momentum energy
Powered by Hydro Tasmania

Victorian Electricity and Gas Market Review Panel
Care of Department of Environment, Land, Water and Planning
1 Spring Street
Melbourne VIC 3000

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Dear Panel

Thank you for the opportunity to provide a submission in response to the Discussion Paper on the Review of 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 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 generator of renewable energy - generating hydro and wind power.

Introduction

Momentum welcomes the opportunity to discuss a number of issues which may be impacting consumer outcomes, however we are concerned that the discussion paper presents a somewhat binary perspective of competition as a concept. The case for competition and retail price deregulation has been established and accepted by successive state and Federal governments. We are concerned that the apparent focus on competitive vs regulated outcomes is causing uncertainty in the industry and potentially undermines the delivery of benefits to consumers and stress that it is not an either/or proposition and that a competitive, deregulated market must operate within appropriate regulatory parameters.

As a challenger brand in the Victorian Energy Market, Momentum can attest to the fierce competition in winning and retaining customers. We understand that the Panel is concerned about retailer margins and cite analysis comparing Victoria with other NEM state tariffs as potential evidence of some issue with the Victorian market. We agree that there are fundamental factors which lead to the retail component of Victorian bills appearing higher than those in other states however we will provide evidence to suggest that the issues are reflective of the higher costs of retailing in Victoria and do not contribute to increased margins.

The existence of challenger brands such as Momentum and the willingness of consumers to switch retailers to find an energy deal which better suits their needs provides ample evidence that competition is providing benefits to consumers. Evidence of good regulatory practice, pragmatism over politics and a willingness on the part of bureaucrats to engage meaningfully with the industry is on the other hand much harder to come by. Momentum asserts that the market is fighting with one hand tied behind its back due to the environment created by regulators and policy makers.

The Benefits of Competition

The Australian Energy Market Commission (AEMC) has repeatedly determined[1] that competition is effective in Victoria. More importantly for this review however, this competition is in fact delivering benefits to consumers. While electricity retail is often regarded as the sale of homogenous electrons, the reality is that retailers are offering an array of differentiated products and service offerings. Challenger brands such as Momentum are providing customers with alternatives to the traditional incumbent retailers.

As outlined out at the hearings, smaller retailers have established a range of business models which enable them to offer products to meet different customer needs. While it is true the electrons (or gas) sold by Momentum are identical to those offered by our competitors in that they allow the customer to operate appliances, Momentum offers a product and service which provides simplicity and transparency to customers. We do this through offering competitive headline rates and not a confusing, deep discount product like the majority of our competitors.

We have taken this approach because we are aware that many customers are not sufficiently interested in their energy supply to ensure that they are making appropriate decisions, and we believe that an opportunity exists to cater to these customers. This is the clearest possible example of competition at work to deliver outcomes for consumers, and we daresay that each of our competitors has entered the market because they have identified an opportunity to provide a product or service to satisfy a need which wasn't being met.

As we acknowledge that cost is a primary driver for customers making energy purchases we do compete hard on pricing but we believe that many customers value a number of our differentiators and choose Momentum because of our Australian ownership, local call centres and commitment to sustainability. We also acknowledge that some customers may value other things and we believe that the market is operating appropriately to cater for these needs.

In order to further differentiate ourselves, Momentum is investing heavily in an IT systems programme (known internally as Alchemy) to allow us to improve customer service as well as uncovering efficiencies to allow us to compete even more vigorously and pass on savings to customers. Our investment in Alchemy will raise the bar for all retailers ensuring that the entire market, and not just those customers who choose Momentum, will benefit in the long run.

Hand in hand with the concept product differentiation, the issue of price dispersion within the market, characterised by some as a signal of potential market failure, is in fact a proof point that the market is working as intended. Different price points allow customers to choose what they consider to be of value. If a customer is merely seeking to minimise their energy costs, providers who offer the bare minimum in terms of customer service or online capability are an entirely appropriate

[1] AEMC, 2016 Retail Competition Review, Final Report, 30 June 2016, Sydney P.14, Australian Energy Market Commission, 2015 Retail Competition Review, Final Report, AEMC, 30 June 2015, Sydney. P.xi.

choice. Many customers however, are prepared to pay a small premium to ensure that their energy retailer has a focus on sustainability and that service centre representatives are courteous and knowledgeable. As outlined at the hearing, and as evidenced by our growth in the market over a number of years, Momentum offers these differentiators and, in our opinion, considerably more value than that.

It is also important to consider that the retail energy market is about to be dramatically transformed by a range of external factors. Substantial reforms to the National Electricity Market (NEM) are underway following recommendations to the state and federal governments by the AEMC's Power of Choice review – giving consumers options in the way they use electricity. These reforms are coming at time when new technology is developing rapidly and consumers are beginning to question the need to stay connected to the network. This environment provides retailers with both challenges and opportunities as they will be able to provide customers with a new range of services through enabling technology (smart metering and storage in particular) while be subjected to additional competition from non-traditional retail models and energy service providers. Provided retailers are allowed to compete on a level regulatory playing field with these new service providers, consumers will undoubtedly continue to benefit.

