Next Business Energy - Submission

Consultation Paper: Bipartisan Review of the Electricity and Gas Retail Markets in Victoria.

Next Business Energy welcomes the opportunity to comment on the response to the Bipartisan Review of the Electricity and Gas Retail Markets in Victoria (the "Consultation Paper").

Authorised/licensed in 2014, Next Business Energy is a newer entrant energy retailer in the Victorian market. Next Business Energy commenced operations in 2015 and specialises in small–medium business clients across New South Wales and Victoria, offering tailored pricing and billing solutions.

Next Business Energy strongly supports the implementation of recommendations 3–11, as outlined in the Bipartisan Review of the Electricity and Gas Retail Markets in Victoria (the "Bipartisan Review"). Next Business Energy believes that, if implemented effectively, these recommendations will increase customer engagement in the energy market and enable flexibility to meet diverse consumer needs, which will ultimately lead to improved consumer outcomes. This will further evolve into increased innovation in the energy retail market in Victoria, particularly as new energy-saving technologies and products continue to be adopted. On this basis, Next Business Energy does not support recommendations 1 and 2 but supports the implementation of recommends 3–11.

In formulating our response to the Consultation Paper, Next Business Energy has given regard to the suite of regulatory changes, reviews and matters currently being undertaken within the energy market. Of relevance are:

- The Australian Competition and Consumer Commission (ACCC) Retail Electricity Pricing Inquiry (the "ACCC Inquiry"), which is due for finalisation in June 2018 and will draw data-based conclusive findings about the state of the energy market and energy retail pricing in Australia. The ACCC Inquiry is discussed further in Appendix A.
- The recent finalisation of the Essential Service Commission (ESC) Payment Difficulty Safety Net (the "PDSN"), which comes into effect on 1 January 2019 and aims to provide further protections and safeguards for Victorian energy consumers who may be struggling to pay their energy bills.

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- The Australian Energy Market Commission's (AEMC) Annual Retail Energy Competition Review, which considers indicators of retail competition in electricity and gas, and reviews retailer offers and margins. The AEMC inquiry is discussed further in Appendix A.
- The proposed introduction of the National Energy Guarantee ("the Guarantee") currently under consideration by the Energy Security Board (ESB) and the Council of Australian Governments (COAG). The Guarantee aims to ensure security and affordability of energy supply while simultaneously meeting Australia's emissions targets. Further information on the Guarantee is due in April 2018.
- Various other rule changes, including (but not limited to):
  - the proposed "preventing discounts on inflated energy rates" rule change currently being considered by the AEMC
  - the "notification of end of fixed benefit period" rule change, which was recently finalised by the AEMC and the ESC.
- The continued refusal of the Victorian Government to adopt the National Energy Customer Framework (NECF), which was adopted in other National Electricity Market (NEM) states from 2012–2015 and continues to provide a single national framework for non-price regulation of energy retailers.
- The closure of Hazelwood and the ongoing volatility of energy wholesale markets in the NEM.

While the matters outlined above are the most relevant for the purposes of this submission, they are only some examples of the ongoing regulatory changes and issues facing the Australian energy market. The breadth and volume of changes — both current and historical — occurring in the energy market stand as a caution against any hastened decision-making by the Victorian Government in relation to the introduction of a Basic Service Offering (BSO) or removal of the standing offer (recommendations 1 and 2, respectively, of the Bipartisan Review).

By way of general comment, Next Business Energy is concerned with the lack of data-based analysis to support the need for a BSO, as well as the short timeframes in which this matter will now be considered. This is particularly concerning because the adoption of such an initiative will result in the potential departure of retailers from the market, as well as a significant reduction in competition and innovation in Victoria. Next Business Energy does, however, agree with many concerns raised in the Bipartisan Review, and we are committed to working with the industry and policymakers to remediate these issues.

With these overarching considerations in mind, Next Business Energy has structured its submission as a broader commentary around the consequences and considerations for recommendations 1 and 2 (Appendix A), and we have provided responses to specific questions posited by the Consultation Paper (Appendix B).

