

27 March 2014

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH, NSW 1235

Dear Sir/Madam,

We write to you in relation to the National Energy Retail Rules (NERR) rule change request by the Consumer Action Law Centre (CALC) and the Consumer Utilities Advocacy Centre (CUAC) to the Australian Energy Market Commission (AEMC);

National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014.

Executive Summary:

Business SA acknowledges the role of the AEMC in promoting efficient investment in the national energy market to protect the long term interests of consumers with respect to price, quality, safety, reliability and security of energy supply concomitant with providing appropriate protection for small customers, including many small businesses. Any amendments to the NERR must not be to the detriment of competition which will ultimately provide the most benefit to all consumers in the long term and erode any imbalances associated with oligopoly market structures.

Notwithstanding, Business SA recognises the need to improve transparency within electricity markets in relation to contract terms between retailers and consumers. Well functioning competitive markets work on the premise that contract structures are easily understood with respect to fixed terms and prices. As a general rule, a party will enter into a fixed term contract to benefit from a fixed price or to manage price risk. While we support the intent of the proposed rule change to overcome imbalances in the market which have caused many small customers to endure unexpected price rises during fixed term contracts, we disagree on the proposed mechanism for addressing this issue. The AEMC should enforce additional product disclosure rules to help inform consumers about the features of various fixed term product types rather than prescribing the nature of products which the market can offer as that will only serve to stifle competition. The key issue of explaining what fixed term contracts entail should be addressed by way of improved product disclosure, not by limiting product offerings.

Background:

Business SA notes the proposed new rule 46A, an amendment to the National Energy Retail Rules (NERR), which is as follows:

46A Fixed period market retail contract

1. This rule applies to market retail contracts with a fixed period.
2. For such market retail contracts, all tariffs and charges payable by the customer are not to change for the duration of the fixed term.
3. For avoidance of doubt, for contracts subject to this rule, the retailer is not able to vary the tariffs and charges that affect the consumer.

We provide comment on the proposed rule change as follows:

1. We recognise the significant increases in electricity prices over recent years which have adversely impacted on small business in South Australia. Since 2008 electricity prices have risen approximately 80%, largely as a result of increased network charges, the carbon tax and various green energy schemes, most notably the Renewable Energy Target. Business SA has been a strong advocate on issues affecting underlying electricity prices and will continue to be so. South Australian businesses already face an extremely uncompetitive State based tax impost and it is critical that businesses have access to low cost reliable energy in order to help transition our economy beyond auto-manufacturing post 2017.
2. We agree a level of confusion exists in the electricity retail market about exactly what a 'fixed term' contract means. This has lead to a situation where consumers, including small businesses, enter into fixed term electricity contracts which can be subject to price changes at any time. In effect, the risk of price rises for such contracts is completely borne by the consumer, which is more akin to monopoly/oligopoly markets, as opposed to competitive markets. However, this may suggest something about the maturity of Australia's electricity retail market, particularly in South Australia where it is dominated by gentailers (retailers with generation capacity).

Notwithstanding some fixed rate/fixed term contracts do exist, they are in the minority of currently available market offers and as such are subject to risk premiums averaging approximately 8% above fixed term only contracts.

The hallmark of well functioning markets is an implicit understanding from each party entering into a transaction about exactly what will be delivered/transacted at a given point in time and the associated cost. The classic example of this occurs in commodity markets where parties enter into a range of contract types and where a commodity is to be delivered at a future point in time, a price is fixed to ensure both parties to the transaction understand and are able to manage the level of price risk in the ensuing time prior to delivery. While there are a number of derivative contracts available, the underlying premise is that parties must manage their risk of fixing a price at some future point. Furthermore, clauses such as 'Force Majeure' are incorporated to allow for a party

to default on some contract terms due to specified acts of God, but there are limited, if any, opportunities to pass on input price rises.

Freight contracts are another good example of where companies often enter into fixed price/fixed term contracts. However, considering inputs such as fuel costs are typically outside the control of freight providers, contracts often include a separate fuel charge which can be linked to an average bowser price to pass on the cost of fuel directly to the customer, allowing for rise and fall provisions.

