



27 March 2014

Mr Chris Spangaro
AEMC Senior Director
Australian Energy Market Commission
PO Box A2249
Sydney South NSW 1235

Dear Mr Spangaro

Consultation Paper- National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014

Origin Energy (Origin) welcomes this opportunity to respond to the Commission's consultation paper on the proposed rule change to the National Energy Retail Rules (NERR) submitted by the Consumer Action Law Centre and the Consumer Utilities Advocacy Centre (herein the "proponents").

Origin does not support the rule as proposed. We strongly believe that its inclusion will have a significant and negative impact on the retail energy market, limiting product innovation by large and small retailers and resulting in unnecessary and permanent increases in energy prices for small consumers accompanied by minimal incremental benefits. The uncertain impact of risk premiums to compensate for unforeseen changes in input costs beyond a retailer's control (network charges, government policy) may result in significant changes in prices and products offered by individual retailers. The proposed rule would require the determination of such risk premiums.

In short, we believe the proposed rule would impose a form of price regulation on retailers and the costs of its implementation and impact will significantly outweigh any benefits. We do not believe the proposed rule satisfies the National Energy Retail Objective (NERO) due to the new, additional and uncertain costs that will result if it is implemented. In particular, the proposed rule is likely to:

- Detract from efficient investment in energy services by creating disincentives to innovate on the part of retailers and the concern that new products and services will face restrictive regulation in the future;
- Impose new costs in the operation of the market for energy services by increasing regulatory burden, the calculation and maintenance of additional risk premiums for each individual jurisdiction where the rule applies, limiting the pass through of price signals from network tariffs and requiring a significant reorientation of the suite of products made available in the retail energy market; and
- Discouraging the efficient use of energy services by reducing choices available to customers and in particular eliminating a significant feature of the most common market retail contract (MRC) sought by customers at present in the competitive market.

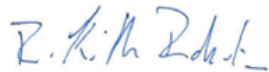
In our response to question 12 on pages 9 and 9 we discuss these costs associated with implementation of the proposed rule in further detail.

Observations of the retail energy market as it has evolved and feedback from customers indicate a general understanding that prices under both standard retail contracts (SRCs) and MRCs change over time often at predictable intervals. Customers have access to a wide variety of information sources and are able to assess MRCs that suit their circumstances if they wish to make such choices. Retailers have sufficient existing obligations under the Australian Consumer Law (ACL) and the National Energy Consumer Framework (NECF) and other jurisdictional energy regulations relevant to retailers to ensure that at the time customers enter into a MRC they are aware that prices may change and how notification of changes will occur.

The proponents do not provide evidence of market failure; rather, there is a reliance on anecdotal evidence via case studies and a theoretical examination of consumer and producer surplus that applies conditional assumptions with respect to products with fixed periods. As such, we believe the proponents have not provided data that supports the proposed rule change; a change that would have a profound impact on energy retailing particularly as the products affected are the most popular among energy consumers in the market today.

We respond to specific questions set out in the consultation paper below. If there are any matters raised within this response that the Commission would like to discuss further with Origin, please contact David Calder (Regulatory Strategy Manager) in the first instance on (03) 8665 7712.

Yours sincerely

A handwritten signature in blue ink, appearing to read "K. Robertson".

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Question 1: Are there any other matters that the AEMC should consider in its assessment of the NERO test?

Origin considers that the NERO test is an effective means by which to assess the proposed rule. We note that the Commission's starting point is that competitive markets provide the best means of promoting efficiency and thus the best outcomes for customers. The range of market offers now available in electricity and gas markets is evidence of the strong rivalry among retailers to win market share, as well as evidence of consumer demand for a variety of service offerings. Origin is concerned that the proposed rule will materially impair the efficient operation of the retail energy market and may deter new entrants as it represents yet another condition they must satisfy to actively compete with current participants.

Furthermore, the proposed rule change will disallow an extremely common type of MRC, being those that feature a discount on energy rates for a defined benefit period. The Commission finds that this type of MRC accounts for 44 percent of those offers currently available in Sydney.¹ The changes that the proposed rule will trigger will inevitably impact on the efficient operation of the market.

