Retailer Price Variations in Market Retail Contracts

Rule Change Request

for

Australian Energy Market Commission

Donald Lloyd

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Person Making Request for Rule Change

Name of Proponent **Donald Murray Lloyd**

Address of Proponent [redacted]

Signed:

D. Lloyd

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Statement of Issues

This rule change request applies to retailer price variations during fixed term or fixed benefit period contracts, at any time when the customer is unable to terminate the contract without incurring a termination charge. I will call the period protected by termination charges the "locked in period" of the contract, and will call such contracts "lock in contracts".

The problem is that, except when the contract specifies that prices are fixed, the retailer may be free to make unjustified price increases during the locked in period. Wholesale energy costs may rise during the locked in period and the retailer must be free to raise pricing rates accordingly, but for new and existing contracts equally. What I am proposing is a rule that limits the size of price increases during the locked in period.

Retailers will naturally wish to maximize their profits, and when retailers are free to set their own prices, the only process keeping prices down to the benefit of consumers is competition between retailers.

But as things stand, competition between retailers for lock in contract business occurs only before the contract is signed. During the locked in period, the retailer has no price competition unless the consumer is willing to pay a termination charge. The only way to bring such prices under the influence of competition is to link them in some way to prices being offered under new contracts at the time.

With customers seeking a bargain and retailers wanting to maximize their profits, the result can be a battle of wits in which retailers offer discounts that not what they seem. The contest between a

retailer's marketing team and an individual customer is an unequal one, and I think the rules should be changed so that customers get what they can reasonably expect.

If a retailer sells a lock in contract to a customer with a discount and competitive initial pre-discount pricing rates but is then free to raise the pre-discount pricing rates to uncompetitive levels during the locked in period, then the contracted discount rate is essentially meaningless. The customer is entitled to expect a "genuine" discount for the locked in period. The retailer should not be able to claw back some of the discount by means of selective pre-discount price increases during the period.

Normally a retailer's initial pre-discount prices under a lock in contract are the same as their prices under a non-lock in contract for the same customer at the time, so the discount can be regarded as an inducement to the customer to sign a contract with a locked in period. For a genuine overall discount amount equal to the contracted discount percentage of what the cost would be if the customer had signed with the retailer but not for a locked in period, the pre-discount pricing rates at all times during the locked in period would have to match the retailer's prices applying had the customer signed a non-lock in contract.

Moreover if the prices under this alternative non-lock in contract ever exceeded those for a similar new contract, then the customer would have been free to sign up for the new contract. So the retailer's pre-discount pricing rates at all times during the lock in period would have to match their prices under a new non-lock in contract.

But as noted above, a retailer's prices under new non-lock in contracts will normally be the same as their pre-discount pricing rates at the time under new lock in contracts for a given customer. This has the further consequence that under a lock in contract, a retailer's pre-discount pricing rates at all times during the locked in period should match their pre-discount prices for new lock in contracts with the same customer.

Alternatively if a retailer sells a lock in contract to a customer who is currently buying direct from another retailer with no locked in period, and the new retailer's initial pre-discount prices are the same as the old retailer's prices for non-lock in contracts, then the retailer's discount can be regarded as an inducement to the customer to switch from the new retailer. By a similar argument, to provide a genuine overall discount amount equal to the contracted discount percentage of what the cost would be if the customer had remained with old retailer and not signed for a locked in period, the new retailer's pre-discount pricing rates at all times during the locked in period would have to match the old retailer's prices for new non-lock in contracts with the same customer, or equivalently the old retailer's pre-discount prices under new lock in contracts.

In the next section below I will argue that these ideas need to be developed further to protect the interests of the customer.

My own experience as a customer illustrates those points. My first contract with my present retailer (AGL) was a 2-year electricity contract with a 10% discount, commenced in August 2011. Previously I had been buying from my electricity retailer/distributor (EnergyAustralia), under a contract with no locked in period. The initial pre-discount pricing rates under the retailer's contract were the same as I had been paying my old retailer. I saw the discount as an inducement to switch to the new retailer. The contract didn't actually specify it, but in order for my overall saving to be

10% of what I would have paid at my old retailer, the new retailer's pre-discount prices would have to match those of my old retailer throughout the 2-year term.

