



EnergyAustralia

LIGHT THE WAY

28 November 2017

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Dear Mr Sims

Submission to the inquiry into retail electricity supply and pricing following the Preliminary Report

EnergyAustralia is one of Australia's largest energy retailers with more than 2.6 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate an energy generation portfolio across Eastern Australia, including coal, gas, and wind assets with control of more than 4,500MW of generation in the National Electricity Market (NEM).

We welcome the opportunity to comment on the preliminary report on the inquiry into retail electricity supply and pricing (Preliminary Report) recently released by the Australian Competition and Consumer Commission (the Commission).

The Commission's Preliminary Report, by necessity, covers a broad range of energy market issues and the inquiry has received a significant volume of data over a short period. We support the objectives of this inquiry and believe that the breadth of data that has been provided will assist the Commission in undertaking a thorough analysis. Until that analysis is completed, we believe it is premature to conclude that there is insufficient competition in the generation and retail markets. It appears that these initial findings draw from other reviews and are not yet fully informed by the detailed data available to the Commission.

NEM generation and retail markets have evolved and changed over the ten-year scope of the Commission's inquiry. The retail market has been privatised and deregulated in stages, with each stage aimed at improving the outcomes for customers. Retail competition has delivered "*negligible positive*" retail margins in 2015-16 for commercial and industrial customers (who represent a high market volume), and low net margins for small customers given retailers' role in underpinning generation investment and the Renewable Energy Target in a time of high policy uncertainty. While we certainly agree

that further improvements to encourage competition are necessary, we don't believe that the retail market is on the wrong trajectory.

As the Commission observes, the energy retail market is exceptionally complicated. Some of this complexity is inherent to the nature of electricity and gas supply, but much of the complexity arises from the regulatory design of the market. Almost every aspect of energy retailing is defined through a complex web of national and state regulations. While most NEM States have adopted the National Energy Retail Law, all have at least some complex derogations, and Victoria has its own unique framework. Retailers cannot easily simplify their pricing, marketing or billing to help consumers because the current regulatory environment prescribes complexity.

EnergyAustralia strongly supports reforms to simplify and improve customer experience and their ability to engage with the market. The single biggest opportunity to reduce costs and complexity for customers and retailers would be to fully implement a single national energy retail framework uniformly across all NEM States. For too long this has been perceived as politically impossible, but Australian energy consumers deserve better.

The integration of the NEM States into a national electricity market has demonstrably delivered significant benefits for consumers over a long period, including high reliability, efficient investment and competitive prices. The market is currently suffering under significant stress. The key problem for the wholesale market over the decade has been protracted energy and carbon policy uncertainty and incoherence. That is, despite long running debate over these issues, we still lack a stable plan that facilitates the optimal build of generation and associated infrastructure across the entire NEM.

After 15 years of having sufficient supply capacity, the supply-demand of the wholesale market is precariously balanced following recent closures of Hazelwood and Northern Power Stations at very short notice. No market structure should be expected to cope with supply being withdrawn faster than it can be replaced. The problems with the wholesale market are clear, and the market is already responding with this recently removed capacity to be restored by 2020.

Perceived issues arising from ownership and market structure are at best secondary. It has not yet been established that factors such as market concentration, structure and vertical integration are negatively impacting on prices and effective competition. A case may be made for further reforms to competition policy, however, to address high retail prices, the key issue that must be solved is the physical lack of supply.

In responding to the Preliminary Report, we have provided additional clarification or evidence where we felt this would be useful. We have also included further discussion or proposals on ideas raised by the Commission.

If you require any further information on our submission, please contact James Chisholm on 8628 1202.

Yours sincerely



Catherine Tanna
Managing Director
EnergyAustralia

**The EnergyAustralia submission on the
ACCC inquiry into retail electricity supply and
pricing – Preliminary report**

28 November 2017

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1. Networks costs

1.1. Network over-investment and write-downs

The Commission has confirmed that the largest increase in electricity prices over the last ten years has been caused by network costs with over-investment being a major contributor to the increase in network costs.¹

EnergyAustralia has observed that governments, safety regulators or other bodies often have the power to dictate engineering standards or technologies to network companies. We agree that network over-investment could be partly addressed by requiring that engineering standards are subject to economic regulation.² While the Australian Energy Regulator (AER) may be able to assess or benchmark these recommendations before they are implemented by network companies, we believe they are often unable to reject or modify the proposed change in any significant way. This lack of integration between engineering, safety and economic decision making can lead to higher than necessary costs for customers. Given the volume and opacity of this information, EnergyAustralia is unable to quantify the over-investment resulting from this issue, but believe it warrants further review.

