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2 July 2019

Ms Kate Symons  
A/Chair and Commissioner  
Essential Services Commission  
Level 37, 2 Lonsdale St  
Melbourne VIC 3000

Submitted electronically: [RetailEnergyReview@esc.vic.gov.au](mailto:RetailEnergyReview@esc.vic.gov.au)

Dear Ms Symons,

### **Re: Issues Paper - Ensuring energy contracts are clear and fair**

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to respond to the Essential Services Commission's (the Commission) Issues Paper on the implementation of recommendations 3A and 4A to E of the *Independent Review of the Electricity and Gas Retail Markets in Victoria* (Thwaites Review). The issues paper provides an opportunity for early engagement between all parties, and to work together to identify a considered approach that produces the greatest net benefit for Victorian consumers.

### **Evolution of Victorian Regulatory Framework**

It is safe to say that since the Thwaites Review, there has been a number of changes to the Victorian regulatory framework and the practices of energy market participants. As a result, it is unclear to us that the recommendations remain fit for purpose, and they should not proceed as initially proposed.

As an example, the Australian Energy Market Commission (AEMC) noted the following about the Victorian market in its 2019 Retail Competition Review:

*There are now a number of offers in Victoria that are just as competitive as those with discounts, without requirements such as 'pay-on-time'. There are also competitive deals with fixed prices available, which gives customers more bill certainty.<sup>1</sup>*

We maintain that competitive energy markets - supported with appropriate safeguards - offer the greatest benefits to consumers in terms of price and service standards. Regulation should then ensure that consumers have the information they need to participate in the market with confidence. The Commission has achieved this to date, as recent regulatory measures mean that consumers receive clear advice and information about their energy contract and other offers in the market.

This will be very visible to consumers as they receive prescribed notices, such as inclusion of a best offer calculation on bills and advance notice of price changes throughout an energy contract. In addition to the clear advice entitlement, these measures mean consumers will fully comprehend the terms and conditions of the

<sup>1</sup> Australian Energy Market Commission (2019), 2019 Retail Competition Review: Jurisdictional Findings at a Glance, available at <https://2019.aemc.gov.au/competition-review/jurisdiction/victoria>

offers available to them. At the same time, the Victorian Default Offer (VDO) exists as a safeguard for those who are unable or unwilling to participate in the market.

In our view, each of the consumer segments that the Thwaites Review expressed concern about such as those who may have participated in the market at some point in the past but not recently, or those who need more assistance when assessing different retailers' offers will benefit from these measures.

The regulations that came into effect on 1 July 2019 empower consumers to choose retail products that best reflect their needs and preferences. This position is echoed by the Commission in its final decision to enact the clear advice entitlement:

*Under our approach, the customer retains the agency to make decisions on their own behalf, and is accordingly accountable for those decisions. By contrast, the retailer is accountable for providing the relevant information to the customer in a way, consistent with the objective, which enables the customer to exercise its agency in a confident and informed manner.<sup>2</sup>*

Red and Lumo urge the Commission to retain this philosophy as implements the remaining recommendations. More restrictive options to implement the next round of recommendations will undermine this agency and reduce access to more competitive market offers.

As an example, the automatic migration of a consumer to a specific offer at the end of a benefit period or contract - one of the options the Commission is considering - could place them on a product to which they are not suited (e.g. a 'best' offer that could involve a conditional discount). Similarly, mandating a fixed price contract for a defined period could prevent a consumer from accessing a more competitively priced product that involves some limited exposure to movements in cost (either upwards or downwards).

### **Flexibility within the Terms of Reference**

We welcome the Commission's statement in the issues paper that '*as we progress to making proposals on implementing the recommendations, we will consider them as a package to test the practicality in their inter-relationship, particularly in light of the reforms that commence from 1 July 2019.*'<sup>3</sup>

The Terms of Reference also appear to grant the Commission some discretion to adopt a broader view, rather than to simply implement the recommendations mechanically. They refer to 'implementation issues' and instruct the Commission to consider its objectives. In our view, the Commission can take a proportionate response to these recommendations, noting recent regulatory initiatives.

We also note the market has evolved since the completion of the Thwaites Review, in terms of contract periods and discounting practices. As an example, Red Energy does not offer substantial conditional discounts and offers discounts offer the entire bill (rather than usage).

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<sup>2</sup> Essential Services Commission (2018), Final Decision: Building trust through new customer entitlements in the retail energy market, pg. 59

<sup>3</sup> Essential Services Commission (2019), Issues Paper: Ensuring energy contracts are clear and fair, pg. 11

## Fixing contract prices (recommendations 4A and 4B)

The Thwaites Review expressed concern about retailers' flexibility to vary their prices up or down under a market retail contract without prior notice, leading it to make recommendations 4A and 4B. However, this flexibility is the mechanism for retailers to share some of the risk of their exposure to significant movements in cost inputs with customers, and for those customers to benefit through a lower price and/or deeper discount.

