

Essential Services Commission
Level 37, 2 Lonsdale St
MELBOURNE VIC 3000

Lodged by email: retailenergyreview@esc.vic.gov.au

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Ensuring Energy Contracts are Clear and Fair

The Australian Energy Council (the '**AEC**') welcomes the opportunity to make a submission to the Essential Services Commission (the '**ESC**') on the Ensuring Energy Contracts are Clear and Fair Issues Paper (the '**Issues Paper**').

The AEC is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

Early and open consultation

The AEC welcomes the ESC's approach to engage early with stakeholders by publishing this issues paper. Genuine and open consultation is critical given the speed at which reform has progressed in recent years.

But, we are concerned that the ESC appears to have interpreted the Terms of Reference (the '**ToR**') provided by the Victorian Government on 21 December 2018 as requiring the *implementation* of recommendation 4A to 4E of the Independent Review of the Electricity and Gas Retail Markets in Victoria (the '**Thwaites Review**'), irrespective of the merits or costs of each recommendation. While we accept that the ESC has individually assessed each recommendation and its possible implementation options to encourage comment from stakeholders, the AEC does not consider the Issues Paper lends enough weight to the need to consider the benefits, or *effect* of the recommendations in totality.

The ESC's approach is in contrast to the Government's request in the ToR. The ToR does not use the word implement, instead requiring the ESC to 'conduct a review... on appropriate amendments' to 'give effect to the recommendations', and to 'advise of any implementation issues arising from these ToR'. The ToR clearly states that in conducting the review the ESC must have regard to the legislated objectives under the Essential Services Commission Act 2001, the Electricity Industry Act 2000, and the Gas Industry Act 2001. Importantly, these legislated objectives require the ESC to have regard to the interests of consumers, the benefits and costs of regulation, and the impacts on competition.

The AEC considers that the ToR obligates the ESC to undertake a comprehensive review of the Recommendations as a package, importantly identifying what problems it seeks to resolve and the preferred outcomes post implementation. As was highlighted at the ESC's stakeholder workshop on 17 June, considering options before the intended outcome is understood leads to more questions than answers. A decision to increase technical regulations like those in recommendation 4 should not be taken lightly.

The AEC is committed to working with the ESC, and the Victorian Government, to deliver a regulatory framework that genuinely benefits energy consumers. In order to achieve this outcome in what is becoming

an increasingly complex regulatory framework, the ESC should consider the impacts of incremental changes against two key questions:

1. Does the change *encourage* energy consumers to actively participate in the market and to *benefit* from that engagement?
2. Without the change, are energy consumers *unfairly disadvantaged* for failing to engage?

The AEC considers 'unfair disadvantage' to be a critical definition for the Government and the ESC. We agree that a customer might be unfairly disadvantaged if it would be unreasonable or impractical for them to protect themselves from that disadvantage. A customer would not be *unfairly disadvantaged* merely because they made a choice that negatively impacted them.

It is our expectation that implementing a number of the recommendations in the manner suggested in the Issues Paper would detrimentally impact the ability of the competitive market to operate in conjunction with the VDO's safety net.

It is absolutely critical that the ESC assesses the merits of these recommendations in light of the substantial regulatory interventions that have taken place in the Victorian retail market since 2016 when the recommendations were developed. We consider the ToR is clear on this need, and suggest the ESC reconsider their approach moving forward to ensure any changes ultimately implemented are those proven to deliver benefits to Victorian energy consumers. Without a genuine merits based review being undertaken, stakeholders cannot be confident that the long term interests of consumers have been appropriately considered.

Delivering improved customer outcomes

The Thwaites Review made 11 recommendations, comprising some 29 sub-recommendations. The Issues Paper notes that a number of these recommendations, including Recommendation 1 (the Basic Service Offer, now known as the Victorian Default Offer (the '**VDO**')) and Recommendation 3 will be implemented on 1 July 2019 (collectively referred to as the '**2019 recommendations**').

Yet, the ESC fails to adequately consider the impacts of such reform in the Issues Paper, and how recommendations 3A, and 4A to 4E (the '**2020 recommendations**') will change the post 1 July 2019 retail market. The AEC considers the 2019 recommendations will fundamentally change the operation of the Victorian retail energy market. The VDO in particular, coupled with the best offer and clear advice obligations, are significant; the Government describes the VDO as the "biggest reform of the retail sector in over a decade".

