



# Council of Social Service of New South Wales

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Independent Pricing and Regulatory Tribunal  
Review of Requirements for Early Termination Charges  
[ipart@ipart.nsw.gov.au](mailto:ipart@ipart.nsw.gov.au)

Dear Sir or Madam

## **RE: Review of Requirements for Early Termination Fees**

Thank you for the opportunity to provide comment on the base early termination fee (ETF) cap for market electricity contracts for small customers in NSW.

In its Draft Report, IPART proposes that the base ETF cap be set at:

- **\$130** within 12 months of the date of first supply, and;
- **\$45** thereafter (until the end of the fixed term contract or fixed benefit period of a market retail contract).<sup>1</sup>

In our view, these caps are excessive. Our primary concern is that a base ETF cap of the magnitude proposed by IPART will disproportionately impact low-income and vulnerable customers.

More detailed information on the likely impact of ETFs on particular customer groups is provided below, followed by a critique of the method used by IPART to calculate these fees.

### ***Early Termination Fees: Customer Impacts***

We recognise that under the regulations<sup>2</sup>, base ETF caps cannot be applied to:

- customers on hardship programmes;
- customers receiving the Low Income Household Rebate or the Medical Energy Rebate;
- customers that paid any part of the last bill by an Energy Accounts Payment Assistance (EAPA) Scheme voucher.

While we appreciate the protection these regulations provide for some low-income customers, these exemptions do not fully address our concern that the proposed ETF cap will disproportionately impact some groups.

First, there is evidence that a significant number of customers are currently falling through the gaps: they are not aware of the assistance that may be available to them, even though

<sup>1</sup> IPART (2013) *Early Termination Fees: Regulating the fees charged to small electricity customers in NSW. Draft Report – Electricity*.

<sup>2</sup> Clause 73A, *National Energy Retail Law (Adoption) Amendment (Early Termination Charges and Site Specific Conditions) Regulation 2013* (NSW).

they may be eligible.<sup>3</sup> These customers may therefore be charged an Early Termination Fee even though they would theoretically be exempt.

Second, for low-income customers who sit just outside the cut-off point for eligibility for one of those rebates listed above, an early termination fee of the magnitude proposed by IPART will present a significant barrier to switching retailers. A single person earning more than \$501 per week, for example, would not be eligible for the low-income household rebate. For such an individual, the base ETF cap represents one quarter of weekly earnings, making switching retailers within the first year of a contract an unaffordable choice.

Furthermore, low-income earners who struggle to cover their basic living expenses are more likely to be susceptible to market offers that provide short-term relief from high electricity prices, and will be at greater risk of being locked into deals that do not offer better value in the longer-term.

Third, people living in insecure housing are likely to be negatively affected by high ETFs. Such people may have no choice but to cut short their electricity contract: high termination fees will penalise individuals and their families for this lack of choice.

### **Approach to calculating Early Termination Fees**

In determining the base ETF cap, IPART is required to take into account “a retailer’s reasonable costs of giving effect to the early termination of a market retail contract”<sup>4</sup>.

IPART’s discussion paper on early termination charges suggests there are two possible ways in which these ‘reasonable costs’ might be interpreted.<sup>5</sup> The first interpretation includes those costs a retailer would have avoided if the customer had not signed the contract, while the second includes those costs a retailer would incur if a customer terminates early.

In its draft report on Early Termination Fees IPART has applied this first interpretation of reasonable costs.<sup>6</sup> This approach allows for the inclusion of a broader range of costs, resulting in a very high cap for early termination fees. We do not agree that costs included in this approach can be considered reasonable, and strongly encourage IPART to review its decision.

We note that the approach IPART has adopted in its Draft Report is not consistent with that used in other jurisdictions. Following a review of Early Termination Fees in Victoria, the Essential Services Commission ruled that:

‘[T]he most straightforward and unambiguous estimates of damages from early termination are those that result from the link between customer actions and the direct costs incurred by retailers. These costs include the costs of inducements or gifts that are provided to the customer when the contract is signed, the incremental administrative costs associated with early termination (such as final meter reads) as well as any hedge book imbalance cost (noting that, like fixed term loans, the effect of early termination can also be a benefit). These costs do not include foregone net margin or other customer acquisition costs’.<sup>7</sup>

In particular, we do not consider that customer acquisition costs and the cost of bad debt should be included in the calculation of ‘reasonable costs of giving effect to the early termination of retail market contract’.