After the 1 July 2012 price review I checked my pre-discount prices and found that they were higher those from the old retailer's website, meaning that my overall saving would be less than 10%. I queried this fact with the new retailer. I am not sure that I got a proper explanation, but they met my complaint by switching me new to a new 3-year contract at a 15% discount. In July 2012 also we had the gas connected, and signed up with the same retailer for 2-year contract with a discount of 10%.

Then in March 2013 we agreed to enter new 2-year contracts giving discounts of 17% for electricity and 14% for gas. I now understand that these were fixed benefit period rather than fixed term contracts, but the difference is not important here.

At the start of the latest contracts I was already a customer of the new retailer, and the old retailer's prices were less relevant. The initial pre-discount prices were the same as for a contract with the retailer having no locked in period, so I saw my discount more as an inducement to sign up for a locked in period. For my overall discount amount to equal 17% or 14% of what my cost would be if I had not signed for a locked in period, my pre-discount pricing rates at all times would have to match the retailer's prices for new non-lock in contracts.

After the 1 July 2013 price review I again checked the prices, this time for gas as well as electricity. My pre-discount price rates were already higher than those on the retailer's web site for new plans with no locked in period (less than 4 months into the contracts), although the differences were smaller in the case of gas, meaning that my overall savings compared with contracts of no locked in period would be less than 17% or 14% as the case may be. I prepared detailed comparisons and asked the retailer for an explanation. I learned that, for a customer in given circumstances, the retailer has potentially different pre-discount "market prices" under each plan, including closed plans. My plan was already closed to new customers and this is why my pre-discount prices were higher than those being quoted for new contracts on the retailer's website. I was offered an opportunity to have the latest bill recalculated using the prices for new plans, but only if I signed up for yet another pair of new contracts.

At this stage I decided that my retailer's pricing flexibility was weighted too much in their favour, declined the offer for new contracts and decided to wait out my current contracts and then find a new retailer. I raised the retailer's pricing practices with the ombudsman's office, but they declined to take any action unless the retailer was actually breaking the terms of their contract.

The following table shows the numerical effect of the higher pre-discount prices for my contracts compared with new contracts, after the 1 July 2013 pricing review. Perhaps the important thing is the difference in pricing rates, but the table goes on the express this as a clawing back of the discount rate. The rates (including GST) for new plans were obtained from the retailer's website based on my circumstances (postcode 2075, residential usage, time-of-day metering for electricity). The rates for my plans were notified to me by my retailer. Under the plans, electricity and gas usage prices are discounted as indicated, and daily supply charges are not discounted.

1 July 2013	Pre-discount Rate for New Plans	Pre-discount Rate for My Plan	Rate Difference (%)	Nominal Discount	Effective Discount	Units for Rates
Electricity:						
Peak Period	52.547	56.958	8.39%	17%	8.61%	cents per kWh
Shoulder Period	21.846	23.122	5.84%	17%	11.16%	cents per kWh
Off Peak	13.167	14.179	7.69%	17%	9.31%	cents per kWh
Supply	87.175	89.069	2.17%	0%	-2.17%	cents per day
Gas:						
First 15000/year	3.6157	3.6982	2.28%	14%	11.72%	cents per Mj
Next 18000	2.1175	2.1912	3.48%	14%	10.52%	cents per Mj
Next 69000	2.0878	2.1615	3.53%	14%	10.47%	cents per Mj
Supply	51.799	55.2200	6.60%	0%	-6.60%	cents per day

After the 1 July 2014 pricing review I again compared my revised pre-discount prices with those I would be charged under a new contract, on a similar basis to the previous year. The comparison was complicated by the repeal of the carbon tax, retrospective to 1 July 2014. Both sets of pricing rates shown below are after the carbon tax repeal. In a similar comparison of the higher rates set before the carbon tax repeal (not shown), the old rate differences had much the same pattern. The following table shows the numerical effect of the higher prices:

