



EnergyAustralia

LIGHT THE WAY

23 January 2020

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Lodged electronically: www.aemc.gov.au (RRC0028)

Dear Commissioners

**Draft rule determination - Regulating conditional discounting -
21 November 2019**

EnergyAustralia is one of Australia's largest energy companies with around 2.6 million electricity and gas accounts across eastern Australia. We also own, operate and contract an energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 4,500MW of generation capacity.

We appreciate the opportunity to provide feedback on the Commission's draft rule determination regarding the regulation of conditional discounting in retail markets.

EnergyAustralia supports effective and targeted regulatory interventions to make market offers more comparable and empower customers when shopping around for a better deal. We are also focussed on listening to customers and providing them with simpler price offerings. EnergyAustralia's products from 1 July 2019 have not featured conditional discounts.

The Commission should draft rule provisions to ensure that all legacy contracts with conditional discounts are subject to an appropriate transitional period. We also recommend the Commission seek to achieve national consistency in approach, with a preference for a regulatory-determined maximum value.

Our submission also has some observations on the evidence before the Commission, as well as the justifications for and possible effects of intervening in retailer product offerings. Some of our observations will be more relevant for the Commission's ongoing monitoring of retail markets and gathering of related information.

If you would like to discuss this submission, please contact me on 03 8628 1655 or Lawrence.irlam@energyaustralia.com.au.

Regards

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Over-representation of hardship customers is a key concern

The Commission's evidence highlights problems for hardship customers in meeting pay-on-time conditions. The Commission should consider preventing retailers from offering pay-on-time discounts to these customers, or require them to provide such discounts unconditionally as proposed by the Victorian Essential Services Commission (ESC).

The Commission has not opted to target hardship customers in this rule change, citing several protections that have been introduced recently, including a hardship policy obligation to review and ensure each customer is on an appropriate market contract.¹ If the Commission maintains this view for its final decision, it should explain how regulating the size of conditional discounts would address the low rate of discount realisation for hardship. This appears to be a key reason why the ACCC originally recommended regulating conditional discounts and is also quoted by the proponent. Specifically, the ACCC's Retail Electricity Pricing Inquiry (REPI) found that in 2016-17, as a total of those on conditional payment plans, 41 per cent of hardship concession consumers and 56 per cent of payment plan consumers had met their discount conditions.²

To inform further policy responses, including enforcement of existing retailer obligations for hardship customers, we recommend the Commission further explore the scale of the problem being addressed such that it can be monitored over time. As discussed further below, evidence before the Commission is currently sparse.

In its treatment of hardship issues in the REPI, the ACCC specifically recommended state and federal funding to assist vulnerable consumers to improve energy literacy and assist them in choosing offers that suit their circumstances:

Funding could also be used to assist consumers to better understand the market and to gain confidence to navigate the offers that are presented by retailers. Improvements to the government run comparator websites, along with other recommendations made by the ACCC in part 3, will assist consumers generally to engage. However, some consumers will struggle to navigate the market and will always require some assistance. We consider it is important, while providing assistance to consumers in the way of better hardship programs and concessions to help reduce costs, to also assist them to take steps to learn about and engage in the market. Consumer advocate organisations could assist them to learn to use government-run comparator websites, to read their energy bills, to know what to ask when considering an offer, and how to find important information. This will help vulnerable consumers to avoid the 'loyalty tax' imposed on consumers who remain with a retailer for an extended period without seeking to switch. It would also be valuable to recent migrants to Australia and could be provided in the material they are given on arrival as part of their education program.³

We support these findings and the associated recommendation for targeted financial assistance, which the ACCC is monitoring.⁴ The Commission may also wish to explore progress on this recommendation in making its final rule and otherwise in monitoring outcomes for vulnerable customers.

¹ AEMC, *Regulating conditional discounting*, Draft rule determination, 21 November 2019, pp. 21-22.