We also note that the Commission contemplates voluntary or compulsory write-downs where it can be determined that over-investment has occurred.³ Absent voluntary write-downs by network companies, we believe that write-downs could be challenging to achieve in practice and are likely to be counterproductive. Dr Alan Finkel has cautioned that compulsory write-downs are problematic in that this will increase creditors' perception of risk and therefore making financing more expensive and thereby increasing costs for consumers offsetting any gains in the reduction of the regulated asset base.⁴

However, we find that write-downs or impairment of the asset value of generators by energy companies has frequently occurred in response to the market and is a common element of the Australian electricity market. We also observe that over-investment has generally been greatest under government ownership⁵ and that the productivity of government-owned networks is often significantly lower than those privately owned.⁶ Government's should voluntarily and permanently write off any inefficient over-investment from the regulated asset base of the networks that they own. Write-downs should precede privatisation as it is not acceptable for Government to legislate value away from investors after they have banked the value of over-investment through a sale.

There have been several steps taken by government, the Australian Energy Market Commission (AEMC) and the AER to remove limited merits review, tighten up network regulation and improve the regulatory engagement process. Additional reviews and measures are likely to be required in future once it's possible to ascertain if these earlier initiatives have worked or not.

¹ ACCC, Preliminary Report, page 6

² ACCC, Preliminary Report, page 109

³ ACCC, Preliminary Report, page 153

⁴ Dr Alan Finkel, Blueprint for the Future: Independent review into the future security of the National Electricity Market, June 2017, page 136

⁵ AER, Submission to the Senate Select Committee on Electricity Prices, September 2012, p6-7

⁶ AER, Annual Benchmarking Report – electricity distribution network service providers, November 2016, p15-16

1.2. Stranded assets

There is a growing risk with electricity networks that those who can afford to seek out alternatives to the centralised energy network may do so, while other customers may choose to reduce their use of grid-supplied electricity but remain connected. The danger for network companies is the 'death spiral' where they are likely to receive regulated revenue across a small number of customers who use less energy, thus further driving up regulated network tariffs, and incentivising customers to further reduce electricity supply or go off grid. Network companies are heavily regulated in terms of their revenue, tariff structure and business model and are thus less able to respond than other parts of the supply chain. This issue will become exacerbated as the reliance on traditional networks is reduced.

We are currently seeing very few customers going off-grid entirely, and this means that the vast majority of customers are still contributing to a significant portion of the network costs. Network companies have shifted more of their revenue to fixed charges over the last ten years as network tariffs are made more cost-reflective. This means that if a customer remains connected to the network and uses less electricity, there is less reduction of network companies' revenue than might have been the case.

To help solve the death spiral requires a different approach to the one we are currently taking. The policy environment should encourage networks to plan and price network access efficiently. This includes maximising economic use of the existing network, and ensuring only efficient augmentation in future. In addition, we should encourage networks to plan for an accelerated rate of load reduction and customers going off-grid; and separately to incentivise customers to reduce load or go off-grid if these targets cannot be met without intervention.

EnergyAustralia believes there are ways for distribution networks and retailers to work together to at least partly alleviate the issue of stranded network assets. This could involve initiatives to avoid augmentation or more directly alter regulated asset base, for example:

- the extension of existing trials and other programs to encourage customers to take up new technologies to minimise their contribution to network peak demand;
- partnering to provide off-grid solutions to customers where network extension or upgrade is not economically viable (e.g. those customers who are at the edge of the grid or whose local network has been destroyed by bushfire);
- voluntary agreements between networks, customers and retailers to take certain assets out of the rate base (to avoid asset stranding); and
- networks implementing commercial incentives for retailers to provide smart metering data or to configure smart meters in such a way that allows networks to incur lower costs.⁷

⁷ e.g. it seems that some networks require that we leave their controlled load devices connected when a new smart meter is installed at a customer's premise – alternatively, the network could provide an attractive time-of-use off peak price for the controlled load device and request that the time switch is set to an appropriate time period.