To discuss any aspect of this submission further, please contact Naomi Feast, Risk, Regulatory and Compliance Manager, via email (naomi@nextbusinessenergy.com.au) or telephone (03) 8535 2591.

Appendix A: Next Business Energy's position on recommendations 1 and 2

Summary of the Recommendations 1 and 2

Next Business Energy understands that the BSO is intended to provide a regulated price — set at the "efficient" level of running an energy retail business — to both residential and small business, gas and electricity consumers with an annual consumption of less than 40 mWh per annum.

The Consultation Paper acknowledges that electricity is an essential service – and that the BSO would be designed to provide a "no fuss" option for energy consumers. As noted in the Bipartisan Review, customers cannot exit the market if they are dissatisfied with the price or service offered by energy providers for their gas and electricity service.

The BSO would be structured as a regulated price, set at a distribution zone level. Retailers would be compelled to offer the BSO in any situation where they are currently compelled to offer a standing offer contract (for example, deemed customer arrangements or at the end of a fixed-term contract where the customer has not made other arrangements). The contractual basis for a BSO would be similar to or substantially the same as the current standing offer terms and conditions (and the standing offer in its current form would cease to exist).

Assuming this is the correct interpretation of the BSO, Next Business Energy's comments and concerns in relation to recommendations 1 and 2 are set out below.

1. *Conflicting objectives and policy approach*

From Next Business Energy's perspective, it is unclear what problem the BSO is attempting to solve. The broad intention of recommendations 3–11 can be understood providing further opportunity for transparency and clarity in retailer practices and the energy retail market. This assumes that the successful adoption of recommendations 3–11 would increase engagement, education and trust between consumers and retailers, and provide further assistance to energy consumers who may be vulnerable in their dealings with energy retailers otherwise disadvantaged. Again, Next Business Energy supports the adoption of any measures that meet these broad objectives.

Next Business Energy notes the Victorian Government's commitment to implementing recommendations 3–11. These recommendations would improve and enhance competition in the energy retail market. However, recommendations 1 and 2 appear to do the opposite. The introduction of recommendation 1 accepts as a foregone conclusion that customers do not wish to engage in the market or feel unable to do so in its current form, or significantly disadvantaged n their current interactions with energy retailers. The BSO, as currently proposed, assumes that customers cannot or will not engage in the market and should be able to access a "no frills" option.

However, we believe that such an assumption ignores the current (and future) safeguards that exist in the energy market for small customers, including:

- The right of complaint or escalation to the Energy and Water Ombudsman of Victoria (noting that every retailer is required to be a member of the Ombudsman scheme, and that work is currently being progressed to extend the Ombudsman's jurisdiction in Victoria).
- The right of small customers to switch energy providers, without penalty through early termination or exit fees, to another energy retailer, if they are dissatisfied with their retailer's price or service.
- The protections offered under the existing Energy Retail Code or associated regulatory instruments, particularly the requirement for retailers to:
    - Provide prescribed information to customers as part of their marketing and contracting activities
    - Provide a ten-day cooling off period to small customers as standard
    - Follow robust prescribed procedures in assisting customers who are experiencing financial difficulty, including prohibitions on disconnection of energy supply in certain circumstances.
- The protections offered under the new PDSN framework, due to commence on 1 January 2019, which will provide further safeguards for customers who are experiencing financial difficulty.
- The increased proliferation of energy saving devices and alternatives which reduce consumers reliance on traditional energy retailers.

We note that some of these have yet to commence or may be fundamentally strengthened through the adoption of recommendations 3-11). If the BSO is adopted and the standing offer removed, Next Business Energy questions the relevance of adopting recommendations 3–11, which are aimed at further engaging consumers. This is particularly the case given that that the above protections / considerations are designed to accommodate a market-based solution with appropriate safeguards.

Without first qualifying the problem that recommendations 1 and 2 are attempting to solve, any implementation of these recommendations would be without a clear objective. If the desired objective is to provide a fall-back offer for customers who do not wish to engage with the retail energy market, then this can be better achieved through the retaining of the standing offer in Victoria and perhaps reintroducing a regulated price cap on standing offers. If the desired objective is to provide a safety net for vulnerable and disadvantaged consumers in Victoria, this may be achieved through a social tariff or other hardship pricing. Both options could be considered as solutions that do not unnecessarily remove competition from the energy retail market.