² ACCC, *Retail Electricity Pricing Inquiry—Final Report*, June 2018, p. 264

³ *ibid.*, pp. 305-6.

⁴ ACCC, *Inquiry into the National Electricity Market - August 2019 Report*, 20 August 2019, p. 129.

Consequences of the draft rule for legacy plans

The Commission's draft rule amendments require existing contracts to comply with conditional discount regulations from the date their contract term or conditional discount period is "extended" or "renewed" from 1 July 2020. This seems to presume that all legacy contracts with conditional discounts would be within a benefit period as at 1 July 2020. We expect retailers will have different contract terms or practices that are incompatible with the Commission's draft rule.

If the Commission's intention is for all legacy plans to no longer have conditional discounts greater than 'reasonable costs', we recommend the final rule contain clearer transitional requirements to cater for scenarios it may not have contemplated. A further discussion of our own situation is contained in the confidential Appendix attached to this submission.

In resolving this issue, the Commission may wish to consider drafting that sets an explicit effective date for all legacy contracts, which still gives retailers the freedom to manage their own circumstances.

We support a consistent approach to determining what are "reasonable costs"

As the Commission is aware, the ESC is proposing to prescribe a maximum percentage value for conditional discounts in Victoria. Irrespective of approach, we urge the Commission to engage with the ESC to ensure alignment in regulations between Victoria and NECF states.

The Commission's proposal is to allow the AER to investigate "reasonable costs" on a case-by-case basis. This has merits as it would allow targeted action against undesirable pricing practices (including potential 'naming and shaming' of non-compliant retailers), rather than impose a blanket restriction across retail products that might otherwise be valued by customers.

Our preference, however, would be for the Commission to provide for a regulatory determination of a numerical cap as it provides certainty on what is acceptable and would avoid administrative costs in monitoring and investigating potential disputes. We consider these benefits would outweigh the burden of periodic stakeholder engagement on the appropriate value of any cap.

Evidence cited by the Commission is sparse and reflects conflated issues

The primary concern leading to this rule change, and also cited by the ACCC, is that the magnitude of conditional discounts is likely above reasonable costs. The proponent also suggests that customers who do not meet payment conditions result in them "paying the highest prices in the market".⁵ These concerns are overlaid with a broader issue that all forms of discounting contribute to customer confusion and hamper competition on price terms.

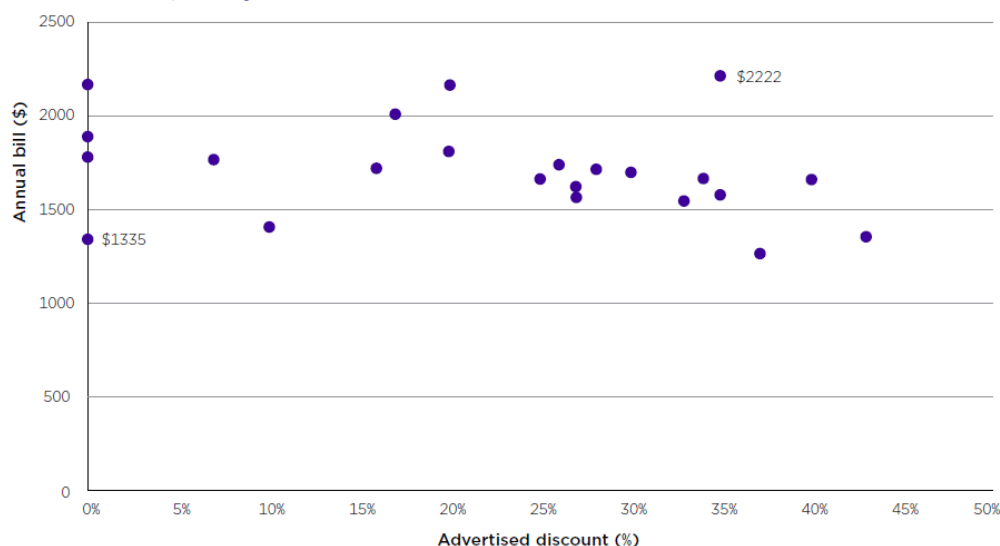
⁵ Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, p. 3.

