

4 May 2012

Australian Energy Market Commission
PO Box A2449
Sydney NSW 1235

Dear Commissioners

POWER OF CHOICE (EPR 0022) — DIRECTIONS PAPER

Thank you for the opportunity to comment on the Australian Energy Market Commission's (AEMC's) Directions Paper for the Power of Choice review.

Simply Energy fully supports the submission made by the Energy Retailers' Association of Australia (ERAA) and the responses provided in that submission to the questions posed in the Directions Paper. Simply Energy would like the AEMC to consider the ERAA's submission as a component of this submission.

This submission makes some high level points about the following key areas of the AEMC's review:

- Consumer participation and the role of third parties in the energy retail market
- Role of price signals and the need for additional consumer support
- Networks and their proposed DSP incentive mechanism
- The barriers that energy retailers contend with in delivering DSP to energy customers

Consumer participation and the role of third parties in the energy retail market

Simply Energy's view:

- 1. Regulation of the energy retail market is fragmenting as new market players are or are intending to develop direct contractual relationships outside the protections of the National Energy Consumer Framework.**
- 2. The need for an energy-specific customer protection framework was founded on the idea of energy being an essential service. The concept of energy as an essential service now extends beyond just the supply of the energy and a network and now includes the supply of information, energy management services and network management services.**
- 3. The requirements of the National Energy Consumer Framework should apply to all parties who wish to develop a direct contractual relationship with energy customers for the purposes of selling an energy supply, selling network services, selling energy information services, selling energy management or energy efficiency products and/or selling network management products.**
- 4. To do otherwise would lessen the protections currently enjoyed by customers.**

The AEMC notes that in the next stage of its review it will consider:

- The role of networks, retailers and other third parties and their engagement with customers — how dialogue can take place in a transparent manner when offering different products and services; and

- Possible changes that may be required to provisions in the Rules so that consumers can have timely access to their consumption data.¹

Regulation of the energy retail market is fragmenting

The introduction of new technologies into the energy market is creating the opportunity for customers to receive and take advantage of new services and products. Whereas previously the energy market was structured and designed to only deliver energy to the customer, the concept of an energy market is now expanding to include the delivery of energy information services, energy efficiency services, and energy and network management services.

The arrival of new products and services has resulted in the entry of new players in the energy retail market. Some distributors are considering or intending to develop direct contractual relationships with customers to deliver network management services, such as load control, and possibly a variety of other products and services. There are also entirely new entities entering the market — loosely termed ‘third party suppliers’ — offering customers information, energy efficiency and energy management products and services. These third party suppliers are looking to profit from the premise that they can assist customers manage their energy use for the ultimate purpose of minimising their energy bills.

While the potential of these new services and entities in the energy retail market is good for customers, a large gap in the regulatory framework may be opening up that has the potential to expose customers to detrimental outcomes.

The National Energy Consumer Framework (NECF) was designed to ensure customers are protected and empowered over the choices that they make in the energy retail market. As the AEMC is aware, it sets out specific requirements on those operating in the energy retail market, including contractual requirements, disconnection procedures, hardship requirements and the way marketing is undertaken.

It appears unclear to what extent the provisions of the NECF apply to distributors or ‘third party suppliers’ where these entities wish to develop a direct contractual relationship with customers. For example, if a ‘third party supplier’ wishes to directly market their energy management services to customers (say through a D2D channel), are these entities required to meet the energy marketing requirements of the NECF? Similarly, if distributors develop a direct contractual relationship with customers and directly bill the customer for those network services, are the NECF provisions broad enough to require them to provide a customer who is in hardship with two opportunities to enter into a payment plan with the distributor prior to disconnection?

The concept of what constitutes an energy service that is essential needs expanding

The need for an energy-specific customer protection framework was founded on the idea of energy being an essential service. The Productivity Commission (PC) noted in its Review of Australia’s Consumer Policy Framework that:

The intent (of an industry-specific approach) is to provide more effective and certain consumer protection than could the generic provisions alone. In particular, taking action after the event under generic law may not provide adequate consumer protection where:

- The risk of consumer detriment is relatively high and/or detriment suffered if things go wrong is potentially significant or irremediable; and/or
- The suitability and quality of services is hard to gauge before or even after purchase.²

¹ Australian Energy Markets Commission 2012 Power of Choice — Giving Consumers Options in the Way They Use Electricity, Directions Paper, p. 40

² Productivity Commission 2008 Review of Australia’s Consumer Policy Framework, Productivity Commission Inquiry Report, Volume 2 — Chapters and Appendices, p. 83