The Role of the Retailer

As outlined in Momentum's verbal submission to the Panel, the role of retailers in the market is grossly simplified by most. While retailers themselves sometimes make representations that they are 'just the billing engine', this characterisation is used to facilitate a basic understanding of the role of a retailer in a relatively complex supply chain. The role of the retailer, and consequently the range of costs which they face, is much broader than is commonly understood.

As the intermediary between the end user and the entire upstream energy market the retailer faces a range of costs which relate to activities well beyond simply billing for the electrons (or gas) which a customer uses. As such, much of the analysis which breaks retail electricity tariffs into constituent components of whole, network and retail does not consider exactly what the customer is getting for their money.

Wholesale

As outlined at the hearings, the retailer makes wholesale purchases on behalf of the customer. In a market in which the spot price can reach up to $14,000/MWh this involves taking on considerable risk on behalf of the customer. Because of this risk, it is inaccurate to consider average wholesale prices as even close to an approximation of the cost of energy as a number of reports which been cited in the media have tended to do.[2] The superficial analysis undertaken by "industry experts", who are in actuality some way removed from the reality of the market, tends to consistently understate wholesale costs or, overestimate retail costs (resulting in a proportionally lower wholesale component).

[2] CME 2015, A critique of the Victorian retail electricity market

For example, the widely reported CME Critique of the Victorian Energy Retail Market reported based on Australian Bureau of Statistics for energy prices without disclosing that these prices related to retailer standing offers. These are hardly representative of the market as a whole, accounting for just 10% of customers. In addition to this, metering charges related to the Victorian smart meter roll-out were included as a retail component, despite more accurately being attributable to networks.[3] Similarly, St Vincent De Paul reports[4] wholesale energy as average spot prices plus a seemingly arbitrary figure added for hedging costs. These significant inaccuracies perpetuate the myth that the Victorian energy retail market is failing consumers.

The price of forward contracts is a more appropriate estimation of wholesale price as these include a premium to take into account wholesale market volatility and factor in significant events (such as the closure of the Hazelwood power station) ahead of time. The forward contracts may be more expensive than average spot prices over a period of time to take account of the range of factors which drive volatility. These include

- Matching supply and demand;
- Load profile, and significant variations to it;
- Generator outages;
- Fuel commodity prices; and
- Weather

Given the potential for significant variations in any of these factors it is no wonder that the certainty that forward contracting provides retailers commands a premium.

Further, forward contracting is not a point in time occurrence. Retailers 'build a book' over time as it would be imprudent to lock in purchases to service their retail portfolio in one go as the quantity of energy required is not known in advance. The actual amount of energy consumed by customers can vary greatly from forecasts due to weather conditions, economics factors and of course the impacts of competition as customers switch from one retailer to another. Because of these factors, it is inaccurate to state that all retailers face similar wholesale costs and it is almost certain that external analysis of wholesale prices is unlikely to properly reflect reality.

While much of the concern about retail margins seems to focus on electricity, the Victorian wholesale gas market is equally beset by issues. This has been acknowledged by the Victorian Government as recently as 2015 when it engaged the AEMC to review the Declared Wholesale Gas Market. This review found:

- An inability to hedge price risk, other than through very long term, illiquid Gas Supply Agreements;

[3] Ibid P.10
[4] St Vincent de Paul Society and Alviss Consulting, The NEM – A hazy retail maze, Melbourne, December 2016 P15

- Decisions on network investment being taken by the Australian Energy Regulator, exposing consumers to risks;
- Short-term price signals provided through the spot market reflect immediate demand and supply conditions only ;
- Current arrangements are complex and not suited to the transitional shift occurring;
- There is a need for greater flexibility in buying and selling gas.

These challenges faced by retailers dealing with the illiquid wholesale gas market ultimately flow through to the final retail price. The upstream gas market is going through an unprecedented period of structural change which is also exacerbating both gas prices and wholesale gas risks for retailers.

Distribution

Network costs are the second distinct component of retail tariffs. Until relatively recently, retail tariffs have largely reflected the structure of network tariffs as this approach best mitigates the risk that a retailer faces if the customer's consumption patterns do not align with expectations. With the widespread rollout of smart metering technology retailers are now beginning to roll out new tariff structures and innovative products as greater insights exist into actual customer consumption patterns.

Development of these products was perhaps slower than anticipated, due to customer scepticism towards the enabling technology, however we believe that competitive forces will continue to drive innovation in this area and lead to additional consumer benefit. At the present time however, we consider it appropriate that network costs be treated as a relatively discrete component of the retail tariff, much the same as in other jurisdictions.

