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Consultation Paper: Response to the Bipartisan Independent Review of the Electricity and Gas Retail Markets in Victoria

Thank you for the opportunity to provide a submission in response to the Bipartisan Independent Review of the Electricity and Gas Retail Markets in Victoria.

Momentum Energy is a 100% Australian-owned and operated energy retailer. We pride ourselves on competitive pricing, innovation and outstanding customer service. We retail electricity in Victoria, New South Wales, South Australia, Queensland, the ACT, and on the Bass Strait Islands. We offer competitive rates to both residential and business customers along with a range of innovative energy products and services. We also retail natural gas to Victorian customers.

Momentum Energy is owned by Hydro Tasmania, Australia's largest producer of renewable energy.

Introduction

Momentum Energy supports the objectives of Government to improve outcomes for energy customers. We agree that some customers in Victoria are paying too much for their electricity and gas, and that all customers are entitled to clear, transparent information in order to get the best deal for their energy. Momentum believes that more can be done to improve retail competition and outcomes for customers, particularly for the significant minority of customers who are not actively engaged in the market. Therefore, we are broadly supportive of implementing recommendations 3-11 of the Thwaites Review. We believe that implementing these recommendations will improve transparency for customers and enable them to more easily shop around, compare offers and get a better deal.

However, we also believe that to address the issue of energy affordability properly, it is important to examine the issues in the appropriate context to ensure that the likely impacts of a policy response, such as Basic Service Offer (BSO), are properly understood.

1. Viewing a policy response in the appropriate market context

The relevant context includes:

- the role of retailers in the supply chain;

- the structure of the electricity market;
- how competition works in the retail market; and
- nationally proposed energy market reforms.

1.2 The role of retailers in the supply chain

Retail remains a relatively small part of the costs of the supply chain – the recent Australian Competition and Consumer Commission (ACCC) report calculates that retail costs make up 24 per cent of an average residential customer bill across the NEM (of which 16 per cent represents retail costs and 8 per cent EBITDA). By contrast, the ACCC notes that wholesale and network costs represent 22 per cent and 48 per cent of bills respectively. This implies that even if retail costs and margins were reduced materially, the impact on final electricity prices would be modest. This is not to suggest that reducing retail costs and margins should not be pursued (see below), but inevitably there is a limit to what can be achieved for customers by doing so. In comparison, reducing wholesale and network costs could have a much more material impact on final electricity prices.

1.3 The structure of the electricity market

The wholesale and retail markets in Victoria display a high degree of vertical integration. The ACCC notes that:

"Following the retirement of the Hazelwood plant in March 2017, the big three retailers control 64 per cent of generation capacity in Victoria, while also each supplying 19–27 per cent of retail electricity customers. Snowy Hydro has 23 per cent of generation capacity and supplies 16 per cent of electricity customers in Victoria."[1]

Vertical integration is driven by the need to use physical hedging to manage commodity price risk in one of the world's most volatile markets. The degree of price risk was demonstrated last year following the closure of Hazelwood. The Australian Energy Regulator (AER) noted in its recent advice to the Council of Australian Governments (COAG) Energy Council that wholesale prices in Victoria and South Australia spiked following the closure of Hazelwood, and confirmed that it would continue to monitor the market to understand the long term impacts. The AER stated that:

"*Ownership in the South Australian and Victorian markets is concentrated, with a few, largely vertically integrated participants controlling a significant proportion of capacity in both regions."*[2]

1.4 How competition works in the retail market

Market concentration can, however, make it harder for competition to be effective in either the wholesale or retail markets (i.e. some of the retail costs that are now incurred reflect this). The ACCC has flagged concerns about the potential for the exercise of market power, as market concentration has increased. To demonstrate the level of the ACCC's concern and focus on this issue, they have issued a number of requests for information from retailers to understand the implications of vertical integration on the retail market.