Removing this flexibility in all contracts could add to retailers' risk and potentially add a premium to energy prices. This is one of the reasons why few customers have signed on to fixed price market retail products in the past; they have historically not been as competitively priced as more flexible contracts. The AEMC noted that the proportion of fixed or capped price offers rose from only 1% of the market in NECF jurisdictions to 7% during 2018/19, reflecting the demand for price certainty among some consumer segments.<sup>4</sup>

Within this context, we are pleased the Commission acknowledges this issue and is considering options 'towards the centre of the scale', namely, by avoiding a prohibition on variable price contracts but taking some action to address concerns about the certainty of prices. All Victorian consumers will have the information they need and those who choose to act on it can continue to access more competitively priced products, while other consumers have options that suit their needs.

Our preference is for retailers to retain the flexibility to offer a fixed price retail product (as suggested in option 2(a)), rather than mandating that retailers fix all rates under all contracts for at least 12 months after a consumer enters a contract (as proposed in option 1). Option 1 is more restrictive and could flow through to a higher price for all contracts.

Option 1 would also have a far greater impact on retailers' systems and current practices for managing price changes. This is the most costly option to implement and maintain, and would flow through to higher operating costs for retailers, and then to consumers as a consequence. It is much easier for retailers to create a separate retail offer in their billing systems - under which prices are fixed for the first 12 months - that any consumer could access rather than to manage what would effectively be a much larger number of separate price changes for every customer across a 12 month period. We would welcome the opportunity to engage directly with the Commission to further explain this issue.

These options do not exist in isolation. Consumers are aware that prices can vary under a market contract through the clear advice entitlement and explicit informed consent. From 1 July 2019, all Victorian consumers can access the VDO, the price of which is not only set by the Commission but is also fixed for 12 months from 1 January each year. This provides certainty to those consumers who value it, while other consumers would retain the ability to choose a more flexible product that is potentially more competitively priced. Furthermore, as consumers now receive advance notification of price changes, which includes a best offer calculation, they will be able to assess the impact of that price change and whether a better offer exists for them. The Commission should also note retailers' commercial incentives in a competitive market to manage any customer frustration with price variations. This not only occurs

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<sup>4</sup> Australian Energy Market Commission (2019), *2019 Retail Competition Review*, page 87

at the start of a contract, but also throughout their experience with that retailer. Retailers can manage their customer's experience and expectations in various ways, for example by choosing to hold prices constant for some initial period.

Further, as the Commission continues to evaluate the competitiveness of the retail energy market, it can monitor the take up of fixed priced offers -- and adjust the Code accordingly if it is not providing the expected benefits to Victorian consumers.

### **Practices at the end of benefit and contract periods (recommendation 4C)**

The issues paper suggests a number of options for assigning consumers to an alternative offer at the end of a benefit period and at the end of a contract, namely, the VDO, best offer, cheapest offer, or cheapest equivalent offer. As the Commission correctly notes, neither of the last two are feasible.

A requirement for retailers to roll all consumers onto their 'best offer' at the end of a fixed benefit period will reduce the incentive for them to offer such products. More significantly, there is no reason to believe that the 'best' generally available offer is suitable for every consumer. In some instances, it may incorporate a conditional discount or some other term or condition that doesn't reflect their customer's preferences.

Consumers on contracts where benefits have expired have clearly participated in the market at some point and there is no evidence supporting an assumption that they cannot do so effectively again. There is high potential that more restrictive options could frustrate many consumers by assigning them to a product that they have not explicitly chosen. This undermines not only a customer's agency, but also the notion of informed consent. In our view, is also inconsistent with the intent of many of the 1 July 2019 initiatives. We note that these consumers will receive a best offer calculation on their bills throughout the benefit period, giving them numerous prompts to consider their options and to enquire about the best offer (or indeed, any other offer).

Looking ahead, the clear advice entitlement will provide additional information to consumers who are considering contracts with fixed benefit terms (including what occurs at the end of the period) and they will also receive advance notice with a best offer calculation. Our preference is for the Commission to retain a framework that is based on customer agency and the provision of information to allow informed engagement, i.e. to avoid prescribing a contract to which the retailer must assign a consumer at the end of a finite benefit period.

Therefore, we support the Commission's option 5, which is supported by recent regulatory initiatives such as advanced notice of the end of a finite benefit period.