The one factor with regard to network tariffs which differs in Victoria is the existence of five distinct distribution networks. While privatisation of the networks has delivered efficiencies[5] it has posed challenges to retailers as they interact with each networks' processes. This largely manifests in minor operational differences, however, certain issues have created meaningful challenges and imposed more significant costs on retailers. Examples of this have been prevalent throughout the evolution of Victorian solar policy with each distributor developing its own approach to 'flagging' accounts as having particular types of feed in generation, some of which were easier to identify than others.

Similar issues exist with within the Victorian Gas market as the three distributors operate multiple zones. While the divergence of processes is a lesser issue, developing product offerings and pricing for each of these zones results is a resource intensive exercise.

Although the issue of multiple distribution businesses exists in Qld and NSW, the discrepancies do not seem to arise, presumably due to their common (Government) ownership. We do not suggest that these process differences which arise in Victoria add significant additional cost, but they cannot be dismissed as a factor.

[5] AER 2016 Distribution Network Service Providers Benchmarking Report.

While wholesale and network components are relatively discreet elements of retail prices, one aspect which is frequently overlooked in the discussion about retail margins is that fact that as agent for upstream participants, the retailer is the sole element of the supply chain which faces any real credit risk. The wholesale market settles and network bills are paid regardless of whether or not the end user pays their retail bill. While properly characterised as a retail operating cost, this credit risk being inequitably shared across the supply chain is partially to blame for creating a delta between wholesale + network and final retail prices.

The Retail Component

As previously outlined, the over simplification of the role of the retailer has created a tendency to question retail margins. While the role of the retailer is relatively uniform across NEM jurisdictions, it is the environment in which retailers operate in Victoria which adds cost.

Before considering the broader role of the retailer however, it is important to consider the most basic function of the retailer – invoicing a customer for energy consumed. In order to do this, retailers require complex systems which must accept meter data from the market (nearly 5000 data points per customer per quarterly bill) and refine them into a format which can be understood by the customer and complies with regulatory requirements.

Once the bill has been composed, it must be printed and sent. As the panel would be aware from publicity around Australia Post, the costs of doing this have increased in recent times.

Following dispatch of the bill, the retailer must have in place mechanisms to receive payment (a range of options of varying cost are mandated by regulation) a call centre to manage customer queries and credit and collections processes to chase up recalcitrant consumers.

As initially pointed out, this is the most basic function of the retailer and, while the costs associated with these activities are scalable in relation to the size of the customer base, none are directly related to the amount of energy consumed and are consequently reflected in the fixed component of a bill. This basic outline of what a retailer does, is however only a very small part of a typical energy retailer operation.

As well as providing a suite of safeguards to customers in recognition of the essential nature of electricity supply, the regulatory framework dictates that retailers have a direct role in the delivery of social and environmental policy outcomes. Given that the retailer has a direct relationship with the customer, this is not necessarily inappropriate, but it must be recognised as a significant cost driver, and while this role is not unique to Victoria, the policy settings and bureaucracy associated with it has been relatively expensive in comparison with other states.

Social Policy (Concessions)

Social policy is executed by retailers on behalf of the Department of Human Services (DHS) in the form of a requirement to provide concessions and grants. While Momentum gladly undertake this role as it is in the interests of our customers and the business, concessions policy is developed in isolation of broader energy policy and, in our experience, with little understanding of the capabilities of retail businesses.

As cited above, retailer billing systems are necessarily complex in order to handle significant amounts of data. The impact of changes to concessions on retailer systems is often underestimated and the guidance of how concessions must be applied is unreliable. Additional headcount is also required to manage concessions, increasing retailer costs.

This issue exists in all jurisdictions however the Victorian percentage based concessions, while arguably more equitable for consumers than the flat rates which exist in other states are particularly challenging. Percentage based concessions raise questions of application particularly with regard to solar customers, discounts (although this is a lesser issue for Momentum) and any tariff structure which does not reflect traditional network tariff models. Advice on these matters is not always consistent and we note that advice on the treatment of demand tariffs was only provided in the 2017 Guidelines which were issued after the commencement of the calendar year. Uncertainty of this type adds to retailer costs.

Environmental Policy

Energy retailers also execute environmental policy on behalf of the Government. While the Renewable Energy Target obligations exist across jurisdictions, the Victorian Energy Efficiency Target (VEET) is exclusive to Victoria. Analysis of retail prices generally includes the cost of acquitting VEET liabilities however they do not account for, or do not fully account for, the administrative and compliance costs associated with undertaking this task. Additional, costs include:

- Auditing costs;
- Staffing/contracting costs associated with managing certificate creation partners;
- IT changes to allow the cost of certificates to be passed on to consumers.