The AEC would welcome the opportunity to work with the ESC and other stakeholders to detail a new 'status quo' scenario, taking into account the fundamental reforms implemented in the last two years. The market has changed, and the impact of these changes will influence customer outcomes for many years to come. While the AEC has remained broadly supportive of the intention of Recommendations 3-11, the rolling approach to implementation presents an opportunity to reassess the merits of each recommendation, and sub-recommendation, in light of previous market reforms. As highlighted above, further incremental reforms must deliver identifiable customer benefits over and above those already implemented.

Fixing contract prices

Recommendation 4A – Preferred approach

Recommendation 4A was proposed by the Thwaites review as a means to avoid customers experiencing a price increase immediately after signing up to a new retail offer. Thwaites suggested that this practice was damaging confidence in the switching process, however presented no evidence as to why a 12 month ban on price changes was the optimal solution. A true cost benefit analysis would have considered whether the perceived consumer benefits of certainty outweighed the likely higher costs of limiting flexibility for retailers.

This trade-off was recently discussed by Craig Emerson Economics (CEE), in their report “Economic consequences of the Victorian Default Offer”.¹ CEE highlighted the experience of the federal government’s proposal to regulate the way fuel retailers published prices in 2008. The stated aim of Fuel Watch was to reduce the variability of fuel prices, and while the average price of fuel might go down, it would necessarily increase costs for cost conscious consumers who were taking advantage of the fuel price cycle by filling up when prices were low.

“Motorists told pollsters they disliked the fuel price cycle, but they were never asked whether they would be willing to pay higher prices in order to smooth out the cycle.”

This is analogous to the energy market. Are all customers failing to appreciate the variability of prices, and thus being unfairly disadvantaged by their disengagement?

The ESC immediately rejects a ‘do nothing’ scenario for recommendation 4A, on the basis that it would not directly tackle the issue of consumers facing a price change soon after signing up to a new offer. In making this assessment, the Issues Paper relies on Thwaites’ interpretation of the retail market in 2016 and does not give due consideration to the significant changes since then, in particularly the new clear advice entitlement (CAE), the best offer notification, the obligation to notify customers in advance of any changes that will impact their bill, and the VDO.

These changes mean the “new” status quo is vastly different to that seen by Thwaites. Post 1 July 2019, a customer who signs up to a new offer would need to be informed clearly, and in simple English, “*any specific price changes that will apply to that customer retail contract*”.² The ESC have previously noted that “*the clear advice entitlement ensures all customers will be clearly provided with the key information they need to assess their options prior to signing onto a new plan*”.³ If customers are unhappy with the possibility of a price increase in the near future, they would be able to opt for an alternative offer that provided the certainty they desired.

The best offer obligation, and the bill change notifications, will also encourage better outcomes for energy customers engaging in the market under the true status quo scenario. If the customer signs up to an offer that is subsequently increased, the retailer will be required to notify the customer, at least 5 business days in advance, to advise them that their prices are increasing, and provide advice if there are any better offers available. If the customer is unhappy, they would be able to switch to a new retailer, or immediately opt into the VDO at no cost. In 2016, retailers had no obligation to notify customers at all in advance of a price increase. Further, in 2019 if a customer fails to heed the advice at that time to switch to a more preferable offer, the retailer will be required to continue to notify the customer on their bill, at least quarterly, that

¹ Craig Emerson Economics, Economic Consequences of the Victorian Default Offer, pg 5

² New rule 70H(1)(b) in the 1 July 2019 Energy Retail Code

³ Essential Services Commission 2018, Building trust through new customer entitlements in the retail energy market: Final Decision, 30 October, pg 3

there are better offers available. They will also be required to notify the customer of the existence of the VDO, as a fairly priced offer for customers who do not wish to continue to engage.

If the problem the Thwaites Review was intending to solve was an information imbalance between retailers and customers that led to inefficient decision making, then the AEC considers that the post 1 July 2019 status quo would *give effect* to Recommendation 4A, without unfairly disadvantaging those who chose not to engage.