2. Retail costs and margins

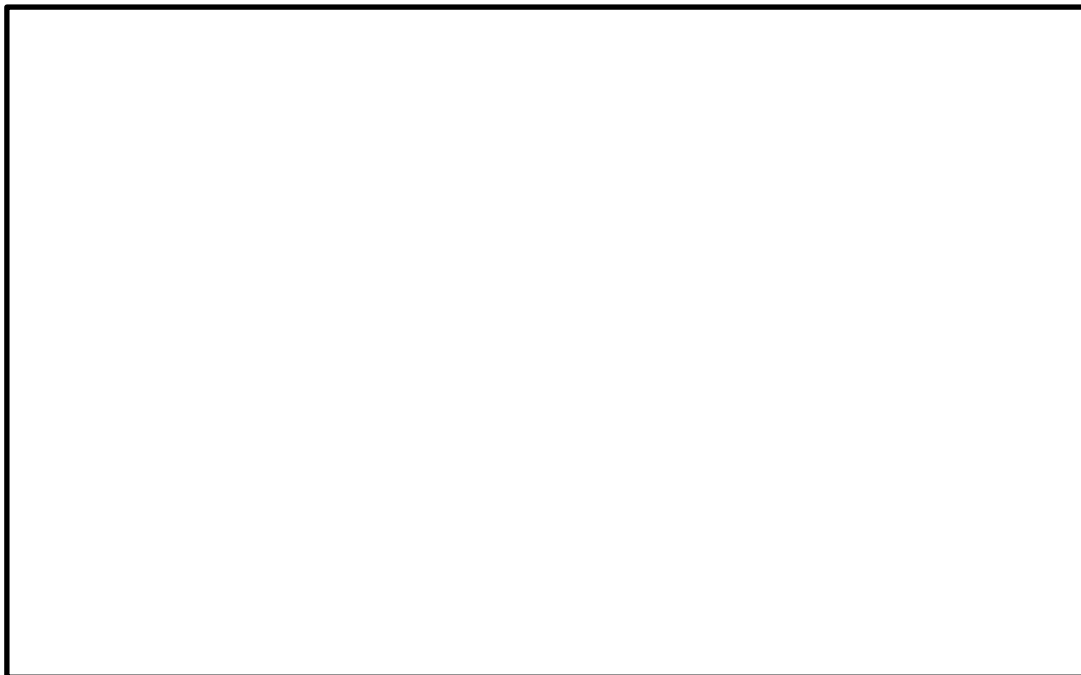
2.1. Retail costs and margins

In the Preliminary Report, the Commission has identified retail margins as one of a number of drivers of increases in electricity prices and inferred that the *"increases in gross margin could potentially be due to increase in costs or profits or both."*⁸ Our experience with increases in gross margin reflect the Commission's preliminary finding that *"it appears a lot of this is due to increases in retail costs, rather than increases in EBITDA margin."*⁹

In order to better understand margin and enable more accurate comparisons over time and between participants, it is recommended that the Commission focus on EBIT margin. Stopping at the EBITDA level excludes the costs incurred that are capitalised and then depreciated over time. Using EBIT margin would mean that comparisons made between participants or between different periods are not impacted by different business approaches or accounting policies.

A significant portion of our retail operating costs are the costs associated with developing and implementing new projects. A significant proportion of this expenditure is capitalised. In 2016, approximately █████ of our project operating expenditure was directed towards implementing new regulatory obligations an additional █████ went towards maintaining compliance with existing obligations and other routine projects (Figure 1).¹⁰ The costs associated with regulation are greatly exacerbated by having multiple overlapping regulatory regimes in different jurisdictions. Additionally, constant changes to regulations are an increasingly heavy constraint on retail innovation as well as a driver of retail cost increases.

Figure 1: EnergyAustralia 2016 projects by category (confidential)



⁸ ACCC, Preliminary Report, page 71

⁹ ACCC, Preliminary Report, page 72

¹⁰ Based on 2016 data

The industry is currently experiencing unprecedented levels of regulatory change. Implementing these changes is costly and is displacing other customer initiatives that we would otherwise implement. While some regulatory amendments may seem conceptually straightforward, they can often be very complex to set up and operationalise across our IT systems and sales and service channels. IT systems can only handle limited changes at any one time. The current volume of change means that project delivery times are lengthened as we try to absorb various new and urgent regulatory changes.

