



EnergyAustralia

LIGHT THE WAY

3 March 2017

Review of Electricity and Gas Retail Markets
Department of Environment, Land, Water & Planning
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RE: Review of Electricity and Gas Retail Markets in Victoria

EnergyAustralia welcomes the opportunity to make a submission to the Review of Electricity and Gas Retail Markets in Victoria, Discussion Paper.

Energy is a vital social good. It lights our homes and drives our businesses. As an electricity generator and energy retailer EnergyAustralia takes our responsibility seriously. We want our customers to access reliable energy at an affordable price.

Offering customers the best possible value and service drives much of what we do at EnergyAustralia. We do this by delivering competitive pricing, innovative energy solutions and first class service. We are also rewarding customer loyalty with lower rates and the opportunity to go 100% carbon neutral at no cost. And our customers are noticing and they are staying longer. In the last year our Ombudsman complaints are down by 34% and our customer satisfaction survey results are up by 10%.

This review of the Victorian electricity and gas retail markets is particularly timely, given the evolution in energy products and services that is currently underway as new data and technologies become available.

It is important that the Government ensures the Victorian energy retail market is operating in a way that maximises potential benefits to consumers, particularly in light of regulations that may impose barriers to new innovative technology or place unnecessary cost burden on customers.

We are concerned about the level of regulatory intervention in the Victorian retail market and the negative impact it has on customers. For example, the recent announcement of 11.3c/kWh feed-in tariff for solar customers (which will be time variant from 2018) is expected to increase electricity bills for all non-solar Victorian customers (~85% of total residential customers). Cross subsidies of this nature are also evident in other Government policies and are addressed in our submission.

This type of policy or regulatory intervention is in direct conflict with the intentions of this review and the review of the Payment Difficulties Framework being undertaken by the Essential Services Commission, which is looking at issues of hardship. We encourage

the Panel to highlight this inconsistency to the Government and recommend action be taken to reduce regulatory burden in the State. First of foremost among any recommendations should be that Victoria immediately adopts the National Energy Customer Framework (without derogation) to reduce duplication of retailer systems and processes, and therefore prices for customers.

EnergyAustralia has consistently argued for retail energy market reforms that deliver in the best interests of customers. We believe this is best achieved through competitive markets where customers are able to make informed choices and where vulnerable customers are given appropriate support.

EnergyAustralia considers that the Victorian retail market is a very competitive and evolving market that delivers choice, affordable prices and innovation to customers. We do, however, recognise that it can be confusing for some customers, particularly when they are pressured or misled by marketing activity. Our submission includes a number of recommendations to reduce this risk and improve outcomes for customers.

We acknowledge that customers will, at times, struggle to pay their electricity bills and require additional help. Our dedicated support program, *EnergyAssist*, offers a range of support to customers including tailored payment arrangements, energy efficiency advice and appliance swaps. However, there are challenges in aligning retailer support with other government welfare assistance. We see opportunities for retailers, community groups and government to work better together and encourage the Panel to consider our recommendations in this area.

If you have any questions in relation to this submission please contact Sara Williams, Policy and Advocacy Lead, on (03) 8628 1742.

Regards

Kim Clarke

Chief Customer Officer

About Us

EnergyAustralia is one of Australia's largest energy companies, providing gas and electricity to 2.6 million household and business customer accounts in NSW, Victoria, Queensland, South Australia and the Australian Capital Territory. EnergyAustralia owns and operates a multi-billion dollar portfolio of energy generation and storage facilities across Australia, including coal, gas and wind assets with control of over 4,500MW of generation in the National Electricity Market (NEM).

In Victoria, we provide gas and electricity to around 20% of households. We also service 15% of small business electricity needs and 19% of their gas needs.

EnergyAustralia is the only major vertically integrated energy retailer based in Victoria with approximately 2000 employees – at the Yallourn power station and mine in the Latrobe Valley and contact centre and head office staff located in metropolitan and CBD locations. Last year our contact centre, based at Geelong, was awarded best contact centre in the large centre category.

As an energy retailer we acknowledge the important role we play in supporting vulnerable customers who, for whatever reason, are unable to pay their energy bills. We do this via a dedicated hardship program, *EnergyAssist*, which we deliver in cooperation with Kildonan Uniting Care to provide tailored assistance to customers facing payment difficulties. The *EnergyAssist* program offers individual case managers who support customers with a range of advice about payment plans, government grants, financial counselling, energy efficiency information, home energy audits and appliance swaps. In Victoria, there are 14,000 customers participating in our *EnergyAssist* program every year.

The Victorian Retail Market

Prior to the 1990s, Australian energy markets comprised of vertically integrated, government-owned monopolies.

Jurisdictional regulation prohibited new energy retailers from entering the market and customers did not have a choice of energy retailer.

Between 2001-2004, significant efforts were made across jurisdictions to transition towards a more open and competitive national energy market that would deliver improved economic and environmental performance and deliver benefits to households, small business and industry.¹ State and Territory Governments progressively introduced full retail contestability, the majority of which have removed price regulation. Victoria introduced full price deregulation in 2009.

At the same time as deregulation of pricing occurred, regulation of energy retail markets evolved to promote competition and influence the pace of these markets' transition through the competitive stages.²

Competitive markets are a powerful vehicle for delivering the outcomes customers genuinely want and value.

The dynamic process of effective retail competition accomplishes three very important things on behalf of customers:

¹ Council of Australian Governments, *Australian Energy Markets Agreement*, 30 June 2004 (revised 2013) p1

² Australian Energy Market Commission (AEMC), *2016 Retail Competition Review Final Report*, 30 June 2016, p3

1. the minimisation of wasted resources deployed in the provision of energy services (efficiency) – by penalising suppliers with relatively high cost bases for a given service;
2. insulation from poor business decision making – whereby retail businesses wear the cost risk of bad investments; and
3. the promotion of new and better ways of providing energy services (innovation) – giving customers more choice of products and services to suit their energy needs.

In EnergyAustralia’s view, alternatives to competition with respect to the provision of energy services, such as direct regulation, are very unlikely to drive efficiency and innovation to the same extent as competition does. International evidence supports this. In the UK, for example, reforms to restrict tariffs offers and ban discounting resulted in customers paying £1.4 billion a year more than they would in a fully competitive market³. Appendix 1 includes further information on the UK experience.

A competitive retail sector drives economic efficiencies ‘forward’ in the mass-market and commercial and industrial markets for electricity; and ‘backward’ in wholesale spot and hedging markets for electricity.

Deregulated retail markets also offer opportunities for active customers to seek and obtain the best retail offer for their circumstances. This is particularly valuable for low or fixed income households which traditionally are more price sensitive and active in the market.⁴

Victorian retailers provide a range of services to, and on behalf of, customers including:

- billing and service functions for the entire energy delivery chain;
- purchasing wholesale energy on behalf of customers;
- managing the risks associated with wholesale market volatility;
- purchasing renewable energy certificates;
- purchasing energy efficiency scheme (VEET) certificates;
- assisting customers experiencing hardship;
- managing credit and bad debt risk (network and retail); and
- offering price, product and service differentiation to suite customer needs, including information about energy use and energy efficiency.

It is important to remember that the efficiencies and improvements that are driven by a deregulated retail energy market remain largely under-observed, given the absence of a counterfactual monopoly or regulated market.

What makes up an energy bill?