The PC also noted that:

There are good reasons to supplement the generic consumer law with specific measures to protect and empower energy consumers. They are essential services, with disconnection having potential harmful effects; billing is lumpy increasing the risk of financial stress for low income households; price menus and product bundling can be complex; and some areas of supply are not yet fully competitive.³

In Simply Energy's view, the concern about these risks apply regardless of the type of energy product or service the customer is consuming in the energy retail market. For example, the detrimental impact of disconnection for non-payment is as real for customers who owe a distributor as it is for customers who owe a retailer. Similarly, empowering customers to make an effective choice about the energy management services offered by a 'third party supplier' is as important as it is for the customer to make an effective choice about their energy supply.

The customer protection framework in energy has focussed on the delivery of energy to the customer as this has been the only service delivered to customers historically. This delivery has required:

- An energy supply (generators, retailers)
- A network (TNSPs, DNSPs)

However, technological innovation has expanded the range of services and products that customers can now take advantage of. As a result, the energy market now constitutes:

- An energy supply (generators, retailers)
- A network (TNSPs, DNSPs)
- Energy information (All including new players)
- Energy/network management/efficiency products (All including new players)

The National Energy Consumer Framework should apply to all parties who wish to develop a direct contractual relationship with energy customers

To ensure customers receive the same protections as new products and services enter the market, government, regulators and industry need to re-think the question of who is required to meet the obligations set out in NECF and to which parts of the NECF they are subject. In Simply Energy's view, NECF should apply to all parties who wish to develop a direct contractual relationship with energy customers for the purposes of:

- Selling an energy supply
- Selling network services
- Selling energy information services
- Selling energy management efficiency products; and/or
- Selling network management products

Alternatively, if energy-specific regulations are considered not necessary for protecting customers in the delivery of these new services and products, then the question needs to be raised on whether heavy-handed energy-specific regulation of traditional energy retailers is still required.

Simply Energy believes this issue requires urgent review if the regulatory framework is to keep pace with technological developments in the marketplace.

³ Ibid, p. 108

Role of price signals and the need for additional consumer support

Simply Energy's view:

- 1. Price signals are important if a change in customer behaviour is required**
- 2. More complex tariff structures can create a price shock for customers used to a flat rate tariff structure and who do not have the information, education or capability to change their consumption patterns in response to the price signals. While customers have the flexibility to invest in more energy efficient devices, often the customers that can afford the upfront cost of these devices are not the ones who feel the impact of the price increase.**
- 3. Any shift to more complex network tariff structures must be accompanied by a full range of customer education and support measures that give customers the tools to make a choice about their consumption.**

Price signals are important if a change in customer behaviour is desired. An appropriate cost-reflective price structure can inform the customer about the relative costs and benefits of their consumption at a point in time. We query whether cost-reflective pricing can ever be achieved in the presence of retail price regulation and Ministerial interventions in how retailers price their products in the market.

However, price signals are not a panacea for whatever problem the AEMC is attempting to solve with this review. As network charges typically comprise 40-50% of a customer's bill, there is a significant price shock associated with changing from a flat rate tariff to a more complex time varying tariff structure. For example, one Victorian distributor's proposed peak period price for residential customers is around 50% higher than the current flat rate network tariff and will apply from 7am to 11pm on a business day. Another Victorian distributor's proposed residential time varying network tariff is 300% higher than the current flat rate network tariff during peak times.

The way that customers are transitioned to a new form of tariff must be carefully managed. Customers must have the information and more importantly, the capability to change their behaviour in response to those price signals. If customers cannot change their behaviour in response to the price signal, then more complex network tariff structures revert to a revenue raising tool for network providers from which the customer receives no benefit.

Any shift to more complex network tariff structures must be accompanied by a full range of customer education and support measures that give the customer the tools they need to make a choice about their consumption.

Network incentives

Simply Energy's view:

1. Network providers currently comprise around half the cost of delivering energy to consumers.
2. The new incentive mechanism proposed by some distributors at the AEMC forum creates a high risk of distributors capturing the benefits of customer or retailer-initiated DSP.
3. Any intention to change the incentive structures applying to distributors (or any other player) must consider the industry-wide impacts.

The AEMC's review is looking at options to provide the appropriate commercial incentives for distribution network business to invest in DSP.

