

27 March 2014

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Sir/Madam,

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

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide feedback in response to the *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014* (the Consultation Paper).

The ERAA represents the organisations providing electricity and gas to almost 10 million Australian households and businesses. Our member organisations are mostly privately owned, vary in size and operate in all areas within the National Electricity Market (NEM) and are the first point of contact for end use customers of both electricity and gas.

The ERAA does not support the rule change request (the proposed rule) put forward by the Consumer Action Law Centre (CALC) and the Consumer Utilities Advocacy Centre (CUAC) (collectively referred to as the proponents). The ERAA does not believe that the proposed rule will, or is likely to, promote the long term interests of consumers as required under the National Energy Retail Objective (NERO) as:

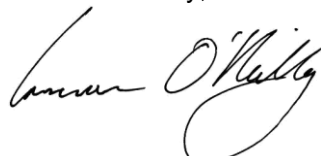
- the proposed rule will reduce choice - retailers already offer a wide variety of contracts, including those with fixed prices over a fixed term and offers with no exit fees
- this proposed rule may reduce competition as retailers will no longer have a strong incentive to innovate as it will remove many offers which are currently most attractive to consumers
- consumers will have reduced efficient operation and investment signals for their choices in energy services
- customers are already informed of the nature of fixed term contracts when signing up to new deals.

This submission will discuss:

1. the nature of retail energy market offers, and the manner in which customers are able to exercise choice whilst being appropriately protected from price variations
2. the impacts of the proposed rule on consumer protections and the efficiency of the retail energy market
3. why the proposed rule does not meet the NERO test
4. the alternative rules contained in the Consultation Paper.

Should you wish to discuss the details of this submission, please contact me on (02) 8241 1800 and I will be happy to facilitate such discussions with my member companies.

Yours sincerely,



Cameron O'Reilly
CEO
Energy Retailers Association of Australia



The collective voice of
electricity and gas retailers



1. Current arrangements

Retailers are incentivised to provide customers with competitive products and services

Competition in retail energy markets, as in other sectors of the Australian economy, incentivises businesses to improve service, develop products that meet consumer needs and find ways to lower their costs and to pass these savings onto consumers. Retailers compete to provide customers with the offer that best reflects their customers' needs whilst mitigating a customer's exposure to the various cost inputs that makes up a retail tariff. In effect, the retailer takes on the role of risk manager for their customer.

As customer preferences vary, and bearing in mind the risk that retailers absorb, retailers provide a broad range of market offers. Customers then choose from these offers based on their individualised preferences. Customers are currently able to access the following market retail contracts¹:

1. Products where the term of the contract is fixed (fixed term contracts).

Although the retail price can be varied during this period, it is usually in response to increases to input prices. These products allow retailers to accurately reflect the efficient cost of providing these services, and customers are informed before prices are varied.

2. Products where the price is fixed over the term of the contract (fixed price contracts).

These products are generally more expensive and considered a premium product, as retailers must incorporate a greater risk premium, yet are made available to customers that wish to effectively lock in a rate for a defined period.

3. Fixed term contracts with no exit fees allowing customers to switch contracts at no cost.

4. Products with a benefit (e.g. discount) over a defined period, with either a fixed length or evergreen product (fixed benefit period contract).

These offers are based on an introductory offer being made to the customer, with a change after that period, either to a standard market contract rate or to a standing offer contract.

5. Products tailored to a customer's needs, which can be fixed term contracts or evergreen contracts – for example flexible prices or discounts that apply based on certain conditions (e.g. direct debit).

These contracts vary in application, although they are all market retail contracts. The ERAA believes that this highlights the wide variety of choice customers have in selecting an energy provider and product. The AEMC should not use one term "fixed period" in their paper to describe the plethora of options available to customers. The terms "fixed term contract" and "fixed benefit period contract" should apply when describing market retail contracts, as each contract is distinct in its application which is described to the customer for their informed consent upon selection.

The proposed rule will either limit these offers to customers, or increase retail tariffs as higher premiums are factored in by retailers as more risk is now assumed.

Robust customer protections are already in place

Retail energy customers are already protected by the Australian Consumer Law (ACL), and all consumers are already informed that prices may change during fixed term contracts.

The proponents argue that Rule 46 of the National Energy Retail Rules (NERR) expressly permit retailers to allow for price variations during fixed periods in the market retail contracts,

¹ Note: Consumers are also able to access standing or regulated offers under the NERL.

meaning that the ACL does not protect customers from price changes during fixed term contracts. The ERAA does not agree with this interpretation.

Rule 46(2) states that a contract must contain all tariffs and charges and Rule 46(3) states that a retailer must give notice of any variation to those tariffs and charges. However, whilst Rule 46(3) places a requirement on the retailer to notify customers of a price variation, it does not expressly permit retailers to include terms that allow for price variations. Therefore, the unfair contract term provisions of the ACL will apply regardless of the existence of Rule 46 and consumers retain the protections under the unfair contract terms provisions.