On average, energy costs typically account for a small proportion of a household’s disposable income, or around 2.6%.⁵ It rates significantly below other household expenditure such as food, housing and recreation. However, low income households traditionally spend a higher proportion of income on energy for a variety of reasons such as less efficient appliances and housing.⁶

³ Competition and Markets Authority (CMA), *Modernising the Energy Market*, 24 June 2016, p6

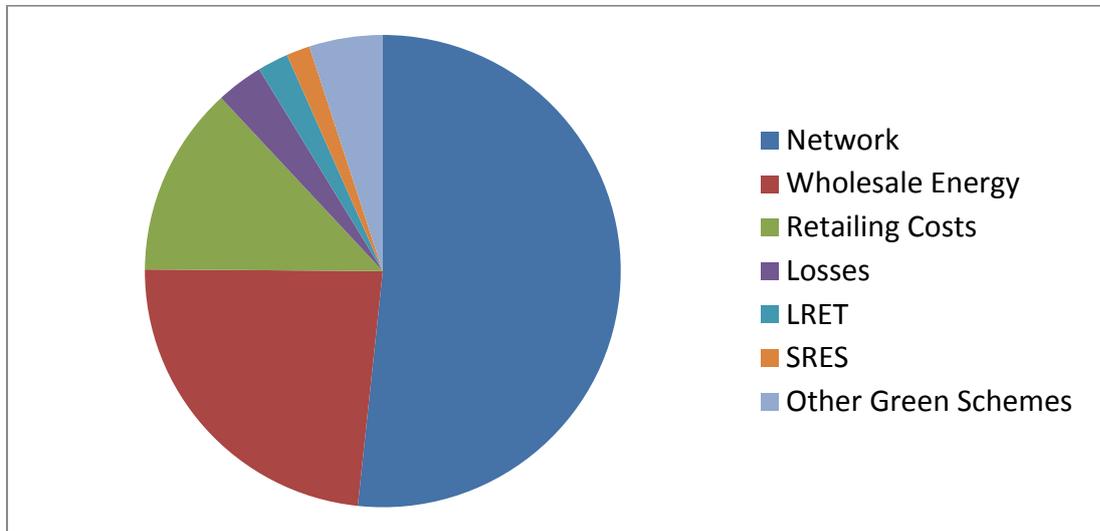
⁴ AEMC, *2016 Retail Competition Review Final Report*, 30 June 2016, p13

⁵ Australian Bureau of Statistics, *Household Income, Expenditure and Wealth* (Housing comprises 18% of average household expenditure, 17% for food and non-alcoholic beverages, and 13% for recreation)

⁶ Australian Energy Regulator (AER), *Annual Report on the Performance of the Retail Energy Market 2015-16*, p51

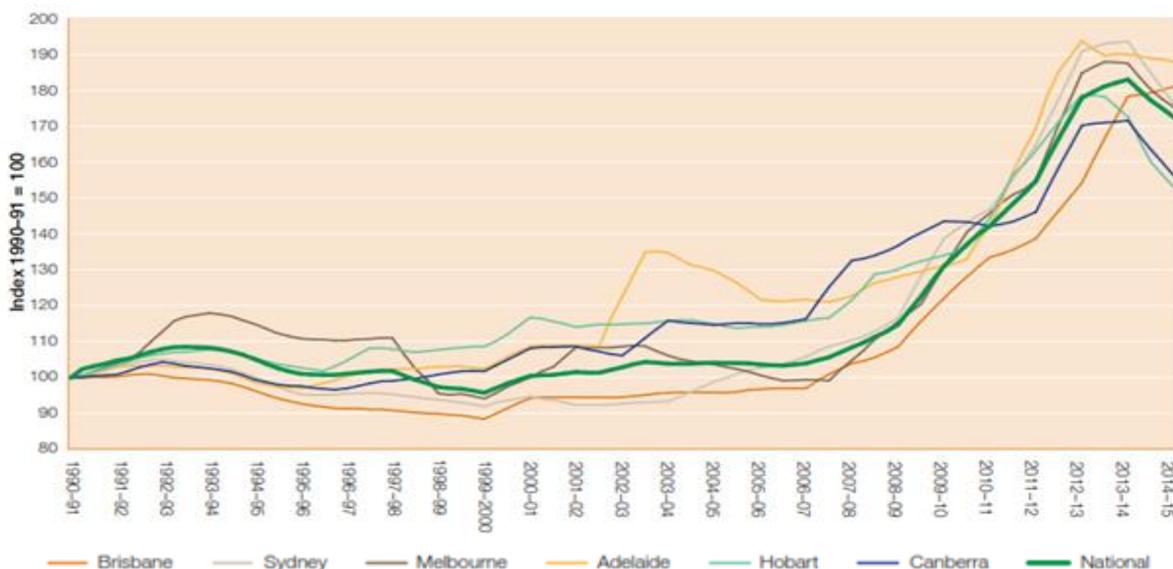
The average household bill comprises the cost of energy, networks (including metering), retailing costs, green schemes, and any losses as the result of transporting electricity or gas. Figure 1 below provides a breakdown of an average national electricity bill.

Figure 1: Electricity Bill Breakdown⁷



As Figure 2 shows, many households went through a period of bill shock between 2007-08 to 2013-14 as electricity prices rose by around 10% per annum after a period of relative price stability. These increases were largely driven by network investment as ageing assets reached their end of life (typically 40-50 years), as well as new investment needed to meet peak demand.⁸ In Victoria, distribution network investment in capex and opex increased by \$7.4 billion during the 2011-15 regulatory period.⁹

Figure 2: Retail electricity price index (inflation adjusted) – Australian Capital Cities¹⁰



⁷ ACIL Allen, *RET Review Modelling*, 7 August 2014, p24

⁸ AER, *State of the Energy Market 2015*, p134

⁹ AER, *Victorian Electricity Distribution Network Service Providers - Distribution Determination 2011-2015 Final Decision*, October 2010, pii

¹⁰ AER, *State of The Energy Market 2015*, p135

We know that future energy price rises will largely be driven by the wholesale market, with the closure of Hazelwood power station in early 2017 and tightening gas supplies across the NEM.¹¹ At the same time, the wholesale market is experiencing increased volatility due to greater penetration of intermittent renewable generation. The Victorian Renewable Energy Target will also increase price volatility. This volatility will need to be managed by retailers on behalf of consumers to prevent further bill shock.

The retail component of the bill largely consists of wholesale management costs, retail operating costs and a margin for providing the service. Each element is discussed in the following section.

Wholesale management costs

Energy retailers manage the risk of wholesale electricity prices for customers and reduce their exposure to real-time volatility. Wholesale prices in the NEM can range from negative \$1000/MWh to \$14,000/MWh and can change every five minutes. The ability of retailers to insulate customers from this volatility and offer a consistent c/kWh price is vital to an effective market.

Retailers will generally hedge their wholesale risks through contractual arrangements with generators via a mix of pre and post payment contracts (eg. swaps, caps). Retailers enter these arrangements based on assumptions about the amount of energy they will need and the profile of their customers' usage.

Changes in usage patterns or disruptions in the wholesale market can severely impact a retailer's exposure to wholesale costs. A risk premium is included in all retail products to manage this.

Retail operating costs

Retail operating costs include obvious functions, such as billing and contact centres, but also include other functions that are less obvious, but equally important, such as credit management and hardship support. The largest contributor to retail costs was Credit (including an allowance for bad and doubtful debts) which, in EnergyAustralia's case means carrying hundreds of millions of dollars of debt on behalf of residential customers. Retailers carry the debt cost for the entire delivery chain – wholesale, transmission and distribution – which means we have to pay all of these businesses regardless of whether our customers pay their bills. As shown in Figure 4, this credit management function makes up a significant proportion of our retail operating costs.

At any point in time EnergyAustralia has more than 45,000 customers on payment plans and 14,000 customers in our *EnergyAssist* program. The hardship debt alone carried by EnergyAustralia amounts to more than \$20 million and may never be fully paid off due to the challenging circumstances faced by our hardship customers.