However, if all the recommendations arising from the Bipartisan Review were adopted, Next Business Energy believes that they would be attempting to meet conflicting objectives. On one hand, recommendations 1 and 2 would reduce the number of players and consumer engagement in the market. While on the other hand, recommendations 3–11 would increase consumer engagement while simultaneously promoting innovation and competition.

Therefore, Next Business Energy submits that the objectives of the BSO need to be more clearly articulated, and that the Victorian Government needs to be clearer on the problem it is attempting to address. We also suggest that the implementation of the BSO is premature without this analysis and is premature until recommendations 3–11 can be implemented and their efficacy assessed.

Next Business Energy seeks further clarity on the desired objectives of the BSO so that alternatives can be properly assessed.

Next Business Energy proposes that any decision to adopt the BSO be deferred until the effectiveness of implementing recommendations 3–11 can be assessed.

2. *Lack of evidence-based approach and cost-benefit analysis*

Next Business Energy is concerned with the lack of comprehensive consultation to date on recommendations 1 and 2. While the Bipartisan Review was completed in August 2017 (and the government was due to respond to the Review by the end of 2017), further formal consultation on this workstream was not undertaken until March 2018. Of primary concern is the lack of independent cost-benefit analysis proposed by the government to assess the efficacy of the BSO, should it be introduced.

This is particularly concerning given the potentially catastrophic outcomes for smaller or new entrant retailers within the Victorian energy market. These concerns have been relayed through discussions with relevant stakeholders and in formal roundtable settings with the Department of Environment, Land, Water and Planning (DELWP) and include (at a high level):

- potential reduction in competition as Victorian retailers exit the energy market
- reduced ability to make investment decisions regarding generation, product innovation and other consumer-facing initiatives
- further regulatory divergence in Victorian from established national regulatory frameworks
- the detrimental effects on niche or new entrant retailers who are attempting to expand their customer base (as opposed to larger market participants who already have an established base) as a result of the proposal to remove any customer acquisition and retention costs (CARC) from the proposed pricing of a regulated BSO.

Although electricity is a homogenised product (as noted in the Bipartisan review), the way in which consumers use energy (and associated technologies) and engage with their retailer differs greatly from consumer to consumer. The adoption of new technologies will only compound this and lead to further product diversity. It is therefore short sighted to assume that energy is a homogenised product for all consumers, or to assume that it will remain homogenised forever. The introduction of a BSO appears to reduce the ways in which innovation in this space can occur. We believe that a strong regulatory framework should provide a long-term solution for expansion of innovation in the market.

Given these concerns, the desire to finalise a position on the BSO within such short timeframes appears ill-advised, particularly given the work of other stakeholders in this area (please see further comment on this at section 4 below).

Further, while Next Business Energy is aware that the Bipartisan Review and other studies[1] indicate that retail margins in Victoria are higher than other jurisdictions, other studies and analysis undertaken within the industry do not necessarily support this conclusion.[2] We are concerned that the Victorian Government has drawn conclusions about retail margins in Victoria that are unfounded without further

[1] See, for example, *Grattan Institute, Price shock: is the retail electricity market failing consumers.*
[2] See, for example, *Oakley Greenwood, Review of the Thwaites report and associated research, prepared for the AEC*

analysis. Worryingly, these conclusions appear to be drawn about the entire industry, rather than attempting to identify the market participants who are engaging in this behaviour. As we have done with the ACCC, Next Business Energy is willing to provide (on a confidential basis) information about its pricing and margin position in Victoria.

Recommendations 1 and 2 would result in a fundamental change to the operation of the Victorian energy market and create significant risk for retailers, particularly new entrant and niche retailers and smaller players. Given the magnitude of change proposed, it would appear consistent with best practice regulatory process to assess — independently and comprehensively — the benefits to the community and consumers against the cost to industry and the economy of implementing recommendations 1 and 2.

Next Business Energy urges the government to commit to a cost-benefit analysis given the breadth, complexity and uncertainty around the BSO and the lack of clear evidence to support it.

