Let's be clear:

PIAC submission to the AEMC's Consultation Paper – *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014*

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Oliver Derum, Senior Policy Officer
Energy and Water Consumers' Advocacy Program

Level 7, 173-175 Phillip Street, Sydney NSW 2000 • DX 643 Sydney
Phone: 61 2 8898 6500 • Fax: 61 2 8898 6555 • www.piac.asn.au

1. Introduction

1.1 The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights; and
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from NSW Trade & Investment for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

1.2 Energy + Water Consumers' Advocacy Program

This program was established at PIAC as the Utilities Consumers' Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Park and Village Service;
- Ethnic Communities Council NSW;
- Rural and remote consumers;
- Retirement Villages Residents Association;
- Physical Disability Council NSW; and
- Affiliated Residential Park Residents Association.

2. The proposed rule change

PIAC welcomes the opportunity to provide comment on the Australian Energy Market Commission's (AEMC) Consultation Paper, *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014* (the Consultation Paper). The Consultation Paper seeks comment from stakeholders about a possible amendment to the National Energy Retail Rules (NERR), proposed by the Consumer Utilities Advocacy Centre (CUAC) and the Consumer Action Law Centre (CALC). The proposed rule 'seeks to prohibit retailers from including terms in their contracts that allow them to change prices during the fixed term or fixed benefit period of market retail contracts'.[1]

PIAC takes the view that fixed-term (or fixed benefit period) contracts that permit retailers to change the price are not beneficial to consumers. The proposed rule change would have a number of positive impacts for consumers, including increasing competitive pressure on retailers and making the benefits of switching more certain.

PIAC accepts that if the proposed rule change were implemented, retailers may respond by changing the structure of their offers in order to manage the risk of increasing costs that they could not immediately pass on to consumers. PIAC takes the view that this would more accurately reflect the true cost of an energy contract. Nonetheless, PIAC recommends that the AEMC study the risk premiums in fixed term contracts and the few fixed-price contracts in the market in order to understand the impact of risk premiums on prices.

Finally, PIAC makes a number of recommendations for alternative rules that could be considered if the AEMC elected not to implement the rule change proposed by CUAC and CALC. These recommendations cover notifying consumers of price changes, providing consumers with details about how prices may change during a contract term and allowing consumers to break a contract without paying an exit fee in a period following a price rise.

3. Benefits of the proposed rule to consumers

PIAC believes that prohibiting retailers from increasing the price of energy during fixed-term contracts would benefit consumers. The Consultation Paper notes that a 'possible impact of the proposed rule is downward pressure on prices due to increased certainty for consumers regarding future prices'.[2] The Consultation Paper outlines three key ways that this could occur.

Firstly, where consumers have a greater understanding of the prices they are agreeing to pay (because these prices will not change at an unknown time), they are better able to compare offers between retailers.[3] If consumers are more informed, this increases the competitive pressure on retailers. Where competitive pressure increases, retailers should, in theory, be more likely to develop products that are attractive to consumers. Where true prices are opaque and

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1 AEMC, 2014, *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014*, i.

2 Ibid 45.

3 Ibid.

prone to unpredictable and significant change, retailers may create offers that initially appear attractive but quickly become less beneficial when prices rise.

Secondly, a greater understanding of future prices under a particular contract makes the benefits of switching more certain for consumers.[4] Where clarity exists around current and future prices, consumers are better able to weight price and other contract terms, such as exit fees, against their existing contract (or other offers) to decide which is the best option for them. Further, where consumers are better able to choose an offer that is right for them, search costs will be reduced or deliver better results. If consumers spend time seeking out an offer that is not what it appears to be (because the price increases soon after they sign up), they may choose to invest more time seeking an alternative. As noted in the economic analysis accompanying the rule change proposal, 'search costs tend to be sunk costs', which cannot be recovered.[5] Accordingly, PIAC argues that measures that minimise these costs will benefit both consumers and society more broadly. At the same time, PIAC notes that a prohibition on price changes within contract periods may mean retailers offer shorter contract length (this issue is discussed further below).

Thirdly, where consumers have a better understanding of what they are purchasing (or not purchasing), their preferences are more clearly communicated to retailers.[6] Data collected for the AEMC's review of the effectiveness of retail competition in NSW suggests that retailers are currently only mildly effective at meeting consumers' expectations. Of surveyed consumers who had switched retailers, little more than half (57%) were satisfied with their new provider.[7] PIAC takes the view that this low figure is, in part, due to retailers not offering consumers products that truly meet their needs. This situation may be improved if consumers are better able to convey their preferences through their consumption decisions, benefitting both themselves and retailers.