Some stakeholders have compared electricity to other important services such as superannuation, where the default plan is the lowest cost option in market, and question why the default for electricity is the highest price in market. However, such comparisons are not valid because they do not consider the level of risk associated with carrying debt on behalf of customers.

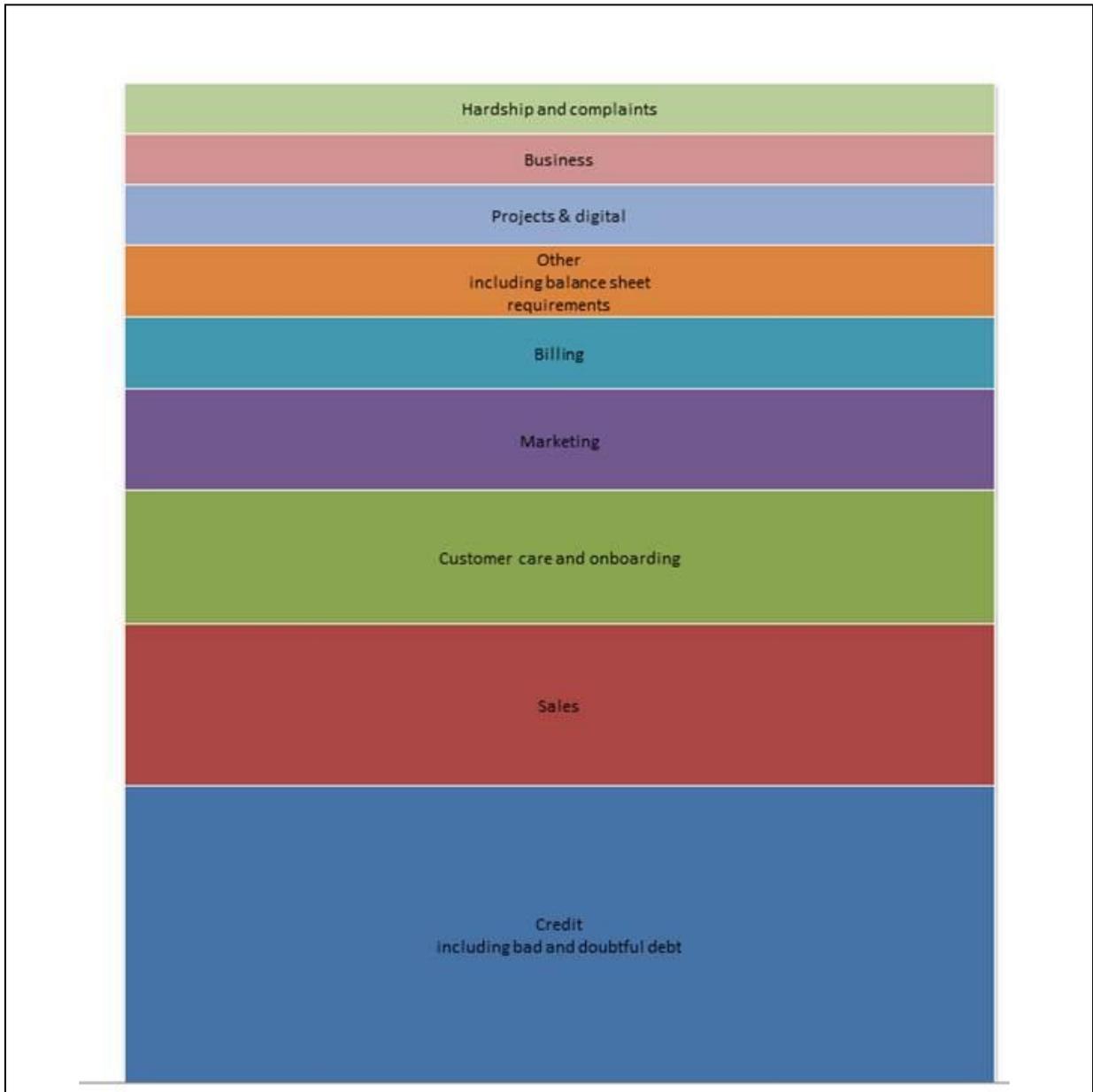
With other services such as superannuation, there is no risk of not being paid for a service you have provided. If the customer chooses a low fee, low return default super rate they wear the entire benefit or detriment of that decision. However, this is not true

¹¹ AEMC, *2016 Residential Electricity Price Trends*, 14 December 2016, p4

of the energy market, where a good has been provided and must be paid for, if not by the customer then by the retailer. Having a default rate that is lower than a market offer would create a subsidy from active customers to non-active customers.

Figure 3 is breakdown of EnergyAustralia's retail cost categories. Each of the components is impacted by various factors, such as interest rates (Credit), vendor costs (Product and Marketing) and national economic conditions (Hardship and Complaints). Retailers make decisions on potential cost movements on these items a year ahead when they set annual prices.

Figure 3: Retail Cost Breakdown



Retail margins

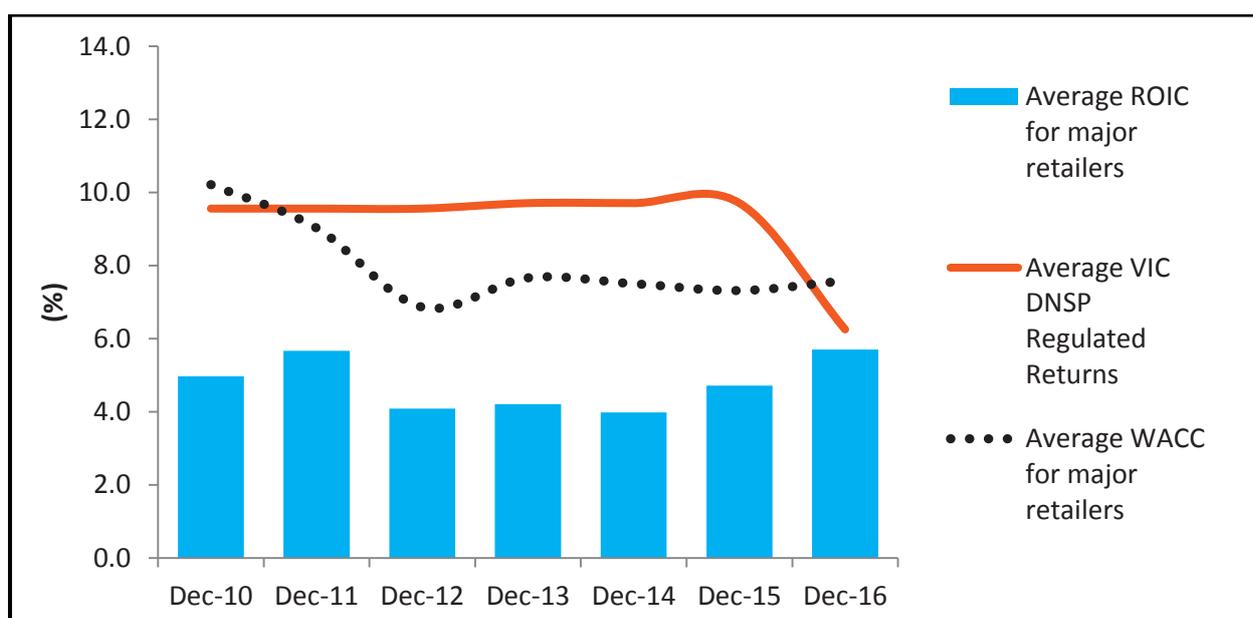
The Discussion Paper refers to reports that have questioned the margin of energy retailers.¹² These reports fail to accurately reflect reality, largely because they under represent retailer wholesale hedging or operating costs, or they overestimate the revenue received by retailers, particularly when discounted tariffs are considered.