### **Customer Acquisition Costs**

As PIAC’s response to IPART’s Issues Paper notes, the regulated retail electricity price

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<sup>3</sup> In their work on disconnections, for example, PIAC found that half of survey respondents did not know about energy vouchers. PIAC (2013) *Cut off III: The Social Impact of Utility Disconnection*.

<sup>4</sup> O’Farrell, B (2013) *Terms of Reference – Requirements for early termination charges*, 17 July 2013.

<sup>5</sup> IPART (2013) *Early Termination Fees – Regulating the fees charged to small electricity customers in NSW: Issues paper*.

<sup>6</sup> *Ibid*

<sup>7</sup> Essential Services Commission (2006), *Final Decision: Early Termination Fees*, December, p. 1.

(determined by IPART in June 2013) already contains an allowance for customer acquisition and retention costs<sup>8</sup>. Since the regulated price acts as a benchmark for market offers, retailers are, in effect, already compensated for these costs.

Furthermore, we submit that the majority of risk associated with marketing and acquisition costs should be borne by retailers. Offsetting any risk to retailers through excessive Early Termination Fees will lessen the incentive to reduce these costs, and may lead to more aggressive marketing practices that will do little to benefit customers.

### ***Bad Debt***

IPART's Draft Report indicates that the most significant cost associated with losing a customer is the cost of bad debt.<sup>9</sup> In the absence of evidence to the contrary, we support the view that bad debt is a cost of doing business, and is unrelated to whether an account is terminated early. The cost of bad debt should therefore not be included in the ETF.

It is not clear how the allowance for bad debt in the proposed ETF has been calculated, and whether it allows for the recovery of bad debt across the entire customer base. We consider that it is unreasonable for customers who terminate a contract early to bear these costs.

### ***Early Termination Fees: Impacts on competition***

In making its determination on early termination fees, IPART must also consider the potential impacts on consumer prices and on competition in the relevant markets.

IPART asserts that its proposed approach to calculating ETFs will facilitate greater diversity in market offers: low prices with high ETFs and higher prices with no or low ETFs.<sup>10</sup> While this may be the case, we do not agree that this diversity will lead to more effective competition.

Greater diversity in terms of fees and charges will only benefit customers who are in a position to make a well-informed choice about their electricity contract based on accurate information. We are concerned that many customers are not in this position.

In their analysis of the effect of Early Termination Fees on competition, the Victorian Essential Services Commission suggests that rather than enhancing competition, the complexity resulting from greater diversity in the form and value of ETFs will in fact inhibit customers' ability to make an informed choice about competing products.<sup>11</sup>

The Commission concludes that: "greater transparency and simplicity can improve the effectiveness of price signals and enhance competition. Added to this, a regulatory regime that does not present consumers with an unreasonable barrier to switching retailers is also likely to stimulate competition among retailers to attract customers by offering better pricing terms."<sup>12</sup>

We agree with this assessment of the impact of Early Termination Fees on competition, and believe that excessive Early Termination Fees will inhibit low-income and other vulnerable customers from participating effectively in the market.

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<sup>8</sup> PIAC (2013) *A friendly goodbye: PIAC submission to IPART's Issues Paper, 'Early termination fees—regulating the fees charged to small electricity customers in NSW*. Available at: [www.piac.asn.au/publication/2013/09/friendly-goodbye](http://www.piac.asn.au/publication/2013/09/friendly-goodbye).

<sup>9</sup> IPART (2013) *Early Termination Fees: Regulating the fees charged to small electricity customers in NSW. Draft Report – Electricity*, p. 22.

<sup>10</sup> *Ibid*, p. 25.

<sup>11</sup> ESC (2008) *Early termination fees compliance review—supplementary report*

<sup>12</sup> *Ibid*, pp. 8-9.

## **Conclusion**

We believe that the base Early Termination Fee caps proposed by IPART in its draft report are excessive, and are likely to unfairly impact low-income and vulnerable consumers while having a negative impact on competition. We strongly encourage IPART to reconsider its approach to calculating Early Termination Fees, particularly the inclusion of market and acquisition costs and the cost of bad debt.

Thank you again for the opportunity to provide input into the Review of Requirements for Early Termination Charges. If you would like any further information on the issues raised in this submission please contact Rhiannon Cook, Senior Policy Officer, on (02) 9211 2599 ext 128 or email [rhiannon@ncoss.org.au](mailto:rhiannon@ncoss.org.au)

Yours sincerely

A handwritten signature in cursive script that reads "Alison Peters".

Alison Peters  
Chief Executive Officer