The conflation of these concerns creates problems in designing appropriate regulatory solutions, as well as setting expectations on how individual interventions will improve customer outcomes. The Commission should consider these different concerns in making its final rule. While the evidence before the Commission is currently limited, data collected and reported recently by the ESC may be useful.

The ACCC's electricity monitoring data are insufficiently disaggregated

The pricing and billing data published by the ACCC in its REPI did not distinguish between conditional and unconditional discounts. Figure 13.2 reproduced below is an example of this. Recommendation 33 of the ACCC's 2018 REPI Final Report was to regulate conditional discounts because of concerns about the size of the discount relative to the payment condition and impacts on financial hardship customers.⁶ In our view, it was not based on any systematic analysis of whether customers on these products were paying too much on their overall bills as stated by the proponent.

Figure 13.2: Annual cost of offers (\$) by advertised offer discount in the Powercor distribution network (Vic), January 2018



Source: Based on St Vincent de Paul Society Electricity Market offer data, January 2018.

Source: ACCC, 2018, p. 261.

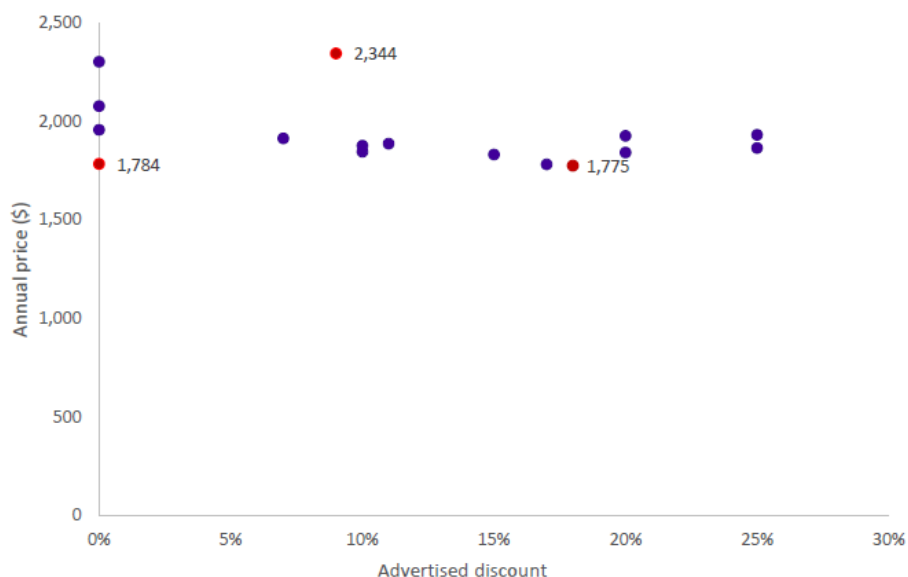
In its more recent August 2019 monitoring report, the ACCC explored one example of a conditionally discounted offer, marked in red in figure 3.1 reproduced below:

...the annual price amount for the cheapest offer with an advertised conditional discount of 18 per cent shown in figure 3.1 above was in fact \$2092 if every bill was not paid on time, \$317 more than if the conditional conditions were met and \$308 more than the cheapest offer with no advertised discounts. Of particular note, even if only one bill was not paid on time, the annual price increased by an amount such that the offer was no longer the cheapest.⁷

⁶ ACCC, 2018, p. 268.

⁷ ACCC, August 2019, p. 41.

Figure 3.1: Annual price amount (\$) for an offer with a given advertised discount in the SA Power Networks distribution zone in July 2018



Source: ACCC analysis based on St Vincent de Paul Society Electricity Market offer data, July 2018. Note that annual price amount is calculated using the AER model usage determination of 4000 kWh p.a.