Although similar schemes exist in both NSW and South Australia, the impact of the scheme on Victorian retailers is significantly higher due to policy and bureaucratic failures. These failures are linked to culture of inadequate engagement of regulators and policy makers with the retail energy market. For example –

The Essential Services Commission of Victoria has a statutory requirement to publish Greenhouse Gas Reductions Rates by May each year. These rates dictate retailers' VEET liabilities for the year in which they are published. Retailers have long lobbied Government to require these figures to be published in advanced of the year in which they are to be effective to allow for accurate price setting as the current approach requires retailers to make an estimate of their liability which inevitably leads to a risk premium being factored into prices. Momentum is aware that retailers have made this issue known to Government as far back as 2012 and, as at time of writing this submission, the issue has not been rectified. This is despite the fact that no new regulation or amendment to existing regulation is required if bureaucrats are prepared to work with industry to achieve a positive outcome for Victorians.

Similarly, as the VEET scheme has grown in scope, amendments have been made which have hampered retailers' ability to comply. In 2015 when the scheme was expended to included businesses, a decision was made to exempt particular large scale energy users who had been a part of the Energy and Resource Efficiency Plan (EREP) scheme administered by the Environmental Protection Agency. As part of the 'consultation' on this change, retailers made representations to the ESC that they would be unable to identify which businesses were exempt based on the information that was being provided to them via the EREP register, and requests to provide appropriate identifiers were ignored. To add insult to injury, the EREP was disbanded within the first 12 months and retailers were advised to continue using the now completely meaningless register.

The Department commenced a consultation on these VEET issues in 2016 with a view to addressing these issues for prior to the commencement of the 2017 compliance year however as at time of writing, the Department has not made recommendations and merely prolonged the uncertainty for both retailers and customers.

While Momentum supports the scheme and its objectives, the failures outlined above have led to undue costs being imposed on Victorian consumers.

Solar Feed-in Tariffs.

Solar Feed-in Tariffs are another element of environmental policy facilitated by retailers. Momentum fully supports the policy of successive governments of rewarding small renewable energy generators as evidenced by our currently paying small solar generators 40% above the minimum rate. While we believe however that the policy settings add unnecessary costs to consumers (this is discussed later) the following section focusses on the recent process issues which have added to the cost and are emblematic of the increased cost of participating in the Victorian market.

In 2015 ESC was tasked with undertaking a review of distributed generation to ensure that consumers were receiving the "True Value" for the energy which they feed into the grid. The Terms of Reference for this Inquiry outlined that the ESC "should have regard to the most appropriate policy and regulatory mechanisms for compensating different benefits of distributed generation, including considering their practicality and costs".[6]

While the ESC did seek cost information from retailers, this information was sought on the basis of high level proposals with virtually no operational detail. In their final report the ESC notes that retailer estimates to implement ranged from $60,000 to $3,000,000 and that "Most retailers we approached provided some level of cost information, however the completeness and level of detail varied significantly." [7] Rather than causing pause for the ESC that perhaps insufficient details of the proposal had been provided, the ESC determined that the lower end estimate was appropriate and proceeded with its recommendations. We consider that this demonstrates either a complete lack of understanding of the businesses which they are charged with regulating or a wilful dismissal of data provided to them.

[6] Essential Services Commission 2016, The Energy Value of Distributed Generation, Distributed Generation Inquiry Stage 1 Final Report, August 2016. Appendix B. P141

[7] Ibid P.105

A tight implementation timeline compounded this failure to consult. While delays to the passage of legislation were out of the ESC's hands, and recent advice indicates that they will delay making a determination which will create major impacts, retailers have faced the challenge of working towards a 1 July commencement date for a considerable IT change in the absence of any certainty the legal mechanisms to require it would exist.

Cost and uncertainty issues of this nature could have been addressed through adequate consultation.

The commercial objective

While from an operational perspective, the breadth of the retailer's role is outlined above, this overview does not capture the retailer's primary purpose, namely to make a return on investment to its shareholders. This is the reason that any business enters the market, and it is ultimately the reason that customers do, and will continue to benefit from competition.

In a competitive market, firms can only make normal long run profits. If a business is making excessive margins, competitors simply undercut marginally to attract a greater share of the customers. When margins have been reduced to their sustainable level, as has occurred in the Victorian energy market, competitors invest in customer acquisition by other means. This necessarily involves a degree of expenditure on promotion, sales and marketing in order to compete, however these costs are eclipsed by investments in innovation, and product development. [redacted].

The competitive pressure which drives the acquisition and retention customers creates a commercial imperative for innovation and efficiency. As outlined above, Momentum is investing in its Alchemy programme to improve customer service, product offerings and efficiency in order to retain our current customers and attract new customers and we are aware of other retailers undertaking their own investments to the same end.

Coupled with the need to constantly improve and innovate is the need to ensure that all activities are carried out in accordance with the legal and regulatory framework. [redacted] While we believe that this investment is necessary to ensure customers are provided with to which they are entitled, we consider that the regulatory framework is making these costs unnecessarily high.