Question 2: Consumer protection test

- (a) Is the scope of the consumer protections that the Commission intends to consider appropriate for this rule change request?
- (b) Should the Commission consider any other factors in assessing the rule change request against the consumer protections test under the Retail Law?

In terms of the scope of consumer protections being considered, the Commission should ensure that adequate weight is given to the protections under the ACL, particularly the prohibition on misleading and deceptive conduct (discussed below). In addition, it is important to consider the various protections, including under NECF, as a complete package - in particular the obligations to:

- obtaining explicit informed consent (EIC) to any market contract - this requires that the customer be informed of all matters relevant to their decision to enter the contract, including the potential for prices changes;
- providing required information to the customer before or as soon as practicable after the formation of the contract;
- giving customers a 10 business day cooling off period (and ensure they are made aware of this);
- preparing, and making available and offering to customers, energy price fact sheets.

Question 3: Risk allocation in market retail contracts

Do the current rules result in an inefficient allocation of risks between retailers and consumers in retail markets?

¹ AEMC (2014), *Consultation Paper- National Energy Retail Amendment (Retailer price variation in market retail contracts) Rule 2014*, page 35.

Origin does not agree that the current rules produce inefficient allocation of risks between retailers and consumers in retail energy markets. Retailers (including their trading operations) perform a fundamental and important role managing risk in energy product markets. As the Commission is aware, retailers are deeply involved in hedging changes in wholesale gas and electricity prices through a range of risk management instruments in order to minimise price impacts to end-use customers.

On page 27 of the proposed rule change, the proponents state:

“...consumers are required to manage the risk of price fluctuations, rather than retailers themselves.”²

This assertion understates the important role retailers play in managing wholesale price risk fluctuation on behalf of customers, a role that has been performed well for more than a decade in contestable jurisdictions of the NEM and relevant gas markets. Origin agrees with the proponents that it is a retailer’s task to manage such fluctuations. However, there are some costs that are beyond the control of retailers such as changes in transmission and distribution network charges, market charges (participation fees), government imposed policy changes (taxes, environmental programs) and so on. The proposed rule goes beyond a retailer’s ability to pass through changes in wholesale and retail costs, extending to these other categories of exogenous costs. The proposed rule if implemented as drafted will require retailers to factor in additional risks, inevitably creating an increase in risk premiums incorporated into end-use prices. Since network costs changes and costs stemming from government policy cannot be either beyond retailer influence or can only be controlled on a limited basis by retailers (and their future direction is often unpredictable), such premiums are likely to be material and permanent. This is particularly the case given the proportion that such uncontrollable costs comprise as part of an average residential electricity bill is more than 65% of the total according to the Commission’s own data.³

Question 4: Risk premiums

- (a) If the proposed rule is made, would risk premiums be built into fixed period contracts?
- (b) How significant would these risk premiums be and would these risk premiums create a permanent increase in the price of fixed period contracts?

As discussed above, Origin believes that risk premiums would likely be built into end-user energy prices should the rule be made. If retailers are unable to manage risks, they will individually assess the nature of this risk and price accordingly.

With respect to question 4(b), Origin considers that such risk premiums would be material. Due to the limitation on the sharing of risks, including those beyond the control of a retailer, such premiums would necessarily become a permanent feature of the marketplace.

Origin has MRCs with fixed pricing over a defined period in the market today.⁴ These products do contain a premium above offers where prices can be varied during a benefit period. In Origin’s experience, these products are typically less attractive to the majority of customers compared with products featuring a discount to a price that may change over time (even within a benefit period). The proposed rule would result in customers facing fewer product offerings than today, requiring

² Consumer Action Law Centre and Consumer Utilities Advocacy Centre (CALC and CUAC, 2013), *Unilateral Price Variation & Market Retail Contracts Rule Change Request for Australian Energy Market Commission*.

³ AEMC (2014), *op. cit.*, page 30.

⁴ Noting that the nature of energy supply under such MRCs is evergreen.

customers to adopt a type of offer that is currently niche in its appeal, and thereby making it less likely customers can choose products that suit their particular circumstances.

