

20 December 2012

Attention: The Project Leader  
Review of Regulated Retail Prices and Charges for Electricity - 2013 to 2016  
Independent Pricing and Regulatory Tribunal of New South Wales  
PO Box Q290,  
QVB Post Office, NSW, 1230

By email

Dear Sir/Madam

**RE: IPART Review of Regulated Retail Prices and Charges for Electricity - 2013 to 2016**

Thank you for your invitation to make a submission to this important review. Momentum Energy is a second tier retailer with current retail electricity licenses in Victoria, New South Wales, South Australia and the Australian Capital Territory. Momentum Energy is fully owned by Hydro Tasmania, one of the largest clean energy producers in Australia.

In considering the issues in this paper Momentum Energy believes the 2013-2016 represents a key turning point in the lifecycle of the NSW electricity market. While the AEMC assessment of retail competition is an important step towards the phasing out retail price regulation, the 2013-2016 determination should provide the basis for the market to progress to full deregulation. In order to facilitate such a transition, IPART should continue to focus on encouraging new entrant retailers into NSW and ensuring that the long term interests of consumers are served by a competitive market.

In responding to the specific issues in the paper Momentum Energy has considered the opt-in proposal and believes that while it may increase the overall level of customers on market contracts, it is unlikely to improve competition in the NSW market. While the proposal encourages customer to move off the standard contract, the incumbent retailers will have a significant longer term retention advantage over second tier retailers, dulling the benefits of competition.

As well as the opt-in model, Momentum Energy believes IPART should give further consideration to making the sign-up process easier for customers such that the information they are provided at the point of sale ensures they make a well informed decision about their energy contract.

In moving towards a mature market with deregulated pricing, Momentum Energy contend that IPART needs to recognise that price is not the only motivating factor and that for some customers convenience, non-price incentives, security and brand attributes are far more important. A belief that every customer should be on the lowest priced contract in the market fails to recognise these are other important purchase considerations

for the customer. In spite of these non-price purchasing decisions, the customer will be better served to rely upon competition to reduce prices, rather than regulatory intervention.

As a second tier retailer, Momentum Energy also addresses the greatest barrier to entry in NSW; price regulation. Momentum Energy is cognisant that the political impacts of any competition reform program which affects energy can create difficulties for Governments, but believes the misunderstandings and misinformation about price reform can be mitigated with coordinated communications from government and retailers.

Thank you for the opportunity to contribute to this important consultation. Should you or your staff wish to discuss this matter further please feel free to give me a call on (03) 8612-6471.

Yours sincerely

Alastair Phillips  
**General Manager Regulatory and Compliance**

### ***Consideration of an opt-in model for the 2013 determination***

In comparing the proposed IPART opt-in model with that offered by Ofgem, it is apparent that although they share the same name, there are nevertheless a number of key differences between the two approaches.

The Ofgem model incorporates the following features:

1. A limit on the number of tariffs each supplier can offer (nominally four)
2. The removal of two-tier tariffs
3. The requirement on suppliers to advise consumers of their cheapest deal (and produce a Tariff Comparison Rate for all tariffs to allow consumers to compare their deals with those from other suppliers)
4. A prohibition on suppliers being allowed to keep consumers on uncompetitive tariffs no longer open to new customers, ie 'dead tariffs'.

The objective of the Ofgem model is to address the problem that 75 per cent of British consumers are still on standard tariffs, and resulting low customer engagement.<sup>1</sup>

Our understanding of IPART's opt-in model is the following:

1. The existing regulated retail prices will become unregulated;
2. The establishment of a limited number of new cost-reflective regulated prices for each Standard Retailer, and;
3. Customers who are on an existing regulated price will be required to exercise one of three options:
  - o do nothing and remain on their current but now unregulated price
  - o 'opt in' to regulated prices by electing to move onto a new regulated price offered by their Standard Retailer, or
  - o sign a market contract
4. Customers who already have a market contract would still have the option of reverting back to the regulated tariff.

In contrast to the UK, IPART reflects that over the last 2 years the number of customers remaining on regulated prices has fallen from two-thirds to around one half of all small customers in NSW<sup>2</sup>, with just over half of all electricity customers in NSW remaining on a regulated tariff<sup>3</sup>. Therefore the application of the same opt-in proposal used in the UK would not necessarily be the right solution for the NSW market.