Recommendation 4A – alternative approaches

The ESC provides three alternative approaches in the Issues Paper to implement 4A. Of these alternatives, option two provides the least risk to both industry and consumers. The ESC is required under its legislated objectives to promote competition, and promote protections for customers. Requiring retailers to offer at least one fixed price offer allows these objectives to be met. Again, the CAE requires retailers to notify customers about available offers that may better suit their needs. The fixed price offer (likely more expensive than a variable offer) would be available for a customer seeking certainty, and to ensure they are not unfairly disadvantaged for failing to engage. The variable price offer would be available to ensure that customers who wish to engage are able to benefit from doing so, likely in return for a cheaper price. Regulating out the availability of these lower priced offers is likely to result in engaged customers paying more than they otherwise need to.

While Option 2a and 2b are ultimately likely to have the same effect on customers, the AEC considers 2a to be most practical. Not requiring retailers to have a fixed price option for each individual offer will enable innovation, while still ensuring the objective is met.

Option 1 might protect consumers unable to make an appropriate choice for their own circumstances, but to the detriment of all others. It assumes that no customer is willing to take any risk in return for a lower energy price. This is a concerning assumption, and would largely render the 2019 Recommendations irrelevant. The 2019 recommendations have been implemented as a means of mitigating the information asymmetry between retailers and customers, to enable better choices. If there are no choices to be made, then these reforms will not deliver the value they sought to. The AEC strongly believes that option 1 should only be considered after a comprehensive cost benefit analysis has been undertaken. There is a very real risk that it would increase energy costs for the average Victorian.

Option 1 would further necessitate the need for the ESC to consider an exemptions framework for costs outside of a retailers' control. An exemptions framework will likely decrease the benefits of option 1. For customers valuing price certainty, they will be sold a product that might change due to factors extraneous to them. Energy prices are not broken down into components on customer bills, and highlighting that some components are able to be changed while others are fixed seems inconsistent with the intent of the recommendation. If effectively drafted, option 2 might be able to avoid the need for an exemptions framework, noting that some retailers offer both fixed and variable products today.

Recommendation 4B

The ESC does not discuss options to implement Recommendation 4B, given that it is consequential to the approach taken in 4A. That being said, irrespective of the 4A approach, the AEC considers that 4B is unnecessary given the presence of the CAE. The CAE was not suggested by the Thwaites Review, and as noted above, requires retailers to give clear advice about relevant contractual terms. These relevant contractual terms would include advice about the presence (or otherwise) of any fixed price periods. No new regulation is required.

Practices at the end of benefit and contract periods – Recommendation 4C

Recommendation 4C would require retailers to roll customers onto the nearest matching, generally available offer at the end of a contract or benefit period. Effectively, 4C removes (or at least diminishes) the concept of explicit informed consent. It is important to note that the practice of rolling over contracts was common prior to 2015 when Version 11 of the Energy Retail Code (ERC) prohibited it due to concerns it was removing customer agency.

Scope

It is arguable whether a fixed price period proposed in Recommendation 4C would be captured by the definition of fixed benefit period (**'FBP'**) as defined in the current version of the ERC. The definition states:

***fixed benefit period** means a period of a market retail contract (where the end date of that period is specified or ascertainable at the beginning of that period) during which a benefit to the customer (such as a price discount) is available.*

As described in the Issues Paper and the Thwaites Review, the 12 month fixed price period is a reasonably ascertainable benefit. The AEC does not consider consumers are benefited by this definition, particularly given the new bill change notice obligations. The ESC should make amendments to this definition to highlight that a regulated fixed price period is not a fixed benefit period.

Recommendation 4C - Preferred approach

The AEC considers that different approaches should be taken for fixed term contracts (**'FTCs'**), and FBPs.

For FTCs, retailers are currently required at the conclusion of the term to roll customers onto the standing offer if the customer fails to enter into a new market retail contract. Given the presence of the VDO as a no-risk offer for customers who do not wish to participate in the market, we consider rolling these customers onto the VDO to be the most appropriate approach.

For offers with FBPs, the best approach is less clear.