Question 5: Transparency and market retail contracts

- (a) When entering fixed period contracts, do some consumers believe that the prices will be fully fixed when in fact they are not? If so, what proportion of consumers are likely to fall into this category?
- (b) Are there some consumers that are not aware that fixed period contracts with fully fixed prices are available on the market? If so, what proportion of consumers are likely to fall into this category?

All retailers are obliged to provide extensive information to customers at the time of formation of a market retail contract. This includes an explanation of how prices under the agreement may change over time. This is needed to satisfy both the EIC requirements under NECF and the misleading and deceptive conduct prohibition in the ACL. The proposed rule does not seek to strengthen any of these already effective and comprehensive requirements. Instead, it will limit the range of products that retailers are able to offer and will significantly impact upon existing marketing and billing processes of retailers.

Customers seeking information on available products, including specific information on market offers with fixed prices, are able to source this from individual retailers, respond to marketing campaigns and examine a range of price comparison services, including the Australian Energy Regulator's *Energy Made Easy* website. In addition, retailers' energy price fact sheets must clearly set out whether or not prices will change - so clear and relevant information is easily accessible to all customers.

Question 6: Barriers to consumer participants and engagement

- (a) Does the ability for retailers to vary prices lead to perceptions for consumers that changing to a new retailer or contract would waste search costs?
- (b) To what extent might the existence of exit fees and other transaction costs affect consumer behaviour after a price variation in a fixed period of a *market retail contract*?

Origin is not aware of any evidence that suggests customers see little gain in changing to a new retailer as they consider that their new provider may vary prices. The rate of customer switching in the National Electricity Market and related geographic natural gas markets remains the highest globally for those markets that permit customer choice of energy retailer.

The proposed rule change may inhibit customers changing to another retailer once it is in force. This is because the price offered by their new retailer may exceed the discounted price associated with their legacy MRC; in the meantime, other retailers will have factored in risk premiums to compensate for future uncontrollable input cost changes.

Given current and relatively extensive regulation around agreed damages and limits applying in NECF and non-NECF jurisdictions, it is doubtful that the application of exit fees presents a deterrent to customers intending on changing retailers following a variation in prices during a fixed period under a MRC. Generally, Origin's exit fees are a very small fraction of the annual cost of an energy bill and the value of any discount is also a multiple of exit fees that may be applied.

Finally, Origin does not believe search costs are prohibitive; access to comparison tools (including *Energy Made Easy* and the *My Power Planner* website in Victoria) reduce transaction costs and have the purpose of minimising challenges for customers to identify offers that best suit their needs.

Question 7: Impact of proposed rule on consumer participation and engagement

- (a) Would the proposed rule improve the level of consumer participation and engagement in the retail energy markets?
- (b) To what extent would the proposed rule place downward pressure on prices in retail energy market due to improved consumer engagement and participation?

Origin does not believe the proposed rule will improve consumer participation in the retail energy market. While superficially a rule that keeps prices fixed for a defined period of time and disallows any variations over that period would seem to increase certainty. However, the basis of any risk premium built into the final price to account for uncertainty will vary by retailer and will not be understood by customers. Perversely, the proposed rule therefore has the potential to reduce consumer confidence in the market and add to search and transaction costs.

With respect to question 7(b), Origin believes there is extensive engagement at present from customers wishing to find benefits from participation in the competitive energy market and intense and sustained rivalry among energy retailers. There is also growing competition from alternative sources of energy (such as solar photovoltaic generation) that place competitive pressure on conventional retailers. Notwithstanding Origin's view that we believe it possible that the proposed rule will detract from rather than enhance customer engagement, any improvement resulting from it would be marginal at best.

The proposed rule will result in a reduced range of offers and/or more expensive MRCs made available just ahead of distribution and transmission price resets. Those customers that can't control when they contract (i.e. those who move home frequently such as those renting premises) will be most affected by this consequence of the proposed rule. Such customers are often among the most vulnerable in the retail energy market.

Question 8: Competition between retailers

- (a) How would the proposed rule affect larger retailers compared to smaller retailers?
- (b) Would the proposed rule make it more difficult for new entrants to enter retail energy markets?