1 July 2014	Pre-discount Rate for New Plans	Pre-discount Rate for My Plan	Rate Difference (%)	Nominal Discount	Effective Discount	
Electricity:						
Peak Period	51.128	55.649	8.84%	17%	8.16%	cents per kWh
Shoulder Period	19.657	20.966	6.66%	17%	10.34%	cents per kWh
Off Peak	10.758	11.803	9.71%	17%	7.29%	cents per kWh
Controlled Load 1	8.822	9.603	8.85%	17%	8.15%	cents per kWh
Supply	89.353	91.289	2.17%	0%	-2.17%	cents per day
Gas:						
First 15000/year	4.0964	4.1228	0.64%	14%	13.36%	cents per Mj
Next 18000	2.3452	2.3595	0.61%	14%	13.39%	cents per Mj
Next 69000	2.3012	2.3254	1.05%	14%	12.95%	cents per Mj
Supply	56.76	64.6140	13.84%	0%	-13.84%	cents per day

For my existing electricity plan the prices were again significantly higher than for new plans, so again my savings are less than 17% of what my cost would have been if I had not signed for a locked in period. For my existing gas plan, the usage charges are only slightly higher than those for a new plan, but the gas supply charge was 13% higher than for a new plan and that seems hard to justify.

Online retail quotes from my old energy retailer also give pricing rates that apply only to new customers. Customers who signed prior to the last price review may have different rates, presumably higher. This suggests my retailer may not be the only one with selective pricing that disadvantages existing customers.

The initial prices for lock in contracts from various retailers are generally public knowledge. By contrast during the locked in period price increases are at the discretion of the retailer and these prices are not publicly available, making comparison between various retailers impossible. Under the PDS my retailer can increase prices during the locked in period, with the proviso that if the

post-discount charge is greater than would be the case if the contract had no locked in period, then the customer can terminate the contract without penalty (if they realise the situation exists). This means that my present contract allows my retailer to give me zero effective discount. Since the discount is a reward to a customer for signing a lock in contract, as previously argued it would more appropriate for the customer to be able to terminate the contract without penalty if the <u>pre</u>-discount charge is greater than if the contract had no locked in period.

Description of Proposed Rule

The problem presented is that once a lock in contract has been signed, the retailer can raise pricing rates during the locked in period, free from any competitive pressure unless the customer is willing to pay termination charges. The solution would be to link prices under the existing contract to prices offered under appropriate new contracts, since these are under the pressure of competition.

In the case of pricing elements within a lock in contract that are not subject to discount, we can stipulate a simple rule. At all times during the lock in period, the pricing rates must not be greater than the corresponding pricing rate under similar new contracts on offer from the retailer to customers in a similar situation.

In the case of pricing elements subject to discount, the solution is more complicated. We have seen that a genuine discount at the contracted level can be provided if at all times during the locked in period the retailer's pre-discount prices are not greater than the their prices for compatible new non-lock in contracts to customers in a similar situation.

Also we have seen that if the discount is offered by a retailer to an existing customer of a another retailer then a genuine discount at the contracted level can be obtained if at all times during the locked in period the new retailer's pre-discount prices are not greater than the old retailer's prices for compatible new non-lock in contracts to customers in a similar situation.

It would not be practicable to force a retailer to follow the pricing of another retailer, nor to discriminate between customers depending on who their previous retailer was. We can only require that the retailer's pre-discount prices at all times during the locked in period should not be greater than the retailer's prices for any compatible new non-lock in contracts for customers in similar circumstances.

A retailer may well offer different prices to customers depending on which distributor they have. Customers in "similar" circumstances referred to above would among other things have the same distributor, so pre-discount prices during the locked in period are being linked to prices for new contracts with same retailer and distributor. More generally, a retailer could be offering more than one compatible non-lock in contract to customers in similar circumstances, so the reference to "any" above means pre-discount prices during the locked in period are being linked to prices for the cheapest of these non-lock in contracts.

I received an offer from my old electricity retailer to return to them under a 12-month contract with a 15% discount and no locked in period. This can be compared with a bank offering a higher interest rate for a limited time to new depositors. This "disloyalty bonus" may be distasteful to existing customers but is not illegal. So I suppose that the rules have to allow for a discount to be offered on the prices for non-lock in contracts to new (including returning) customers.