Momentum Energy has assessed IPART's opt-in model and believes it is highly likely to be confusing for customers, and is highly unlikely to have a positive impact on competition in the NSW market. Customers assessing their options under this model will be confused as to the difference between it to the current state, and Momentum questions whether if NSW customers were presented with these alternatives would they actually make this choice themselves?

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<sup>1</sup> OFGEM, The Retail Market Review: Domestic Proposals, 1 December 2011, p.8

<sup>2</sup> IPART Review of regulated retail prices and charges for electricity 2013 to 2016, p.1

<sup>3</sup> IPART Review of regulated retail prices and charges for electricity 2013 to 2016, p.29

The biggest problem with the IPART opt-in proposal is that there is no guarantee or additional incentive that a customer who takes out a market contract will actually assess the offers available to them from other retailers. As such, it is very likely that the customer will remain with their Standard Retailer regardless of whether they make a decision to remain on the Standard Offer, choose to do nothing, or take up a market contract with that Standard Retailer. Because of this, Momentum Energy considers the IPART proposal provides a distinct advantage for the incumbent retailers that, over time, will not result in more competitive product offerings.

To actually facilitate competition, as opposed to simply creating customer churn within a Standard retailers customer books, Momentum Energy would propose that the 'opt-in approach' be expanded to facilitate competition through collective purchasing or collective switching, ie: the switching of retailer and not just product. In other words, Momentum Energy believes IPART, should encourage customers to consider the options open to them before making their decision<sup>4</sup>. There are several possible models, but under a collective-switching model generally an intermediary<sup>5</sup> would manage the bulk transfer to the winning supplier<sup>6</sup>. The December 2012 Consumer Action Law Centre (CALC) report authored by Allan Asher of the Foundation for Effective Markets & Governance proposed that consumers could:

*“.. partner with a trusted social organisation or charity to spread the word and collate willing participants in the auction. The prospect of winning or losing a significant block of market share should compel suppliers to compete for the group’s custom, perhaps drawing in new entrants with quick acquisition of market share<sup>7</sup>.”*

According to this recent report prepared for the CALC, this approach removes the need for consumers to invest heavily in searching out a better deal, and as such encourages previously disengaged consumers to engage with the market, and has the potential to deliver real savings for those unable or unwilling to pursue more traditional routes to find a new supplier. In establishing the success criteria for the opt-in model, finding access to alternative suppliers, as well as to alternative offers, should be an equal objective.

In considering alternatives to the opt-in proposal Momentum Energy highlights that the process of transitioning to a market where there is no price regulation is best done in our experience where customers have the ability to experience retailers setting the price. Momentum Energy therefore is of the view that in transitioning from the current market framework, IPART should consider how it can provide retailers with the ability to begin setting the price for all their offers in the market. Moving away from the regulated standard offers setting the price benchmark in market should remain IPART’s focus in the transition to deregulated pricing. A potential interim option could be a transitional propose/respond approach (consistent with the approach taken in gas<sup>8</sup>) for all standard contract customers, which is then followed within a fixed period by full price deregulation, inside which all retailers must publish standard offers.

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<sup>4</sup> IPART Review of regulated retail prices and charges for electricity 2013 to 2016, p.34

<sup>5</sup> This could be an IPART appointment, or any other suitable organisation

<sup>6</sup> Consumer Focus, Get it Together: the case for collective switching in the age of connected consumers, 2012 available at: <http://www.consumerfocus.org.uk/files/2012/04/Consumer-Focus-Get-it-together.pdf>

<sup>7</sup> Consumer Action Law Centre and Foundation for Effective Markets & Governance, A Policy Trilemma, November 2012, p.52

<sup>8</sup> IPART Review of regulated retail prices and charges for gas, 2013 to 2016, p.2

**At this stage IPART do not fully understand why half of all small electricity customers in NSW remain on regulated prices. Are they reluctant to participate in the competitive market due to?**

- **the complexity involved in assessing offers and signing a market contract**

Momentum Energy would highlight in response that the complexity of assessing offers in the market is aggravated by regulatory obligations focused on ensuring retailers inform customers of the details of regulated supply contracts should they take up the product. Requiring retailers to recite these details to potential purchasers does not assist the customer with their decision about the energy offer they should choose, and if anything makes it harder for them to disseminate the core feature and benefits.

