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27 March 2014

Retailer Price Variations in Market Retail Contracts
Australian Energy Market Commission
ATT: Sarah Lau

Submitted online: http://www.aemc.gov.au/About-Us/Contact-Us/Lodge-A-Submission.html?RuleChange=RRC0001

Dear Sir/Madam,

RE: Consultation Paper- National Energy Retail Amendment (Retailer Price Variations in Market Retail Contracts) Rule 2014

Red Energy welcomes the opportunity to provide comment on the AEMC's Retailer Price Variations in Market Retail Contracts Rule Change Consultation Paper (the Consultation Paper).

Red Energy is a 100% Australian owned and operated subsidiary of Snowy Hydro Ltd. Red Energy currently retails electricity and gas in Victoria, and electricity in NSW, QLD, ACT and South Australia and is one of the larger second tier retailers in the National Electricity Market (NEM).

In reviewing the Consultation Paper, Red Energy has focused on a number of key factors it feels are of particular benefit or detriment to the market overall. This advice is based on our experience as a current retail market participant.

Summary

As a general principle, Red Energy has concerns regarding new regulation in the energy retail market if there is no clear evidence of market failure. The primary benefit of a deregulated, competitive energy market is that it enables customers to not only choose the best offer that is available to them, but also that competitive rivalry between retailers encourages innovation, pricing and terms and conditions to meet customer demand. A retailer's ability to choose and develop products, and price them efficiently to best meet consumers demands can be the difference between success and failure as a participant in the National Energy Market (NEM). Fixed price products exist, but are not widespread across the energy industry, suggesting demand is low at the pricing offered.

The energy industry is unlike the banking or telecommunication industries to which comparisons are made in terms of fixed pricing. There are a number of different factors making up a customer's bill that a Retailer has little or no control over. Network costs for example are regulated by the AER and are completely outside a Retailers control. These costs are a significant component of a retail customer's bill. In some states, network costs make up approximately half of an average customer bill. Forcing Retailers to price in risk premiums for costs completely outside their control will be expensive for consumers.

The suggested rule change submitted to the AEMC by the Consumer Action Law Centre (CALC) and the Consumer Utilities Advocacy Council (CUAC) acts as a disincentive to retailers to develop new products that best suit market demand. This in turn is likely to reduce the choice and variety of different offers in the market. Red Energy is very concerned that changes to the regulations stipulated in the Consultation Paper may dilute choice in the market and drive up prices, which is obviously not the intended benefit of the rule change submitted. As the AEMC is aware, some Retailers already offer fixed price products in the market. If there is demand, Retailers have incentive to offer these products in a competitive market. These offers however are generally priced at a material premium to variable price products due to the costs of bearing significant risk. Limiting retailers to only offer these premium products will limit a consumer's access to lower priced alternative offers.

The National Energy Retail Objective (NERO)

Red Energy agrees with the Commission's methodology of review that any potential retail rule change must satisfy both the NERO test and the Consumer Protections test.

Given this is the first retail rule change request, Red Energy feels the Commission's assessment of the NERO test is of particular importance as this assessment will help guide determinations with regard to the National Energy Customer Framework (NECF) in the future. The Consultation Paper states "The NERO requires that efficiency in the investment, operation and use of energy services is the principal consideration for determining what is in the long- term interests of consumers"[1]. Red Energy does not believe this rule change will be in the long- term interests of consumers.

Efficient markets are regulated as required, however should be allowed to develop under the pressures of market forces present in that market. In the NEM, the key benefit of deregulated markets with minimal market constraints in the form of excess regulation is that Retailers are empowered and encouraged to offer the products that their customers want. In the current market, these include fixed price products, as well as fixed term variable price products. This choice benefits consumers in that they can choose the product

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[1] Australian Energy Market Commission, Consultation Paper- National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule, p. 21, 2014

that best meets their needs. Removing this choice will negatively impact consumers in general.

Consumer protections in the market

Red Energy does not believe that Rule 46 of the NERR adversely impacts the consumer protection requirements of the NERO.

Energy Retailers are obligated to provide the customer with information advising of the ability of that Retailer to change the pricing during the term of the contract. To this end, Red Energy obtains explicit informed consent regarding this provision from all of its customers prior to entry into the Market Retail Contract. As such, we do not agree that customers entering fixed term contracts are unaware the pricing is not fixed.