The Issues Paper does not adequately highlight that Recommendation 4C clearly interacts with the benefits of other recommendations. The AEC is particularly concerned with the impact of the suggested options in the Issues Paper on the recently implemented Recommendation 3G. Recommendation 3G will require retailers to include best offer information on customer bills at least quarterly. In effect, if the customer's existing benefit period is not the retailer's best offer, the retailer will need to recommend the customer provide EIC to switch to that deemed best offer. At the conclusion of the contract period, option 2 would require the retailer to then automatically place the customer onto the best offer without first obtaining EIC.

Regulating option 2 would likely render Recommendation 3G as obsolete. Requiring a customer to provide EIC to get onto the best offer during the contract period, then suggesting the customer would then be 'rolled onto' that same best offer without EIC at the end of the period clearly encourages disengagement.

The obligation to supply in Victoria requires retailers to offer their existing customers the VDO. No other offer is captured by the obligation in clause 16 of the ERC, however retailers may elect to offer a market retail contract if they wish. The obligation to supply principles were recently re-affirmed by the Victorian Government in its implementation of the VDO. Given this, if the ESC is committed to implementing Recommendation 4C through a regulatory solution, the only approach consistent with clause 16 would be option 1. Retailers cannot be required to offer any other market offers.

That being said, there are a number of retailers who currently do offer some customers the opportunity to extend their FBP, or to retain the benefits of the FBP, under the terms of their existing contract. The AEC is concerned that regulating option 1 alone might result in retailers being required to shift customers who would otherwise have been offered a continuation of the benefits of the FBP onto a higher priced VDO. This does not appear to be the intent of the Recommendation. A possible solution to this could be a hybrid approach, where retailers must ensure the customer does not end up on an offer worse than the VDO at the end of their FBP. In effect, retailers would be free to use their discretion as to the offer to roll the customer onto, provided that offer was cheaper than (or equivalent to) the VDO.

Unintended outcomes of 4C

The ESC has a responsibility under its legislative requirements to determine whether the benefits of this regulatory change outweigh the costs. We do not consider this has been adequately proven for 4C.

At the very least, some of the potential options to implement Recommendation 4C would significantly deter retailers from offering benefit periods. Again, this will work to limit the availability of low cost offers in the market, and will further cause the dispersion of offers to narrow to near, if not at, the VDO.

We urge the ESC to undertake a more thorough impact assessment, including obtaining independent advice on the likely effect of this Recommendation on engaged energy consumers, before implementing any of the options proposed in the Issues Paper.

Similarly, it is important to remember that the increased prevalence of FBP's from 2015 coincided with changes to the ERC that made it more difficult to offer FTC's. Retailers were incentivised to create other products that avoided the 'clunky' FTC regulations. There is a risk that any moves to make it more difficult to offer FBPs will merely create another issue to be resolved in a few years. Properly considered principles based regulation is likely to result in better outcomes for energy consumers than merely banning another practice considered undesirable.

Recommendations relating to discounting – 3A, 4D, & 4E

How discounts are presented (recommendation 3A)

The AEC supports the suggested approach of the ESC to give effect Recommendation 3A by integrating the reference pricing obligations for electricity contained in the recent s13 Order in Council into the ERC. Avoiding the development of an additional piece of information inconsistent with current regulatory requirements will hopefully make things simpler for customers engaging in the energy market.

Other complementary obligations should be streamlined at the same time as implementing the reference price obligations, in particular ensuring that the information in the DELWP produced Victorian Energy Fact Sheets are consistent with retailer presentation obligations. This will ensure that the governments 'trusted' information is aligned to the information retailers are required to provide customers in their marketing.

For gas, the AEC would welcome a discussion with the ESC and Government to consider how a gas reference price mechanism could be implemented that would allow gas and electricity to be compared in the same manner. We do not consider it will be in customer interests to have different comparison approaches for the two fuels, particularly given the likelihood of the fuels being marketed together. To this end, we will write to the Energy Minister to discuss possible approaches that would deliver the outcomes sought in 3A to gas customers.