Energy retailers (like a market participant in any sector) will apply a margin which they consider represents a reasonable return on investment, the risk involved in seeking that return and the prevailing market conditions.

The Return on Invested Capital (ROIC) of the three major retailers over the last six years ranges from 2% to 8.2%. Over the same period the average Weighted Average Cost of Capital (WACC) was 8.02%. Whilst this analysis is NEM wide, with most jurisdictions now fully deregulated it shows that the major retailers are not covering their costs of investment.

As a point of comparison, Figure 4 below shows the average rate of return for Victoria's distribution network service providers (DNSPs) over the same period, as allowed by the Australian Energy Regulator (AER), was around 9%. DNSPs are monopoly business with little of the risk that retail and generation businesses are exposed to and, as a result, have higher credit ratings and lower borrowing costs.

Figure 4: Major Retailer ROIC & WACC Comparison¹³

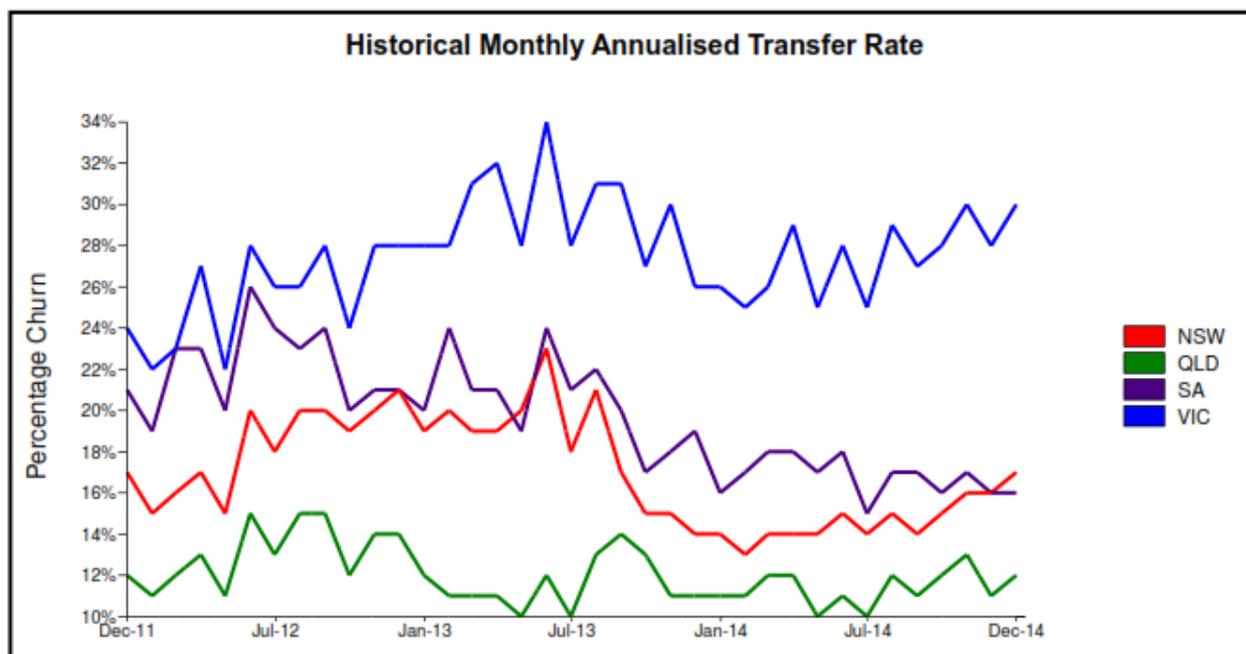


¹² Department of Environment, Land, Water and Planning (DELWP), *Review of Electricity and Gas Retail Markets in Victoria Discussion Paper*, January 2017, pp9-10

¹³ Material sourced from Bloomberg, AGL and ORG investor presentations and AER regulatory determinations. Note: ROIC calculation is normalised for all impairments, gain on sale of investments, acquisition and divestiture relates expenses.

Since retail contestability and then price deregulation, the number of retailers has gradually increased to the current situation where we have 29 electricity retailers and 11 gas retailers operating in Victoria.¹⁴ This has resulted in a variety of products, services and prices available to customers. Victoria has also experienced the highest churn rates of all NEM jurisdictions (see Figure 5 below).

Figure 5: NEM Churn Rate 2011-2014¹⁵



This churn activity has seen a move away from the three major retailers towards smaller entrants who are offering differentiated products and services, and pursue aggressive marketing activity. EnergyAustralia has consistently lost market share in Victoria equivalent to around 10,000 customers each year for the past three years. This trend is equally true for the other large retailers, AGL and Origin.¹⁶

It is evident that even if the major retailers wanted to increase margin to achieve a ROIC comparable to their WACC, they would not be able to as smaller retailers would continue to undercut them on price and/or service and take further market share.

Regulatory Burden

Regulation should be designed in the interests of customers and enable retailers to provide services in the most efficient low cost manner and in the way most beneficial to customers.

Fifteen years ago, the Parer Report recognised the unnecessary cost burden imposed on consumers by regulatory duplication.

“The differing rules between states, and between gas and electricity, can boost the cost of new market entry by retailers by up to one third through the need for additional IT

¹⁴ Essential Services Commission (ESC), *Victorian Energy Market Report 2015-16*, p11

¹⁵ Australian Energy Market Operator (AEMO), *National Electricity Market Monthly Retail Transfer Statistics*, December 2014

¹⁶ ESC, *Victorian Energy Market Report 2015-16*, p80

system capital and operating costs, and the inability to take advantage of back office scale economies that should otherwise be available.”¹⁷

In response to the Parer Report, the Council of Australian Governments (COAG) agreed to wide reaching energy market reforms to achieve efficiency and lower costs for consumers.

In recent years however, individual government policy and regulation are eroding these gains, creating duplication and inconsistency. EnergyAustralia undertook an assessment of its regulatory obligations and found we have 5500 different obligations within over 250 instruments (State and Federal) involving in excess of 50 different regulators.

Much of the regulatory burden in the energy sector stems from replication with differentiation across and amongst States/Territories and the Commonwealth. Given this situation, we are surprised that energy is not one of the COAG Deregulation Priority Areas.¹⁸

The most notable regulatory inconsistency is that Victoria is the only jurisdiction in the NEM that has not applied the National Energy Retail Law and Rules (collectively known as the National Energy Customer Framework) and continues to maintain separate regulatory obligations administered by a State regulator, the Essential Services Commission (ESC).

The ESC and the AER fundamentally do the same role. The AER is the retail regulator for all NEM jurisdictions, except Victoria for which the ESC has retained responsibility. The AER is the regulator in Victoria for wholesale markets and most network issues. The two regulators are even based three blocks from each other in Melbourne. The ESC charges Victorians through licence fees and State taxes whilst the AER recovers costs through Federal taxes that Victorians also pay.

The Australian Energy Market Commission (AEMC) is the rule maker for the National Electricity Law (NEL) and the National Gas Law (NGL) that apply in Victoria, while the National Electricity Retail Rules (NERR) do not. When the AEMC makes new rules, they apply seamlessly across the NEL/NERR, except for Victoria. The ESC must then make changes to its retail code or choose a different path entirely. When they make an update that is not identical to the NERR, it is costly and confusing for everyone.