Whilst the intent may be to reduce the problems of information asymmetry, we are reminded that just because information is disclosed, it does not mean that all consumers will understand what the implications of this information is for them;

*For clients of the Brotherhood, the decision to switch at the door is a difficult one, and can have impacts upon existing payment arrangements. Many of the clients that contact us for an affordable small loan, for example, have had marketers interrupt their existing Centrepay or smoothed payment arrangements, resulting in multiple bills and confusion.<sup>9</sup>*

In fact consumer advocates frequently argue that disclosure alone is not sufficient to ensure adequate protection of consumers. Whilst normative concepts like fairness are prominent in Australian consumer protection law, in reality, notions of fairness typically vary across cultures, and can also differ across demographic groups or other socio-economic groups within them. In short what might be considered fair for one demographic group of consumers might be less so for others<sup>10</sup>.

So what exactly is the expected outcome of this current requirement; consumer protection? For energy retailers, consumers' rights are upheld through legal and regulatory obligations, supported by a regime of legal and regulatory compliance auditing of retailers. These rights exist, and indeed this enforcement occurs; and because of this the current standard form contracts provide customers with a significant level of protection. Consumers are best served when they have access to proper information on how to choose the energy offer which best suit their needs, and the ease of them understanding the information available to them about the offer. Information which clearly explains the core features, benefits and risks of the pricing structure and term of the contract is currently difficult to disseminate due to the excessive focus on providing customers with detailed information setting out their legal rights; even though these rights are operationalised (delivered anyway) and cannot be taken away from them. The NECF may provide some relief for customers from information overload at the point of sale, but understanding this may help with understanding where the real complexity in the purchase originates.

- **lack of trust or confidence in signing a market contract, perhaps particularly when approached by door-to-door or telephone marketers.**

Momentum Energy does not consider that the lower number of customers on market contracts is related to a lack of trust in signing such contracts with door-to-door sales people or telephone marketers. While there are some customers who prefer to sign their energy contracts via alternative methods, the large proportion of

<sup>9</sup> Brotherhood of St Lawrence, submission to AER Pricing Information Guidelines Issues Paper, April 2010.

[www.aer.gov.au/sites/default/files/Brotherhood%2520of%2520St%2520Lawrence.pdf](http://www.aer.gov.au/sites/default/files/Brotherhood%2520of%2520St%2520Lawrence.pdf)

<sup>10</sup> Consumer protection and financial innovation: A few basic propositions. Lumpkin S, OECD Journal: Financial Market Trends, Volume 2012, Issue 1, p 6

customers who sign up through direct sales channels demonstrates that this is not inhibiting competition in the NSW market. It is instructive to note that since the sale of the three state owned retailer brands and customer bases in 2011, AGL has undertaken an extensive and highly visible campaign to increase its share of electricity customers. It is important to note that AGL, a second tier electricity retailer in NSW increased its customer share from 14% to 19% through an aggressive direct marketing campaign between 2011 and 2012, demonstrating that customers do have confidence signing up to new offers via direct sales channels.<sup>11</sup>

This evidence therefore suggests that a lack of trust or confidence in switching is not necessarily a significant driver in customer choice not to switch. This is further evidenced by the fact that customers have confidence in the major gas and electricity retailers they choose to stay with. For example, AGL was rated one of Australia's most prominent brands by brand experts Interbrand in 2009, while Origin Energy's Sustainability Drive promotion generated thousands of entries, brand awareness and positive consumer sentiment in 2011. We should be reminded that one of the learning's from the recent Global Financial Crisis is that a good reputation and perceptions of an institution's safety tend to be more highly valued by consumers than the savings from lower fees and prices<sup>12</sup>.