Making discounts evergreen (recommendation 4D)

The AEC does not consider the case has been made by Thwaites or the Government that the benefits of this recommendation will outweigh its obvious costs. The ESC correctly highlights the key issue here – that implementing 4D will effectively ban benefit periods. FBPs play an important role in the competitive market, and allow retailers to make beneficial offers to customers, without significantly increasing their risks. Even retailers that do not offer FBPs often have clauses in their Market Retail Contracts that set out that discounts are subject to change, either due to changes in market conditions or regulatory interventions.

In the post 1 July 2019 retail market, the consequences of this recommendation are more complex. Retailers will be subject to annually varying VDO prices, and as such, the AEC would expect the reasonable discounts retailers can afford to offer their customers will vary annually. Forcing retailers to only offer conditional discounts that they can guarantee to be able to afford in perpetuity will likely result in the discounts available to either decrease or disappear.

The Thwaites Review suggested that customers were finding themselves on poor energy deals when they lost discounts. Whilst this issue might remain, the best offer obligations in 3G, and the clear advice obligations, will undoubtedly assist customers in identifying whether or not the offer they are signing up to, or remain on, meets their needs.

Ensuring discounts are cost reflective (Recommendation 4E)

In line with its legislative responsibilities in s10 of the Electricity Industry Act, the AEC strongly suggests the ESC align its approach to implementing this recommendation to that taken by the Australian Energy Market Commission in considering the Australian Government's conditional discounts rule change.

Notwithstanding our preference for national consistency, the AEC does not consider that post 1 July 2019, this recommendation will be as valuable as it might be today. The Thwaites Review highlighted that customers risked paying too much if they failed to meet the terms of the contract. This is the case today, where retailers have been incentivised to 'inflate' their standing offers in order to increase the size of advertised discounts. There is no evidence, however, to suggest that retailers are offering large discounts in order to benefit from customers failing to meet those discounts, and in any event, the evidence suggests a significant majority of customers pay their bills on time.⁴

With the introduction of the VDO, and importantly the reference price (not envisaged in this manner by Thwaites), the incentives facing retailers will change. In effect, Recommendation 4E is intended to solve a problem not yet proven in the reformed retail market. Given this, the AEC encourages the ESC to initially implement the lightest possible regulatory approach, if in fact it considers there remains merit to the recommendation at all.

Option 1 represents clear price regulation. It will diminish the ability of retailers to offer discounts commensurate to their particular savings, and transitions risks onto consumers. The reasonable savings will vary significantly for different retailers. A very small start-up retailer, for example, might benefit more greatly from a customer paying on time (and therefore improving their cash flow) than a very large retailer with significant financial backing. This creates a difficult situation for the ESC as a price regulator. Setting the cap too high will mean some customers might face a greater risk if they fail to meet the conditions of the offer. Setting it too low will mean retailers are limited in their ability to offer their customers cheap deals. Neither outcome is optimal, particularly given the number of reforms currently being implemented will make it impossible for the ESC to make a reasoned judgement.

⁴ ACCC, Retail Electricity Pricing Inquiry—Final Report, Figure 13.7, Pg 264

Option 2 seems a more reasonable approach. This approach better aligns with the Australian Government's rule change request, and offers greater flexibility in an evolving market. The Issues Paper is unclear about whether the ESC envisions retailers would proactively need to justify their discounts offered, or whether the justification would simply need to be available. The AEC sees no additional benefit from taking the former approach, merely increasing the regulatory burden on retailers.

Prior to 2019, the ESC was committed to objective based regulation. Objective based regulation is particularly beneficial when subjective matters, such as 'reasonable costs', are being regulated. The AEC considers a higher level approach would best achieve the purpose of this recommendation, without unnecessary and onerous compliance processes that will not deliver any customer benefit.

Conclusion

The AEC is committed to continuing to work with the ESC and the Government to deliver workable solutions to the problems facing Victorian energy consumers. We strongly believe that the competitive market, with tools to encourage engagement, and a fair and reasonable safety net for those unable to engage, will deliver the best outcomes for all Victorians in the long term. Unproven and inflexible regulatory solutions will not enable these outcomes.

For any questions about our submission please contact me by email at ben.barnes@energycouncil.com.au or on (03) 9205 3115.

Yours sincerely,



Ben Barnes
Director, Retail Policy
Australian Energy Council