Recommendation 1

PIAC recommends that the AEMC adopt the CUAC/CALC rule change and prohibit retailers from including terms in their contracts that allow them to change prices during the fixed-term or fixed benefit period of market retail contracts.

4. Risk management and the impact on price

In PIAC's assessment, the key issue of the proposed rule change relates to which party bears the risk of future price changes and who is best placed to manage these risks. According to the Consultation Paper, 'the principal role of the retailer in energy markets is to manage risks on behalf of its customers'.[8] In PIAC's view, retailers are better placed than consumers to manage risk, because the former have greater resources and expertise with which do to so.

The Consultation Paper also asserts that the competitive market should create 'strong incentives for retailers to manage risks in the most efficient way for their customers'.[9] However, PIAC

4 Ibid.
5 Consumer Action Law Centre (CALC) and Consumer Utilities Advocacy Centre (CUAC), *Unilateral Price Variations & Market Retail Contracts Rule Change Request for Australian Energy Market Commission,* 2013, 38.
6 AEMC, above n 1, 45.
7 Ibid, 41.
8 Ibid, 28.
9 Ibid.

submits that where retailers are able to pass on any price increases to consumers, this incentive is much weaker. As noted by the economic analysis accompanying the CUAC/CALC rule change proposal:

> The ability to unilaterally alter the terms of the contract shifts risk from the retailer to the consumer. It removes or reduces the incentive for the retailer to assess and properly provide for risk. The contract is likely to be inefficient.[10]

It follows from this analysis that allowing retailers to unilaterally vary the price of electricity in a fixed-term or fixed benefit period contract is producing sub-optimal outcomes for consumers in retail energy markets.

PIAC also notes that the expert advice provided as part of the rule change proposal argues that energy retail contracts are generally 'sufficiently short' that retailers should be expected to address the risk within the contract 'without the need to have the right to unilaterally alter the contract terms'.[11]

4.1 Possible retailer responses to the proposed rule change

If the proposed rule change was introduced, PIAC believes that retailers may respond by changing the design of their offers. PIAC anticipates that retailers may seek to manage the increased risk they faced in three possible ways, or through some combination of the three. Firstly, retailers could increase the price of contracts, to include an additional risk premium in case of higher costs during the contract. Secondly, retailers could seek to manage the risk of higher costs by increasing the exit fees on fixed-term contracts, subject to any restrictions on exit fees in a particular jurisdiction. Finally, retailers could reduce the length of the fixed-term contracts they offer, in order to reduce the period over which they risk seeing their costs increase without the ability to recoup the higher amount.

While the cost of a contract would be higher if retailers took either of the first two responses, this higher cost is more likely to reflect the true cost of the contract. As noted in the rule change proposal, these transparent costs are 'likely to enable competition to work more effectively to encourage efficient pricing'.[12]

However, PIAC notes that if retailers are unable to alter the price during a fixed term contract, they may include a risk premium that sees higher prices over the contract term than would be the case under current arrangements. To help stakeholders better understand the impact of the proposed rule, PIAC recommends that the AEMC analyse risk premiums in current fixed term contracts and compare these with the small number of fixed-price contracts available in the market. In doing so, any comparison should be between fixed price contracts and variable contracts *after* the first price increase. This is because PIAC is aware of a number of customers who have signed up to a contract with a low initial price and seen the cost go up soon after, only to find that the lower price to which they were originally attracted is still available to new customers of that retailer.

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[10] CALC & CUAC, above n 2, 39
[11] Ibid.
[12] Ibid, 27.

Recommendation 2

PIAC recommends that the AEMC examine prices and risk premiums in fixed-term and fixed-price contracts. This analysis should examine prices after the first price increase, especially where this occurs soon after a contract has been entered into.

5. Alternative rule changes

The Consultation Paper discusses a number of alternative rules that could address the issues outlined in the CUAC/CALC rule change request. PIAC reiterates its support for preventing retailers from increasing prices during a fixed-term contract (or the fixed-term benefit period of a contract). Nonetheless, this section discusses an alternative rule to improve consumer participation in the retail energy market. PIAC's comments in this section are applicable if the AEMC elects not to adopt the CUAC/CALC rule change in its proposed form. These alternatives relate to notification of price changes, information about the possibility of price changes and allowing consumers to break a contract without paying an exit fee where the price of that contract has been increased.