EnergyAustralia has seen a gradual and significant increase in project spend on new regulatory requirements and to keep pace with innovation and customers' expectations, for example:

- **The Victorian Government State-wide smart meter rollout** - The cost of EnergyAustralia's system upgrades to manage the increase in data was [REDACTED]. The objective of this regulatory initiative was to provide benefits to customers through lower costs and better service levels and to allow the introduction of innovative new products and offers. Victoria has since decided to allow 'flexible' time-of-use network pricing to be rolled out only on an opt-in basis. This has severely limited the take up of this type of pricing among small customers and has meant that the benefits identified at the start of the smart meter program have not yet been realised.
- **Electricity metering contestability (Power of Choice)** - Retailers are currently in the process of readying themselves for commencement of Power of Choice metering contestability changes from 4 December.¹¹ EnergyAustralia anticipates spending around [REDACTED] on this change which has necessitated significant system upgrades to allow for new market structures and processes.

For example, more than 180 existing work instructions will be updated and 150 new work instructions will be created. Over 2,000 staff are being trained to the appropriate level for their role and a specialist customer service team with direct contact in order to be available to resolve all metering related issues. More than 35 IT applications will change with around 2,000 new requirements being implemented.

This illustrates the changes required to give effect to regulatory change of this size and the consequential impact to retail costs and go some way to explain recent increases in retail margins identified by ACCC. As the project is completed it will be capitalised and depreciated over a number of years. It is important not to follow the Victorian lead and instead allow the market to evolve to realise the longer-term benefits of the investment in Power of Choice so that customers may see the benefits of meter contestability.

- **Concession changes** – From March 2014 to October 2016, new concessions and changes to existing concessions schemes in NSW and Queensland resulted in total IT system change costs to EnergyAustralia of [REDACTED].

In future, we are expecting to incur the following costs for other planned or likely regulatory or government-initiated changes:

- **Victoria Payment Difficulty Framework** - [REDACTED]

¹¹ Australian Energy Market Commission (AEMC), <http://www.aemc.gov.au/Rule-Changes/Expanding-competition-in-metering-and-related-serv#>

- **Victorian regulated time-of-use feed-in-tariff with critical peak price** – [REDACTED]¹²
- **Five-minute settlement rule change** – Approximately [REDACTED] across our retail and wholesale functions. A final decision was made on 28 November 2017.
- **NSW Energy Bill Relief Package for Households and Small Business** – Approximately [REDACTED].
- **Victorian Government Review of Retail Markets** (recommendations) - Approximately [REDACTED] in operating expenditure and a similar amount in implementation costs.

[REDACTED]

It is also important to understand that while retailers are required to undertake most regulatory changes at the same time, different retailers are at different stage in terms of their ability to absorb new changes. The costs of regulatory programs may be much smaller for some retailers than others. This is not necessarily a function of scale, and there may, in fact, be an inverse relationship between costs and scale. For instance, smaller retailers may be more readily able to give effect to new customer notification requirements because their systems are much simpler and better able to absorb the new change, whereas a larger retailer may require significant changes to systems and processes in order to effect these changes for a much larger customer base.

2.2. Comparison of retail margins

As the initial instalment of the first in depth report on retail electricity net margins, we were interested to see the Commission's findings on margins. In our view, the EBITDA margins do not indicate a lack of competition and are not higher than expected given the risks faced by retailers. The Commission's analysis of retailers' data showed "*there was a negligible positive retailer margin in 2015-16*"¹³ for commercial and industrial (C&I) customers.

EnergyAustralia supplies a large number of C&I customers and understands the difficulties that rising electricity prices put on their businesses. The Preliminary Report outlined that C&I customers found that there was "*little or no competition between offers*".¹⁴ We assume this may mean that fewer offers are available, or that not all retailers are able to offer prices close to the level of the best offer. This retailer behaviour is consistent with the low margins observed by the Commission¹³ and certainly doesn't indicate that there is a problem with price gouging by retailers.