Policy settings, excessive red tape and inefficient regulatory practices are leading to poor consumer outcomes both directly and through the imposition of additional costs on retailers. In many instances, the regulatory framework extends beyond the provision of customer protection proscribes a level of standardisation which stifles innovation and product development. This ultimately deprives customers of the products and services which may best meet their needs.

Victorian energy consumers are served by a highly effective Ombudsman scheme which protects consumer rights and has a focus on fairness as well as technical compliance. Reviewing the regulatory framework, or transitioning to the NECF, to make compliance easier would allow retailers to innovate in the way they communicate with customers and develop products and services without a degradation in consumer rights. The Ombudsman's fee for service model creates an incentive for retailers to take actions which minimise their complaints and ensures that retailers' primary focus will be to satisfy (and hopefully retain) their customers rather than complying with sometimes unhelpful regulatory requirements. This approach would also ensure that compliance costs are more within the retailer's control as they will be able to reduce costs if they reduce the reasons they give their customers to complain.

Tariff Structure

The panel raised concerns at the hearings with regard to the ratio of fixed to variable charges, particularly in when compared with the ratios for network tariffs. We understand concerns that such a tariff structure diminishes the ability for consumers to reduce costs in line with reductions in consumption however, these structures reflect the makeup of retailer costs. While many costs are variable in relation to the number of customers served, very few are directly related to the number of kWh's sold.

Those functions which the retailer takes on in its role as interface between the customer and the rest of the supply chain, and in its role in executing policy require that the retailer must simply "be there" whether or not the customer is consuming any electrons. That is, a retailer must produce bills, provide concessions, administer environmental policy and make facilities for market transactions available to the customer, even if the customer never so much as turns on a light.

A key irony with regard to the structure of retail tariffs is that they have tended more heavily towards fixed costs as a result of Government policy which notional seeks to pursue cost reflectivity. The Victorian government has created conditions which have unwound cross subsidies for some consumers while increasing them for others. These are outlined further in Tariff Policies below, but primarily relate to the creation of favourable conditions for solar consumers and particularly engaged consumers who have considerable control over their consumption patterns.

Momentum, and evidently most other retailers, has determined that the most equitable way to recover costs from those customers who have been beneficiaries through government policy at the expense of others is to impose higher fixed charges.

Policy Settings

While the examples outlined above indicate a lack of understanding on the part of policy makers and regulators about the impact that their decisions on the more peripheral elements of the retailer's role, Momentum firmly believes that policy decisions in a number of areas are directly adding cost to Victorian energy bills.

The panel has heard that Victorian consumers are missing out on efficiencies as a result of successive Governments failing to adopt the National Energy Customer Framework (NECF). Despite being touted as a move to preserve customer protections, we believe that this position is ideological and has in fact led to Victorian consumers being worse off.

The Victorian Energy Market has led the evolution of Energy markets in Australia since around 2002. The introduction of Full Retail Contestability followed by the progressive removal of retail price regulation led to the industry concentrating in Victoria. The Victorian customer protection framework, primarily the Energy Retail Code was regarded as the Gold Standard of consumer protection and consequently became the basis of the National Energy Customer Framework.

Throughout the development of the NECF the Victorian regulatory framework was looked to to provide a basis for the new national regime and was the model for the National Energy Retail Rules, the key element of the NECF. In light of this, a cynical person may view claims that customer protections were being preserved by retaining the bespoke Victorian framework as political rather than factual. While the decision not to proceed with NECF cost retailers (and consequently customers) significantly in terms of sunk transition costs, the failure to capture the efficiencies that national harmonisation was supposed to bring continues to manifest itself through higher retail tariffs.

Other States were understandably cautious about changing to a new regulatory regime, however, they handled it more pragmatically. For example, as a condition of its introduction to the state in 2013 the South Australian Government required a review of consumer outcomes under the framework to be completed within two years of its commencement. The review found “the NERL is operating well in South Australia and that South Australian energy customers, have generally benefited from being part of the national customer protection arrangements” and in particular “It has resulted in improved customer access to hardship programs and better data to analyse the experiences of and outcomes for hardship customers”. [8]

In the RIS for NECF, the comment is made ”…the compliance burden on retailers and distributors indirectly impacts energy customers through market inefficiencies, less competitive energy pricing and less innovative service offerings”.[9] While duplicate processes and compliance costs account for a significant portion of the untapped efficiencies, the critical element is the relative lack of regulatory risk faced by retailers operating in NECF jurisdictions. In contrast to the Victorian scenario where the ESC is both regulator and rule maker, these functions are separated in NECF markets and rule changes are made via a transparent process.

The 2002 Parer Review forecast cost savings of the order of $673 million in 5 year net present value terms[10] from implementing its recommended governance and regulatory reforms, including a move to a single national regulator, with associated reductions in regulatory risk. In practice, this has led to a more stable regulatory environment and a generally higher standard of regulatory practice. The recent work in relation to vulnerable customers undertaken in parallel and Victoria and the NECF states provides a stark comparison of the differing approaches under the two frameworks. This is outlined in detail in Appendix A.