Although commodity markets worldwide may be dominated by large companies, many small businesses, including farmers, interact with these markets and sell their produce on what are often standardised contracts, such as the Grain Trade Australia (GTA) contract used in 95% of Australian grain market transactions¹. Small businesses such as farmers are willing and able to be party to contracts which link into world commodity markets because there is an implicit understanding in the market of when a contract is spot, forward (fixed) and so on which provides a level of confidence in how the market functions.

Mortgage markets are similar in so far as how market participants interrelate with one another. Prospective home owners understand that that a fixed rate loan implies exactly that, a fixed rate for the term of the loan. On the other hand, a variable rate loan is subject to change. Although there are combination products, they typically only combine what is otherwise already understood i.e. a fixed and variable component. The mortgage market is highly competitive, like commodity markets, and they both share the feature of well understood contract features with terms such as 'fixed' denoting a fixed rate for the contract term.

3. One of the key assumptions of the rule change proposed by CALC and CUAC is that the unfair contraction provisions in the Australian Consumer Law (ACL) are overridden by the NERR. Although the AEMC proposed an alternative interpretation on this matter, there is no official interpretation on behalf of the ACCC which would need to be made publically available before any rule change is progressed under the NERR. Business SA does not support any regulatory change without first testing whether existing regulation is in fact capable of addressing the issues in question.

Moreover, it is important for reasons of economic efficiency that consumer protection measures are consistent across markets. If the NERR is inconsistent with the ACL in terms of consumer protections, there will need to be additional Government resources made available to enforce compliance.

4. Business SA is mindful not to enforce restrictions on the types and nature of products electricity retailers can offer should it stifle competition in what is arguably a maturing market. Were we to support the rule change, it would have to be subject to some level of pass throughs for Government policy changes such as the carbon tax and potentially regulatory decisions on network revenues. Given this, it is likely that the benefits of fixing electricity contract prices to consumers would be limited considering the bulk of price rises in recent years have emanated from network costs and Government policy decisions relating to environmental matters.

¹ Grain Trade Australia, *Strategic Directions 2013*

5. If it was to be determined that the unfair contract provisions of the ACL apply to the NERR, there would still be a significant number of small businesses which fall outside the scope of the ACL. As previously stated, the key feature of well functioning competitive markets is an implicit understanding of contract features, including whether or not the contract price is subject to change. Consequently, the key issue for Business SA is that small customers, including businesses, must be adequately informed before entering into fixed term contracts. If there is to be any change to the NERR, it should only be to ensure the level of disclosure involving fixed term contracts is more explicit on the basis and frequency in which prices or other charges are subject to change.

The NERR should operate to ensure consumers can easily understand key features of electricity price contracts, but increasing the level of competition in the market will be the most effective way of protecting consumers' long term interests.

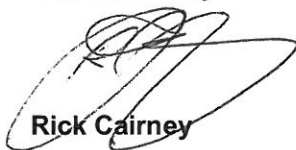
6. The proposed rule change is only in relation to *market retail contract* offerings by energy retailers given that *standard retail contracts* already provide limitations on the regularity of price variations, being no more frequent than six monthly. Given all energy retailers must offer standard retail contracts to small customers, there is an embedded level of protection which needs to be considered when making additional regulatory changes to protect small consumers in terms of overall regulatory burden on the electricity market.

Who we are:

As South Australia's peak Chamber of Commerce and Industry, Business SA is South Australia's leading business membership organisation. We represent thousands of businesses through direct membership and affiliated industry associations. These businesses come from all industry sectors, ranging in size from micro-business to multi-national companies. Business SA advocates on behalf of business to propose legislative, regulatory and policy reforms and programs for sustainable economic growth in South Australia.

Should you require any further information or have any questions, please contact Rick Cairney, Director of Policy, Business SA on (08) 8300 0060 or rickc@business-sa.com.

Yours sincerely



Rick Cairney

Director of Policy