smart meters will give consumers greater control over usage.

5.2.5 But there are other aspects of electricity supply that further differentiate it from other products and contribute to consumer inertia:

a) **Electricity is homogenous**. Beyond basic attributes of continuous, reliable supply, and sustained frequency and voltage, the electricity product does not differ by supplier. Retailers must therefore compete on price and service quality dimensions (and potentially turn to additional product offerings such as dual fuel or telecommunications services).

b) **Electricity is intangible**. The demand for electricity is a derived demand (consumers want the services it provides such as lighting and heating, rather than electricity per se). Combined with the fact that it is a relatively small proportion of most households' expenditure, this means it has low visibility to consumers.

c) **Supply is continuous**. Unlike other consumer goods (for example petrol), there are few regular opportunities to compare suppliers and purchase decisions are "low involvement" on the part of the consumer. The main opportunity is on moving house; otherwise consumers (unless proactively approached with marketing) must actively investigate alternative suppliers, perhaps prompted by dissatisfaction with their current retailer (eg large price increases or an unexpectedly large bill).[3]

5.2.6 The prevalence of consumer inertia provides an advantage to incumbent suppliers because they can engage in price discrimination.[4] Watson et al suggest that consumers' search for information is made more difficult in the case of electricity because:

consumers are unlikely to know the price their current suppliers charge, or their volume of usage, and so any price message can easily become confusing, and as such probably ignored. Indeed the potential for "confusion marketing"... in utility pricing is a real danger to the logical process of competition.

5.2.7 This serves to reinforce consumer inertia, and points to a particular role for improved transparency of charging information.

5.3 Drivers of consumer switching behaviour

5.3.1 The factors that influence consumer switching decisions are set out in Figure 1.

5.3.2 The figure shows four stages of a consumer's decision-making process and links those stages with factors that may influence a consumer's thinking at that stage. The illustration is a work in progress that is intended to reflect the role of information during the switching decision.

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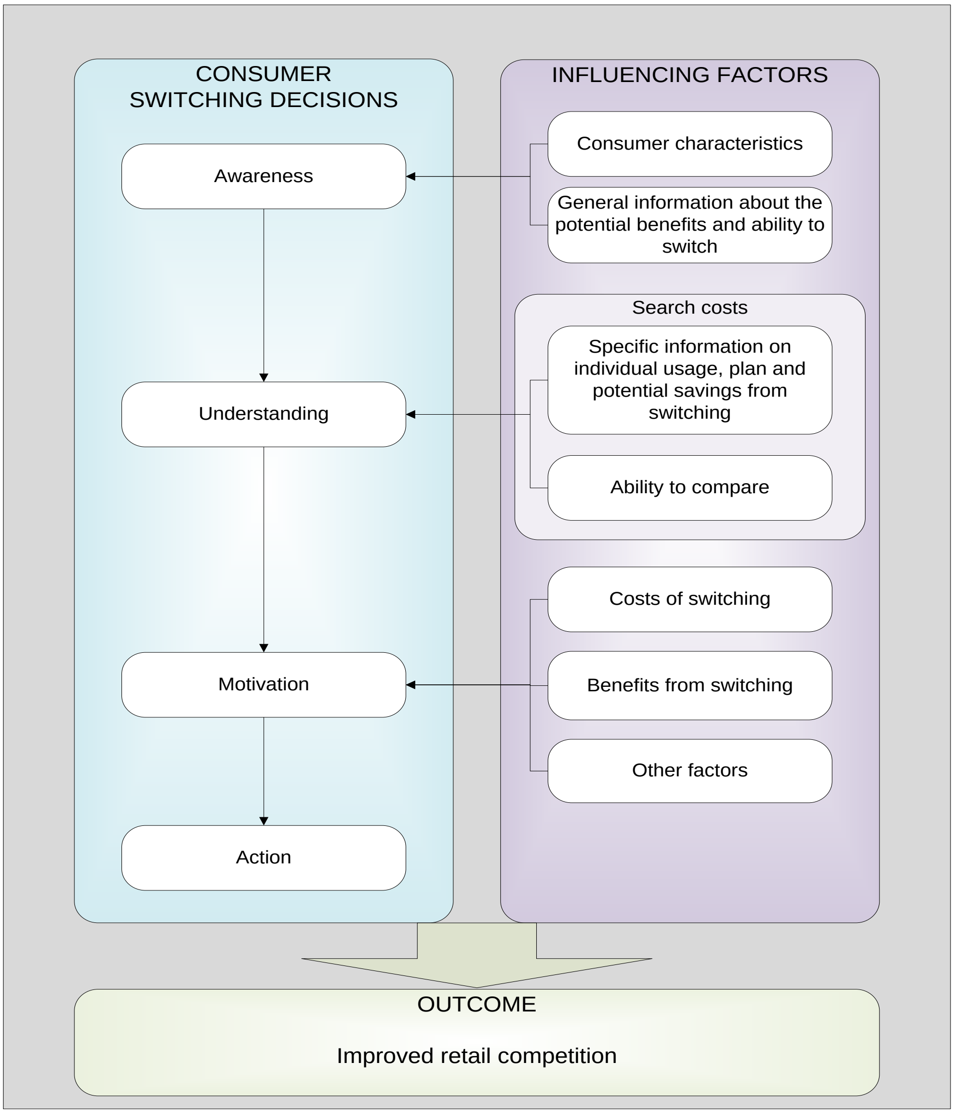
[3] Based on Anna Watson, Howard Viney and Patrick Schomaker (2002) 'Consumer attitudes to utility products: a consumer behaviour perspective', *Marketing Intelligence and Planning* 20/7(2002): 393-404.