[8] ESCOSA 2016, National Energy Retail Law: Review of operation in South Australia, Final Report April 2016 P. 2

[9] National Energy Retail Law, Regulatory Impact Statement P.7

[10] Council of Australian Governments 2002, Towards a Truly National and Efficiency Energy Market 2002. P.44

Tariff Policies

A number of policy settings outside the scope of the NECF are also increasing the costs to Victorian consumers, and in some instances, to specific classes of customers.

The key example of a policy which seeks to benefit a particular customer class at the expense of others is the amendment to the Electricity Industry Act introduced in 2015 to prevent product discrimination against solar customers. According to Government, the amendment would "prohibit retailers from including eligibility criteria in their supply offers that restrict customers who have solar or other renewable energy generation from taking up an offer that would otherwise be available to them.

That is, while energy retailers may still make electricity sale offers that are specific to solar and renewable energy customers, such customers must also be able to access the same offers as any other customer." In effect this hinders' a retailer's ability to reflect the specific costs which solar customers impose on the broader market[11] in a solar customer's tariff. This means that these costs are socialised across the customer base as an additional fixed cost.

Such policy does not exist in other jurisdictions.

Similarly, government policy regarding cost reflective network tariffs has created further burdens on particular customers. With its near universal rollout of AMI metering technology, the Victorian Government was in a position to assist with a transition to a pricing model which accurately the reflects the costs that each consumer places on the network. Due to political expediency however, the tariffs were made optional to customers meaning that only those customers who knew that they could reduce their costs would transition to the new tariffs.

If the philosophy of the Government is that every customer should pay according to the cost that their consumption places on the network, then Momentum agrees with this position provided appropriate support in the form of concession reform and funding for social services is provided. By making this policy optional however, the government has rewarded the most engaged consumers (both those who take up reflective network tariffs or those who choose to stay on flat tariffs as they have determined that it is in their best interest) at the expense of those customers who lack the sophistication to engage with the market to this degree.

These tariff policies have resulted in higher fixed components on bills as retailers have determined that this is in fact the most equitable way to unwind cross subsidies which have been created.

Non-aggregation

[11] The ESC review recognises that these costs exist however chooses to ignore them in its analysis claiming that the terms of reference instruct them to do so.

The Victorian market is the only one in which retailers are unable to aggregate small business sites and treat them as a single large customer. This provides the customer with a range of benefits in terms of account management and ability to negotiate bespoke contracts and opt out of provisions which are required by small customers under the Energy Retail Code. This approach also creates efficiencies for the retailer as the customer can managed under a single contract. The additional cost to serve these customers is reflected in retail rates for all consumers and could be reduced with a simple legislative amendment.

The cost of Customer Protection

Successive Governments have determined that two particular customer protections should apply in Victoria. These protections relate to the prohibition, or regulation of fees based on customer behaviour to cover real retailer costs. Prohibition of termination fees in most circumstances (and capping at $20 where they are permitted) and prohibition of late payment fees mean that the costs which accrue to retailers when customers terminate their contracts or fail to pay by the due date are socialised across the customer based instead of being paid by the customer who cause the expense.

Momentum offers no view on whether or not these protections are appropriate, however it is crucial to recognise, as the Independent Pricing and Regulatory Tribunal of NSW has, these customer behaviours impose genuine costs on retailers.

In its decision to cap early termination fees for small customers at $135 (in the first year and $45 thereafter), IPART acknowledged that "…retailers can incur a range of costs in establishing service contracts – including upfront inducements to attract and encourage the customer to sign the contract, investments made on behalf of the customer (e.g., purchasing assets, organising services), and administrative costs associated with establishing the contract. Where these costs are significant, retailers typically structure their product offerings (including the terms and conditions) to recover these costs over a fixed contract term. However, there is a risk that the customer may simply 'walk away' from the contract by terminating it before the end of the term."[12]

We also note that the ESC, the regulator for both the water and energy sectors has acknowledged that there are costs associated with the late payment of customer accounts as late payment fees are permitted in the water industry in Victoria. We fail to see how a case to differentiate between the two industries can be justified.

Momentum, like the NSW Government, believes that it is appropriate that the retailer should have the choice whether to charge the customer who 'walks away' from a contract rather than imposing those costs on the broader customer base. If the Victorian government does not share this view, it must accept that shielding individual customers from these charges comes at the cost of them being recovered across the broader customer base.

Consumer Engagement

[12] IPART 2013, Regulating the fees charged to small electricity customers in NSW P.16

Retailers, consumer groups and regulators have identified consumer engagement as the biggest challenge to ensuring that the benefits of competition flow through to consumers. Momentum's approach to pricing seeks to make energy purchasing decisions as simple as possible for customers as we understand that there is a significant segment of customers who are confused by energy and may not feel empowered to fully participate in the market.