Source: ACCC, August 2019, p. 41.

In this example, the ACCC has compared a conditional offer to the cheapest undiscounted offer in the market. Such a comparison infers poor value and associated customer detriment of conditional offers generally. For this particular offer, the annual bill amount of \$2092 where conditions were not met (for every bill) is comparable to the four offers identified that have no discounts attached. Where conditions were met, this was the cheapest of all offers in the ACCC’s scatter plot and for this reason alone appears to have warranted specific comments from the ACCC.

These comparisons suggest more about the spread of offers in the market, retailer pricing strategies and the state of competition. They do not provide a basis to determine whether or not discount conditions result in customers paying too much. To emphasise our point, a lack of correlation between annual bills and the size of discounts undermines the rationale for regulating discounts, at least from the perspective that they systematically result in customers paying more.

Additional analysis by the proponent is similarly limited

The example in the proponent’s proposal can be similarly explored. It states that amounts of \$616 and \$755, reflecting the loss of discount from not meeting contract conditions, would overcompensate the respective retailers for any costs associated with those conditions.⁸ When viewed in isolation, the proponent and the Commission (in our view, reasonably) consider such an outcome as a penalty for affected customers.

⁸ Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, p. 5.

We scaled the proponent's examples to a benchmark Victorian customer of 4,000kWh and compared these to Victorian offer data in recent ACCC reports.⁹ The resulting undiscounted bill amounts of \$1447 and \$1773 indeed appear to be at the higher end of the range of offers reported by the ACCC. This might be sufficient to substantiate a claim that these customers pay some of the highest rates of the market. However, the corresponding discounted bill amounts of \$959 and \$1152 appear to be at the lowest end of the range. This suggests that these two offers are extreme cases. The size of discounts (45 per cent and 35 per cent) support this view.

Any intervention that regulates the value of discounts for all offers should consider the full range of less extreme outcomes in the market. The information before the Commission suggests that, of all customers with conditional offers, 25 per cent of those pay higher amounts while 75 per cent pay lower amounts. From our perspective there appears to be limited information before the Commission to adequately consider how these different customer cohorts would be affected by restricting conditional discounts, in terms of their existing and expected total bill payments. An analysis of total bills for hardship customers would be especially useful.

For the avoidance of doubt, these observations are not intended to detract from the confusion and detriment that conditional discounts have caused for a significant number of customers. Rather, they highlight potential shortcomings in designing regulatory solutions that might only cater for extreme cases, and in being unable to sufficiently communicate and monitor the impact of interventions on customer outcomes.

Data gathered by the ESC for Victoria may provide some guidance

Analysis by the ESC in its most recent Victorian Energy Market Report presents information on the value of conditional discounts relative to the total customer bill.¹⁰ The ESC presented data on generally available offers as at 30 June 2019.

The ESC's figure 4.3 reproduced below presents an average notional bill paid by a typical customer in Victoria in each distribution zone across different offer types. At a high level, it appears to support the notion that amounts paid by the customer where conditions are not met are higher than what might be regarded as a fair bill. That is, non-discounted offers match what would be paid where conditional discounts are met, and customers pay \$188 above this amount where conditions are not met.

However further disaggregated information in the report's appendix shows a large range of discounts across retailers.¹¹ See the un-numbered chart for the Jemena distribution area reproduced below as an example. We found the ESC's information difficult to reconcile and to draw conclusions from. Some information appears to have been sought from Victorian Energy Compare and in some cases on only three of the largest retailers.¹² Distinctions between conditional and unconditional discounts are not clear. We have not sought to access or interrogate this data set, noting some of it is commercially sensitive, however the Commission may wish to approach the ESC (if it has not done so already).

