



## **SUBMISSION**

**In response to**

**AEMC Consultation Paper, Rule Change ref RRC0001**

### **Regarding:**

**Retailer Price Variations in Market Retail Contracts:**

*Rule Change Proposed by CUAC and CALC*

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**UnitingCare Australia**

**March 2014**

## **About UnitingCare Australia**

UnitingCare Australia is the Uniting Church's national body supporting community services and advocacy for children, young people, families, people with disabilities and older people.

The UnitingCare network is one of the largest providers of community services in Australia, providing services and supports to more than 2 million Australians each year in urban, rural and remote communities. The network employs 35,000 staff and 24,000 volunteers. We provide services to older Australians, children, young people and families, indigenous Australians, people with disabilities, the poor and disadvantaged and people from culturally diverse backgrounds in urban, rural and remote communities.

UnitingCare Australia works with and on behalf of the UnitingCare network to advocate for policies and programs that will improve people's quality of life. UnitingCare Australia is committed to speaking with and on behalf of those who are the most vulnerable and disadvantaged for the common good.

UnitingCare Australia's principal interest in energy regulation arises because energy is an essential service with rising costs that are putting financial pressure on growing numbers of households in Australia, particularly vulnerable and low income households.

## Overview Comments

UnitingCare Australia supports the rule change proposed by the Consumer Action Law Centre and Consumer Utility Advocacy Centre because it responds to an issue of significant concern for small business and household consumers, particularly lower income households.

The problem is that under current electricity and gas laws, retailers offering market contracts can vary prices during the period of an agreed market contract, without any consumer engagement, other than notification of the new and higher price.

This practice of increasing prices within agreed contract periods has four major deleterious impacts:

1. It disadvantages consumers who are already paying historically very high prices for energy. It is common for staff in UnitingCare services (including Financial Counselling, Emergency Financial Assistance, and the Household Energy Saver Scheme) to be assisting households with modest energy consumption who are spending over 10% of their household income on electricity, compared to the 2.3% average reported by the ABS' most recent Household Expenditure survey.
2. It undermines consumer trust in energy markets. Growing numbers of consumers are responding with anger and cynicism to energy companies (and governments) who are seen as unnecessarily pushing up prices (real increases of 70% or more over the past 6-7 years across Australia), reducing services (e.g. long waiting times for call centres) and engaging in aggressive and sometimes confusing marketing strategies.
3. It establishes energy market practices that fail to meet reasonable consumer expectations about the payment for goods and services in Australian markets. The reasonable expectation of Australian consumers is that they will pay the price for a good or service as agreed at the point of sale. A whitegoods retailer raising the price charged for a washing machine, for example, between point of sale and delivery of that washing machine, would be regarded as behaving egregiously. The same applies for other goods sold, whether a kilogram of tomatoes or a home theatre system. Similarly a household engaging a tradesperson expects to be charged either a negotiated price, or a call out fee plus a fixed rate per hour. The notion of prices for a service rising once agreement has been reached is inconsistent with reasonable consumer expectations in Australia.

There are rare examples of other markets where fixed contracts with variable rates are offered, for example the market for housing mortgages. This

market however, has significantly less complexity and more transparency, with consumers able to easily compare the fixed and variable rates and decide on the risks associated with their choices.

4. Additionally, the current high levels of complexity and low levels of transparency in market offers, combined with reduced consumer trust in retail businesses and the market are likely to reduce consumer engagement with energy markets leading to poorer outcomes for consumers.

The following comments respond to the questions posed in the consultation paper.

## 1 Assessment Framework

### Question 1 - NERO test

**Are there any other matters that the AEMC should consider in its assessment of the NERO test?**

In its assessment of the NERO<sup>1</sup> test, the AEMC:

- may weight the NEROs different components (e.g. price, security)
- may satisfy itself that the proposed rule is compatible with the development and application of consumer protections
- must have regard to any relevant Ministerial Council on Energy (MCE) statement of policy principles.