This arrangement is not affected directly by the proposed rule, which applies only to lock in contracts. However in linking pre-discount prices under an existing lock in contract to prices for new non-lock in contacts, we should not include discounted prices for non-lock in contracts to new customers in the comparison, because if the customer had signed originally for a non-lock in contract instead then he would not qualify later to switch to a discounted contract restricted to new customers. That proviso is taken care of, because during the locked in period the customer is an existing customer of the retailer, and in that respect would not be in the same circumstances as a new customer.

The requirement suggested above would be great improvement on the present arrangement, and it may be enough.

But there is a possible weakness. It is possible that during a locked in period, the retailer could start offering a new combination of high pre-discount prices and high discounts, such that the post-discount prices for new lock in contracts were competitive in the market for such contracts. The retailer's motive might be to see if the high discount level alone would attract some customers. The same high pre-discount prices would also apply to new contracts on offer by the retailer but with no locked in period. The latter would then not be competitive in the marketplace for those contracts, but that might be acceptable to the retailer if their priority was for selling lock in contracts. Linking prices under the existing lock in contact to such uncompetitive high prices would fail in the objective of subjecting them to competitive pressure.

In fact it would even be possible for a retailer to offer a series of different lock in contracts over time, each with higher pre-discount prices and higher discounts than the ones before. If the pre-discount prices under an existing contract were linked to these prices as just suggested, then the retailer would be able to apply these ever-increasing prices to the existing contact, while still complying with the previously suggested rule.

To cater for this situation, we could require the retailer's pre-discount prices from time to time during the locked in period to be not greater than their prices under compatible new non-lock in contracts, reduced to take into account any shortfall between the discount level in the existing contract and the retailer's current discount level under new similar lock in contracts. The outcome would be that the post-discount prices under the existing lock in contract would be the same the post-discount prices under new lock in contracts, whenever the new contracts had a higher discount rate than the original.

Alternatively during the locked in period, the retailer could start offering a new combination of low pre-discount prices and low discounts, such that the post-discount prices for new lock in contracts were competitive. The same low pre-discount prices would also apply to new contracts on offer by the retailer with no locked in period, and perhaps the latter would then be competitive in the marketplace for those products.

If we were to apply a similar adjustment to that proposed when discounts increase, we would require the retailer's pre-discount prices from time during the locked in period to be not greater than their prices under new non-lock in contracts, increased to take into account any excess of the discount level in the existing contract over the retailer's current discount level under new similar lock in contracts. The outcome would again be that the post-discount prices under the existing lock in contract would be the same the post-discount prices under new lock in contracts.

However, increasing the pre-discount rates for an existing lock in contract above those for new non-lock in contracts would be contrary to our original requirement for the discount to be genuine, that pre-discount prices under the lock in contract should match the prices for new non-lock in contracts during the lock in period. Consequently in arriving at pre-discount pricing rates during a lock in contract, the rates on offer for new compatible non-lock in contracts should be used, with adjustment only when new discounts are higher.

It may be objected that this latest proposed rule favours the customer in that if discount levels on new contracts increase during a lock in period, the new pre-discount prices may not necessarily be uncompetitive in the market for contracts with no lock in period, in which case the adjustment is not required to make the discount "genuine". But it would be difficult to distinguish between competitive and uncompetitive prices in the NERR, so the adjustment is proposed whenever discounts on new contracts are higher. The principle is that if a discount is offered in a lock in contract then the retailer has an unavoidable obligation to provide it as a genuine discount for the full locked in period, and if the retailer's price variations produce any uncertainty as to what pre-discount prices would result in a genuine discount at the contracted level, then any doubt should favour the customer.

The fact that an existing contract may no longer be profitable at its discount level does not justify the retailer making additional price rises to cover the loss. If a retailer offers a discount and subsequently the contract becomes unprofitable then the retailer should bear any loss that is not recouped by price rises that apply equally to new contracts on offer.

The proposed rule is designed to work when the retailer changes the pricing rates, but if the retailer makes significant changes to its rules specifying which part of the energy use is charged at which rate for new contracts but still leaves existing contracts running under the old formula, then the existing contracts would have no compatible new contracts. The proposed rule links prices during a locked in period to any compatible new non-lock in contracts, so if there are no such contracts then the rule has no effect. This seems an unavoidable limitation of the proposed change, but I don't think that should stand in the way of its widespread benefits in normal circumstances.