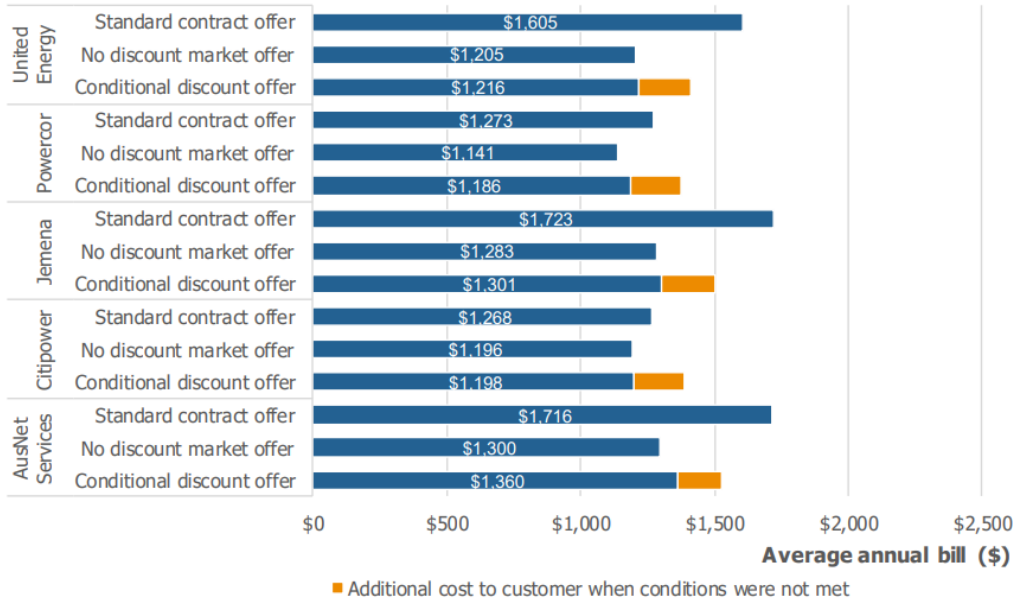
⁹ See ACCC, August 2019, figure 3.7.

¹⁰ ESC, *Victorian Energy Market Report 2018-19*, 29 November 2019.

¹¹ ESC, *Victorian Energy Market Report 2018-19 - Appendix*, 29 November 2019.

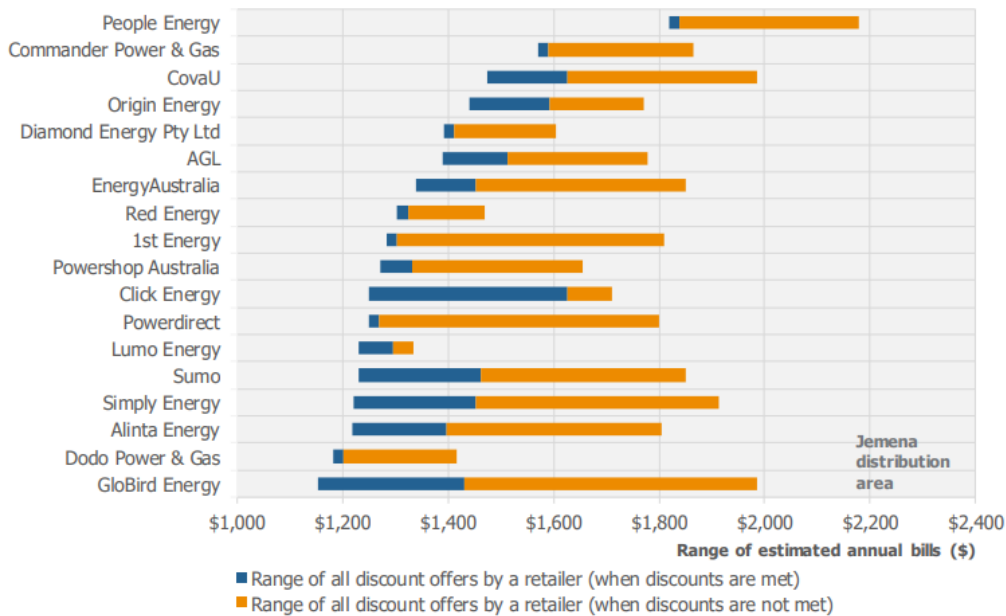
¹² ESC, *Victorian Energy Market Report 2018-19*, 29 November 2019, p. 42.

