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Ref: NB/TF/JD

Thursday 27 March 2014

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Pierce

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

Ergon Energy Corporation Limited (EECL), in its capacity as a Distribution Network Service Provider in Queensland, and Ergon Energy Queensland Pty Ltd (EEQ), in its capacity as a non-competing area retail entity in Queensland, hereinafter referred to as Ergon Energy, welcome the opportunity to provide comment to the Australian Energy Market Commission on its *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014* Consultation Paper (the Consultation Paper).

Specific comments in relation to the issues raised in the Consultation Paper are included in the attached submission.

Should you require additional information or wish to discuss any aspect of this submission, please do not hesitate to contact either myself on (07) 3851 6416, or Trudy Fraser on (07) 3851 6787.

Yours sincerely

Jenny Doyle
Group Manager Regulatory Affairs

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Enc: Ergon Energy's submission

Submission on the *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014* Consultation Paper

27 March 2014

Submission on the *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014*

Consultation Paper

Australian Energy Market Commission

27 March 2014

This submission, which is available for publication, is made by:

Ergon Energy Corporation Limited and Ergon Energy Queensland Pty Ltd

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FORTITUDE VALLEY QLD 4006

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1. Introduction

Ergon Energy Corporation Limited (EECL) and Ergon Energy Queensland Pty Ltd (EEQ), welcome the opportunity to provide comment to the Australian Energy Market Commission (AEMC) on its *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014* Consultation Paper (the Consultation Paper).

This submission is provided by:

- EECL, in its capacity as a Distribution Network Service Provider (DNSP) in Queensland; and
- EEQ, in its capacity as a non-competing area retail entity in Queensland.

In this submission, EECL and EEQ are collectively referred to as 'Ergon Energy'.

Ergon Energy is available to discuss this submission or provide further detail regarding the issues raised, should the AEMC require.

Proposed Rule Change

Ergon Energy understands the purpose of the Consultation Paper is to seek stakeholder comment on a request by the Consumer Action Law Centre (CALC) and the Consumer Utilities Advocacy Centre (CUAC) to enshrine in the National Energy Retail Rules (NERR) a prohibition on retailers including terms in market retail contracts (MRC) that allow price changes during fixed term or fixed benefit periods.

Ergon Energy interprets the CALC and CUAC's rationale for the proposed rule change as an effort to encourage retailers to manage risks more efficiently on behalf of customers and promote customer participation and confidence in retail energy markets.

Furthermore, it appears, CALC and CUAC consider that by allowing retailers to vary prices in MRC's, the current rules give rise to a number of adverse outcomes, such as:

- Inefficient allocation of risk in the market, whereby retailers shift risks associated with cost changes in the delivery of energy services to customers by increasing the prices paid by their customers;
- A general lack of customer confidence and engagement in the market, as customers are discouraged from participating in retail energy markets. The CALC and CUAC suggest this is due to perceptions that retailers will vary prices after customers enter new contracts, in addition to the transaction costs (i.e. exit fees and search costs) involved in switching contracts;
- Inefficient pricing and consumption decisions in the market, as price rises may result in customers using less energy than is efficient or paying retailers more than would be considered efficient; and
- Adverse impacts on the application of certain customer protections, to the extent that current rules affect the protections available to individuals i.e. unfair contract terms under the Australian Consumer Law (ACL).

2. Allocation of Costs and Risks

The CALC and CUAC have expressed concerns regarding the means by which risks associated with increases in the costs to retailers of providing energy services to customers are passed on in the form of increased prices, even during fixed periods. Additionally, the CALC and CUAC consider retailers as being in a better position to manage such risks, but are not adequately directed to manage them. Any positive obligation to manage costs and risk, the CALC and CUAC argue, would inevitably reduce prices paid by customers in fixed periods of MRCs.

Ergon Energy believes it is important to note that network costs are set via an annual network pricing process, determined by the Australian Energy Regulator; therefore retailers cannot be certain of network charges until a month before the start of each financial year. This inability to be certain of network pricing structures is a known and unavoidable risk that is not able to be mitigated. Additionally, there is limited information publicly available regarding long-term pricing trends that can be used to inform retail product offerings. As such, retailers have a very limited ability to effectively 'hedge' against this risk.

Ergon Energy also notes the impact of regulatory changes on retailers, and indeed distributors, can often be significant. One example of this is illustrated by the introduction and now potential repeal of a carbon price which has a +/- impact of approximately $22/MWh. Such regulatory risks are largely outside of the control of energy providers.

As described above, retailers are not in a position to effectively manage all of the risks associated with retailing electricity to customers. This is recognised by energy regulators which include the costs associated with increased network charges or new regulatory arrangements into regulated retail tariffs during annual price setting processes.

Retailers must therefore pass on these uncontrollable risks directly to customers (as occurs now in regulated retail tariffs) or, if prohibited from doing so should this proposed rule change proceed, by incorporating increased risk premiums into market offers.

3. Consumer Participation and Engagement

In the Consultation Paper, the CALC and CUAC consider retailer price increases during the fixed period of a MRC, and believe customers are discouraged from switching retailers or contracts due to:

- Transaction costs i.e. exit fees and waste of search costs; and/or
- Customer decision-making issues i.e. bias towards existing retailer or scepticism of alternatives.