In addition to Retailers obtaining explicit informed consent to the variable pricing during the contract period, the Australian Consumer Law provides protection for consumers from misleading and deceptive conduct by retailers suggesting fixed term contracts have fixed pricing when they are not. Red Energy believes these protections are sufficient to ensure customers are aware of the presence of variable pricing in Retailer MRC's.

Efficient energy pricing

Red Energy believes that variable price contracts are in the best interests of consumers in that they allow a retailer to make better offers to its customers, without the need to price in material risk premiums to cover potential cost movements beyond their control. For example, a retailer offering a price of $x per kWh in 2014 on a variable price product may offer a two year fixed price product at $x+y per kWh over the term of the contract to allow for any unforeseen changes in the market in the next two years. Should these unforeseen cost movements not eventuate, the retailer would have been able to hold rates lower under a variable price contract. In this instance, it is clear that the customer would be disadvantaged by the requirement on the retailer to fix its pricing for a two year period. Some customers may be happy to pay a premium for certainty in a fixed price, others may prefer lower rates that move over time. The market currently delivers this choice.

Red Energy notes that the AEMC has conducted analysis into the pricing of both fixed price contracts and variable price contracts available in the market today. The finding of an 8% premium[2] for the fixed price contract compared with the corresponding variable offering gives some indication of the future of Retail pricing across the NEM should fixed pricing be mandated.

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[2] Ibid, p. 37

Ramifications of increased regulation

An unintended consequence of this rule change could be that retailers no longer offer their customers multiple year fixed term arrangements. Today's market sees a number of different fixed term offers ranging from one to three years. If retailers were forced to fix the pricing of all customers entering into a fixed term contract, it seems highly likely that the length of the fixed term offer will reduce to a period that the retailer feels more confident predicting the pricing. The longer the term of the contract the higher the risk premium expected.

This may mean that choice for two and three year offers reduces. This loss of choice will diminish the benefits that competition has delivered across the NEM. Furthermore, if common contract terms shorten due to the price risks imposed on retailers offering fixer prices, retailers will need to recover acquisition costs over a shorter period in time. This is likely to put further upwards pressure on prices. IPART recently conducted a review into early termination fees (ETFs) in NSW. These costs would need to be borne by customers over a shorter customer lifecycle, increasing customer pricing on a per kilowatt basis.

Customer X and Red Energy

In the Rule Change Request lodged to the AEMC by CALC and CUAC, a case study is provided from a Victorian customer example in which that customer received a substantial price increase during their fixed term contract with Red Energy[3].

It seems this customer was signed to Red Energy on our two year fixed term contract, offering a fixed rate period from August 2012 – 1 January 2013. Red Energy ensures all customers are aware of the fixed rate period of the contract and explicit informed consent of this is obtained during the customer's sales and subsequent verification call.

As part of Red Energy's commitment to providing its customers with the best available offer, this customer was offered a low rate with a clear explanation of the fixed period in which the rate was to apply. Following the conclusion of the fixed rate period, the customer was placed on pricing applicable to the majority of Red's equivalent customers, while also gaining an additional benefit of a two percent higher Pay on Time Discount than was originally contracted for. At no time was the customer paying higher prices than any other equivalent customers, nor was the customer not explicitly informed of the variable pricing during the contract term.

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[3] Consumer Action Law Centre & Consumer Utilities Advocacy Centre- Unilateral Price Variation & Market Retail Contracts Rule Change Request for Australian Energy Market Commission, p. 19, 2013

Conclusion

To conclude, Red Energy does not believe there is a retail market failure regarding energy pricing during fixed term contracts warranting a prescriptive rule change. Red Energy is of the strong belief that energy retailers are incentivised to provide customers with a compelling choice from a range of competitive offers. A retailer who is no longer competitive will be penalised by a higher than average rate of customer churn, and lose the customers they fought to obtain.

Retailers should be allowed to respond to market demand, without regulation designed to second guess the appropriate market outcomes and which risk driving market inefficiencies. If it becomes clear there is demand in the market for higher rates to "lock in" pricing over an extended period, more Retailers will offer these products or risk losing market share in that part of the market. Similarly, the ability to offer a less fixed yet potentially lower cost variable product should not be removed by regulation put in place to repair a market inefficiency that isn't there.

If you have any further comments or queries in relation to this submission please don't hesitate to contact me directly on 03 9425 0496, or Ben Barnes on 03 9425 0530.

Yours sincerely

Stephen Grant
Manager-Quality and Compliance
Red Energy Pty Ltd