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Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

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

The Australian Energy Regulator (AER) welcomes the opportunity to provide this submission to the Australian Energy Market Commission's (AEMC) consultation paper on retailer price variations in market retail contracts.

The rule change request, jointly proposed by the Consumer Action Law Centre (CALC) and the Consumer Utilities Advocacy Centre (CUAC), seeks to prohibit energy retailers from varying prices during fixed term or fixed benefit period market retail contracts. CALC/CUAC consider such amendments would encourage retailers to more efficiently manage risks for their customers and promote more confident consumer participation in energy markets.

As the national energy regulator, we share the objective of improving consumer confidence; to strengthen engagement and active participation in the retail energy market. The National Energy Retail Law (Retail Law) provides the framework underpinning this objective. We are also strong advocates for effective competition in energy markets. We believe that effective competition provides incentives for energy retailers to operate efficiently and deliver innovation, choice and prices for the benefit of energy customers.

We recognise that a competitive retail energy market relies on confident consumers exercising informed choice. We also acknowledge concerns that some consumers find energy

markets complex and may be deterred from engaging fully in the market by lack of access to clear, easy-to-understand information about their current energy contracts and alternative contracts available to them.

Additionally, we acknowledge concerns around impediments to customer engagement underlying CALC/CUAC's rule change request. We support discussion of measures to address these concerns, especially those which are consistent with the current movement towards informed choice, competitive markets and a regulatory framework that focuses on better consumer involvement and engagement.

We are, however, concerned that the proposed regulatory intervention to ban price variations in fixed term market contracts may result in reduced choice and higher prices for customers, and therefore may not be in the long-term interests of consumers. We consider the central issue of this rule change request is that some customers may not understand that a fixed term contract, or one that has a fixed benefit period, does not mean that the price they are charged for energy is also fixed for the period of that term.

We question whether the proposed rule change is a proportionate response to address the concerns raised by CALC/CUAC given some of the likely consequences and impacts on the competitive retail market (as outlined in the AEMC's consultation paper and discussed further below). We are of the view that other strategies, such as improving consumer education and the transparency of information in this area, may more effectively address this issue.

The AEMC's consultation paper presents a well-considered discussion of key issues and appropriately identifies what we agree to be potential consequences, risks and benefits of the proposal. We support consultation on these issues and offer the following additional comments that may assist the AEMC in its consideration of the rule change request. Our response to these issues is drawn from our experience regulating network businesses, and wholesale and retail markets.

We recognise that this is the first retail rule change request to be considered by the AEMC under the Retail Law. We support the assessment framework proposed by the AEMC in its consultation paper.

Allocation of costs and risks

A key issue in the CALC/CUAC rule change request, and presented for consideration by the AEMC, is the appropriate allocation of risk between retailers and customers. In response to the suggestion that the current arrangement leads to an inefficient allocation of risk; we support the AEMC's discussion of the role of retailers in the market, the risks they face, their ability to manage these risks, and whether or not the proposed rule change would result in a more efficient allocation of risk or increased prices for customers (through the addition of risk premiums by retailers).

Retailers are required to manage a range of different risks and costs in providing retail energy contracts. As discussed by the AEMC, a retailer's ability to manage risks varies for the different costs that make up the retail energy bill. For example, while retailers have control over their own operating costs, they have very limited control over regulated network costs, which make up a significant proportion of customers' energy bills.

Network costs are set by the AER through five year regulatory determination processes and vary year-to-year in line with annual pricing proposals (also approved by the AER). The AEMC notes that retailers currently have limited scope to manage this variability or smooth out costs within the five year regulatory period or between such periods. Distributors may also submit cost pass through applications to the AER to deal with unanticipated cost increases and any approved amounts are able to be passed on to retailers and in turn customers. This is likely to make it difficult for retailers to efficiently predict or manage the level of these costs, or changes in these costs.

We note the relevance of the AEMC's current consideration of the electricity distribution network pricing arrangements rule change request. If implemented, we agree that this rule may improve retailers' ability to deal with risks associated with changes in distribution network charges by making network pricing more cost-reflective and predictable, however we do not consider such a reform (on its own) would sufficiently address concerns about risk allocation in this context. Firstly, the reform relates only to electricity, and secondly, we consider the predictive value of pricing structure statements in managing risk would decline over the term of a five year determination period.