We note that in the economic analysis supporting the proponents' rule change, the electricity retail industry is referred to as an oligopoly in a theoretical sense.⁵ While the industry may have some features that support such a characterisation, it is an oversimplification that does not take into account the wide range of innovative business models that have led to the diverse nature of competitors that comprise the retail energy market today. In Origin's view, the proposed rule will cause both large and small retailers to change their approaches to marketing discounted products over defined periods, which will reduce choice for customers with limited if any appreciable benefits accruing to customers.

⁵ CALC & CUAC (2013), *op. cit.*, page 38.

It is our view that the proposed rule will create additional challenges for new entrants and encourage the development of business models depend upon an exemption from retailer authorisation and therefore from the NERR. The proposed rule could weaken consumer protections by encouraging the development of separate markets for energy services, where different standards of consumer protection apply depending on how energy services are delivered and who is delivering them.

Question 9: Innovation in retail market offers

- (a) If the proposed rule is made, are retailers likely to withdraw or offer short period offers from the market?
- (b) If the proposed rule is made and the range of market offers available is reduced, what effect will this have on retail competition and prices in retail energy markets over the long term?

Origin considers that it is probable that if the proposed rule is made, MRCs featuring benefit periods will be withdrawn from the market or will include much shorter periods. Such offers will be less attractive to consumers and will diminish consumer choice. While the proponents have surveyed consumer attitudes to unilateral price change clauses in MRCs (though we note this analysis was limited to Victoria), it might be instructive to see how these views might change if customers were aware that the proposed rule may have the following consequences:

- Eliminate or reduce the availability of products featuring discounts for defined periods, or;
- Would result in an increase in energy prices to support the management of additional risks.

The proposed rule will have a negative impact on competition and thus pricing outcomes over the long term. There will be an impact on dynamic efficiency as further innovation on the part of retailers may face the risk of regulatory sanction in the future. This will discourage the development of products that a large number of customers may actually seek and the cost of this negative long term impact may be substantial.

Question 10: Application of the unfair contract terms provisions in the ACL

- (a) If the unfair contract terms provisions in the ACL generally apply to price variation clauses in *market retail contracts*, should these provisions be relied on to address the issues raised by CALC and CUAC?
- (b) Should changes be made to the retail rules to clarify where the unfair contract terms provisions in the ACL apply to price variation clauses in *market retail contracts*?

If the unfair contract terms provisions of the ACL apply to price variation clauses in MRCs, then it is appropriate that they be relied upon to address the issues raised by CALC and CUAC. These provisions deal precisely with this issue and do so appropriately by requiring a weighing up of a number of factors, taking into account both the interests of the customer and the retailer. They also reflect a policy decision which has been taken (relatively recently) that only residential customers (as opposed to business customers) need to be afforded the protection of these rules. In light of this, convincing evidence would need to be provided to revisit this policy position and Origin does not believe that evidence has been provided to date. In particular, Origin is not aware of any characteristics of retail energy offers or contracts that mean that business customers require more protections in this context than they do when they are contracting with any number of other suppliers.

Origin does not support changing the NERR to clarify where the unfair contract terms provisions in the ACL apply as this is unnecessary. Both the NERR and the ACL are clear in their drafting and are not inconsistent with each other. Therefore they can be interpreted appropriately. Amending the NERR risks introducing inconsistency with the ACL, particularly in relation to which customers are covered and in what situations.

Question 11: Misleading and deceptive conduct and other ACL provisions

- (a) Should the misleading and deceptive conduct provisions of the ACL be relied on to effectively address the issues raised by CALC and CUAC?
- (b) Are there any other consumer protections under the ACL that are relevant to this rule change request?