Expected margins are linked to the risk that the organisations face, and retailers are facing higher risks than allowed for by the Independent Pricing and Regulatory Tribunal (IPART) and Independent Competition and Regulatory Commission (ICRC). Retailers are underwriting investment in renewable generation (via the Renewable Energy Target), and

¹² A final decision will be made by the Essential Services Commission by 28 February 2018. EnergyAustralia believes the cost of the critical peak price is the most problematic element. Although the critical peak price would be known, it would dynamically apply only when the wholesale spot price is greater than \$300/MWh. The cost of building and maintaining the critical peak component would likely be larger in magnitude than the total feed-in credits paid to customers. This is likely as the majority of customers receiving the feed-in-tariff have solar panels that generate very little in the late afternoon when wholesale prices usually peak.

¹³ ACCC, Preliminary Report, page 50

¹⁴ ACCC, Preliminary Report, page 22

more generally in securing generation to meet future needs. The current economic conditions and energy policy uncertainty are also sources of increased risk to retailers. Investment risk in the Australian energy retail sector is also increasing through retailers needing to alter their business models and offers to respond to technological change, and declining demand and revenues. However, these investments are not straightforward and have a high risk of failure. For example, the uptake of solar panels has gathered pace over the last decade, but most other innovations to date have appealed to niche customer groups.

In terms of EBITDA margins for small customers, the Commission says these range from 5-10% and are typically about 8%.¹⁵ We note the comparison to the margin percentages allowed by regulators, IPART (5.7%) and ICRC (5.3%) in setting regulated retail electricity prices for NSW and the ACT.¹⁶ On close consideration of the approach used by these regulators, it's inappropriate to expect that retail net margins should be at this level.

IPART took the most comprehensive review to determine their retail margin; however, this analysis is now out-of-date as it was completed in 2013. Another reason that the IPART retail margin is low is that they didn't allow for all sources of risk that retailers face. They only sought to compensate retailers for 'systematic risk', which includes the risk of variation in load profile, spot or contract prices and general business risk due to economic conditions.¹⁷ Non-systematic risks such as business-specific risks were not allowed for. Instead, IPART made allowance for costs (or benefits) arising from some non-systematic risks (e.g. uncertainties about market and policy developments over the period, etc.) under a cost pass through mechanism.¹⁷ The cost pass through mechanism allowed unforeseen cost increases over a certain threshold to be passed through in the next year's retail regulated prices.

ICRC regulates prices for the ACT electricity and their latest margin (5.3%) is similarly an inappropriate comparison. The margin percentage has changed little since it was set by the ICRC in 2014, and that determination relied heavily on the work of IPART's consultant, SFG Consulting, who completed their last review on retail electricity margins in mid-2013.^{18,19} The ACT electricity retail margin was higher last year (6.04%), but ICRC has made a call to select a margin at the lower end of the range for the 2016-17 year.

So, if net margins less than 6% are inappropriate, where should the Commission expect to see retailer margins across the NEM? To answer this, we reiterate the points we made in our initial submission to this review:

"In trying to understand margin levels and trends within the industry, and particularly for the large three vertically integrated retailers, we've looked at the

¹⁵ ACCC, Preliminary Report, page 75, 24 respectively

¹⁶ ACCC, Preliminary Report, page 75

¹⁷ Independent Pricing and Regulatory Tribunal (IPART), Review of regulated retail prices for electricity, 2013 to 2016, Electricity - Draft Report, April 2013, page 78

¹⁸ Independent Competition and Regulatory Commission (ICRC), Standing offer prices for the supply of electricity to small customers from 1 July 2017: Report 6 of 2017, June 2017, pages 34-36. SFG Consulting, Report to IPART, Estimation of the regulated profit margin for electricity retailers in New South Wales. 4 June 2013.

¹⁹ The Queensland Competition Authority (QCA) "consider it may no longer be appropriate to continue with this approach, given that many comparable jurisdictions (including NSW and South Australia) have removed retail price regulation in recent years." QCA, Final Determination: Regulated retail electricity, May 2016, page 24 prices for 2016-17

Return on Invested Capital (ROIC) as a proxy. The ROIC of the three major retailers over the last six years ranges from 2% to 8.2%, with the weighted average being 4% to 5.7%. Over the same period the average Weighted Average Cost of Capital (WACC) was 8.02%. Whilst this analysis is NEM wide, with most jurisdictions now fully deregulated it shows that the major retailers are not covering their investment costs.”²⁰

This analysis doesn't point to an expected percentage for EBITDA net margins, but if average net margins across the industry are 8% and the largest three retailers are collectively not earning returns at or above their weighted average cost of capital, then margins are certainly not too high.