In turn, the increased market concentration has exacerbated the need to be vertically integrated, as vertically integrated businesses can take advantage of transfer prices,

[1] ACCC Retail Electricity Pricing Inquiry: Preliminary Report, pg 102

[2] AER electricity wholesale performance monitoring – Hazelwood advice, pg 2

whereas non-vertically integrated businesses are exposed to liquidity issues in the market for hedging contracts. This is evident in the volumes in the derivative markets and the reduced capacity of third parties to compete using those markets, as well as the lack of third party entry into the market (i.e. from merchant generators). In practice, this means that the parties that provide most of the competition to the major retailers (i.e. the second and third tier retailers) are increasingly constrained from doing so.

For all practical purposes, the wholesale market has also become un-investable for those considering taking market risk in part due to vertical integration and the broader uncertainties in the energy market (e.g. in regard to energy policy). Therefore, addressing the issue of concentration in the market may be the most effective way of reducing electricity prices to consumers, but it would require some significant market reform to do so.

1.5 National energy market reform

In addition, the proposed National Energy Guarantee (NEG) risks further strengthening the market position of the Tier 1 retailers. An objective of the NEG is to address affordability, and balance it against Australia's emissions reduction targets and reliability requirements. Under the NEG, retailers will fulfil their emissions and reliability guarantee obligations through the contracts they enter into with generators, or through the type of generators they invest in directly. The Tier 1s have a 'structural' hedge through their ownership of generation assets, which may mean that they readily meet or exceed their reliability and emissions guarantees. Smaller retailers would be required to enter into contracts with a mix of generators to meet their customer demand and comply with their obligations. Smaller non-vertically integrated retailers may be disadvantaged, as they will be required to enter into a larger amount of contracts in the market to meet their obligations, making it harder for them to compete.

2. A Basic Service Offer is unlikely to achieve better outcomes for customers

We are concerned that a policy response such as a BSO may amplify these existing issues in the market and therefore not address the Government's objectives. In particular, there is a risk that if poorly designed, a BSO may increase the market power of the Tier 1s, by providing consumers with a low cost, low service option that provides both:

- less reason for them to consider switching; and
- less scope for smaller retailers to provide an attractive alternative.

This would be detrimental to competition and potentially lead to worse outcomes for particular groups of consumers.

If the government wishes to improve the affordability of energy for particular groups of customers (for example, vulnerable customers who are unable to engage in the market), then targeted policies should be designed specifically for those customers. For other groups of customers, such as those who are engaged in the market but may not be on the best deal, or those that find it too hard to engage in the market, we believe the recommendations 3-11 will create greater transparency and assist those customers to engage and find the best offer for them.

To address affordability for the broader market, we believe that it would be more prudent to allow the ACCC to complete its review, and assess a policy response in light of its findings and the final design of the NEG, rather than implementing a BSO now before the implications of these important market influences are known. The work of the ACCC and the Energy Security Board is more likely to result in improved affordability outcomes because they are targeting the areas of the supply chain that have the largest impact on consumer energy prices.

Smaller retailers are, in practice, the key source of competition to the Tier 1s. Smaller retailers have a strong incentive to target the customers of the Tier 1s who have not engaged or are paying too much, such as customers on expensive standing offers, and try to and prise them away with a better deal and better customer service. The higher level of customer service offered by Tier 2 retailers is demonstrated by the fact that second tier retailers, including Momentum, swept all of the 2017 Mozo People's Choice awards[3] and featured in 16 of their 21 Expert's Choice Awards, and all of the Tier 2 retailers featured higher than the incumbents in the Canstar Blue Satisfaction ratings[4].

However, prising away customers from the Tier 1s is not a simple process and attempts to regulate price and service offers risk making it harder for smaller retailers to compete. Anything that makes it harder for other retailers to compete will further entrench the market power of the Tier 1s and likely result in some second tier retailers leaving the market, which will lead to less choice and higher prices for consumers.

A BSO may also lead to lower prices over the very short term, but in other utility industries a regulated price has not always brought with it long term reductions in price (e.g. high prices for 'poles and wires' in electricity networks). And as more customers move to a BSO, retailers will need to raise their prices for other customers to recover the costs. This will be particularly true if retailers are required to provide all of the same services to BSO customers as they do to customers on other offers.