Figure 4.3 Annualised average electricity bill based on a typical residential customer usage of 4,000kWh per year in 2018–19, by distribution area



Source: ESC, *Victorian Energy Market Report 2018-19*, p. 43.

Residential electricity customers – range of discounted market offers generally available, by retailer



Source: ESC, *Victorian Energy Market Report 2018-19 - Appendix*, p. 23.

Risk imbalance may be important but is addressed in better ways

A further concern identified by the Commission is an imbalance of risk between customers and retailers regarding customers' ability to satisfy contractual conditions.

This concern arises from the ACCC's data on discount realisation rates, namely the 27 per cent of residential customers, 44 per cent of payment plan customers and 58 per cent of hardship customers on conditional offers that did not meet discount conditions.

As mentioned above, we support direct interventions to ensure hardship customers are not on plans that have pay-on-time discounts. It should be uncontroversial that customers who are classified precisely because of their difficulties in paying on time should not be on contracts where this is a discount condition.

The case for non-hardship customers is less clear. If the only information at hand is discount realisation rates, the Commission (and others) appear to be assuming that 27 per cent of customers who do not meet discount conditions are not best placed to assess their own situation. The corollary for the remaining 73 per cent is that they are simply lucky and will eventually miss payment conditions and should be protected from such an outcome.

In terms of a risk imbalance, the Commission identifies the following considerations however does not take a firm view on how they apply in the current situation:¹³

- risk should be allocated to the party best able to manage it
- the ACL allows different pricing structures subject to key conditions being clearly disclosed to customers prior to the contract being signed
- customers may not be well-placed to meet contract conditions because they underestimate their ability to pay, or because of unforeseen circumstances
- observations from the ECA that:
 - big headline discounts might catch the eye, but are illusory once conditions and other fees are taken into account
 - retailer offers are complex, making it difficult for consumers to immediately understand the risk of not achieving discount conditions.

As noted above, we consider that concerns with conditional discounts as a marketing tool are conflated with concerns that total bill amounts are unreasonably high where conditions are not met. The additional concern of risk imbalance is not addressed by regulating the quantum of discounts. For example, there may be some deficiency in disclosures or advice at the time the customer makes contact with a retailer i.e. allowing the customer to continue to be distracted by the discount, or making false or misleading claims. Other solutions have been implemented to reduce customer confusion, including restrictions on advertising conditional discounts, which would help resolve any risk allocation issue.

¹³ AEMC, 2019, pp. 10, 19-21.

The expected impact of intervention should be properly communicated

The proponent appears to presume that customers who do not meet discount conditions would see reductions in bill amounts as a result of the proposed changes. For example, the proponent implies the amounts at stake for the average household could be up to:¹⁴

- \$1,000 in New South Wales
- \$600 in South Australia
- \$500 in Queensland.

Assuming retailers do not react to new regulations by varying underlying prices, restricting the size of conditional discounts would mean that customers who do meet discount conditions would actually see their bills increase. Where approximately 75 per cent of customers currently meet discount conditions, customers on average would be worse off and retailers' revenues would increase.