In addition, the NERR already requires that a retailer (or its marketer) inform customers of all applicable prices and how they may be varied. Rule 64(1)(a) states:

- (1) The required information that a retail marketer is to provide to a small customer is information in relation to the following:
 - (a) All applicable prices, charges, early termination payments and penalties, security deposits, service levels, concessions or rebates, billing and payment arrangements and how any of these matters may be changed.

This ensures that customers are informed of all applicable prices and how they may be varied.

2. The impact of the proposed rule

The ERAA believes that the current arrangements are consistent with the NERO, and it is unclear how the proposed rule will provide outcomes that are in the long term interests of consumers. The proposed rule will lead to a number of adverse consumer consequences, potentially including a reduction in consumer choice as shorter term contracts are provided to absorb some of the market risk from what is being proposed, or an increase to tariff premiums to mitigate exposures to uncontrollable costs.

Price

Quite a large proportion of customers choose retail energy offers that have a fixed term period, but not necessarily a fixed benefit period. The proponents of the rule change seem to neglect the fact that retailers (as clearly stated by the AEMC) are price takers when it comes to network prices and changes to government charges and policy. Unlike wholesale costs, retailers have a limited ability to hedge the cost of network tariffs from one year to the next. Whilst some guidance of future price paths can be used to predict future network tariffs, all NERL distributors still have the flexibility to mandatorily reassign customers from one tariff type to another at any time.² For example, customers can be reassigned from a flat rate/standing charge network tariff to a time of use tariff without any notification to the retailer or the customer.

The proposed rule would restrict a retailer's ability to pass through efficient costs, and would contradict the Standing Council on Energy and Resources' long term objective of customers receiving better pricing signals about the cost of their use on the network. Should retailers be restricted from offering contracts that reflect supplier costs at a point in time, the link between prices and costs will be broken. Therefore, consumers will not receive market signals to change their usage or make efficient investment choices. Customers are also likely to experience a large bill shock as the cost reflective and efficient retail price may be very different from one contract to the next. This would represent a significant change to the retail energy market which the ERAA does not consider to be consistent with the NERO.

Retailers must also have flexibility in their tariff structure to allow for changes to government charges or changes in government policy. These changes can range in their predictability, and come both in the form of either direct or indirect costs. For example, different levels of

² Note: Victorian Distributors currently do not have this ability.

government will make policy changes at any time that can increase costs for retailers. If retailers cannot pass these on, a risk premium will have to be factored into future retail energy offers to mitigate the risk. The proponents assume that retailers can just absorb this risk (and the associated costs) as part of doing business. Whilst this may be initially the case for customers that have locked into a contract where prices cannot be varied for the duration of the contract, should the proposed rule come into effect, retailers will readjust their pricing to account for these costs. Retailers would also have to readjust premiums applied to all their tariffs to factor in the potential risk to changes to government policy that materially impacts their business.

Historically, most price variations have been increases. However, cost reductions have occurred at times, and may continue to do so. The proposed rule would prevent retailers from passing on the benefits of decreased costs to consumers during the period of their contract.

Contract length and switching

If implemented, the proposed rule could result in shorter contract periods, as customers choose to forgo the larger risk premiums of longer contracts. This will mean that customers will have to choose a new energy contract more often, increasing the transaction costs that they face. If longer term contracts remain in the market, it is likely that customers that wish to minimise their search and transactions costs by taking advantage of longer length contracts will suffer bill shock. Customers prefer gradual changes to prices, rather than large increases as they are better able to manage and budget for these changes. Yet the proposed rule contradicts this notion as it would result in larger differences between input costs should customers still opt to take longer contracts. Consumers may not understand why costs have increased in the period since they last selected a contract, which may increase complaint levels and Ombudsman cases. This is not in the long term interests of consumers as it does not promote efficient use of or investment in energy services with respect to price.

3. The proposed rule does not meet NERO test

Assessment framework

The ERAA does not believe that the proposed rule will meet the NERO test, as it will not promote:

- efficient investment in energy services over the long term (or short term)
- efficient operation of energy services over the long term (or short term)
- efficient use of energy services over the long term (or short term)
- the interests of energy consumers with respect to price, quality, safety, reliability and security over the long term.

The AEMC states that competitive markets provide the best means of promoting efficiency and has established a set of criteria that it considers reflect the characteristics of a well-functioning competitive market:

- efficient allocation of costs and risks
- effective consumer engagement and participation
- provision of a range of products and services consumers value
- independent rivalry and competition between retailers.

The ERAA agrees that the AEMC should consider how the proposed rule will impact on the effectiveness of competition in the market. Our members are addressing the adequacy of the AEMC's assessment framework more fully in their submissions and we refer the AEMC to those submissions.