The proposed rule change is not only about improved consumer protection but also about improving competition in retail energy markets. The improved protection being sought is a necessary condition for effective competition. The rule change proposal will improve trust in energy markets, reduce transaction costs for consumers and provide greater certainty, all of which encourage consumers to participate in energy markets, thereby providing a basis for more competitive markets, in line with the NERO.

### Question 2 - Consumer protections test

**a) Is the scope of the consumer protections that the Commission intends to consider appropriate for this rule change request?**

**b) Should the Commission consider any other factors in assessing the rule change request against the consumer protections test under the Retail Law?**

The 'development and application of consumer protections' is not defined in the second reading speech of the National Energy Retail Law (NERL), which contains the NERO, nor is there any other legislative or policy guidance.

It is therefore open to the AEMC to consider and rely upon other evidence in 'the application and development of consumer protections', such as evidence from international jurisdictions or relevant consumer protections that are currently in operation.

We note that when the Productivity Commission was considering amendments of the Trade Practices Act 1974 (Commonwealth), it investigated European jurisdictions as part of its Review of Australia's Consumer Policy Framework. The AEMC scoping of consumer protections is in line with this earlier work.

The scope of consumer protections that the AEMC intends to consider, as part of this Rule Change proposal, is appropriate.

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<sup>1</sup> The national energy retail objective (NERO) is to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy. (s 13 NERL)

## 2 Allocation of Costs and Risks

### **Question 3 - Risk allocation in market retail contracts**

#### **Do the current rules result in an inefficient allocation of risks between retailers and consumers in retail energy markets?**

Yes, the current rules result in a very asymmetric and hence inefficient allocation of risks between retailers and consumers in retail energy markets.

It is economically efficient that the party most willing and able to manage risks does so. The AEMC makes this point that risks should be allocated “to the party in the best position to minimise the costs associated with that particular risk.” (p.28 of the consultation paper)

The key consideration for efficient risk allocation is parties’ ability to manage risk relative to each other. Retailers have greater ability, relative to consumers, to manage all input cost risks, and it would therefore be economically efficient for retailers to bear them. Consumers are also paying retailers to manage the market risk; this is a core role for retailers in the NEM.

### **Question 4 - Risk premiums**

#### **a) If the proposed rule is made, would risk premiums be built into fixed period contracts?**

#### **b) How significant would these risk premiums be and would these risk premiums create a permanent increase in the price of fixed period contracts?**

It is likely that retailers would seek to pass a portion of risk management costs on to consumers. The costs of managing many of the risks, such as hedging against wholesale price movements, are likely to be immaterial. Other types of risk, such as regulated network costs or government charges, may be more costly for retailers to manage, and give rise to a material risk premium.

However, any risk explicit premiums should be compared to the current implicit costs consumers currently face to manage the risks themselves. Given retailers’ ability to more efficiently manage risk, the net cost to consumers should be negative, i.e. a saving. The risk premium would be analogous to an insurance payment, for the purchase of insurance against price changes it is what consumers are already paying for. Any increased ‘risk premium’ would be effectively ‘double dipping’ by retailers and hence inefficient, with consumers bearing the full burden of the inefficiency.

Retailers are expected to improve their processes for managing any new or perceived new risks. They can be expected to do so more efficiently and reduce their risk premiums. Vigorous and effective competition between retailers should also see risk premiums driven downward as retailers seek greater cost effectiveness in all aspects of their operation.

### 3 Consumer Participation and Engagement

#### Question 5 - Transparency and market retail contracts

**a) When entering fixed period contracts, do some consumers believe that the prices will be fully fixed when in fact they are not? If so, what proportion of consumers are likely to fall into this category?**

We expect that most customers enter into a fixed period energy contract expecting fixed prices. This is what contracts have traditionally been about: an agreement to purchase an agreed good or service at an agreed price. Fixed prices in fixed term contracts are a completely reasonable and rational consumer expectation.