The inefficiency of maintaining two regulatory systems administered by two different regulators for retail matters in the NEM only increases costs and complexity for Victorians consumers. It requires retailers to maintain separate processes for Victoria and comply with different regulatory reporting arrangements and compliance standards. Other examples of higher regulatory burden in Victoria include:

- a \$22 cap on exit fees (inc. GST);
- higher and time variant feed-in tariffs, including a critical peak price;
- Victorian Energy Efficiency Target Scheme costs;
- same-day standing offer publication requirements;
- special treatment of solar customers; and
- wrongful disconnection payments of \$500 per day.

¹⁷ W.R Parer, *Towards a Truly National and Efficient Energy Market* (COAG Energy Market Review), 2002, p10

¹⁸ COAG Deregulation Priority Areas: Housing and commercial building and construction, road freight, exporters, food and dairy manufacturing, fish processing, agriculture, tourism business licensing, cafes and restaurants, clothing retail, eco-lodge and marine tour operators and native title in mining, gas and exploration

These costs increase inefficiency and cross-subsidies, and are exacerbated over time as, for example, more people take up solar tariffs. The St Vincent de Paul Society estimates that the new 11.3c/kWh feed-in tariff in Victoria (the largest standard feed-in tariff of all jurisdictions) will initially increase bills for non-solar customers by \$20 and will increase as more people take up solar¹⁹. In addition, nearly 90,000 Victorian households are still on the generous 60c/kWh feed-in tariff until 2024 which is embedded in Victorian bills.

A mandated universal smart meter rollout was also a cost unique to Victoria. Whilst meter rollout costs incurred by distributors are determined by the AER, retailer system upgrades to manage the increase in data is not recovered via regulated means, but reflected in increased retailer operating costs. For EnergyAustralia this cost was in the tens of millions. This cost is often not accurately reflected when commentators discuss energy price increases.

Other government policies that directly or indirectly impact the cost of doing business that flows through to Victorian customers includes the Victorian Government's decision to unilaterally increase coal royalties three-fold in 2016 (\$19 million annually), adding another public holiday to the calendar (\$1 million annually), and the newly announced doubling of the solar feed-in tariff (\$3 million initially and possibly a further \$3 million if a time variant FiT is required).

Other Government policies we expect will have an impact on future energy prices include the ban on gas exploration and development, and the Victorian Renewable Energy Target (VRET). Any policy that arbitrarily bans resource development will naturally have a negative demand/supply flow-on effect to customers. The VRET is an example of Government embedding cross-subsidies in electricity bills and is likely to have its largest impact post-2020 once the Federal RET subsidies are exhausted.

In addition, Victorian market participants are currently waiting on major decisions by the ESC and Victorian Government, respectively, with regard to:

- the Payment Difficulties Framework which will cost EnergyAustralia in the tens of millions to implement and significantly increase our ongoing operating costs based on the current draft; and
- whether to defer competition in metering in Victoria for several years, to require new smart meters to meet the AMI specification rather than the national one, or both. We have not fully costed this option yet as the policy direction is uncertain but expect the difference in operating systems to run into the millions of dollars.

Further inconsistencies exist in government concession and rebate schemes. These schemes should be targeted to assist potentially vulnerable customers pay their energy bills. However, the inconsistency across jurisdictions in applying these rebates results in sub-optimal outcomes for vulnerable customers and higher costs for all consumers. This arises from:

- disparity in schemes leading to higher overheads;
- new requirements being added with little lead time; and
- the structures in some states (particularly Victoria) being complex that can lead to over application of rebates to customers that are unrecoverable from government.

Further consideration should be given to harmonising concession and rebate schemes to ensure vulnerable customers are given support that is clear, appropriate and easy to access.

¹⁹ G. Dufty, 'Victoria doubles feed-in tariff to drive solar again', *The Herald-Sun*, 1/3/2017, p9

Recommendation 1

That Victoria immediately adopts the National Energy Customer Framework (without derogation) to reduce duplication of retailer systems and processes, and therefore prices for customers.

Recommendation 2

That the Commissioner for Better Regulation be tasked with undertaking a regulatory assessment of the Victorian energy market to consider opportunities to reduce regulatory burden and reduce costs to Victorian consumers.

Recommendation 3

That the Victorian Government reconsiders its time-variant feed-in tariff and/or allows the full costs of the scheme to be passed onto solar customers directly to reduce the cost burden on other Victorian customers.

Recommendation 4

That Victoria leads concessions reform and seeks national consistency across the NEM jurisdictions.

Recommendation 5

That the Victorian Government immediately reverses its moratorium on gas exploration and development to encourage more gas supplies and reduce energy costs for customers.

Recommendation 6

That the Victorian Government urgently implements reforms that reduce the cost of serving customers at least equivalent to offset the coal royalty increase – see recommendations 1-5 as a starting point.

Increasing transparency of subsidies

The source and extent of subsidies embedded in policy frameworks in the NEM are not always transparent to governments, market participants and consumers of electricity. Subsidies essentially transfer value from one group to another group in a way that would not occur but for the impact of a policy or regulatory setting causing the transfer. Subsidies can be implicit, and often have unintended transfers, or explicit and have purposeful transfers. Some subsidies are in the interests of consumers while others are not, depending on their impact on the efficiency and equity of outcomes in the NEM over time.

Implicit subsidy – for example, non-cost reflective network tariff structures mean that non-peak electricity users are effectively subsidising a portion of peak electricity users’

network costs. This is because network pricing signals received by most households and small businesses fail to reflect the true cost of system peaks varying by location, time of day, time of year and on individual extreme temperature days. Energy Networks Australia has estimated that cost reflective tariffs can lead to savings of \$17.7 billion in present value terms over a 20 year period. A potential efficiency implication is that the incentive to minimise system peaks (and their costs) has been severely dulled. A potential equity implication is that households without the means to invest in embedded generation (and related options) are providing an implicit subsidy to households with the capacity to invest in such options. In the case of solar this means low income households and/or renters are subsidising those that can afford solar panels. Policies, such as the Victorian Government's increased feed-in tariff to recognise the 'social cost of carbon', only make this inequity worse.

Explicit subsidy — for example, the VRET subsidises a portion of the cost of building large-scale renewable generation in Victoria. Contracts for difference signed with the Government will provide guaranteed revenue to the owners of successful renewable proponents. The cost subsidy component of the contracts is recovered from Victorian electricity customers via their final retail bill. A potential efficiency implication is that lower cost, non-renewable forms of emission reduction technologies are not receiving a similar incentive to be deployed (on a \$ per tonne of CO2 reduced basis). To address this issue the UK Government has established a Levy Control Framework (LCF) which is designed to control the costs of supporting low carbon electricity, paid for through consumers' energy bills.²⁰

While subsidies can be beneficial, a lack of transparency makes it difficult to assess their cost and benefits over time.

Recommendation 7

The Victorian Government publically report annually on the costs of its VRET and legislate an immediate review of the scheme if a cost threshold is reached, similar to the Levy Control Framework set by the UK Government.

Testing the effectiveness of competition

As electricity is an essential service, there has been and continues to be ongoing discussion about optimal price, protection and service outcomes.

The AEMC has been tasked by jurisdictional governments to monitor the level of competition across the NEM. As the Commission rightly points out, "Markets are dynamic: conditions change as the cost of inputs and technologies change, demand levels vary, innovation occurs, firms enter and exit the market, and customer preferences change. As a result, the development of effectively competitive markets is a continuous, iterative process and does not necessarily happen smoothly."

