17 July 2018

James Moulder
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cc Miriam R Dean CNZM QC
Chair
Expert Advisory Panel

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Dear James,

Supplementary submission on the "Customer acquisition, saves and win-backs – Issues Paper": helpful guidance from the ACCC

Since MDAG consulted on the "saves and win-backs" Issues Paper, the ACCC has released its final report for its Electricity Pricing Inquiry, Restoring electricity affordability and Australia's competitive advantage, June 2018.

The ACCC report contains information and material directly relevant to the MDAG review, and the specification of the problem definition.

The ACCC report also details various internal documents the ACCC obtained from incumbent retailers, as part of its investigation, relevant to the MDAG review. This information would be helpful for ensuring the MDAG review is evidence-based, and could be obtained using the Electricity Authority's information gathering powers. This would complement the information we have recommended MDAG obtain.

The problem definition the ACCC articulated is the same as our submission

The ACCC's articulation of the problems with customer acquisition, and saves and win-backs, matches and builds on the content of our submission to MDAG.

The following extract from the ACCC report summarises the problem faced in New Zealand well:[1]

> "In retail markets, privatisation generally resulted in the transfer of a large customer base to each of a small number of retailers. This has had profound effects on the development of retail competition. Large retailers enjoy significant advantages of scale and their much smaller rivals must spend large sums to attract and acquire customers. Meanwhile, incumbents have benefited from large parts of their customer bases being inactive or disengaged from the

[1] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page xi.

competitive market, often remaining on high-priced standing offers. Incumbents are able to make very attractive offers to retain customers, effectively through cross-subsidies paid by their inactive customer cohort. This has enabled incumbents to compete only selectively, and with a disproportionate focus on efforts to retain profitable customers rather than to win new ones. In that environment, new entrants and smaller retailers are competing only for the 'active' part of the market which is price sensitive and often low-margin. This model of competition has not delivered a dynamic and competitive market in which many retailers compete vigorously, driving efficiencies and providing innovative products to attract and retain a broad range of customers."

There are a lot of components to the ACCC problem definition, but what it encapsulates is:

- Incumbent retailers are engaging in price discrimination between stayers and switchers;
- Incumbent retailers are exploiting stayers (inactive customers) through excessive pricing;
- Incumbent retailers are using predatory pricing/cross-subsidising switchers;
- Competition is limited to the "active" part of the market (switchers); and
- A failure to deliver the outcomes expected of a well-functioning dynamic and competitive market.

The ACCC's key findings

While we don't repeat all the relevant material from the ACCC report, the following points are also worth highlighting:

- **Over-pricing and cross-subsidy problems:** "… customers who have been active in the market … are likely paying less than the average cost to retailers of supplying electricity."[2]
- "The full extent of costs associated with attracting and retaining customers are … borne by inactive or loyal customers and those unable to navigate the complexities of the market."[3]
- "It appears that large retailers have the financial means to offer such aggressive retention offers by cross-subsiding these offers from the higher profits they are earning from their significant number of sticky high value customers."[4]
- "… customer loyalty is likely penalised with higher prices".[5] "For inactive or 'loyal' customers, retailers appear willing to intentionally increase their prices and use the customer's loyalty against them."[6]

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[2] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page xi.
[3] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page xi.
[4] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page 143.
[5] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page 143.
[6] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page 144.

- The ACCC identified the same issue we did in our submission that "The gap between the best and worst offers in the market has been widening …"[7]

- **There are imperfect information/information asymmetry problems:** "Retention offers are … generally secret offers … This makes it hard for other players to ascertain the competitive dynamics in a market. For example, a retailer may decide to enter a region based on an assessment of the publicly available prices on offer …, and then discover that their competitors are actually willing to offer significantly lower prices that they cannot match."[8]

- **Entrant retailers face asymmetric disadvantages:** The impact of incumbent retailer retention strategies "While … common among all retailers … obviously has a disproportionate impact on smaller retailers …"[9], again a point we made in our submission to MDAG.