3. Wholesale costs

The Commission's independent review and insights into wholesale costs and their contribution to overall customer energy bills provided some valid observations, but we have elaborated on some of the less obvious, but material factors affecting wholesale costs.

We certainly agree that:

- spot prices do not directly determine wholesale costs for retailers;²¹
- contract prices are generally seen to be a premium to expected spot outcomes;²² and
- retailers' wholesale costs differ due to the timing and manner in which they hedge their retail load (or purchase directly from the spot market).²³

Notably, absent from this discussion is any mention of the costs attributable to the shape of the consumption profile (usually referred to as 'load shape' or 'load profile') of a customer base. IPART noted in their review of regulated prices (2013-2016) that:

"The regulated load profile is important because it affects the cost of providing electricity to customers. In general, the more 'peaky' the regulated load profile, the more expensive it is for a retailer to supply the electricity.”²⁴

The simplest way to think about this is that purchasing a flat swap contract for a certain number of megawatts across a time period to hedge a customer's load is only appropriate if that customer has a flat profile (i.e. uses the same amount of power constantly). This is only rarely the case. For any other customer, the retailer would be theoretically better off by only buying contracts that fit the shape of the load at each point in time (otherwise they will have over-hedged or under-hedged). The supply and demand nature of electricity means that that prices (spot or contract) are often highest when demand is high. This means that a customer who uses more electricity when

²⁰ EnergyAustralia, Submission to the inquiry into retail electricity supply and pricing issues paper, 30 June 2017, page 26

²¹ ACCC Preliminary Report, page 53

²² ACCC, Preliminary Report, page 60

²³ ACCC, Preliminary Report, Box 2.5, pages 55-56

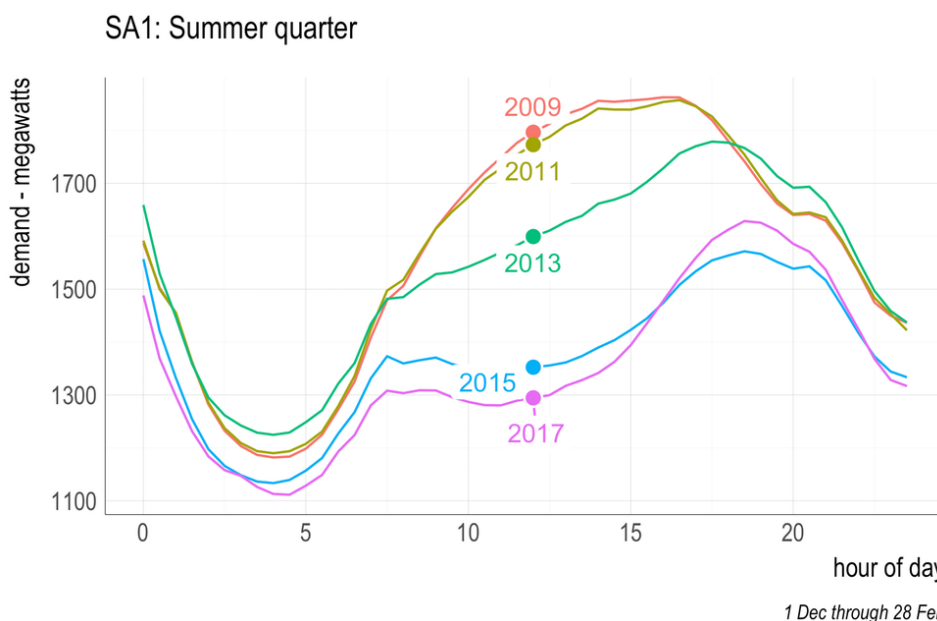
²⁴ IPART, Review of regulated retail prices and charges for electricity: From 1 July 2013 to 30 June 2016, Electricity - Final report, June 2013, page 58

demand is high will create higher wholesale costs for their retailer than a customer with a flat load, or a customer who is using most electricity at off peak times.