In its assessment of retail competition in the NEM, the AEMC considers a number of market indicators:

- customer activity in the market;
- customer outcomes in the market;
- barriers to retailers entering, expanding or exiting the market;
- the degree of independent rivalry among retailers;

²⁰ More information at www.gov.uk/government/collections/levy-control-framework-lcf

- whether retail energy prices are consistent with a competitive market;
- experiences and outcomes related to new and emerging energy products and services; and
- outcomes for vulnerable customers.²¹

The AEMC's most recent report determines competition to be effective across the NEM jurisdictions of South Australia, Victoria, New South Wales and Southeast Queensland. Indeed, key indicators have shown improved outcomes for consumers in terms of customer's satisfaction with their electricity retailer, the quality of customer service and value for money.²²

"In competitive markets, customers are generally aware of the choices available to them and are able to act on those choices. By shopping around to receive better deals or service, they play an important role in maintaining downward pressure on prices and driving retailers to provide new products and the quality of service customer demand... Customer activity is therefore an important indicator of whether competition is effective."²³

As discussed earlier, Victoria has the largest number of electricity and gas retailers. Customers can make significant savings by simply comparing offers and switching to a better one. Households with typical electricity consumption can save \$590 - \$830 per annum (depending on their network area) if switching from the worst standing offer to the best market offer.²⁴

Some observers have queried whether a high level of price dispersion indicates an effective market or one where costs are not being sufficiently managed. Experts note that typically, "the number of rival retailers will increase and the array of products offered will expand exponentially to meet variations in consumer preferences. Given common fixed and sunk costs, price dispersion will increase, not decrease, as competition intensifies. This progression of additional entry, greater product complexity and price dispersion is common in capital-intensive industries and deregulated markets such as telecommunications, airlines and energy."²⁵

EnergyAustralia supports the current retail monitoring undertaken by the AEMC to ensure that Victoria's market continues to be competitive and drive the best outcomes for customers.

Impediments to full benefits of retail competition

Despite evolution in the retail market, not all customers are enjoying the benefits of competition. The AEMC found that around 50% of customers they surveyed in Victoria have not switched electricity retailer in the last five years.²⁶ As discussed, this does not necessarily mean that those customers have not considered switching and/or been given a better offer from their current retailer. Indeed, 91% of those surveyed considered they were getting good value from their current electricity provider.²⁷ However, we should consider if customers have the confidence to shop around for the best product for them.

²¹ AEMC, *2016 Retail Competition Review Final Report*, 30 June 2016, p1

²² Ibid. pi

²³ Ibid, p9

²⁴ St Vincent de Paul Society, *Victorian Energy Prices October 2016*, p4

²⁵ P. Simshauser & P. Whish-Wilson, *Reforming reform: differential pricing and price dispersion in retail electricity markets*, June 2015, p2

²⁶ AEMC, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets* (Newgate Research), June 2016, p157

²⁷ Ibid.

Discounting

The energy industry can be confusing for some customers, particularly those for whom English is not their first language. Prices, in particular, can be confusing for customers as most tariffs are a combination of fixed charges and variable charges (some with multiple time components).

This has seen a large focus on discounting being the primary marketing tool for retailers as it is easier for customer to understand. This has, however, created the scenario where some retailers are pricing higher and offering large discounts in an attempt to attract customers. This can result in customers switching retailers (or products) that do not result in a better deal for the customer.

A potential response is to ban discounting. This was the action taken by the UK regulator Ofgem, which ultimately resulted in an overall increase in retail prices for customers²⁸. Our preference is to implement an energy comparison rate as you see with home loans or petrol consumption metrics for cars. This would enable customers to make an adequate comparison by providing a consistent measurement. From our research we know customers get confused by rates such as c/kWh so an annual or quarterly bill calculation (based on a consistent consumption formula) may be most helpful to customers. Any comparison would need to make allowance for non-monetary benefits such as loyalty programs.

Energy regulation requires retailers to provide customers with Energy Price Factsheets which outline the prices and any special terms and conditions in a consistent format. These should also include the relevant comparison rate.

Recommendation 8

That Victoria implements an energy comparison rate to allow customers to adequately compare offers in a simple and easy to understand manner.

Comparator websites

Customers can currently get an energy offer via various channels. They include multiple channels from the retailer directly, as well as third party providers through online or door knocking services. This variety of offers and channels has seen the growth of private comparison sites and encouraged the Victorian Government to create their own comparator website *Victorian Energy Compare*.²⁹

In Victoria, despite consumers regarding internet-based information sources as the most useful for investigating offers and options, their awareness of comparator websites remains low - especially for the Victorian Government's comparator site. In June 2016, the AEMC found that residential consumers had an unprompted awareness of comparator sites of 0%, and prompted awareness of just 23%.³⁰

The Government could increase awareness of *Victorian Energy Compare* via simple means such as investing in Google optimisation which would make it easier for customers to locate the site. *Victorian Energy Compare* should also align its format with the AER's comparator site, *Energy Made Easy*, which is much easier for consumers to use and for retailers to upload their offers.

²⁸ CMA, *Modernising the Energy Market*, 24 June 2016, pp5-6

²⁹ <https://compare.switchon.vic.gov.au/>

³⁰ AEMC, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets* (Newgate Research), June 2016, p156

Commercial comparator websites also exist however not all retailers, nor all offers, are presented to customers on these sites. There is also a lack of transparency on how offers are ranked and presented. This does not promote confidence in the market and empower customer to make informed decisions.

Recommendation 9

That all commercial energy comparator services are required to be nationally accredited and:

- disclose all commissions in a similar manner to the financial services sector;
- advise that that they do not show all retail offers available;
- rank offers and present information in accordance with a defined industry standard; and
- provide a link to Victorian Energy Compare and advise customers that this is an independent site containing all Victorian offers.

Doorknocking

Doorknocking is a common form of marketing used by some energy retailers. However, this predatory form of marketing is not something customers enjoy and can lead to customers being pressured to take up an offer that may not be in their best interests.

Research undertaken by the Consumer Action Law Centre found that 62% of customers surveyed had a negative doorknocking experience, and in some cases felt pressured to buy.³¹ Unfortunately we have also seen ongoing regulatory action and security issues relating to door knocking.³² Other industries successfully operate competitively without door knocking and energy is no different.

Recommendation 10

That the Victorian Government bans doorknocking for the purposes of selling energy products.

Benefit Periods

Under Section 48 of the Victorian Retail Code, a retailer must notify a customer when a fixed term contract is nearing its completion date. The notice must be given no earlier than 40 business days and no later than 20 business days before the end date of the contract.³³

However, it is worth noting that it is unusual for a retail energy contract, which is an assurance of supply, to have a fixed term. Many retailers, including EnergyAustralia, offer 'evergreen' contracts, meaning they do not have a specific end date whilst the customer receives energy from EnergyAustralia. Retailers then commonly offer a defined discount or benefit period; for example, a 15% discount off the current market rate for a 12 month period.

³¹ Consumer Utilities Action Centre, *The consumer experience of door-to-door energy sales in Victoria*, 2011

³² The Herald Sun, "Electricity salesman bashes elderly Endeavour Hills man who refused his product", 19 August 2016; ACCC, "Origin to pay \$2 million for unlawful door-to-door sales tactics", 30 March 2015; News.com.au, "Simply Energy hit with \$20,400 in fines over 'misleading' door-to-door sales conduct" 12 February 2015

³³ ESC, Section 48 (2)-(3), *Energy Retail Code* (Version 11, 1 January 2015)

St Vincent de Paul's recent report, *The NEM - A Hazy Retail Maze*, argues that there are many examples of poor performance by retailers in this area which largely serves to punish customer loyalty.

"Some retailers are not providing reasonable notice of changes to tariffs, charges or discounts... and some retailers move customers onto significantly worse tariffs at the end of a fixed benefit period."³⁴ Clearly, moving an existing customer from a larger discount to a lower one will have an impact on future bills.