Further, given the low literacy rates in our communities, and the complexity of market arrangements and number of potential offers available to consumers, it is in the nature of these complex offerings that consumers would likely interpret fixed term to be linked with a fixed tariff, for it is likely to be unclear what other benefit might justify signing on to a contract.

Three issues combine to suggest that the majority of consumers would be unlikely to comprehend, from the terminology of fixed period or fixed term that it did not mean fixed prices.

- 1) Rational expectations that contracts in Australia are for a specified good or service at a specified (fixed) price.
- 2) Systemic illiteracy, where approximately 44% of Australians aged 15 to 74 years have literacy skills at levels which mean that understanding the most basic level of information presented in the form of energy prices and contracts would be inaccessible to the majority of them<sup>2</sup>
- 3) The ESC's report<sup>3</sup> which found the average ability of customers to understand pricing offers had fallen steadily since 2004, as had the ease of comparing new offers to the customer's existing terms and conditions.

**b) Are there some consumers that are not aware that fixed period contracts with fully fixed prices are available on the market? If so, what proportion of consumers is likely to fall into this category?**

UnitingCare Australia believes that there are many energy consumers who are not aware that fixed period contracts with fixed prices exist. These offers are not easy to find and the search costs to adequately consider a majority of options (potentially) available to a customer are high. We consider this matter further in our response to question 9.

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<sup>2</sup> ABS (2013), 4228.0 - Programme for the International Assessment of Adult Competencies, Australia, 2011-2012.

<sup>3</sup> Wallis (2013) Victorians' Experience of the Electricity Market, in Essential Services Commission (2013) Victorian Residential Electricity Retail Market Research Discussion Paper [www.esc.vic.gov.au/getattachment/a662edf7-8852-4618-a4e9-28dffc9d4f0/Victorian-residential-electricity-retail-market-re.pdf](http://www.esc.vic.gov.au/getattachment/a662edf7-8852-4618-a4e9-28dffc9d4f0/Victorian-residential-electricity-retail-market-re.pdf)

Apart from new connections, door to door and phone sales have been the most significant drivers of switching across the NEM, noting that energy is defined as a low engagement product. As door-to-door and phone sales are likely to offer consumers only a single product, and be conducted in a high pressure environment, many consumers who are sold fixed term contracts are unlikely to be aware of the terms and conditions of the contract they are signing. Many consumers will not actually receive the detailed terms and conditions until after the point of sale.

We suggest that even if there are reasonable fixed term, fixed price contracts currently available, they are not effectively promoted by retailers.

As a consequence, there is a high probability that the majority of consumers are not aware there are fixed period contracts with fixed prices currently available.

#### **Question 6 - Barriers to consumer participation and engagement**

##### **a) Does the ability for retailers to vary prices lead to a perception for consumers that changing to a new retailer or contract would waste search costs?**

Yes, the ability for retailers to vary prices leads to a perception for consumers that changing to a new retailer or contract would waste search costs, and reduce trust in the retailer.

The amount of time a consumer may invest in actively searching for an alternative offer would be undermined should a retailer raise its prices once a consumer has decided upon a certain product, at a certain price at a given time. Consumers would not see the value in expending additional search costs, given the expectation that prices would change again and consequently the retailer offering the best 'deal' today is different from the retailer offering the best deal in, say, three months time. So new search costs are wasteful for consumers.

##### **b) To what extent might the existence of exit fees and other transaction costs affect consumer behaviour after a price variation in a fixed period of a *market retail contract*?**

The existence of exit fees and other transaction costs would deter consumers from seeking to change energy providers after a unilateral variation. Not only can exit fees be quite high – over \$130 – a thorough search of energy offers is a lengthy, arduous, and unenjoyable process.

These costs will lead consumers to remain with the status quo, even if they could potentially gain a benefit from switching: consumers will have little trust in a potential benefits given the injury to their expectations they have just experienced from a unilateral price variation.

Exit fees also reinforce the asymmetry of many current market contracts. Retailers can vary the terms and conditions of a contract, including price, at any time, while



customers are locked in for a fixed term, irrespective of changes made by the retailer, and are charged a fee for switching to a better deal.