We also recognise however, that some customers are extremely engaged and are looking to take advantage of developments in technology and market design.

This puts retailers, and equally government policy makers, in the unenviable position of trying to cater to both types of customers (ignoring that rather than being a binary position there is in fact a spectrum of consumer sophistication). The ability of consumers to make informed decisions is not being hampered by retailers, but the frenetic rate of change in the industry, and in some cases the ability of governments and regulatory frameworks to keep up. A key example of this the development of the SwitchOn website.

SwitchOn, and a number of incarnations before it, have been established by the Victorian Government to provide consumers with a resource from a trusted party to provide impartial information on retail offerings. The website however is unwieldy and requires consumers to input a significant amount of data meaning that many people seeking a comparison ultimately abandon the process. To compound this issue, the website does not have the capability to accurately present some offers, including the cost reflective tariffs (detailed above) which were promoted by the Government as part of its reforms. Momentum is aware of cases where the website has indicated that customers would benefit from particular plans which in reality are not likely to provide a good outcome. Unfortunately in these circumstances, inaccurate information from a supposedly trusted sources acts to further reduce trust and engagement in the market as the retailer is required to explain to the customer that the independent government compactor is wrong.

An engaged customer base is better prepared with tools to make rational decisions to maximise their utility. Unfortunately, attempts to create a regulatory framework which caters to both the least and the most engaged customers has created the current situation whereby many customers have difficulty in determining what is the best tariff for them.

While we believe that competitive outcomes have been generally good for consumers, unfortunately, the fierce level of competition has led participants to seek to exploit customer disengagement. Many retailers rely on advertising deep discounts to attract customers without making it absolutely clear that these discounts are conditional (on paying on time for example) or what the pre-discount rates are. Momentum has chosen not to take this approach as we believe that customers value and deserve openness and transparency and should be able to compare retail offers on even terms.

Low customer engagement is also a factor in the prevalence of commercial comparator sites which do not always ensure that customers are fully informed about their decision. In our opinion, these comparator sites do not adequately disclose the fact that they do not compare all retail offers or that in some instances the offer recommended for the customer is based on the size of the commission that the site operator will receive. Issues, such as those already mentioned, with the Government site have driven customers to commercial comparators and consequently Momentum is reluctantly involved with a number of such sites. We would however welcome regulatory reform in this space so that retailers are able to compete without having to operate through these channels.

What do appropriate consumer outcomes look like?

Momentum is concerned that the current review is proceeding on the assumption of a market failure without having established what a functioning market should deliver. It has been well established that competition exists in Victoria and it has been well established that consumers have access to a range of products and services. While we acknowledge the need for consumer protections we urge the panel to consider both the cost involved in prescribing the way that these are delivered and the deleterious impact that this has on product and service differentiation.

We note that similar concerns were raised in the United Kingdom resulting in the imposition of regulation designed to address these concerns without first establishing that genuine issue existed. As outlined in appendix B, evidence suggests that the reforms designed to protect consumers have actually resulted in a worsening of consumer outcomes. We contend that the politicisation of retail energy prices over a number of years is having a similar effect in Victoria and we are concerned that reactive regulatory reform which may arise from this review could lead a significant negative step change.

The broader context of market transformation must also be considered in determining how to respond to any perceived issues. The Power of Choice program of work aimed at meeting consumer needs in the new technological environment will further stimulate competition, and the imposition of regulation on traditional retailers will inhibit their ability to participate in the new market, thus decreasing consumer choice. Under this outcome, all the customer protections imposed by successive governments and regulators will ultimately amount to nothing if the traditional, grid connected energy is not a viable option for consumers when compared with those services which operate outside the regulatory framework.

Summary

While the fundamental input costs in Victoria are similar to those in other jurisdiction, Momentum contends that differences in retail tariffs are due to the costs of doing business in Victoria. Retailers face a death by a thousand cuts as a result of various regulatory and policy decisions which seem innocuous in isolation, but cumulatively create a costly, risky and inefficient environment in which to operate.

Policy makers and regulators in Victoria must make a decision on whether consumers are genuinely benefiting from the regulatory framework in place as it is clearly leading to price outcomes which a large segment of the community deem to be inappropriate. We are further concerned that these outcomes come as any surprise to Government as retailers have long argue the benefits of adopting the National Energy Customer Framework with as few derogations as possible. While the efficiencies which have arisen as each previous jurisdiction has adopted NECF have been incremental, Victoria's transition to the Framework would represent a step change as duplicate process, training and collateral costs would be eliminated.

Transition to the Framework would also result in a more stable regulatory and policy environment for retailers with a genuine rule change process. Although retailers may not always agree with decisions of the Australian Energy Market Commission, the rule maker for the national energy retail rules, they are confident of a transparent consultation process which provides all parties with sufficient opportunities to present their case.