***At this stage IPART do not fully understand why half of all small electricity customers in NSW remain on regulated prices. Are they reluctant to participate in the competitive market due to?***

- ***lack of awareness or interest in market offers***

There is a lack of congruence between some stakeholder assertions about there being a general lack of awareness of retail electricity market offers, and the fact that the same consumers increased market awareness of energy price rises and consumption issues has contributed to an industry wide increase in billing complaints<sup>13</sup>. In fact as far back 2006, and 2008, IPART's household survey results indicated there was a very high degree of awareness of full retail contestability. In March 2010 IPART reported that residential customer awareness of full retail contestability in NSW (92%) was about the same as in Victoria (94%) and higher than in SA (82%)<sup>14</sup>, and Momentum notes that neither Victoria nor South Australia have or will continue price regulation. This heightened consumer awareness about electricity market offers in NSW is further validated in the December 2012 McKell Institute report showed that residents of Sydney are more worried about their electricity bills than anything else - including their mortgage, the cost of petrol, or concerns over the presence of police or doctors in their area<sup>15</sup>.

Notwithstanding the high levels of awareness combined with sufficient incentives to look to the market, there may well remain a lack of interest in market offers. In addition to non-price drivers already addressed, there are some consumers who just don't care enough or agree there is sufficient benefit to participate; even if the view of the observer is that they should. Even though there may be significant savings in the market for customers looking around for a better electricity contract, for other customers this process is not worth their effort. Equally, where a customer moves house and begins consuming energy under a deemed contract there may not be any reason to look around for a better deal. In each of these cases, these outcomes may be in these customers' own understanding of their best interests on the basis of both convenience and their needs being met. Nevertheless in each of these situations these consumers have exercised their choice, and they all still benefit from the overall competitive market dynamic putting downwards pressure on prices.

<sup>11</sup> See <http://www.switchwise.com.au/blogs/index.php/tag/agl/>, IPART, Report - Electricity retail businesses' performance against customer service indicators in NSW For the period 1 July 2007 to 30 June 2011, IPART, Report Customer service performance of electricity retail suppliers 1 July 2007 - 30 June 2012

<sup>12</sup> OECD, Consumer protection and financial innovation: A few basic propositions. Lumpkin S, OECD Journal: Financial Market Trends, Volume 2012, Issue 1, p 11

<sup>13</sup> IPART, Report - Electricity Retail Business Performance against Customer Service Indicators – January 2012

<sup>14</sup> IPART, Review of regulated retail tariffs and charges for electricity 2010-2013, March 2010, p.221

<sup>15</sup> UMR McKell Institute Sydney Confidence Monitor, Media Release, Tuesday 4 December 2012

**IPART seeks comments on the following**

- **Is IPART's proposed approach for assessing retail market competition appropriate for this review?**

IPARTs framework for assessing retail market competition is broadly appropriate for this review. These being:

- defining the relevant market(s)
- considering the structural features of this market(s)
- assessing retailer and customer conduct in this market(s), and
- considering the outcomes for customers in the market(s).

When considering the outcomes for customers in the market, we note that IPARTs reflection upon its 2010 review presupposes that price is the measure of positive consumer outcomes in the market:

*Our 2010 review found that outcomes for customers who had entered the competitive market were not uniformly positive. For example, some customers were unknowingly paying rates higher than the regulated rates. We were concerned that this may have been the result of a lack of clear information on how discounts were applied and how prices changed over the life of the contract<sup>16</sup>.*

Focusing solely on price as a measure of the market is fundamentally concerning as it oversimplifies the concept of consumer choice. In the NSW market currently there are numerous offers which are based around upfront incentives. While many customers may focus on price, other customers are more interested in receiving a non-price benefit such as football merchandise, magazine subscriptions, loyalty points or other memberships. Given the number of these offers in the market, Momentum believes it demonstrates that there are a sizeable proportion of customers who are satisfied to receive such benefits.

Along with non-price incentives customers may choose to pay more simply due their brand preference. Some customers may choose a particular energy retailer because they perceive it as having better service or to be more financially stable, environmentally responsible or just because it offers both gas and electricity. Again, because some customers put these features ahead of the price discount does not mean that there is a problem in market. If anything it shows the market is beginning to mature and retailers are responding to their customer needs.

Furthermore, it is not uncommon for people to pay more for comparable products because their choices are based on decision drivers other than price. In 2012 Harvard interviewed over 7000 consumers and hundreds of marketing executives worldwide, examining more than 40 variables, including price, customers' perceptions of a brand and how often consumers interacted with the brand.<sup>17</sup> They found that:

*The single biggest driver, by far, was "decision simplicity" – the ease with which consumers can gather trustworthy information and confidently and efficiently weigh their options on the way to a purchase<sup>18</sup>.*

Non-price purchasing decisions are made every day, and are not a sign of market failure, nor anything to be concerned about provided that price information is widely available; which it undeniably is. Price information is not the only basis for purchase decision making, and consumer decisions aren't always only price rational.