The CALC and CUAC maintain that these costs and disincentives adversely affect confidence and participation, and essentially engender a general apathy towards engagement with the retail market.

Although Ergon Energy welcomes any measure to improve customer protection and engagement, such improvements need to be supported by a corresponding improvement in the degree to which customers are informed.

That is to say, customers need to be engaged and this engagement often requires knowledge, consideration and judgements made by customers in their own best interests. This is how customers who seek the services of any industry (i.e. telecommunications, travel, etc.) make decisions about the appropriateness of the contracts on offer. One likely outcome of the proposed changes, whereby prices are effectively fixed and changes are limited, is that the customer base, over time, will not increase their level of engagement with the market.

Ergon Energy believes the actual effect of the rule change proposal will be to limit the type of market offers available to customers. Under current arrangements:

- Customers who value price certainty can either seek a MRC that provides this or elect to take supply on a retailer's standing offer (in Queensland, the Financially Responsible Market Participant (FRMP) must offer its Small customers the regulated retail tariff via a Standard Retail Contract);
- Customers who value a lower price for electricity can choose to take on the risk that the price may change though negotiated contractual arrangements that give effect to this.

Ergon Energy is concerned that the effect of the proposed rule change will limit the ability of retailers to offer anything to customers other than a fixed rate/fixed term contract. Such an outcome is the antithesis of the CALC and CUACs intended promotion of competition. Ergon Energy likens this situation to the analogy used by the Australian Energy Market Commission (AEMC) in the Consultation Paper which notes that fixed rate mortgage offers are more expensive than variable rate mortgages.[1] As the AEMC explains, retailers generally offer a variety of market contracts, including variable contracts, and this reflects the large proportion of uncontrollable costs faced by retailers.

4. Competition between Retailers

In relation to the efficiency of customer pricing and consumption decisions, the CUAC and CALC have highlighted some common customer responses to retail market price changes. Firstly, CUAC and CALC maintain that customers often enter retail contracts on the basis of price, with a general understanding of the volume of energy they will consume at that price. After a MRC price increase, customers will either consume less energy, pay more to consume the same amount of energy, or perhaps a combination of the two. The CUAC and CALC consider that these responses are less than ideal for the retail market overall because:

- Where the customer reduces their consumption, less energy is being consumed that is efficient for the market; and
- Where the customer pays more, there is a transfer of wealth from the customer to the retailer, which would not occur if the market price was efficient.

Whilst these examples are valid, Ergon Energy is not convinced that, with the operation of an efficient retail market being the underpinning objective, the market will not eventually demonstrate an efficient price without market interference.

[1] Australian Energy Market Commission *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014,* Consultation Paper, page 37.

Additionally, Ergon Energy believes that where it is mandated to have no variations of market prices throughout the contract period, adverse consequences for the market may emerge. For instance, network businesses set network tariff structures and prices to promote efficient use of their network. Where retailers are prevented from passing through changes in network prices, price signals established by network businesses will be ineffective and misunderstood.

Ergon Energy also notes the AEMC stated "The Commission considers that, where feasible, competitive markets provide the best means of promoting efficiency" [2]. Ergon Energy is concerned that the proposed rule change would result in a reduction in competitive activity, as retailers would be limited in their ability to innovate and their variety of product offerings to customers would be reduced.

There is also a concern, that the proposed rule change may undermine the long-term interests of customers, as retailers would need to factor risk premiums into their market offers, thereby initiating an overall increase in the costs to customers.

5. Consumer Protection Issues

Ergon Energy notes that customer protections are already provided in a variety of existing legislative mechanisms (jurisdictional Ombudsman schemes and fair trading legislation, for example), in addition to the existing provisions of the NERR[3] for early termination of MRC's. To the extent that Ombudsmen and jurisdictional Energy Ministers become aware of behaviour inconsistent with the NERR, the opportunity exists to cap exit fees, as New South Wales has already introduced.

With regard to prices, the National Energy Customer Framework (NECF) requirements are reasonably prescriptive; retailers are required to give notice to customers of prices changes[4], in addition to many other information requirements.

To the extent that NECF introduces the possibility of unfair contract terms, Ergon Energy's preference would be to further analyse the operation of the NERR, rather than annexing additional legislative requirements to operate in parallel. Ergon Energy's suggestion would be to further analyse the operation of the NERR and its effect on this issue, and improve what is currently ineffective, rather than importing additional clauses and protections from the ACL, which as highlighted by the CUAC and CALC, do not function consistently with the NERR.

6. Conclusion

Ergon Energy is concerned that the CALC and CUAC have not provided sufficient evidence to warrant a change to the rules on the basis of customer benefit or customer protection. Whilst any analysis of current rules for the purpose of improving customer protection and market efficiency are welcomed by Ergon Energy, there does not appear to be any demonstrated need for this proposed interference in a competitive retail contract market.

[2] ibid, page 21.

[3] NERR 49A – Early Termination of Market Retail Contracts.

[4] NERR 46 (3)(4) and (5).