#### **Question 7 - Impact of proposed rule on consumer participation and engagement**

##### **a) Would the proposed rule improve the level of consumer participation and engagement in retail energy markets?**

Under the current market settings, which allow price variation within a fixed period contract, there is little transparency. This necessarily precludes consumers from making informed decisions or exercising their market power to switch if the product they are receiving no longer suits their needs, or is not what was initially offered. As such, the current rules create a market distortion which fosters low participation and engagement of consumers.

The proposed rule will improve the level of participation and engagement in retail energy markets by allowing more transparent market contract offers and a clearer understanding amongst consumers of exactly the product and price they are signing up for. This will foster more informed decision making amongst consumers (increasing market efficiency) but also greater trust amongst consumers in the product they are signing up for (and by extension, the energy company).

##### **b) To what extent would the proposed rule place downward pressure on prices in retail energy markets due to improved consumer engagement and participation?**

By removing the ability to unilaterally vary prices within a fixed period contract, the prices offered within market contracts will be more reflective of the true cost of energy supply (recognising that some companies may build in a risk premium).

The proposed rule change will go some way to correcting the power imbalance between consumers and energy supply companies. Removing the ability of companies to vary prices within a fixed period contract will lead to increased competition for informed consumers. This should then contribute to downward pressure on energy prices.

#### **Question 8 - Competition between retailers**

##### **a) How would the proposed rule affect larger retailers compared to smaller retailers?**

##### **b) Would the proposed rule make it more difficult for new entrants to enter retail energy markets?**

The focus of the rule change is about improving transparency for consumers, particularly small consumers. The rule change proposal is the same for all retailers and should have minimal difference in incidence for retailers of varying sizes.

UnitingCare Australia does not have a definite view about the effect of the rule change on new entrants. It does note that new or small retailers might be expected to have a less sophisticated suite of products, and a rule change that creates more

stable pricing in contracts may benefit such less sophisticated entrants, making entry easier.

### **Question 9 - Innovation in retail market offers**

#### **a) If the proposed rule is made, are retailers likely to withdraw or offer shorter fixed period offers from the market?**

It is important to draw a distinction between what retailers will do and what perfectly competitive retailers charging at long run marginal cost would do: the hope of competitive markets compared to the reality of consumer experience of Australian energy markets.

In a truly competitive market, retailers would price at marginal cost and would provide a range of market offers to different consumer categories, of varying duration, all based on long run marginal cost, which over the short term is constant.

Price maximising firms in oligopoly markets, as Australian energy markets are, will seek to gain revenue greater than long run marginal cost – a loss for consumers. Regulators play a crucial role in seeking to minimise the pass-through of non-efficient costs to consumers. A greater degree of price certainty for consumers, as proposed by the rule change, is an action that increases consumer information. Perfect information is a necessary pre-condition for (perfectly) competitive market. Given that retailers regularly claim that they want more competitive markets (eg removal of price controls), then (partially) withdrawing from the market or increasing the cost to consumers of greater choice would be antithetical to what retailers want. Consequently withdrawing offers from the market or only offering shorter term contracts would be adding inefficiencies to the market

#### **b) If the proposed rule is made and the range of market offers available is reduced, what effect will this have on retail competition and prices in retail energy markets over the long term?**

Uniting Care Australia does not regard the number of 'market offers' that are available at any point of time to be a good measure of effective retail competition. Indeed, too many market offers with the high level of complexity of many market offers, is likely to actually reduce consumer engagement with energy markets as their search costs increase.