Retailers may object that this proposal is too harsh as they have already given large discounts on existing contracts, expecting to be able to claw some of it back in the later part of the contract. My reaction would be that it was always an unconscionable practice, and they deserve no sympathy.

However if the AEMC think this might be too disruptive, then alternatively the NERR could be changed so that the proposed restriction applies only to contracts written after a certain future starting date.

The proposed rule is intended to prevent selective pricing increases that disadvantage locked in customers. It may still be possible for an ingenious retailer to find a way around the intent of the new rule. Rather than making more elaborate rules now, I suggest this should be left until any further unwanted practices arise.

The following proposed rule change is based on the preceding discussion. If AEMC do not agree with the arguments for the adjustment when discounts on new contracts are higher, then I suggest alternatively that the proposed rule be adopted with all references to the discount adjustment factor removed.

I propose additions to Division 7 of the NERR, relating to market retail contracts. The proposed changes would include a rule, say numbered 52A. Subject obviously to legal vetting as to the exact wording, the proposed rule is:

52A Retail price variations

(1) This rule applies to pricing in market retail contracts having a fixed term or a fixed benefit period, at all times when termination of the contract by the customer would incur a termination charge, but not while the pricing rates are pegged at their initial levels under the terms of the contract.

(2) In relation to pricing rates subject to discount under such a contract, the pre-discounted pricing rates must be not greater than the prices being offered by the retailer under any new compatible contracts with no early termination charge to customers in similar circumstances, multiplied by the discount adjustment factor.

(3) In relation to pricing rates under such a contract not subject to discount, the pricing rates must be not greater than those being offered by the retailer under any new similar contracts to customers in the same circumstances.

We would also need to add these definitions to part 45A:

A customer's circumstances means any factors that a retailer takes into account in determining pre-discounted or non-discounted pricing rates for the customer, including the customer's meter type (simple or time-of-day etc), the identity of the energy distributor and whether or not the customer has a pre-existing contract for the same energy type with the retailer, but not including the details of any such pre-existing contract.

A compatible contract means, in respect of a fixed term or fixed benefit period contract, a contract of the same energy type (electricity or gas), with the same rules for determining how much energy usage is charged at which pricing rate.

A similar contract means, in respect of a fixed term or fixed benefit period contract, a compatible fixed term or fixed benefit period contract having the same length of time during which contract termination by the customer would incur an early termination charge.

Discount adjustment factor:

In the case that the discount rate D in the contract is less than the discount rate CD in the retailer's similar contract, the discount adjustment factor is calculated as (1-CD)/(1-D), and otherwise the discount adjustment factor is equal to 1. If any part of the discount rates C or CD is provided conditionally, for example for payment on time, then for the purpose of this calculation it is to be assumed that the eligibility requirement has been met.

Proposed Rule's Expected Benefits, Costs and Implications

The proposed change would prevent a retailer from using the existence of termination penalties and the absence of competition once a lock in contract commences from making unjustifiable price increases that are greater than those for new contracts on offer in similar circumstances.

For prices subject to discount under a lock in contract, the change would ensure that the customer would receive genuine discounts at the stated level throughout the period, by requiring the use of appropriate pre-discount pricing rates that are subject to competitive pressure throughout. It would prevent the retailer from clawing back part of the discount savings through selective price increases aimed at existing contracts.

A possible consequence could be that retailers will have to offer smaller discounts, knowing that these would continue to be payable in full to the end of the locked in period.

Achievement of National Energy Retail Objective

The National Energy Retail Objective (NERO) states:

The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy.

The proposed rule change would promote the interests of energy consumers with respect to price by protecting them from predatory price increases during lock in contracts.

The proposed change would make retail energy pricing more transparent, and so would enable consumers to make more realistic comparisons between lock in contract offerings by rival retailers, before signing up. This would force retailers to compete clearly on price rather than promoting offers of meaningless nominal discounts. That should force overall net retail energy prices down, to the benefit of consumers.