Given these issues, if the proposed CALC/CUAC rule change was adopted, we agree with concerns raised by the AEMC that retailers are likely to respond by building in a 'risk premium' to retail prices to manage their inability to vary prices within a fixed term contract in line with shifting costs. In effect, this would raise prices for all customers on fixed term contracts, including those who may otherwise have been willing to manage the risk of a price change themselves.

Alternatively, retailers may be unwilling to take on this additional risk and would therefore cease to offer fixed term or fixed benefit period contracts, or only offer contracts with a shorter fixed period. This would result in reduced choice for consumers and could stifle

innovation and competition in the retail energy market. Currently energy consumers have the choice of both fixed price and fixed term contracts. They are also able to compare the relative benefits of these contracts and assess which best meets their needs. We note the AEMC's analysis that contracts with fixed prices are approximately eight per cent more expensive than those with fixed periods only. This enables customers to understand the risk premium associated with fixed price contracts and to choose these types of contracts if they decide this best matches their preference.

Consumer participation and engagement

We acknowledge concerns that some consumers may not make decisions about energy contracts with perfect information—the retail energy market is complex and understanding the detail of these contracts may be challenging for many consumers.

The Retail Law and the Retail Rules contain a range of measures designed to help consumers compare and make informed choices about energy contracts and how they use energy. Of particular importance in informing and empowering consumers is the AER's energy price comparison website, Energy Made Easy (www.energymadeeasy.gov.au). Energy Made Easy helps consumers to compare the range of generally available offers, including across key details such as discounts, incentives, fees and key terms and conditions. We continue to promote Energy Made Easy as a key source of trusted information for energy consumers, not only on available retail energy offers, but also on consumer protections and the energy market generally.

The Retail Law also includes roles for the AER in prescribing how retailers present their pricing information to customers. Under the Retail Law, the AER has developed, consulted on and implemented a Retail Pricing Information Guideline (Guideline). The aim of this Guideline is to assist small customers in comparing contracts by specifying the manner and form in which details of energy prices must be presented by retailers. Among other things, the Guideline requires retailers to use a standardised energy price fact sheet to communicate prices and other key product information when they market or advertise pricing information to consumers. Retailers must publish energy price fact sheets on their websites for all generally available standing and market offers, and include them on Energy Made Easy.

Notwithstanding that both energy contracts and energy price fact sheets must include terms setting out that the retailer may vary prices (as applicable), there may be some customers who do not read and/or understand either document prior to entering into an energy contract. It is not clear how significant a group of customers this might be or whether some customers do enter into a fixed term contract incorrectly assuming the price is also fixed. A better understanding and examination of customers' beliefs (and preferences) on these issues and price variations terms in energy contracts will assist the AEMC to understand the scale of these concerns and any likely consumer detriment. We understand that the AEMC has commissioned a program of market research as part of its annual retail competition review which will consider some of these issues.

We welcome consideration of further initiatives or measures designed to support consumers to better identify and understand the different offerings in the retail energy market and to make more informed choices based on their preferences. We agree these are very relevant and important issues and can help consumers achieve the most benefit from a competitive market. We consider several options in further detail below.

Competition between retailers

As we have noted, effective competition provides incentives for energy retailers to operate efficiently and deliver innovation and prices that benefit consumers. Competition must be effective, and effective competition relies on confident consumers having, and exercising, choice in the market.

We support the discussion presented in the consultation paper and share concerns raised by the AEMC as to the potential adverse impact of the rule change request on the current and future level of competition; on retailer innovation and on choice over time.

In particular, we are concerned that such a rule could result in retailers restricting their offering of market retail contracts with fixed periods, or the removal of such contracts altogether from the market. In our view, a more efficient market outcome could see retailers offering a greater selection of fixed price contracts in response to demand from those customers who are willing to pay more for this price certainty, supported by adequate information for customers to understand the different offerings and choices they are making.

We also agree with the AEMC's observation that the rule change may impact retailers differently, with larger retailers potentially able to manage the additional risks imposed by the rule change more efficiently and therefore at lower cost. This may in turn provide them with a competitive advantage when compared to smaller or new-entrant retailers.

Consumer protection issues

The Australian Consumer Law (ACL) is a national, state and territory consumer protection law and includes unfair contract terms legislation (introduced on 1 July 2010). The regulators of this law include the Australian Competition and Consumer Commission (ACCC) and each state and territory consumer protection agency.