In our view these examples do not demonstrate good customer service and are not within the spirit of the Energy Retail Code.

To this end, it is EnergyAustralia's standard practice that we do not vary the contract a customer signs up to. It is also EnergyAustralia's standard practice to inform customers of any changes to their contract terms and conditions, tariffs, discounts or entitlements. EnergyAustralia customers are assured of receiving between 20 and 40 days' notice of any changes.

In addition, EnergyAustralia recently offered our existing Victorian customers an extra 2% discount on top of their evergreen rate in order to reward loyalty. It is an example where market operators are incentivised to differentiate themselves by offering better outcomes for customers in order to retain or improve market share.

While there are clear incentives for governments to consider a ban on benefit periods, it is worth noting that the end of a benefit period is a timely way for customers to reassess their contract and shop around. By prompting customers to consider their energy contracts on a regular basis, they may, in fact, find a better offer.

However, it is important that customers are made aware of any change to their benefit term in advance so they are able to consider other options. EnergyAustralia encourages the Panel to consider the quality and timeliness of notice provided to customers when their discount or benefit period comes to an end.

Recommendation 11

Regulatory obligations should require retailers to provide customers with easy-to-understand notification in advance of any change to a discount or entitlement.

Supporting vulnerable customers

EnergyAustralia, has a dedicated hardship program, *EnergyAssist*, which provides tailored support to customers in vulnerable circumstances.

In 2016, EnergyAustralia was ranked the number one retailer by the Financial and Consumer Rights Council in recognition of our efforts to assist vulnerable customers. We see it as a fundamental obligation of providing an essential service and have established a *Financial Inclusion Action Plan* to ensure we continue to improve our products, services, policies and practices to support vulnerable customers.

In order to best assist those customers, we have introduced a wide range of assistance measures that are fully targeted to individual circumstances. It is EnergyAustralia standard practice that all customers in the *EnergyAssist* program are moved off standing offers and onto a more appropriate tariff for their circumstances (with their consent).

³⁴ St Vincent de Paul Society, *The NEM - A Hazy Retail Maze*, p50-54

If they have high energy usage, we might offer an energy audit conducted by our community partner organisation, Kildonan Uniting Care. Where appropriate, this may be followed by an appliance swap such as a new fridge or air conditioner to help improve a household's energy efficiency, thereby reducing consumption and energy costs. All of this is at no cost to the customer.

For customers with low energy usage, an appliance swap won't necessarily be the most effective option, so we look at co-payments to incentivise payment and engender a sense of partnership.

Further to this, we would welcome greater action from the Victorian Government to assist customers experiencing hardship.

We know, for example, that the application process for Utility Relief Grants (URGs) can be challenging for some customers. The latest ESC data shows that 62,000 hard copy URG forms were provided to customers last year. Only 33,000 of those forms were then submitted to the Department of Health and Human Services.³⁵ When customers are experiencing hardship due to a change in family circumstances, or their job or their health, filling out a form and mailing it can easily drop off the radar.

We would welcome regulatory reform to enable retailers to obtain consent and electronically lodge URG forms on behalf of customers. It would be a small change but would make a significant difference for those that need it most.

Customers are also not aware that they are entitled to receive up to \$500 per fuel type every two years. We find in some cases that vulnerable customers have carried out their waiting period but are not aware they are entitled to reapply and therefore do not seek the assistance they are entitled to. Notification to eligible Victorians reminding them to reapply for URGs would be another helpful measure.

As discussed above, EnergyAustralia does appliance swaps for vulnerable customers who would benefit from it. Unfortunately in many cases the customer is in rental or government housing which prevents them from making physical changes to the premises. We encourage the Panel to consider ways these situations can be avoided.

Recommendation 12

Retailers should be required to move hardship customers off the SOT and onto the most appropriate market offer for their circumstances (with their consent).

Recommendation 13

The Government should improve access arrangements to Utility Relief Grants, including electronic lodgement by retailers on behalf of their customers (with consent) and notifying customers when they become available for relief grants again after the two year period has elapsed.

Recommendation 14

The Government should work with energy retailers and community groups to enable more appliance swaps to occur in rental accommodation and public housing.

³⁵ ESC, *Victorian Energy Market Report 2015-16*, pp107-108

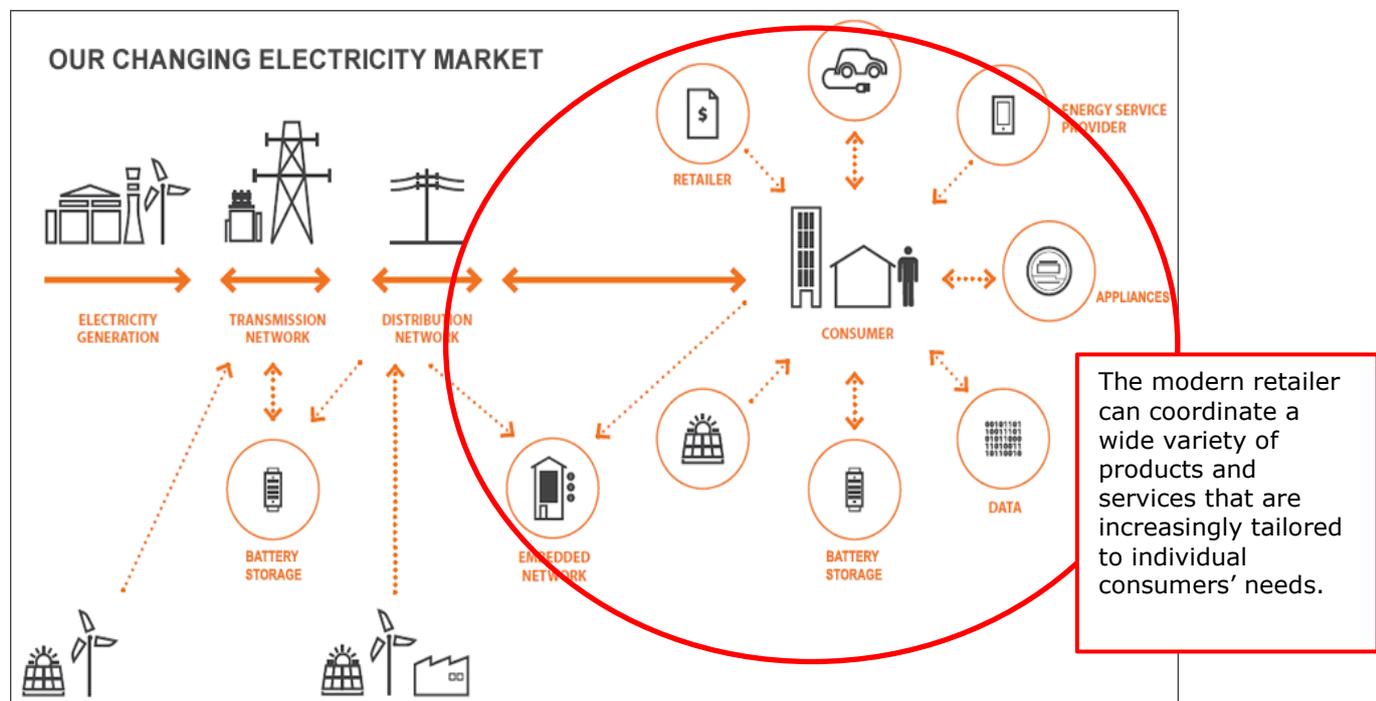
Retailers delivering innovation

The 'traditional' centralised energy supply model is being challenged by emerging technologies, products and services. These include rooftop solar panels, battery storage and smart meters.