Particular customer segments may also be worse off if a BSO is implemented. For example, business customers, who have seen significant increases in their electricity bills over the past 12-24 months, could be further impacted as retailers manage the allocation of costs in response to change in policy. In addition, customers without solar panels are also already paying more in their energy bills than non-solar customers (the ACCC calculates the difference to be $52 per residential bill). Both customer segments (business and non-solar customers) could be adversely impacted by any change to the prices that retailers are allowed to charge other segments of its customer base.

In addition, there is no evidence (that we are aware of) to suggest that a BSO would have a positive impact on the retail market. There are no examples of other jurisdictions re-regulating retail prices, having adopted full retail competition. The lack of evidence elsewhere further enhances the risk of unintended consequences.

Further, a poorly designed BSO is also likely to result in reduced service levels if implemented as proposed in the Thwaites Report. This is because if a BSO is available to all customers, retailers are likely to reduce the level of customer service they provide to save costs elsewhere. For example, call centres and other functions may be moved off-shore to

[3] https://mozo.com.au/peopleschoice

[4] https://www.canstarblue.com.au/energy/electricity-gas-providers/

reduce costs. As a result, customers may not receive the level of service they have come to expect, and Australian jobs would be lost.

3. An alternative approach

We believe that a far more effective approach would be to make it easier for competition to flourish, and provide further encouragement for those not currently engaging in the retail market to do so. We believe that recommendations 3-11 will do this.

We also believe that the reference price being developed by the ESC may also be an effective tool to increase transparency for customers and assist them to compare offers available in the market against a trusted source of data. However, setting a reference price will need detailed consideration to be effective at putting downward pressure on retail prices, and we will be making a submission to the ESC outlining our view on what those considerations should be.

If carefully designed, we believe that implementing a reference price in combination with recommendations 3-11 will be sufficient to make positive impacts on the retail market and drive better outcomes for customers, making a BSO unnecessary and removing the risks associated with doing so.

The following section presents our responses to the specific questions raised in the consultation paper.

4. Our responses to the consultation questions

1. Are there any specific considerations the Government should be aware of if standing offer contracts were to be replaced with a regulated BSO?

The overwhelming majority of Momentum's standing offer customers (99 per cent) are those customers who have chosen not to engage with their retailer when they have moved premises, and continued to take supply under a deemed arrangement by virtue of the retailer having an obligation to supply as the Financially Responsible Market Participant. Replacing a standing offer contract in these circumstances with a BSO would incentivise more customers not to identify themselves when they move into a new premises.

Relatively high standing offer charges provide an incentive for the customer to contact a retailer, if for no other reason than to provide their name and contact details for billing purposes when they move premises, but hopefully also encourage them to engage in the market and choose a better offer. The higher standing offer rates also reflect the higher costs associated with having an unknown consumer, such as the increased credit risk they pose. A considerable portion of the customer debt managed by Momentum is owed by these unknown customers.

A further complication is the role of the standing offer in a Retailer of Last Resort (ROLR) event. A customer who transfers through a ROLR event is usually placed on a standing offer and encouraged to seek a market offer. If customers are transferred to a new retailer through a ROLR event and placed on a BSO, there is limited incentive for them to contact their retailer or shop around for a better deal. If the new retailer is an incumbent Tier 1, it is likely to further concentrate the market.

2. Would the services and service standards associated with a regulated BSO be the same as those existing under the standing offer terms and conditions?

If all requirements of the Energy Retail Code are required to be met under a BSO, the only variable remaining is the level of customer service provided. If the government does not specify which services are in or out of a BSO, retailers will most likely remove any service not specified in the Energy Retail Code and charge a premium if customers wish to choose one of those options. Presumably, solar customers would not be included in a BSO as this involves additional service and costs by retailers to calculate the feed-in tariff adjustments. Therefore, the government is likely to have to make trade-offs between its broader energy policies, and the services and costs it wishes to regulate, if it pursues a BSO.