The issue is less problematic for fixed term contracts. The VDO would seem to be the logical product to which a consumer would be assigned if they reach the end of a finite contract. As with all other consumers, this segment will receive best offer calculations on bills and for price changes over the life of their contract.

### **Discounting (recommendations 3A, 4D and 4E)**

We note that for the majority of our customers, conditional discounts are a way of paying less for their energy and they have little trouble meeting those conditions. We therefore urge the Commission to be mindful of how different options might impact retailers' discounting practices. Regulatory measures - such as requiring retailers to

maintain discounts in perpetuity (recommendation 4D), given they are now to be calculated relative to the VDO - could reduce retailers' ability and incentive to offer such products. As such, we believe recommendation 4D would lead to retailers withdrawing discounts from the market.

However, we also recognise that some customers are not well placed to manage their finances and/or meet conditions in every instance. Therefore, we support measures, including the clear advice entitlement, to enhance consumers' ability to understand how discounts are calculated and what occurs if they fail to meet any conditions. Additionally, these consumers are also supported by the payment difficulties framework, irrespective of whether they select a product with or without a discount, and are experiencing financial difficulties.

In terms of the presentation of discounts in dollar terms (3A), it is not clear that all consumers would necessarily find it easier to compare offers if discounts are presented in dollar values rather than percentages. The perceived harm that was intended to be addressed was that consumers did not have a common reference point and the different bases for discounts (entire bill compared with usage only). This has been addressed through the comparison to the VDO.

Policymakers and regulators, including the Commission, have undertaken considerable research in recent years to understand how best to present market information to consumers. This has informed numerous initiatives, such as the content and structure of Basic Product Information Documents and Energy Fact Sheets, prescribed content when advertising and publish offers relative to the Default Market Offer, and the presentation of a best offer calculation on bills as an annual amount. As many of these initiatives have been implemented recently, it is too soon to determine whether these will improve consumers' ability to compare competing offers.

The next few months provide the Commission with the opportunity to evaluate how consumers are responding to these measures. The Commission should also conduct this review from a consumer's perspective, whether retailers are providing the right level of information. We are concerned that the vast array of changes in communicating to consumers might have the opposite effect, confusing consumers instead of encouraging their participation in the market.

As the Commission seeks to implement changes resulting from the Thwaites Review alongside what it is required to implement under the terms of reference, the Commission must understand the problem that it is trying to solve. We support the Commission undertaking a broader review, and delaying implementation of the 1 July 2020 changes, if it becomes apparent that more analysis is necessary or if the perceived harm is no longer apparent. In the meantime, we support industry initiatives to work with the Commission to develop a reference price for gas.

### ***Cost reflective discounts***

The issues paper proposes two broad options for implementing recommendation 4E for the Commission to develop a cap based on determination of reasonable costs, and a requirement for retailers to ensure conditional discounts reflect reasonable costs (and potentially justifying their position to the Commission).

A cap on discounting necessarily takes larger discounts out of the market, which is to the detriment of some consumers. We note also that various other regulatory

measures that should give the Commission fewer concerns about the size, and impact for some consumer segments, of some discounts, namely:

- the clear advice entitlement, which is intended to give consumers a clearer indication of the implications of failing to meet the conditions for a discount,
- the VDO, which does not include conditional discounts and which is now a common reference point for all discounts,
- the Payment Difficulties Framework, under which retailers discuss the most suitable products with their more vulnerable customers to ensure they are not exposed to significantly higher costs if they cannot meet the conditions for a discount.

A more fundamental issue is how the Commission would identify and quantify the relevant costs on which to base a cap. Retailers offer conditional discounts to manage debt, cashflow and credit risk and the impact of unpaid bills differs substantially across retailers. Relevant factors are the size and composition of the retail customer base, integration with other elements of the energy supply chain, broader risk management strategies, and credit rating. It is hard to see how the Commission could set a cap without disadvantaging specific retailers and/or business models.

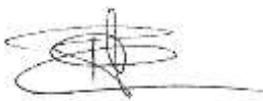
In light of these challenges and the absence of a clear evidence base following the 1 July 2019 regulatory changes, we recommend a relatively light-handed approach to implementing this recommendation, i.e. option 2.

### **About Red and Lumo**

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales, Queensland and South Australia and electricity in the ACT to over 1 million customers.

Red and Lumo thank the Commission for the opportunity to respond to its issues paper. Should you wish to discuss aspects or have any further enquiries regarding this submission, please call Geoff Hargreaves, Regulatory Manager on [REDACTED]

Yours sincerely

A handwritten signature in black ink, appearing to read "Ramy Soussou".

**Ramy Soussou**  
General Manager Regulatory Affairs & Stakeholder Relations  
**Red Energy Pty Ltd**  
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