*Example: Consider a customer seeking to make an informed choice about their electricity contract. Assume a relatively small number of retailers of 5, each providing 5 different market offers, with each offering having (only) 5 variables to consider (amongst the large range of possibilities, such as late fees, supply charge, peak time, shoulder time, off-peak time, peak price, exit fees, summer rate, critical peak pricing etc). In this situation there are 125 separate pieces of information for the customer to gather to make an informed choice. Now consider a 'more competitive' market for the customer*

*with 10 retailers, each offering 10 market offers each with 10 variables, the number of separate pieces of information for the customer to gather is now 1000 separate pieces of information. The search costs for this customer have increased dramatically. Now, if key variables such as prices change regularly, the search and transaction costs rise even more, particularly if annualised. Very, very few customers are likely to have the capacity, time or inclination to engage in the apparently more competitive market. Even a 'rational' customer is likely to regard the search and transaction costs of apparently greater competition to be greater than the dollar value of comprehensive consideration of increased 'choice' to chose (and maintain) the best offer over time.*

Increasing the range of market offers, beyond an optimum threshold, is most likely to reduce competition in practice, due to rising search and transactions costs.

We do not believe that any reduction in the range of market offers, from current levels, as a result of the proposed rule change would have a significant effect on retail competition and prices. Indeed, the rule change may well enhance competition.

## 4 Consumer Protection Issues

### Question 10 - Application of the unfair contract terms provisions in the ACL

**a) If the unfair contract terms provisions in the ACL generally apply to price variation clauses in *market retail contracts*, should these provisions be relied on to address the issues raised by CALC and CUAC?**

Uniting Care Australia draws on general legal advice from the Consumer Action Law Centre in responding to the questions dealing with the Australian Consumer Law interaction with energy market rules.

If the unfair contract terms provisions in the ACL (Australian Consumer Law) are generally applied to price variation clauses, consumers may still not be empowered. This is because they will still face 'decision paralysis', which can result in consumers either not exercising choice or staying with the default option.

The paralysis will be caused by the fact that the consumer is aware that prices can be varied so that there is little point choosing a contract. If they choose a contract, and the price is varied, then they will be required to choose again, only to be faced with the same quandary. This approach by firms to product pricing is sometimes referred to as "confusopoly".<sup>4</sup>

**b) Should changes be made to the retail rules to clarify whether the unfair contract terms provisions in the ACL apply to price variation clauses in *market retail contracts*?**

If it were intended for the unfair contract term prohibition in the ACL to apply to energy market contracts, amendments to the NER would be required to clarify this effect.

The ACL states that unfair terms in consumer contracts are void, and considers as unfair a term that that permits one party (but not another) to vary the terms of the contract. However, this does not apply to a term in a consumer contract if the term is 'expressly permitted' by a law of the Commonwealth, a State, or a Territory.

The meaning of 'expressly permitted' has not been judicially considered, but an explanatory memorandum to the ACL gives *The Uniform Consumer Credit Code* (now the *National Credit Code*) as an example of where unilateral price variation was permitted.

The distinction between the *National Credit Code* and the NERR is that the *National Credit Code* specifies when interest rates may be unilaterally varied, whereas the NERR only specifies what needs to occur if the electricity prices are varied. Therefore, there is no rule in the NERR which expressly permits retailers to vary

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<sup>4</sup> See, for example, Office of Fair Trading (UK) (2013), An Introduction to Confusopoly, [http://www.oft.gov.uk/shared\\_oft/events/confusopoly/introduction-confusopoly.pdf](http://www.oft.gov.uk/shared_oft/events/confusopoly/introduction-confusopoly.pdf)

prices. Rather, it is the case that the NERR simply expressly requires notice to a customer for a variation that is implicitly (rather than expressly) permitted by the NERR.

So if it were intended for the unfair contract term prohibition in the ACL to apply to energy market contracts, amendments to the NER would be required to clarify this effect. However, as expressed in the previous answer, if the unfair contract terms provisions in the ACL generally applied to price variation clauses, consumers may still not be empowered.

**Question 11 - Misleading and deceptive conduct and other ACL provisions**

**a) Should the misleading and deceptive conduct provisions of the ACL be relied on to effectively address the issues raised by CALC and CUAC?**

A contract titled 'fixed term market contract', without any additional misrepresentations or omissions made by the retailer regarding pricing, is unlikely to invoke the operation of the ACL's misleading and deceptive provisions.