[4] Monica Giulietti, Catherine Waddams Price and Michael Waterson (2005) 'Consumer choice and competition policy: a study of UK energy markets', *The Economic Journal*, 115 (October) 2005: 949-68.

Figure 1 Factors influencing consumer decision-making and switching



5.3.3 The influencing factors in Figure 1 are further described below:

a) **Consumer characteristics** – these are consumer specific factors such as household energy usage, income and education which will influence the consumer's awareness of the opportunity to pursue savings.

b) **General information about switching** – the availability and accessibility of information on the ability to switch and on the potential gains from doing so is likely to be an important factor in a switching decision. The focus of the Authority's What's My Number campaign has been on increasing general awareness about the ease of switching and the savings available from switching.

c) **Information search costs** – the availability of information that enables a consumer to understand whether they are on the right offer for them (taking into account price, service levels etc) is likely to be an important factor in a consumer's switching decision. The time and effort required to obtain and understand information about the potential savings specific to the consumer, and make comparisons across retailers, will influence the switching decision. This is a factor that is relevant to this project – do retailers provide information in a way that minimises search costs? Information search costs could be influenced by consistency of terminology about prices (presentation of GST, discounts etc), a consumers understanding of what tariff options are available to them (controlled, uncontrolled, night/day etc) and a consumers understanding of what tariff offer is best given their consumption profile.

d) **The cost of switching** – a consumer's motivation to obtain the savings that are available will be influenced by the cost of switching (actual or perceived). A consumer may consider that five minutes is too long (too costly) to make a switch. Another consumer may perceive the process as confusing or complex even if this is not the case. The Authority's What's My Number campaign has focused on telling consumers that switching is easy, and has relied on tools that reduce the effort required for comparing and choosing a retailer.

e) **The benefits from switching** – consumers need to consider that the quantum of savings will make switching worthwhile and any other benefits such as other product offerings and service quality. This factor is probably more affected by an individual consumer's assessment of the cost of switching versus the savings available, and is less influenced by the availability of information about charges.

f) **Other factors** – such as consumers' attitude towards their current retailer and alternate suppliers, and the degree of trust in the information provided. This factor is probably affected by the consumer's perceptions of the provider of the information.