Origin considers that the misleading and deceptive conduct provisions of the ACL should be relied on to effectively address the issues raised by the proponents. These provisions mean retailers cannot make representations about products that are untrue or otherwise deceptive. Silence can constitute misleading and deceptive conduct and so retailers already need to take this into account when determining what they need to tell customers about products. There is a large amount of case law and guidance from the Australian Competition and Consumer Commission around interpreting these obligations and therefore retailers should be very familiar with these and well equipped to comply. No evidence has been provided to show why retail energy customers need to be afforded greater protection than consumers generally. On the contrary, there are other industries in which consumers enter into contracts with retailers in which the retailer has the ability to unilaterally vary the terms and conditions and prices during a fixed period (eg telecommunications/internet providers and mortgage/finance companies). If this is an issue (and Origin maintains that no evidence has been provided to indicate that it is), then it is an issue in numerous industries and should be addressed for all of them, not separately for energy.

Other relevant consumer protections under the ACL include the unfair terms requirements (discussed separately) and the prohibition on unconscionable conduct.

Question 12: Impacts of proposed rule

- (a) Taking into consideration the potential benefits and costs of the proposed rule, on balance how would the proposed rule affect competition in retail energy markets?
- (b) Considering the issues identified by CALC and CUAC, is the proposed rule a proportionate and appropriate response to address these issues?

Origin strongly believes the proposed rule will reduce choice and benefits available to customers. Choice of MRCs will be reduced materially given the number of customers currently opting in to the type of offer that the proposed rule will affect. Customer preferences have not been adequately researched with respect to their understanding of the consequences and impact of the proposed rule (which will have the general effect of increasing energy prices). Given the number of customers identifying the problem the proposed rule change seeks to address is 2 per cent (in the case of electricity customers in New South Wales); insufficient evidence is available to conclude that customers will enjoy benefits that will outweigh the cost of the change.

The costs for retailers and consumers that Origin sees resulting from the rule change include:

1. The reduction in available offers from all retailers and the consequential opportunity cost of diminished choice and impacts on dynamic efficiency in terms of encouraging future innovation.
2. The inability for retailers to align changes in SRCs (through regulated or published pricing) with MRCs, adding to hedging and portfolio management costs.
3. The additional risk premium required to manage (2) above along with the impact of uncertain changes in distribution and transmission costs, requiring a further premium added to energy prices.
4. The need for further provisions under the NERR to ensure retailers can adjust prices to manage network tariff reassignments (e.g. from flat to time of use [TOU] structures), which are beyond their control.
5. The removal of the opportunity to pass through changes (increases or decreases) in costs associated with government policy (e.g. carbon pricing).
6. The cost of retraining entire front-line call centre staff for all retailers to satisfy the new requirements.
7. The cost of changes to customer relationship management (CRM) information systems and the legal and logistical costs (destruction and printing of new copy) of redrafting terms and conditions for NECF jurisdictions and non-NECF jurisdictions with harmonised regulation.
8. The incentive the rule will create for new entrants to either seek to avoid authorisation as an NERR retailer or to not enter the market at all, creating further costs for consumers.

In terms of the proportionality of the response, Origin considers that the proposed rule change is a heavy-handed means of managing an issue that is not a demonstrated failure of the retail energy market and is not supported by sufficient quantitative evidence of its scale or actual cost-benefit. It is also an issue sufficiently regulated by existing requirements to obtain EIC and through the ACL. For these reasons, Origin does not believe the rule should be made.

Question 13: Limited pass-through of costs

- (a) Would a rule that requires retailers to manage all costs aside from some limited cost pass-throughs better meet the NERO than the proposed rule?
- (b) If so, which types of costs should retailers be allowed to pass-through to consumers and why?

Origin does not agree that a modification to the proposed rule allowing specified pass throughs only will greatly alter the net costs that will result from such a change. Given the significant risk management role currently (and historically) played by retailers on behalf of customers and the absence of evidence of market failure, Origin believes the current consumer protections set out in the NERR and the ACL are appropriate.

Question 14: Other alternative rules

- (a) Are there any alternative approaches that could better address the issues raised by CALC and CUAC and minimise the potential costs of the proposed rule?
- (b) If so, what could these alternative approaches include and what would be the potential costs, benefits and impacts of these alternatives?

Origin does not consider that the proposed rule should be progressed at this time. There may be alternative means of managing the issues identified by the proponents that will not require a change to the NERR with such significant and disproportionate negative impact on energy retailing.

In Origin's view, appropriate solutions should be developed when further evidence of the costs and benefits of these matters is identified.