Ultimately, government must question whether trying to be 'all things to all people' is worthwhile. Are consumers best served by creating frameworks in solar and network tariff reform where there are no losers, only winners as this ultimately puts upwards pressure on prices? Is it appropriate to establish a customer protection framework where customers are not exposed to certain direct costs, only for them to be smeared across the customer base?

Momentum firmly believes that the answer to these questions is no, however this is ultimately a decision for government and government must accept the outcomes which arise from the regulatory framework which it creates.

I would like to extend an invitation to the panel to discuss our pricing strategies and financials and learn more about our operations which would be subject to confidentiality given the commercially sensitive nature of such considerations.

If you wish to take up this invitation, or have any other queries regarding this submission, please contact Joe Kremzer, Regulatory Manager on 8651 3565 or email joe.kremzer@momentum.com.au

Yours sincerely

Joe Kremzer
Regulatory Manager

Appendix A

Case Study – Victorian Vs National Approach to consumer hardship.

Consumers, retailers, media, government and policy makers have all been acutely aware of the cost of energy and the dire consequences of disconnection. In this context the Essential Services Commission of Victoria (ESC) and the Australian Energy Regulator (AER) embarked on a reform process to improve outcomes to consumers. While both regulators found the poor customer outcomes were not a result of widespread retailer non-compliance [13] the approaches differed markedly.

While it is too early to adequately gauge the effectiveness of either, it is telling that the AER developed and implemented an approach with broad agreement from consumer groups and retailers while the ESC's process is mired in stakeholder discontent and has elicited condemnation from both retailers on the basis that is costly, unworkable and will lead to poor consumer outcomes; and consumer groups on the basis that "the Commission has made a mistake in proposing this framework. We believe the negative consequences for people's lives far outweigh any marginal benefits it provides".[14]

The contrasting approaches to the same issue show the benefit of moving to a national regulator. In approaching the issue the AER consulted with stakeholders regularly and drafted the final outcome in full visibility of all parties. This highlights the AER's understanding that consumers and retailers ultimately have a shared objective in ensuring the energy is affordable for consumers and that consumers are provided with realistic options to manage their debts.

The approach from the ESC on the other hand did not give retailers and consumer groups the opportunity to work together to achieve an outcomes or to explain the regulator the reality of issues which they were attempting to address. Not only has was the draft decision universally condemned, but the process itself has been labour intensive and costly for all parties in spite of the fact that an alternative which has satisfied stakeholders exists under the national framework.

As highlighted in this submission, this approach to policy making and regulatory reform is endemic in Victoria and is the leading cause of any degradation in consumer outcomes.

[13] Essential Services Commission 2016, Supporting Customers, Avoiding Labels. Energy Hardship Inquiry, Final Report, February 2016 P10. Australian Energy Regulator 2015, Review of Energy Retailer Hardship Policies and Practices, January 2015 P3.

[14] VCOSS submission – Amendments to the Energy Retail Code, November 2016 P14.

Appendix B

Case Study – OFGEM's regulation of the UK retail energy market.

In February 2008, the Office of Gas and Electricity Markets (Ofgem) the UK market regulator announced its concerns about price differentiation and the potential impact that it was having in undermining competitive outcomes through a review which was to lead to the development of regulatory mechanisms to assist customers to navigate the market.

The final outcome of the review was a range of well-intentioned measures to promote the rights of consumers in the market and protect those who it was deemed were paying too much. These measures included:

- An annual statement comparing the customer's tariff to alternative tariffs available from their retailer;
- An annual prompt to all customers of how to switch provider;
- A price metric to allow customers to compare prices;
- Addressing 'unfair' price differentials.

While these measures were heralded as a win for consumers, the proof was in the pudding and Ofgem's own analysis showed that in the period from 2009-2012 indicates that EBIT margins on domestic supply increased from 0.9 per cent to 4.3%.[15]

Prompted by this and under uncomfortable realities which had arisen as a result of the new regulatory measures, Ofgem introduced further regulation to address the issue.

In order to promote customer engagement and understanding of the market, retailers were limited to offering 4 tariffs per fuel per payment method. These tariffs were required to have a standard two part, fixed and variable structure (the fixed component could be set to £0.00) and any discounts had to be expressed in pounds rather than percentages. Lastly, customers on tariffs which were no longer generally available to new customers had to be transitioned to the retailer's cheapest open tariff.

A further review of the market announced in 2014, this time to be undertaken by the Competition and Markets Authority made further findings which elicited a submission from 5 former Ofgem Chairmen stating "The CMA has provisionally found that the regulatory interventions have had an adverse effect on competition. Rather than… seeking other burdensome but ineffective remedies for that, and rather than introducing new price controls…, we encourage the CMA to respond to…by focusing on "removing unnecessary regulatory burdens on businesses wherever possible", thereby "allowing dynamic competition to flourish … for the benefit of customers".[16]

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[15] Ofgem 2012 State of the Market Assessment p108.

[16] Littlechild, McCarthy, Marshall, Smith and Spottiswoode, 2016