3. Consequences for innovation, investment and competition

The adoption of recommendation 1 would severely hamper development and investment in new and innovative energy-selling models. This is particularly concerning given the prevalence of new technologies and business models entering the market (which are designed to further empower consumers to use energy more efficiently). Most retailers are seeking to develop and Leverage these technologies. Such practices are particularly attractive in the Victorian market given the prevalence of smart meters, which enable data and analytical insights that may not be available to small energy consumers in other jurisdictions.

With the lack of regulatory certainty in Victoria currently, it is difficult to make decisions to invest in these options at a retailer level. Next Business Energy rejects the Bipartisan Review's conclusion that the introduction of a BSO will still permit innovation in product offerings. Particularly for small retailers, investment decisions are carefully weighed against potential returns, and it is difficult to envisage how any investment decision could be made in an environment that seeks to limit a retailer's ability to offer innovative products to existing and potential consumers. Criticisms of retail practices in the Bipartisan Review — for example, that innovation has not occurred in retailer offerings to date — must be tempered by assessing the extremely prescriptive way in which retailers are required to engage with energy consumers (for example, through the way prices are presented in marketing activity, and the overly prescriptive nature of billing and invoicing requirements).

While Next Business Energy agrees that electricity is an essential service and that customers cannot exit the market, we note that, through established and emerging technologies, increasing options to reduce reliance on the energy retail market are proliferating. Although this does not allow for customers to "exit" the market entirely, it does place significant pressure on retailers to provide innovation and improved service offerings if they wish to compete.

4. Outstanding policy matters and regulatory reviews

As noted above, there are several workstreams progressing in this space which will qualify and quantify pricing practices in the energy retail market. Of note is the ACCC Inquiry, which has involved a detailed assessment of actual data, acquired from energy retailers through compulsory information-gathering powers. We believe that the ACCC Inquiry will make definitive conclusions about cost drivers of energy retailers and associated retail margins.

The ACCC Inquiry has produced preliminary findings, with a final report due in June 2018. As this is the same timeframe for final positions to be provided by the Victorian Government, it appears that the findings of the ACCC Inquiry will not be considered as part of this process.

Again, this appears counterintuitive, particularly when the preliminary findings of the ACCC Inquiry do not necessarily support the conclusion that retail margins are needlessly high in Victoria, as has been asserted by the Bipartisan Review. Indeed, the preliminary report by the ACCC provided an indication of retail margins on a state-by-state basis, which showed retail margins in Victoria may be as low as 9%. [3]

> Next Business Energy recommends that the Victorian Government await the outcomes of the ACCC's review into retail energy prices (due in June 2018) before making any decisions regarding the operation of the BSO.

[3] See ACCC, *Retail Electricity Pricing Inquiry Preliminary report 22 September 2017*, page 39.

Appendix B — responses to specific questions raised in the Consultation Paper

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

Next Business Energy is opposed to the introduction of a BSO. Our reasoning for this is set out above. Next Business Energy also strongly rejects the assertion that "the current market encourages retailers to add costs, including market and customer acquisition and retention costs to their business, which are of little or no benefit to consumers".[4]

Next Business Energy disagrees that these costs don't deliver benefits to consumers. Energy retail businesses are incentivised to efficiently manage these costs. This is particularly the case for smaller and newer entrants. These costs are incurred in actively targeting customers with a view to providing a better energy offer than their current offer. This active engagement targets consumers who may not have otherwise considered switching energy providers. Victoria has experienced consistently high switching levels in the energy sector, which is largely driven by small, niche or new entrant retailers who proactively market to customers and place competitive price pressure on larger incumbent providers.

Costs associated with retention activity could be reduced at a retailer level if further regulatory oversight was conducted around win-back activity. In a highly competitive market, much activity is dedicated to both attracting and retaining customers. However, the current approach to retaining customers by some retailers whose customers are seeking to switch providers may be particularly aggressive and creates a relatively high proportion of customers who elect to stay with their existing retailer, often on a contract that is not generally available or has not been put to the customer until they switch. Additional obligations with respect to retention activity — for example, a limit on the amount of contact with customers an incumbent retailer may make, or a requirement to only offer generally available (published) products for win-back activity — may diminish the ongoing inefficient costs associated with customer retention.