- **The electricity retail market is NOT well-functioning despite claims to the contrary in the MDAG Issues Paper:** "In a well-functioning market, the ACCC considers that retention activity is likely to be pro-competitive. In the market in question, however, the ACCC agrees that there are questions as to whether the activity is in the best interests of consumers as a whole."[10]

- **Aggressive retention strategies IS a problem:** "We have engaged closely with a large number of market participants … about aggressive save and win-back activity … There is no doubt that this conduct is significantly affecting the ability of smaller retailers to gain scale in the market, and that the ability for the big three to engage in such aggressive activity is to a significant extent funded by their inherited customer bases."[11]

- **'Tax' on loyal customers:** We agree with the ACCC conclusion that incumbent retailers are imposing a 'tax' on their loyal customers, or what the ACCC describes as a "tax on disengaged customers".

The magnitude of the problem is greater in New Zealand than Australia

Where the Australia and New Zealand situations differ is that while the ACCC recognised "Numerous retailers reported that new customers are regularly switching back to their previous retailer after being offered very aggressively priced retention details, including offers priced well below what is available publicly", the level of saves and winbacks is a lot lower than in New Zealand "with a number of [Australian] retailers estimating that around 20 per cent of newly acquired customers are lost to saves or winbacks".[12]

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[7] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page xi.
[8] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page 143.
[9] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page 142.
[10] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page 143.
[11] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page xiv.
[12] ACCC, Retail Electricity Pricing Inquiry – Final Report, Restoring electricity affordability and Australia's competitive advantage, June 2018, page 151.

Constructive recommendations

The ACCC has recommended the AER continue to explore ways of improving pricing transparency, including increasing the visibility of save and win-back offers, as well as recommending 'losing' retailers NOT be notified in advance of the transfer process being completed. Electric Kiwi considers these options have merit and should be considered by MDAG. The non-notification recommendation would prevent incumbent retailers from mis-using information from the switching process to prevent the switch or enable an earlier than otherwise possible win-back.

Concluding remarks

While MDAG and the Electricity Authority have been slow to release the submissions in response to the Issues Paper, we fully expect the submissions to be divided into new entrant retailers, who want improved competition outcomes, and are concerned about the saves and win-backs problem, and incumbent retailers, who would be worse off if there was stronger competition, and are likely to be more sympathetic to the Issues Paper. This is consistent with what we have seen with the earlier Electricity Authority consultations.

Electric Kiwi considers it notable the ACCC has sided with entrant retailers, in Australia, and articulated the same problem definition we outlined in our submission. It is also notable the ACCC is a specialist anti-trust/competition regulator.

If MDAG chooses to reject our views on the problem definition it needs to be clear not only why it considers Electric Kiwi is wrong, but also why it considers the ACCC also got it wrong.

In light of the comments made by the Electricity Authority's outgoing CEO,[13] we note the ACCC did NOT try and downplay the retail competition market problems, relating to saves and win-backs, by criticising the competitive strategies of entrant retailers. The solution to regulatory problems is in the hands of the regulator, rather than expecting entrant retailers to adopt alternative or sub-optimal acquisition strategies, such as trying to lock customers in to fixed term contracts, which may be unattractive to potential and active customers. Our retail strategy is to get customers to stay because of good customer service and competitive pricing, not by trying to trap customers into fixed term contracts.

Publication of submissions

We consider the failure to publish submissions in a timely manner (generally a day or two after they are made) reflects poor regulatory practice, and results in a non-transparent process. This is a particular problem where an Advisory Group is conducting the consultation given it results in some stakeholders being advantaged over others who aren't group members and don't have access to the same information. We request that the submissions be released. They are likely to be relevant to our submissions to the Expert Advisory Panel.

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[13] Kathryn Ryan interview with Luke Blincoe (CEO, Electric Kiwi), Carl Hansen (CEO, Electricity Authority) and Sue Chetwin (CEO, Consumer NZ), Nine to Noon – Early, 26 June 2018.

Yours sincerely,

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