The proposed rule does not meet the NERO test

The ERAA does not believe that the likely outcomes mentioned in section 2 of this submission will meet the NERO test. These outcomes include:

- risk premiums may be added to offers accounting for the potential cost of unpredictable but large scale events that may or may not occur. This will leave customers paying for the costs of events, regardless of whether they eventuate. This is not in the long term interests of consumers with respect to price, nor does it promote competition.
- customers will require a greater knowledge of the industry to ensure they select a new offer at the best possible time for them
- the proposed rule could result in higher search and transactions costs for customers as customers will have to re-contract their energy supply on a more frequent basis.
- if customers wish to reduce their search and transactions costs by taking advantage of longer term contracts, they could be subject to increased risk of bill shock as prices may change significantly between contracts
- the proposed rule will remove the link between retail prices and costs – meaning it will not fulfil the NERO of ensuring efficiency in investment, operation and use of energy.

The ERAA does not believe that evidence has been provided by the proponents to indicate the exact issue that the proposed rule is trying to address. The proponents cite evidence from the AEMC for the NSW Competition Review. This evidence indicates that only around 2% of electricity customers (and no gas customers) were dissatisfied after switching due to price rises.³ The proponents included a case study of an individual customer's experience (which does not suggest a systematic issue) and a theoretical discussion of the benefits of the proposed rule. The ERAA does not believe that these statements provide adequate evidence to support the existence of a problem, and thus it is difficult to see how the proposed rule satisfies the NERO test.

The proponents suggest that the proposed rule will reduce barriers to participation, and provide greater clarity to customers when considering offers. The ERAA does not agree this will be the case, with the proposed rule delinking the true cost of a retail energy contract with the price paid. The proponents suggest that regulatory changes to increase consumer protections in the UK have been beneficial for increasing participation and consumer engagement. Whilst the ERAA agrees with the AEMC that these comments are out of scope for the NERR, the ERAA notes that competition in the UK has fallen dramatically.⁴

The proponents argue that customers respond to reductions in price by increasing consumption. However, the proponents consider that customers are unable to respond to increases in price, and will continue to consume the same amount of energy if prices rise. These assertions contradict demonstrable data that shows recent reductions in overall consumer consumption in response to price increases and choices made by consumers to invest in alternative energy sources.

Comparisons to other industries

The proponents compare the energy industry to telecommunications and banking. The proposed rule being implemented into the banking sector would preclude all variable interest rate mortgages, which customers make a choice to select. Implementing this into the home loan rules would be telling all customers who are on a 4% variable home loan rate that they must go on a fixed home loan rate at 5.5% because it is better for all consumers. Comparing banking and energy is not appropriate, nor would it be feasible to implement equivalent changes into either sector.

³ AEMC, 2013, Survey of Residential Customers of Electricity and Natural Gas in NSW: Effectiveness of Retail Competition, Roy Morgan Research, p.28

⁴ The ERAA suggests that the AEMC review the statistics, which are available:

<https://www.gov.uk/government/statistical-data-sets/quarterly-domestic-energy-switching-statistics>

4. Alternative rules

The ERAA does not consider that the proposed alternative approaches would be in the interests of consumers. Further comments are provided in Table 1 below.

Table 1: Alternative Rules

Alternative	Allocation of costs and risks	Consumer engagement and participation	Range of products and services	Independent rivalry and competition between retailers
Creating a prescriptive list of costs that can and cannot be passed through to consumers by retailers during fixed periods.	Increased costs may be passed on to consumers with higher premiums applied to tariffs to account for potential cost misalignment and risks.	Will create consumer confusion as to which cost can be passed through and lead to higher transactional costs.	The ERAA agrees with statements made by the AEMC that creating a prescriptive list of costs that can and cannot be passed through will limit the range of market offers and be administratively difficult to monitor.	Uncertain.
Allowing customers a limited amount of time to switch retailers or contracts without paying an exit fee following a price variation.	As above, the risk of customers leaving following a price variation increase, will be result in higher retail tariffs as higher premiums are applied to account for such thing as potential losses in out of the money hedge contracts and retail transactional costs. ⁵	Will increase customer transactional costs, considering that most price variations will impact the whole market and will not be limited solely to one retailer.	Will not reduce choice but will potentially increase prices.	Uncertain.
Requiring retailers to provide more information to consumers about how prices could vary under market retail contracts.	Will impact on costs which will be factored into retail prices.	Agree with the AEMC that information will need to be consistent to be effective.	No impact.	Uncertain.

⁵ These risks are clearly defined by retailers to customers and explicit within the terms and conditions of the energy contract selected by the customer. Customers also have the added protection of a 10 day cooling off period under ACL, which allows them to read, review and understand the T&Cs and change/cancel the contract if they do not want to be bound by them.