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

Again, please note that Next Business Energy does not support the introduction of a BSO.

However, there are several existing obligations tied to a standing offer in Victoria that add costs to retailers, which would appear to conflict with the concept of a "no frills" energy offers, such as the BSO, as they provide a higher or more costly level of service than what is currently offered by many retail market contracts. These include, for example:

- requirements to notify the customer at least 10 days before any price change takes effect
- requirements to produce quarterly paper bills for customers on a standing offer
- an obligation to supply energy to a site where the retailer is the financially responsible market participant (FRMP), which creates financial and bad debt risk for many retailers, especially in the case of "deemed" customer contracts

[4] Consultation Paper: Bipartisan Review of the Electricity and Gas Retail Markets in Victoria ,page 6.

- an obligation to calculate each bill only on actual data, rather than estimated data (where actual data cannot be obtained), as Explicit Informed Consent (EIC) is required for the use of estimated data as a basis for bills
- an obligation to offer customers a bill-smoothing arrangement, which is based on a 12-monthly estimate of energy consumption
- prohibitions on retailers charging for meter checks in advance
- specific requirements around contract termination.

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?

Next Business Energy does not support the introduction of a BSO. However, the application of a BSO to anything apart from general usage (e.g. through a flat tariff) appears in conflict with the BSO's stated approach, which is to act as a "no frills" offer.

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?

Next Business Energy believes that the introduction of a regulated BSO should only occur once a cost-benefit analysis has been undertaken by the Victorian Government.

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?

Next Business Energy does not have any specific comments on question 5.

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)?

Next Business Energy believes that the BSO will have significant impacts on the retail sector and, consequently, significant impacts for residential customers and small business customers in the medium to long term. Although Next Business Energy accepts that energy consumers cannot "opt out" of the retail market, a central tenet of the competitive retail market is that customers can exercise their option to switch energy providers if they are unhappy with their current retailer (and for customers consuming less than 40 Mwh, this can be done without exit fees). This option will be removed when energy retailers exit the Victorian market, which will in turn lead to less innovation and product diversity in the market.

7. Are there any alternative design options for price regulation that would achieve the Review's intended outcomes?

Please see the response to question 10 below.

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

Next Business Energy suggests that potential benefits and effects should be assessed through an independent cost-benefit analysis prior to implementation.

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

Next Business Energy believes that a BSO should only be incorporated into Victoria's energy sector framework if recommendations 3–11 are implemented and fail to result in improvements for Victorian energy consumers, and/or until an independent cost benefit analysis has been undertaken.

10. Are there alternatives to introducing a BSO and revoking standing offers?

Next Business Energy again reiterates the need for clarity and problem definition in considering whether the BSO is a required change to the regulatory framework. As noted above, there may be other alternatives — including a social or hardship tariff for eligible customers, or a price-capped standing offer — that may successfully alleviate issues faced by vulnerable or disadvantaged energy customers.

It appears that one of the key issues in the Victorian market is price dispersion — being the variation in prices across the industry and, indeed, across some retailers' own portfolio of products. Again, it is unclear whether simply revoking the standing offer and offering a BSO in its place would resolve this issue. Currently, only 10% of the Victorian energy retail market accesses a standing offer. Ergo, this would only solve the "problem" for that 10% of the market.

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?

Next Business Energy does not have any specific comments on the adoption of reserve power to regulate prices, but we suggest that the adoption of such power be deferred, or a decision to implement a BSO be considered only when the outcomes from implementing recommendations 3–11 of the Bipartisan Review can be assessed.

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

Next Business Energy believes that the most appropriate approach is to require retailers to only amend their prices once a year, in accordance with the Victorian distribution annual price variation. A simple way to implement this would be to include such a disclosure as a pre-condition to explicit informed consent (EIC), in a similar vein to price variation disclosure under the National Energy Retail Rules.

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

Next Business Energy believes that these can be implemented within the next six months.

Questions 14–16

Next Business Energy does not have any specific comments on these questions, but we support any initiatives that increase availability of customer data to empower consumer decision-making in the energy retail market.