It would be reasonable to expect, however, retailers to react to a cap on discounts by revisiting their overall approach to pricing and discounting. Retailers have used discounts to aggressively compete for customers. It may be the case that a material proportion of customers meeting discount conditions are being supplied energy at very low or even below cost, with any cross-subsidises falling to customers who do not meet conditions or from higher unconditional priced offers. The few example cases explored by the ACCC and the proponent support this. While the ACCC does not appear to have found recent evidence of this in current market offers¹⁵, information on legacy contracts would be required to monitor the impact of the Commission's rule change. Any price impacts from regulating discounts, including a narrowing of dispersion, may also be difficult to decompose from recent market changes in response to the Victorian Default Offer (VDO) and Default Market Offers (DMO).¹⁶

Restrictions on conditional discounting may also push retailers further towards offering non-price benefits in designing new products. The nature of these benefits means they are difficult for regulators to monitor over time, including in terms of customer value. For the same reason, they also potentially run counter to the effectiveness of reference pricing in ensuring customers can easily compare offers.

These are matters the Commission may wish to examine in its market monitoring roles and in any communications of its final rule.

In terms of desirability for customers, the Commission, ACCC and the ESC find themselves in an unusual position of wanting retailers to reduce discounts which, at least in concept, are of benefit to consumers. Although some may fairly characterise pay on time discounts as late payment penalties, a significant proportion of customers are likely to see, and realise, value in these products and will object at a perceived or actual loss of benefit if discounts are changed or withdrawn. Retailers would be left to explain to their customers that this change has been mandated by governments or regulatory agencies. Some customers may not find this a credible explanation, particularly as the

¹⁴ The Hon Angus Taylor MP Minister for Energy, *Cracking down on sneaky late payment fees*, Media release, 18 February 2019.

¹⁵ ACCC, *Inquiry into the National Electricity Market - November 2019 Report*, 29 November 2019, p. 109.

¹⁶ *ibid.*, pp. 13-18.

proponent has requested this intervention on the basis that it would reduce “sneaky late payment fees”¹⁷ rather than something affecting discounts. Such mixed messaging to customers would further erode trust in the energy market, retailers and regulatory agencies.

The market has moved on and appears unlikely to return

As the Commission is aware, the ACCC’s latest electricity monitoring report states that more than 80 per cent of offers in the market are now without conditional discounts.¹⁸ The size of the average conditional discount in offers has dropped to 8 per cent.

A significant proportion of customers is dissatisfied with these products and this has become a point of product differentiation for several retailers including EnergyAustralia. At the same time, some customers still see value in these products and remain on offer. Our view is that the recent trend away from conditional discounting reflects an airing of customer concerns on the back of the ACCC’s REPI, as well as advertising restrictions associated with the DMO and VDO reference price.

We disagree with the Commission’s view that it would be prudent to assume this trend would reverse if not for its rule change.¹⁹ Such an assumption implies retailers would withdraw a product that is valued by a significant (and likely growing) proportion of the market. While there is some evidence of retailers continuing to offer conditional discounts as a means of product differentiation, the Commission has also heard evidence of retailers not preferring to, or reluctantly, employ it as a marketing tool, as reported in its 2018²⁰ and 2019²¹ retailer competition review reports.

We note the Commission’s concern at the proportion of existing customers on large conditional discounts. The presumption is that legacy customers also do not have the capacity to determine the likelihood of meeting discount conditions and pay unreasonably higher amounts on their bills. This reflects the issue outlined above in terms of knowing the overall customer bill rather than the size of the conditional discount. Concerns of this nature may be better addressed by measures to improve the ability of these customers to seek out better plans if they desire, particularly DMO reference pricing and other measures to facilitate competition and switching such as the Consumer Data Right.

¹⁷ The Hon Angus Taylor MP Minister for Energy, *Cracking down on sneaky late payment fees*, Media release, 18 February 2019.

¹⁸ ACCC, November 2019, pp. 108-9.

¹⁹ AEMC, 2019, p. 16.

²⁰ AEMC, *2018 Retail Energy Competition Review*, Final Report, 15 June 2018, pp. 63-4.

²¹ AEMC, *2019 Retail Energy Competition Review*, Final report, 28 June 2019, p. 86.