Arguably, many of the protections in the Energy Retail Code and Marketing Code of Conduct are in place to protect customers from potential harm they could face from a competitive market, which a BSO would be protecting them from anyway.

3. Would a BSO based on a 'flat tariff' apply to general usage only or should it incorporate controlled load and/or solar tariffs (as is the case for standing offers)? What are the benefits and challenges associated with different approaches?

Using a flat tariff would not allow customers to benefit from cost reflective pricing if it benefited them to do so. Nor would it send the right price signals to drive energy efficiency and a greater update of renewables or gain the benefits from the functionality of smart meters.

4. **What other principles should the ESC consider in setting the BSO maximum regulated price profile? Should these principles differ between a BSO for electricity and a BSO for gas, residential and small business customers?**

There are three threshold questions that arise in respect of how a BSO might be designed:

- who it applies to – is it just domestic customers on standing offers (as implied above)
- whether it is applied on an 'opt-in' or 'opt-out' basis
- whether there is a term associated with it (e.g. if its opt-in and the customers decides to do so, are they locked into staying on the BSO for a certain period)

In Momentum's view, if a BSO were to be considered it should only be as a replacement to standing offers (subject to the above), should be on an opt-in basis and it should have a term associated with it. The first two go to ensuring that the BSO is targeted to those customers who are not engaging in the market, and are unlikely to do so, and so does not distort the market where competition is already occurring.

The term associated with the BSO is critical to enabling it to provide a lower cost option. In other words, if the BSO has no term, it is unlikely that it will enable retailers to lower costs or margins. This is because the retailers will have no certainty in respect of serving that customer (unlike a customer on most market offers), and that lack of certainty imposes costs.

Customers on longer term offers, where there is limited customer interaction required (through a limited services offer), would more likely enable retailers to provide a lower cost service. Allowing a certain term (say three years) would enable retailers to lower marketing and wholesale costs. A trade-off of this nature would minimize the benefits to some customers, but reduce the negative impacts to many.

Marketing and acquisition costs are closely linked and we understand that neither would be included in a BSO price. For the purposes of this discussion, acquisition is described as the cost relating to each individual sale, whereas marketing is the broader costs associated with promoting the brand and product. Momentum's current marketing budget includes costs associated with developing regulated collateral such as Energy Price Fact Sheets and mandatory communications to customers. Such costs must be allowed for under a BSO, or it would clearly not be reflective of the actual cost of serving consumers.

A dedicated headroom component plays an entirely different role to margin. It is factored in to regulated prices, with an expectation that it *will not be recovered.* By making an allowance for headroom, an incentive is created for competitors to undercut the maximum regulated price to try and obtain a greater market share. Retailers enter the market and compete the headroom down, through innovation and efficiency. If headroom is not allowed, there is no incentive for retailers to compete in the market as prices can only be undercut by eroding margin, meaning that there is no prize for obtaining market share. Headroom also plays another crucial function in that it serves as insurance to both the market participants, and the regulator, in the event that the regulated price does not adequately reflect retailer costs.

5. **Are there alternatives for setting the BSO maximum regulated price profile? For example, should the ESC 'simply' set a BSO tariff or a specific tariff structure that must be applied by retailers?**

Tier 1 retailers have a different scale of operating costs to smaller retailers. If the ESC uses conservative assumptions to determine a BSO, or does not have access to accurate historical data across the range of retailer size and model, then it is likely to make it harder for Tier 2s and Tier 3s and new entrants to compete with Tier 1s, regardless of the tariff or tariff structure it applies.

6. **What are the likely effects of a regulated BSO, as described above, on the energy markets (electricity and gas wholesale, distribution and retail markets, and residential and small business customers)?**

As discussed above, a BSO will make it harder for smaller retailers to compete with Tier 1s. Tier 1 retailers have greater access to capital and will be better placed to sustain operations under a price cap than Tier 2 and 3 competitors. Compounding this is the fact that the vertically integrated retailers face a different wholesale exposure, as explained above. For these reasons, it is more likely that Tier 1 retailers will endure while smaller retailers will exit the market as it will be harder for them to compete. This will result in less choice for consumers and ultimately lead to higher prices.