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<sup>16</sup> IPART Review of regulated retail prices and charges for electricity 2013 to 2016, p.28

<sup>17</sup> Harvard Business Review, Spenner, S & Freeman K, <http://hbr.org/2012/05/to-keep-your-customers-keep-it-simple/ar/1>

<sup>18</sup> Harvard Business Review, Spenner, S & Freeman K, <http://hbr.org/2012/05/to-keep-your-customers-keep-it-simple/ar/1>

More broadly, measuring the outcomes for consumers in a competitive market is a measure of the overall competitive market dynamic putting downwards pressure on prices, and the alternative offers that consumers have easy access to (though they may not necessarily choose them).

- ***What can be done to facilitate retail market competition in NSW over the 2013 Determination period?***

In previous determinations IPART has sought to facilitate retail market competition. Historically the greatest barrier to entry in NSW has been insufficient headroom, inhibiting the ability to strike a price at a sufficient discount to the regulated price, or to cover the costs of upfront or non-price incentives, to attract market share. IPART has regularly underestimated key components necessary to establishing competition, such as retailer operating costs and acquisition costs<sup>19</sup>, and unfortunately there is no known mechanism to ensure perfect foresight of the wholesale energy market. While regulators may not be less skilled than market participants and consumers at foretelling the future, there is no compelling evidence in support of their being superior at it<sup>20</sup>.

Bearing this in mind, IPART and other stakeholders need to start considering the coming determination in a wider context than as a mechanism for suppressing retail prices. Network and retail pricing structures that are resulting in inefficient peak demand, and are distributing the costs of this across the entire consumer base, will continue to drive a requirement for incentives for customers to make decisions about energy use<sup>21</sup>. These customer decisions will be enabled by technology accumulating at the consumer end. These technologies may resemble retailer installed smart meters and in home displays, or they may be other data streams and technologies not yet marketed, (or even invented) to assist consumer decisions.

International consulting group Deloitte assesses that inside the next five years utilities will experience a greater than 20% change<sup>22</sup> in their business from what they name as the impending digital disruption. They also found that nearly half of all businesses plan to offer mobile applications to their customers in the next three to five years, compared to just 18% now<sup>23</sup>. This is a complex environment, and energy regulators need to be conscious that retailers are uniquely positioned to bring benefits this digital change to their customers. The benefits of this change will include, for example, the technology enablers' for the smart grid and coverage on demand side response available inside the next five years, with the potential to reduce peak demand<sup>24</sup> by 20%. Regulators need to remain mindful that in each case, where and if benchmark customer pricing is subject to determinations that do not allow for, or that remove retailers' abilities to recover the costs of supplying these consumer products, then markets will never deliver these benefits.

Similarly, demand side programs will also be essential to achieving renewable energy integration, distributed energy integration, and for supporting electric vehicles<sup>25</sup>. Digital technologies that will assist to optimise the use of distribution and transmission grids, support energy efficiency and contribute to the innovation economy that have not even been designed yet may be available within five years. As IPART is aware, the Energy White Paper (2012) pursues development of a truly national approach to consistent regulation across the country, one that creates a level playing field that stimulates competition, innovation and consumer choice, and provides stronger consumer protections.

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<sup>19</sup> For example, Frontier and SFG consultants 2007 assessment of Retail Operating Costs (ROC) of \$60-\$80 per customer was well below the ROC benchmarks of \$93-\$95 per customer used in other jurisdictions at that time (source: AGL)

<sup>20</sup> OECD, Consumer protection and financial innovation: A few basic propositions. Lumpkin S, OECD Journal: Financial Market Trends, Volume 2012, Issue 1

<sup>21</sup> Energy White Paper 2012, Australia's energy transformation, Resources Energy and Tourism 2012

<sup>22</sup> Building the lucky country, business imperatives for a prosperous Australia, Issue 2, Deloitte, 2012

<sup>23</sup> Optus Future of Business Report – Research and Findings, 2012, p. 8

<sup>24</sup> The Smart Grid and the promise of Demand Side Management, McKinsey 2010

<sup>25</sup> Smart Energy Demand Coalition, [www.sedc-coalition.eu/](http://www.sedc-coalition.eu/)



The challenge for IPART is then to either devise a flexible regime that can readily accommodate change, or to become more adept at identifying change beforehand and then act pre-emptively. The next best thing to letting the market work and to set efficient prices and to innovate, as the Victorian and now South Australian Governments have now laid the groundwork for, is to make sure that innovation is not suppressed.