Many of these new products and services provide customers greater control over how their electricity is delivered and consumed. Some allow customers to cede control over how their electricity is delivered and consumed to third parties.

These developments are transforming retail energy markets. And the role of retailers is changing too. The traditional retailer was simply a billing engine and call centre. The new retailer offers you the most efficient way to manage your energy via a mix of technology, advice, pricing choices and (possibly) finance options. The figure below depicts the coordinating role that retailers are best placed to coordinate.

Figure 6: Potential coordinating role for retailers



Our Victorian customers also tell us they want more from their retailer. Our customer insights analysis shows that customers in Victoria give equal weighting to other factors beyond price, when compared to other NEM jurisdictions. This is because the Victorian electricity and gas retail markets are the most mature and customers have been exposed to more types of market offers and services.

What is increasingly apparent across NEM jurisdictions is that retailers will only win and retain customers if they provide compelling offers, services that customers value, and good customer service.

An example of this customer-centric innovation is the new 'Go Neutral' product that EnergyAustralia launched in November 2016 for our existing customers.

Go Neutral enables customers to fully offset their energy consumption for free through a simple opt-in function. This initiative was developed through consultation with our customers that revealed people value action on climate change but want to exert

minimum effort and expense. EnergyAustralia has allocated \$20 million to support a range of domestic and international emissions reductions projects on our customers' behalf and the uptake to date has been positive.

Some of the other exciting new products and services we have recently launched or that are underway include:

- Tesla Powerwall - EnergyAustralia has teamed with Tesla Energy to offer customers the Powerwall battery storage system. This allows customers to store energy from their solar panels when the sun is shining or from the grid when rates are low, so they can use the stored power at night, or at some other time.
- Solar Inverter - EnergyAustralia is releasing a solar inverter system developed by Australian-based Redback Technologies. This package combines a smart solar inverter, battery enclosure and "intelligent" energy management software into a seamless experience that the customer can manage from their smartphone.
- *My Account* customer portal – *My Account* allows customers to log on via their computer or smart phone and see their energy usage, pay their bills and manage other parts of their account. In the last 13 months, uptake for the online portal has lifted from around one third of customers to about half. Victorian customers have benefited most from this due to the installation of smart meters.

It is important regulation is not allowed to stifle innovation and allows markets to evolve. Network tariff reform and a move towards cost-reflective network pricing would reduce cross-subsidies embedded in electricity pricing and could enable a greater range of products and services to benefit customers, including:

- peer-to-peer energy sales/trading
- demand-side response which allows consumer to reduce both their energy and network cost.

The Victorian exit fee cap is a useful example of regulation impacting innovation in that it can limit the ability of retailers to offer more upfront benefits when customers sign up to longer term contracts. We have seen a willingness by customers in NSW for example, where exit fee caps do not apply, to take up a 12c/kWh feed-in tariff and other solar products on a three year contract.

Allowing customers to opt out of the exit fee cap would enable them to access better offers or cheaper prices. Customers who leave prior to completion of the benefit term would be liable for an agreed amount. This would work similarly to a fixed interest mortgage rate or mobile phone plan.

Recommendation 15

The Government should consider the removal of regulatory barriers that constrain the emergence or growth of new products and services. This includes the development of a transition pathway to introduce more cost reflective pricing that unwinds existing cross-subsidies while providing adequate support for vulnerable customers.

Recommendation 16

Customers should be able to opt out of the fixed exit fee cap to encourage innovation in the Victorian retail market.

Appendix 1 – Case Study

Energy Market Regulation - the UK Experience

The UK fully deregulated retail electricity markets in 2002.

Over time, electricity and gas retail offers proliferated with high levels of dispersion in price, products and services.

In response to public concerns that the retail energy market had become too confusing, from 2008 onwards the UK energy regulator, the Office of Gas and Electricity Markets (Ofgem), started to impose restrictions.

Regulatory changes included limiting energy retailers to four tariff offers per fuel type, bans on discounting, and bans on price differentiation between regions or by payment method.

Ofgem's reforms were intended to encourage customer engagement and give them the ability to confidently compare prices. However, the result was reduced competition, customer switching which fell by half, and increased profits for suppliers.

In June 2016, the UK's Competition and Markets Authority (CMA) completed an investigation into the energy retail sector to ensure the market was operating in the best interests of consumers.

The CMA found there were perverse outcomes from Ofgem's regulatory interventions and customers were paying **£1.4 billion a year more** than they would in a fully competitive market.

Evidence presented during the CMA investigation showed that Ofgem's regulatory restrictions prevented discounts and tariff types that customers had come to value, particularly vulnerable customers.

Contrary to Ofgem's policy rationale that price dispersion and differentiation was a sign of ineffective competition, experts noted that effective competition incentivises differentiation as an economically efficient way of recovering costs.

Emeritus Professor at the University of Cambridge, Stephen Littlechild, has studied Ofgem's approach during 2008 and 2009 and observed that "[Ofgem had]... previously argued that 'you pay a lower price if you shop around, so the market is working'. Now it argued that 'you pay a higher price if you don't shop around, so the market is not working'. The glass was now half-empty rather than half-full." Professor Littlechild highlighted that Ofgem used little empirical evidence to inform its regulatory changes which may, in part, have been the result of fewer economists (and therefore economic thinking) at Ofgem.

The CMA is now working to unwind Ofgem's limitations on the retail energy market. Instead, customers are being empowered to choose the best offers through better information and tools such as price comparator sites.

Sources:

CMA, *Modernising the Energy Market*, 24 June 2016

S. Littlechild, *Promoting or restricting competition?: Regulation of the UK retail residential energy market since 2008*, September 2014

Appendix 2 – Recommendations Summary

Recommendation 1

That Victoria immediately adopts the National Energy Customer Framework (without derogation) to reduce duplication of retailer systems and processes, and therefore prices for customers.

Recommendation 2

That the Commissioner for Better Regulation be tasked with undertaking a regulatory assessment of the Victorian energy market to consider opportunities to reduce regulatory burden and reduce costs to Victorian consumers.

Recommendation 3

That the Victorian Government reconsiders its time-variant feed-in tariff and/or allows the full costs of the scheme to be passed onto solar customers directly to reduce the cost burden on other Victorian customers.

Recommendation 4

That Victoria leads concessions reform and seeks national consistency across the NEM jurisdictions.

Recommendation 5

That the Victorian Government immediately reverses its moratorium on gas exploration and development to encourage more gas supplies and reduce energy costs for customers.

Recommendation 6

That the Victorian Government urgently implements reforms that reduce the cost of serving customers at least equivalent to offset the coal royalty increase – see recommendations 1-5 as a starting point.

Recommendation 7

The Victorian Government publically reports annually on the costs of its VRET and legislate an immediate review of the scheme if a cost threshold is reached, similar to the Levy Control Framework set by the UK Government.

Recommendation 8

That Victoria implements an energy comparison rate to allow customers to adequately compare offers in a simple and easy to understand manner.

Recommendation 9

That all commercial energy comparator services are required to be nationally accredited and:

- disclose all commissions in a similar manner to the financial services sector;
- advise that that they do not show all retail offers available;
- rank offers and present information in accordance with a defined industry standard; and
- provide a link to Victorian Energy Compare and advise customers that this is an independent site containing all Victorian offers.

Recommendation 10

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Recommendation 15

The Government should consider the removal of regulatory barriers that constrain the emergence or growth of new products and services. This includes the development of a transition pathway to introduce more cost reflective pricing that unwinds existing cross-subsidies while providing adequate support for vulnerable customers.

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Customers should be able to opt out of the fixed exit fee cap to encourage innovation in the Victorian retail market.