5.1 Notification of price changes

Currently, retailers are required to notify consumers of a change in price 'as soon as practicable or, at the latest, the next bill'.[13] In practice, PIAC understands that it is unusual for consumers to be informed of a price rise before the next bill. This means that consumers are using energy thinking they are purchasing it at a one price, when they are actually being charged another price. This hampers their ability to respond to a price signal about the increased cost of the product they are consuming.

PIAC, therefore, recommends that the NERR be amended to require retailers to inform consumers of a price rise before it takes effect. This would allow consumers to respond to this price increase and, if able, reduce their consumption in response. PIAC recommends that consumers be given a minimum of 21 days notice before a price increase takes effect.

Modern communications technologies, such as email and text messages, offer a low-cost option for retailers to contact many consumers about price increases. Where consumers elect not to be contacted in this way (including because they do not use the internet or mobile phones), retailers will have to contact consumers by mail. PIAC accepts that there is a cost associated with any mail out to consumers and that informing consumers of price rises through bills minimises this additional cost. Where retailers cannot contact a consumer electronically—and choose not to send a separate letter, due to the cost of doing so—those suppliers would need to schedule price rises to take effect at least 21 days after a bill is issued.

Recommendation

PIAC recommends that the NERR be amended to require retailers to give consumers 21 days notice of any price increase. This notification could be delivered electronically, where consumers agree to be contacted via such channels.

[13] AEMC, above n 1, 28.

5.2 Estimates of price trends

If the AEMC choses not to prevent retailers from unilaterally varying the price of energy in a fixed-term contract, PIAC supports requiring retailers to give consumers better information about how prices can vary during the contract. As noted in the in the Consultation Paper, this requirement 'could improve the transparency of information available to consumers when they are deciding which contract to switch to'.[14]

As noted in the Consultation Paper, it will be vital that retailers 'provide such information on a consistent basis'.[15] If the form of the information is properly considered, it will allow consumers to be better informed, while 'not imposing significant compliance costs on retailers'.[16] PIAC, therefore, recommends that if the AEMC choses not to restrict price increases during a fixed-term contract, it require retailers to inform consumers in a clear and consistent manner about how prices may vary during the contract.

Recommendation

PIAC recommends that if the AEMC chooses not prevent retailers from unilaterally varying the price in fixed-term or fixed-benefit period contracts, then it require retailers to clearly and consistently inform consumers about how the price may vary during a contract period.

5.3 Prohibiting exit fees where prices increase

PIAC believes that consumers on a fixed-term contract would benefit if they were permitted to terminate a contract within a given period following a price increase without paying an exit fee. The Consultation Paper notes that when the price of a fixed-term contract changes, 'the existence of exit fees may restrict consumers from seeking a more competitively priced contract'.[17] As such, exit fees represent a potential barrier to consumers participating in the market in order to find a better offer when their current contract has just increased in price.

PIAC submits that this barrier would be reduced or removed by allowing consumers to exit a fixed-term contract without paying an exit fee where the price of that contract has been increased. This recommendation could work in concert with the recommendation above about informing consumers of changes in price. Once consumers are informed about a price rise, they would have the period until the price rise takes effect (21 days) in which to exit their existing contract without being subject to an exit fee. This provision would increase competitive pressure on retailers, which should, in turn, improve outcomes for consumers in the competitive market.

Recommendation

PIAC recommends that if the AEMC choses not to prevent retailers from altering the price during fixed-term contracts, it amend the NERR to permit consumers to exit such contracts without being subject to an early termination fee within 21 days of being informed of a price rise.

[14] Ibid, 64.
[15] Ibid.
[16] Ibid.
[17] Ibid, 44.

6. Conclusion

PIAC supports the proposed rule change and considers that it would benefit consumers. Where consumers are better able to understand the true cost of a contract before them, they are better able to make informed decisions. This, in turn, increases competitive pressure on retailers and improves the efficiency of the retail market.

If the AEMC elects not to adopt the proposed rule change, a number of other amendments to the NERR could improve the functioning of the competitive retail market. These changes include improvements to the way consumers are notified about price changes, allowing consumers to break a contract without paying an exit fee following a price rise and requiring retailers to better explain the possible price changes during a fixed-term contract.