6 Further development of options for improving transparency

6.1.1 The issues paper set out some preliminary options for improving transparency of consumers' electricity charges. However, there is not a one-size-fits-all approach to making information available. Different consumers will have different information requirements when making decisions. Consequently, a consumer may want none, some or all of the following to assist their decision about their choice of retailer:

a) a breakdown of the components of their charges (ie the proportion of their bill represented by transmission, distribution, energy and retail costs)

b) confirmation that they are on the right plan with their current retailer

c) price trends over time (ie historic) and reasons for changes in their charges

d) ways to reduce their electricity use

e) direction to independent comparison sites.

6.1.2 The options for improving transparency will be developed further in the next discussion paper, taking into account the following issues raised by submitters:

a) practical implications and costs for retailers

b) how to meet differing consumer needs for information, both in level of detail/complexity and in the communication channels for delivering the information to consumers

c) minimising the risk of stifling innovation.

6.1.3 The intention is to link the options for improving transparency to a stage of the switching decision or a factor influencing the switching decision. For example, transparency of consumer charging information is likely to be relevant to the general information available to the consumer (understanding of their own situation), information search costs (a consumers ability to compare) and the benefits from switching (savings available from switching).

7 How this project fits into the Authority's work programme

7.1.1 Table 2 provides an overview of the Authority's existing initiatives or projects that are intended to promote retail competition. The factors on the left reflect the factors influencing consumer switching behaviour from Figure 1 above. The middle column in the table shows the types of information that might be useful, and the third column lists the existing initiatives and projects that are in each area.

7.1.2 The table is a work in progress, and will be developed further for inclusion in the next discussion paper. The ultimate intention is to show how consumers are currently able to obtain pricing information and how gaps in available information will be addressed by each of the initiatives and projects. This will then show whether there are gaps in the availability of pricing information that can be addressed by this project.

Table 2 Overview of related initiatives and projects

Factor	Intervention/measure	Existing initiatives and projects
General information	General information on the industry and price trends/drivers General information on energy efficiency measures Public education about switching Information on average tariffs	Monitoring and market facilitation (improving access to retail data) What's my number? Factsheets
Information search costs	Explaining price changes Breakdown of component charges Comparison of specific plans/components Consistent terminology Price trends Checking on right plan Tailored information on reducing electricity usage	What's my number Factsheets Market facilitation (improving access to retail data – retail tariff database) Group switching
Costs of switching	Improve ease of switching by simplifying decision process, shortening decision time	Group switching and mass market aggregation What's my number?
Benefits from switching	Determined by the market	Monitoring and market facilitation (improving access to retail data) What's My Number?
Other factors	Assurance that information on prices and price changes is authoritative and reliable	Monitoring and market facilitation (improving access to retail data) What's my number?

7.1.3 A key initiative of the Authority relevant to availability of information is the *improving access to retail data* project. The scope of this project is being finalised and workshops with participants on this are planned. Consideration will be given to developing a national tariff database, with open access to third parties. The expected benefits could include:

a) More accurate collection and reporting of pricing and movements therein.

b) Easier and less costly access to consumers' data. This will facilitate consumers granting and/or third parties obtaining access to data, stimulating the development of the energy services sector, and enable the market to respond to the information needs of specific consumer groups. It could also facilitate collective consumer responses, something that will be separately explored in the group switching project.

c) Standardisation of data formats, which will assist comparability.

d) Improved independence and governance of data through regulatory controls, which could foster greater trust in the information provided. This in turn could encourage switching, as consumers have more confidence in the quantum of potential savings.

8 Next steps

8.1.1 The next steps are:

a) the summary of submissions will be published on the Authority's website

b) the secretariat will draft a second discussion paper taking into account submissions on the first discussion paper and the RAG's feedback on this paper. The RAG will consider the second discussion paper at its October meeting and approval of the paper will be sought offline, following the meeting

c) the second discussion paper will be published for consultation (in November) following feedback from the Authority Board and final approval from the RAG

d) submissions will be due in January 2014, and will be considered by the RAG in February 2014

e) the RAG's recommendation is intended to be provided to the Authority Board in April 2014.

Appendix A Improving transparency of consumers' electricity charges – summary of submissions