While every retailer is likely to account for these 'shape costs' in a different way, they represent a significant portion of electricity wholesale costs. We've also seen changes in the shape of the load profile for large customers or across a group of small customers be a contributor to retail price increases.²⁵ The change in load profile observed for small customers in NEM States is typically that demand is increasingly lower in the middle of the day (due to the effect of solar generation), and the late afternoon demand peak is increasing sharper and higher (see Figure 2).

This sharper afternoon peak demand frequently coincides with high spot prices and this makes it more expensive for retailers to supply South Australian customers each year. Note that this correlation of peak demand and spot prices is the underlying reason for the prices and occurs despite the small drop in the average peak demand. As noted in Figure 2, the peak demand seen on very hot summer days in South Australia is much higher and, contrary to average peak demand, the maximum peak demand has increased. The higher shape cost effect is also seen regardless of the manner in which the retailer purchases electricity as expected spot prices for these periods are linked to the prices of cap contracts or other hedging products a retailer may use, and the cost of the running higher marginal cost generators to meet the peak demand.

Figure 2: South Australia averaged summer demand 2009-2017²⁶



"The plot of averaged demand by time of day, for the summer quarter, helps illustrate the way the uptake of domestic solar PV has impacted demand for grid base electricity, reducing midday demand by ~ 30% (~500 megawatts) on average."

²⁵ The contribution of the shape effect to retail prices increases was also noted by ESCOSA in mid-2017 in their letter to the South Australian Treasurer. ESCOSA, Advice to the Treasurer on 1 July 2016 South Australian retail electricity price increases, released 9 June 2017, Finding 5, page 4

²⁶ Mike Sandiford, University of Melbourne, first published on The Conversation, 20 February 2017, <https://theconversation.com/the-anatomy-of-an-energy-crisis-a-pictorial-guide-part-2-65206>

The other costs that are associated with wholesale costs and may be grouped together differently by different retailers include losses, ancillary service charges and fees. Together they are typically a smaller amount than the shape costs, but are still a source of difference between observed spot prices and retailers' wholesale costs. Another component to be considered are the credits paid to customers for their solar and other distributed generation.²⁷ The way different retailers treat or categorise these costs may also contribute to the differing wholesale costs between retailers and therefore to differing retail margins.

4. Generation market

4.1. Hazelwood Power Station closure

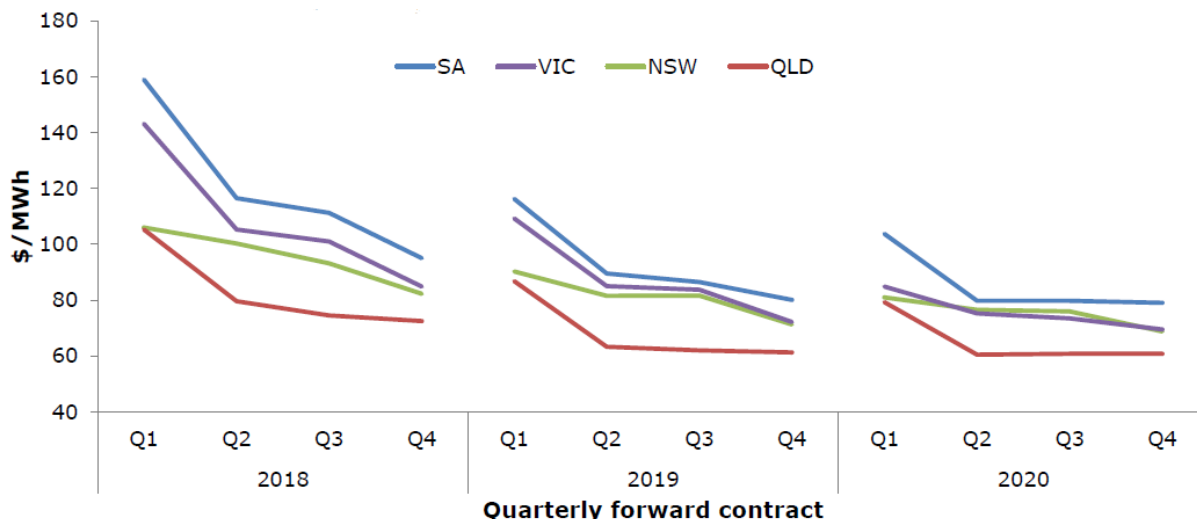
The Commission discusses the closure of Hazelwood Power Station in Box 3.2 of the Preliminary Report and makes some initial comments about price movements that are yet to be reviewed by the AER in their report to the Council of Australian Governments Energy Council in April 2018. The Commission appears interested to understand why wholesale contract prices in Victoria remain high now that prices have reduced following the immediate impact of the closure of Hazelwood.