We note the AEMC's consideration of whether provisions in the ACL relating to unfair contract terms apply to price variation clauses in market retail contracts. Where the application of those protections is confirmed, a detrimental change to a consumer's contract, through a unilateral variation without appropriate notice and offering the corresponding right to terminate without penalty may be considered unfair (for further information on the application of unfair contract terms law see Australian Consumer Law, A guide to the unfair contract terms law, 2011).

We also note the views offered by CALC/CUAC in their rule change request. These discussions demonstrate that there is a degree of uncertainty around the potential application of the ACL unfair contract term provisions and that it is, as yet, untested by the courts. In light of this, we consider that these provisions should not be relied upon to address the issues raised by CALC/CUAC, particularly if other actions can be taken to more effectively address these concerns and that do not require a change to the Retail Rules.

We support the AEMC's discussion of the application of the misleading or deceptive conduct provisions in the ACL to retailers' marketing conduct and how they explain to customers any variations to their prices in fixed term contracts. The ACCC's 2014 Compliance and Enforcement Policy identifies consumer protection in the energy sector as a priority, particularly with regard to representations about the savings a customer can make (also referred to as 'discounts off what?').

In December 2013, the ACCC instituted proceedings in the Federal Court against AGL South Australia Pty Ltd (AGL SA) for making false or misleading representations and engaging in misleading or deceptive conduct. The alleged conduct relates to representations made by AGL SA to residential electricity consumers in South Australia about the level of discounts off electricity usage charges that would be obtained by consumers under AGL SA's market contracts. Specifically, the ACCC alleges that when AGL SA increased rates for energy usage charges under its market contracts in mid-2012 and mid-2013, AGL SA made false or misleading representations to customers who had entered into a market contract that they would continue to receive their discount or that there had been no change to the discount, when this was not the case.

We also support the AEMC's approach to considering the rule change request in light of the operation of other jurisdictional consumer protections and energy regulation frameworks, including the likely adoption of the NECF in other jurisdictions and the way different jurisdictions regulate exit fees. We note the Retail Rules prescribe that exit fees must be a reasonable estimate of the costs to the retailer resulting from early termination of the contract.

Alternative approaches

CALC/CUAC's rule change request discusses two alternative options. Firstly, they consider a proposal which would allow some particular price variations to be passed through (government charges only). It is our view that this option is likely to result in many of the same impacts on competition and prices as their preferred option but would also result in more consumer confusion and uncertainty (as the price of these 'fixed' contracts would not be wholly fixed). Such a rule is likely to be more complex for the responsible regulator to administer, as it would require prescribing those costs that could be passed through, and subsequent monitoring of price variations under market contracts, to ensure only allowed costs were passed through. This is also likely to result in a higher regulatory burden on retailers, depending on the monitoring, reporting and compliance arrangements established.

Secondly, CALC/CUAC propose to remove Retail Rule 46 to allow the unfair contract term provisions in the ACL to apply. Given the uncertainty as to the application of unfair contract term provisions, we do not consider the deletion of this rule should be relied upon to allow for these protections to apply.

The AEMC consultation paper also invites consideration of other potential alternative approaches to address issues of concern to CALC/CUAC, including issues of transparency and consumer education.

The AER's Retail Pricing Information Guideline provides for the development of energy price fact sheets, and prescribes the information retailers must include in the fact sheets. In accordance with the retail consultation procedure,¹ the AER could amend the Guideline to clarify and improve information available to customers to address concerns raised by CALC/CUAC. For example, requiring retailers to present information more clearly and prominently about the applicability of price variations for energy contracts on their energy price fact sheets; being more prescriptive (as well as promoting better practice across retailers) about how they describe fixed price and fixed term contracts on energy price fact sheets. We could also work in partnership with energy retailers and consumer organisations to improve energy customers' understanding and awareness of these different contracts.

Further, the AEMC might take account of the unfair contract terms provisions of the ACL in considering the advantages and disadvantages of retailers notifying customers in advance of a price change (in a fixed term contract) before it takes effect or of allowing customers a limited period of time to switch retailers without paying an exit fee following a price variation.

As an interim measure, we have recently added relevant content on our Energy Made Easy price comparison website and made improvements to ensure clear and accessible information is available to consumers explaining the difference between fixed price contracts and contracts with a fixed benefit period or fixed term.

The AER looks forward to continuing to work with the AEMC on these important issues. If you would like to discuss any aspect of this submission please contact Jacqueline Thorpe, A/g General Manager, Retail Markets, on (03) 9290 1994.

Yours sincerely

Andrew Reeves
Chair

¹ National Energy Retail Rules, rule 173