As discussed above, we also believe that business customers will be impacted by higher prices as retailers reallocate costs.

7. **Are there any alternative design options for price regulation (to those outlined above) that would achieve the Review's intended outcomes?**

As stated above, we believe that a far more effective approach would be to make it easier for competition to flourish by implementing recommendations 3-11, and adopting the ESC's reference price without implementing a BSO.

8. **How should the potential benefits and effects of a regulated BSO be assessed following implementation?**

We do not agree that implementing a BSO is the correct approach. Should the government choose to do so, the benefits and effects should be assessed through the lens of the impacts on the concentration in the market, the impact on customer choice in terms of retailers, services and offers to choose from, and the change in pricing for other customer segments.

9. **How should a regulated BSO be incorporated into Victoria's energy sector regulatory framework?**

A BSO should only be incorporated into Victoria's energy sector regulatory framework if it can be shown that the remaining recommendations from the Thwaites review, and any reforms arising from the ACCC's review, have not provided sufficient benefit to consumers. At that point, a thorough examination of the existing regulatory framework and its interaction with the national framework should be undertaken to determine how a BSO should be incorporated into the Victorian framework to minimize further amplifying the compliance costs of retailers who operate in Victoria.

10. **Are there alternatives to introducing a regulated BSO and revoking standing offers?**
    a. **How would these alternatives achieve the objective and principles set by the Review?**
    b. **How would these alternatives affect other Review recommendations?**

c. **What would be the likely effect of these alternatives on Victoria's energy sector and energy consumers?**

d. **Would these alternative approaches cause any distortions or inequities between different groups of customers?**

As stated above, we believe that a far more effective approach would be to make it easier for competition to flourish by implementing recommendations 3-11, and adopting the ESC's reference price without implementing a BSO. We believe that these measures would meet the objectives of the Review without incurring the risks to the energy market and customer outcomes described previously.

11. **Are there any specific considerations of which the Government should be aware of if the reserve power to regulate prices was strengthened? What should be the trigger for regulation and when or under what circumstances should the regulated price requirement end?**

Victoria has signed on to the National Energy Agreement and consequently any regulation of pricing must follow a report from the AEMC finding that competition has failed. The agreement was designed to minimise regulatory red tape and bring benefits to consumers in the form of lower prices through harmonisation and efficiency.

Re-regulating prices should only be re-considered if outcomes from the ACCC's report cannot be demonstrated to have led to lower prices for consumers. As discussed above, to address affordability for the broader market, we believe that it would be more prudent to allow the ACCC to complete its review, and assess a policy response in light of its findings and the final design of the NEG, rather than implementing a BSO now before the implications of these important market influences are known. The important work of the ACCC and the Energy Security Board is more likely to result in improved affordability outcomes because they are targeting the areas of the supply chain that have the largest impact on consumer energy prices.

12. **What is the most appropriate approach to implementing Recommendations 4A to 4E?**

Momentum considers that thorough consultation with stakeholders is needed to guide the implementation of 4A to 4E.

13. **How can these recommendations be implemented in a timely manner?**

While Victorians deserve reform to the energy market, timeliness must be secondary to the need to carry out proper process and avoid unintended consequences.

14. **What are the barriers to consumers and authorised third parties' ability to easily access smart meter data?**

Considerable effort has gone into removing barriers to consumers accessing their smart meter data however, Momentum considers that the key barrier is a symptom of the broader issues within the retail energy market, namely lack of consumer engagement (whether through lack of interest or an inability to navigate the complexity of the market, that recommendations 3-11 will address). Retailers are required to provide consumers with their smart meter data on request at no charge. However, the uptake of this option is quite limited.