- ***Is the stand-alone approach for estimating the LRMC of generation the most appropriate approach for the 2013 determination?***

Momentum Energy agrees that the stand alone method remains the most appropriate LRMC method for the determination period, and supports the reasons outlined by IPART in the issues paper. More broadly from a consumer confidence and therefore facilitating retail competition perspective, the LRMC has a smoothing influence on tariff changes over the determination period, as it is not affected by the volatility of the wholesale market price. With the proposed 75% weighting of LRMC of electricity generation, consumers are then not exposed to excessive swings in price within the determination period. Setting wholesale energy costs below LRMC may appeal politically because it can put downward pressure on retail prices; however competition not regulation is the best way to limit price rises.

- ***How should IPART make best use of publicly available market forward price data and modelled forward price data in estimating the market-based energy purchase cost?***

Momentum Energy is generally supportive of a rational component of the wholesale energy cost being determined by forward prices. However the wholesale energy price determined should adhere to firm economic principles, as any failure to pass on the true cost of energy to the consumer will create significant price shocks in the future.

IPART has historically assessed that the allowance for each year is not lower than the least-cost mix of generating plant, including any plant that would be required to meet any regulatory obligation, to efficiently meet each Standard Retailers forecast regulated load. This approach suggests that an estimate of the LRMC of electricity generation (the least cost mix of generation plant) should act as a price floor in determining the energy purchase cost allowance<sup>26</sup>. There is an economic rationale to this approach.

- ***Is including a volatility allowance within the market-based purchase cost an efficient and reasonable means of addressing the risk of wholesale electricity price volatility?***

Momentum Energy notes that for the 2013 determination, IPART proposes to adopt its approach from the previous determination again. The unfortunate paradigm of the regulatory allowance for volatility is that it is unable to account for anything other than the expected. IPART's view is that all appropriate costs and risks associated with purchasing electricity from the NEM should be compensated for only once in the regulatory package<sup>27</sup>. With the potential risk of permanent capital loss this regulatory approach brings, long term investment decisions become more uncertain.

Notwithstanding this, if IPART are going to attempt to replicate the market cost of managing volatility with this allowance, then the allowance needs to be set on the high end rather than in the mid-range of any plausible model to facilitate long term investment.

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<sup>26</sup> IPART Issues Paper, July 2009.

<sup>27</sup> IPART Issues Paper, November 2012

**5. *Should the retail margin continue to be set as a fixed percentage of total costs and recalculated as part of the annual review process?***

The net margin of an energy retailer is the difference between its retail revenues and its costs, comprising wholesale energy costs, transmission and distribution costs, fees levies and schemes, and retailer operating costs. The net margin is usually expressed as a percentage of this total of revenues. An incorrect estimation of any of these costs can have a significant impact on retail margin. For example a \$20 variation in cost to serve allowance can affect retail margin by 2-3%<sup>28</sup>.

The rationale behind regulators setting prices in the transition to effective competition is that the regulated price, and therefore the regulated margin, sits alongside a competitive market price. The regulators aim is to encourage developments in the competitive market with a view to setting an efficient market price, which will provide customers with electricity supply at the cheapest cost in the long term. Short term attempts to suppress the retail price will not deliver on the regulators longer term objectives<sup>29</sup>.

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<sup>28</sup> CRA International, Impact of Prices and Profit Margins on Retail Competition in Victoria, Final Report, November 2007

<sup>29</sup> In Canada, Alberta set price caps sufficiently high as to not deter new investment. Ontario, on the other hand, undertook actions to intervene with low price caps (a freeze) and actually deterred investment. More detail at: Power Generation Investment in Electricity Markets, OECD/International Energy Agency, 2003 pp. 59-63