If a consumer simply signed the contract holding an erroneous assumption that the price was fixed without any conduct or representation by the energy retailer to induce it, then the misleading and deceptive provisions of the ACL are unlikely to apply.

Due to this, the misleading and deceptive conduct provisions do not sufficiently protect consumers who are 'confused'. Moreover, this prohibition is insufficient to empower consumers to activate competition, in a way described under question one.

**b) Are there any other consumer protections under the ACL that are relevant to this rule change request?**

We submit that there is a range of other consumer protections that are relevant to this rule change, including:

- Victorian unfair contract terms legislation and cases determined under that law;
- The Unfair Terms in Consumer Contracts Regulations 1999 (UK); and
- Industry specific protections established by UK's Ofgem.

## 5 Alternative Approaches to the Issues Identified in the Rule Change Request

### Question 12 - Impacts of proposed rule

**a) Taking into consideration the potential benefits and costs of the proposed rule, on balance how would the proposed rule affect competition in retail energy markets?**

We strongly believe that the proposed rule would enhance competition in retail energy markets through more efficient and transparent market operation and contracting, greater trust in energy markets – over time, more efficient and equitable allocation of risk, and increased long term consumer welfare.

Increased consumer certainty around contracted prices would enhance their ability to participate with confidence in the market and would potentially overcome some of the existing barriers to switching. The effectiveness of consumer choices would be improved, and consumers would perceive greater fairness in the market.

Elements of price risk would be more efficiently, equitably, and properly reallocated from the consumer to retailers. The reallocation would better recognise the asymmetry of information and opportunities between the various parties.

Consumers are unlikely to experience more limited choice in energy contracts as a result of this Rule Change – indeed, material consumer choice is likely to be increased, as consumers will be able to explicitly select between fixed and variable rates.

**b) Considering the issues identified by CALC and CUAC, is the proposed rule a proportionate and appropriate response to address these issues?**

Uniting Care Australia believes that the proposed rule is a proportionate and appropriate response to address the material issue that has been identified. There are strong economic benefits that may arise from prohibiting energy retailers from including terms in their contracts that permit unilateral variation of price.

### Question 13 - Limited pass-through of costs

**a) Would a rule that requires retailers to manage all costs aside from some limited cost pass-throughs better meet the NERO than the proposed rule?**

**b) If so, which types of costs should retailers be allowed to pass-through to consumers and why?**

A rule that allowed the pass through of costs to consumers would not better meet the NERO. Retailers are better placed than consumers to manage all upstream energy risks, and consumers are – as now – unlikely to appreciate why some costs can be passed through, but not others: the problems CALC/CUAC have highlighted in their original submission will remain.

The notion that retailers could be required to manage all costs has not been effective for consumers to date. The proposed rule change improves market transparency and so is preferable to the suggested 'retailers manage all costs' idea.

We do not accept that there should be pass throughs for changes in distribution prices or government policies. The opinion of Ofgem, the UK regulator, is useful on this issue; that suppliers should be fully aware of their obligations in respect of government policies and estimate their costs accordingly, as they do with other costs.

**Question 14 - Other alternative rules**

**a) Are there any alternative approaches that could better address the issues raised by CALC and CUAC and minimise the potential costs of the proposed rule?**

**b) If so, what could these alternative approaches include and what would be the potential costs, benefits and impacts of these alternatives?**

We are aware that Consumer Action and CUAC presented a number of alternatives in their Rule Change Proposal, where they provided information that suggested why these approaches would not sufficiently address the issues raised as a result of existing regulations where retailers can unilaterally vary prices under fixed term/period/benefit contracts.

UnitingCare Australia has not identified any alternative approach to better address this issue for consumers; we support the rule change proposal as presented.

**Conclusion**

UnitingCare Australia supports the rule change proposed by CALC and CUAC as it both provides greater certainty for consumers, including lower income and disadvantaged consumers, while also enhancing the trustworthiness and hence efficiency of energy markets in Australia