Momentum currently provides this data to customers via a manual process however we would ideally create an automated solution to allow customers to access their data directly and analyse it online. The current demand for data does not however justify investment in this technology. The creation of BSO would further reduce the demand for such data as it would serve little purpose to help customers reduce their costs.

Retailers will invest in options to make customer data easier to access if there is sufficient reason to do so. In order to drive demand however, consumers need to feel that it is worthwhile to engage in the market and to compare retail offers. Recommendations 3-11 will make the market easier to navigate for consumers and will hopefully give them with the confidence to approach their retailer (or whichever party makes it easiest for them) to obtain their data and properly examine the options which are available to them.

15. **What further assistance and support programs should government consider in responding to the recommendations?**

As discussed above, if the government wishes to improve the affordability for particular groups of customers, such as vulnerable customers, then it should develop specific policies for those customers. To assist these customers, government could investigate reforms to energy grants and concessions as well as programs for assistance with housing costs.

The Victorian Energy Efficiency Target scheme provides consumers with some assistance in reducing costs by reducing the prices of selected energy efficient appliances. However, barriers to its uptake exist for those consumers who are in rental accommodation. Exploring options to reduce their barriers, or providing incentives for landlords to make energy efficiency improvements would reduce energy costs for a lot of low income consumers.

Finally, although its direct ability to influence is limited, the Victorian government must clearly articulate a policy position for the increase of Centrelink payments for job seekers, pensioners and other groups who are disproportionally represented among those who are experiencing payment difficulty.

16. **Are there specific recommendations or initiatives that should be prioritised due to the benefits they could elicit for low-income and vulnerable consumers?**

Momentum does not have a view on which initiatives should be prioritised except to the extent that a coordinated approach to implementation is required and that efforts from a range of Government departments, stakeholder groups and industry are focussed on providing the best possible outcomes for Victorians. Greater coordination between departments is encouraged.

17. **Are there specific groups of consumers that should be considered in addition to low-income, vulnerable and concession card consumers?**

While Momentum believes recommendations 3-11 will de-mystify the market for the majority of consumers who chose to engage, we believe that there will always be barriers to participation which can only be lowered through the use of targeted assistance from government.

While statistics suggest that they are also likely to fall into a low-income bracket, refugee groups and the broader community of non-English speakers, and Victorians suffering from the mental impairments should be provided with the tools to participate in the market rather than have their best interests assumed by the government and be provided with a

BSO. Government engagement with consumer representatives is crucial to ensure that the needs of these groups are appropriately catered for.

18. Are there specific single buyer or group purchasing models that would provide beneficial outcomes for vulnerable customers or concession cardholders?

We note that the government has initiated a tender process to investigate a brokerage service for low income and vulnerable customers. Momentum is not aware of examples of similar models elsewhere.

19. Are there any specific issues or concerns with particular group purchasing or single buyer models for vulnerable customers or concession cardholders?

Momentum supports group purchasing and single buyer models however we consider that a thriving competitive market is required to enable this. In the event that a BSO is introduced, it is difficult to see the additional value that a group purchasing or single buyer option would bring.

20. Are there any retail market regulation issues arising from the ACCC preliminary report that the Victorian Government should consider as part of its response?

Our concerns regarding the issues raised in the ACCC's preliminary report with respect to the recommendations of the Thwaites Review have been discussed previously in this submission. In addition, we also think it is important to note that the ACCC preliminary report commented that the Victorian regulatory regime may be adding to the costs faced by consumers when compared to other states.[5] We also note the South Australian government's review of the National Energy Retail Law, which has found that on balance it has provided better outcomes for consumers.[6] Any policy response should be conscious of adding additional costs, which will further drive up prices for Victorian customers.

Additional information

If you require any further information with regard to these issues, please contact me on (03) 8651 3565 or email joe.kremzer@momentum.com.au.

Yours sincerely

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[5] ACCC Retail Electricity Pricing Inquiry: Preliminary Report, 2017 pg 11

[6] Essential Services Commission of South Australia, National Energy Retail Law: Review of operation in South Australia, 2016 pg 9