There was a proposal for a new incentive mechanism put forward by two distributors at the AEMC's forum on 19 April 2012. Simply Energy's understanding of the mechanism was the following:

- It would be based on the value of reduced energy consumption – the DNSP would be allowed to charge higher prices if they reduce energy consumption through DSP
- It would have targets based on the net benefits achieved from DSP

Simply Energy is concerned about this proposed incentive mechanism because it creates a high risk that distributors will capture the benefits of customer or retailer-initiated DSP. Our concerns are that:

- The cause of a reduction in energy consumption cannot be isolated. For example, if a customer invests in PV panels to lower their off-take from the grid, this will reduce energy consumption for distributors. However, an incentive mechanism would allow them to increase average network prices more than otherwise may have been the case, allowing the distributor to capture at least part of the benefit of the customer's decision. The situation would be the same with regard to energy efficiency scheme liabilities that retailers have under schemes such as REES and VEET.
- It undermines the incentive customers have to invest in DSP technologies. As distributors capture at least part of the benefit, there is a risk that it undermines the incentives customers have to invest in DSP.
- In a time of use pricing environment, the mechanism may create a large wealth transfer from customers to distributors. The aim of time of use pricing is to reduce average energy consumption through the peak periods. The incentive mechanism may allow the distributors to capture the value of this reduction because for every unit of energy that a customer reduces their use during the peak period, the distributor is compensated through a higher network tariff. The value of this benefit to the distributor is amplified by the fact that the value of the reduced energy consumption is calculated using the peak period price which can be 10 times the off peak period price.

Any intention to change the incentives that distributors (or any other players) have to invest in or roll out DSP activities must consider the industry-wide impacts as well as the benefits enjoyed by the end-use customer. DSP is something that can be delivered by a range of parties, including distributors, retailers and other third party players. DSP can also be undertaken by the customer based on their own purchasing decisions.

Barriers to retailers delivering DSP to small customers

Simply Energy's view:

- 1. A significant contribution to DSP could be made by retailers and the products that they have available for customers. However, Simply Energy encounters barriers that discourage or prevent us from becoming fully active in the DSP space.**
- 2. The installation of energy-efficient devices typically requires a capital investment by the customer and/or the retailer. The energy-specific customer protection framework allows customers to switch away from Simply Energy at any time, even though the customer may have an outstanding debt with us. This creates a very high risk that the capital cost of a DSP solution cannot be recovered.**

A significant contribution to DSP could be made by retailers and the products that they have available for their customers. However, Simply Energy's experiences suggest that there are significant barriers to retailers delivering DSP to small customers.

There is large potential for retailers to package energy supply with DSP products as one product bundle. For example, a retailer may offer solar hot water or solar roof panels as part of a broader energy sale contract with the customer. A retailer may also look to offer IHDs or some other form of energy information product that makes accessing current and historical consumption patterns easy for the customer.

This style of product offering has significant benefits for the customer. First, it is deriving from a customer choice to take up that retailer offering. As a result, the customer is not being forced onto something they do not want or don't understand. Second, the customer has the opportunity to bundle all the energy supply products and services that they want into one contract, making the contracting process easy and efficient for the customer. As a result, there is more likelihood that the customer may find value in and be willing to enter into a form of DSP that suits them.

However, there are currently barriers that discourage or prevent retailers from becoming fully active in the DSP space or make it difficult for the customer to engage with their energy retailer on DSP.

The energy-specific customer protection framework can act as a major disincentive for Simply Energy to offer energy efficiency solutions to our customers, or if we do so, the contractual arrangements are convoluted and potentially act as a disincentive for customers to take up the offer.

Offering energy-efficiency solutions typically involves some form of capital investment by the retailer if offered as part of a product bundle. For example, there may be the cost of the hot water system, roof panels or IHD. To be able to recover this cost, we must be able to lock the customer in for a length of time until the capital cost of the infrastructure is recovered.

However, the customer protection framework allows customers to switch away from Simply Energy at any time even though the customer may have an outstanding debt with us. As a result, there is a high risk that the capital cost of the infrastructure provided to the customer as part of the deal will not be recovered. Once a customer leaves a retailer, it is very difficult to recoup monies owed.

As a result, Simply Energy has contracted the DSP solution separately to the supply of energy, making the deal complex and difficult for us and the customer. Alternatively, we may only provide the DSP solution if the customer makes an upfront capital contribution toward the infrastructure being supplied, reducing the appeal of the deal to the consumer. It may also restrict those most in need of DSP (ie low income households) from accessing those DSP solutions.

The ultimate outcome is that the take-up of DSP solutions is less than the efficient level.

You can contact me on (03) 8807 1132 if you have any questions concerning this submission.

Yours sincerely

Dianne Shields
Senior Regulatory Manager