In EnergyAustralia's view, futures contract prices are still higher than the long-term average and can be explained by the market conditions in southern Australia. Hazelwood was one of the cheapest sources of baseload electricity in the NEM, and its closure has meant that more energy is generated by higher priced generators. We note that Q1 2018 is the first quarter without Hazelwood and that the Victorian Q1 2018 forward swap is currently trading at \$149/MWh (Figure 3). The corresponding Q4 2018 swap is at \$84/MWh and is closely aligned with spot out turns in this current quarter (Q4 2017). In addition, as the Commission is aware, gas prices are currently very high and this is driving up the costs for gas powered electricity generation. Current prices indicate there is a fundamental shortage of supply – not a lack of competition. There is vigorous competition in the electricity market, and high prices can only be addressed by dealing with the physical supply issues.

The current high swap contract prices for Q1 2018 for Victoria and South Australia are due to a forecast reserve shortfall. This high price level is partly due to the closure of the Hazelwood Power Station removing 1,600MW of capacity from the market. While steps have been taken to provide back-up generation over summer, a combination of differing views on the likelihood of a supply shortfall, AEMO intervention and differing risk appetites have increased contract prices in Victoria and South Australia to higher than usual levels. Looking at future years, swap prices are expected to fall across corresponding quarters; that is the market is in backwardation of around \$30/MWh (Figure 3). This trend appears to be due to new renewable generation coming online in future years and alleviating the shortfall issue. Current cap contract prices however, are barely at new entrant level and hence do not similarly reflect the reserve shortfall.

See also: AEMO: South Australian Electricity Report, November 2017, http://www.aemo.com.au/-/media/Files/Electricity/NEM/Planning_and_Forecasting/SA_Advisory/2017/South-Australian-Electricity-Report-2017.pdf, pages 14-15

²⁷ Regulation of feed-in-tariffs have been increasingly removed, but notably are still regulated in Victoria where retailers pay more for customers' exported generation than the energy would be worth in the wholesale market.

Figure 3: Quarterly swap prices (1 November 2017)²⁸

We previously outlined the factors affecting electricity supply and wholesale prices²⁹ and that in times of supply contraction, there is a temporary period in which prices are higher that has the effect of attracting new generation, after which prices reduce again. This is exactly the pattern we're seeing now. Comparing the current period of high wholesale prices with the last time that prices peaked (2007-08), we observe that:

- both periods are around 18 months in length; but
- wholesale prices in the recent period have been even higher due to the effect of high gas prices, renewable energy targets and energy efficiency schemes and policy uncertainty that weren't present in the earlier period.

In between these peak periods, there were periods where wholesale electricity prices were so low that some generators mothballed units or closed altogether.³⁰ Changes to the market that seek to constrain high wholesale prices need careful evaluation as they have the potential to exacerbate these low-price periods, discourage new entrants and to hamper the move to a cleaner energy mix.

Apart from the factors discussed above, it is possible for structural or behavioural factors to influence price levels, but very complex to quantify the impacts of all the individual contributing factors and individual participants. We therefore urge the Commission to fully assess generation market trends with detailed input from the AER.

4.2. Bidding in good faith

When energy providers were considering the rule change, there was a large concern that spot trading teams would be so overwhelmed with recording details about their decisions

²⁸ Daily Electricity Curve, 1 November 2017, provided by GFI, Australia Pty Limited. GFI Australia Pty Limited retains all right, title, interest in and copyrights to the relevant data.

²⁹ EnergyAustralia, Submission to the inquiry into retail electricity supply and pricing issues paper, 30 June 2017, pages 5-6

³⁰ For example: Swanbank E Power Station in Queensland closed in 2014 taking 385MW capacity out of the NEM and 235MW capacity was also withdrawn from the market in 2014 at Pelican Point Power Station in South Australia. Tarong mothballed 700MW – see Courier Mail, 17 Jan 2013, <http://www.couriermail.com.au/news/tarong-mothballing-the-right-response-to-todays-market/news-story/9622ba1918cdb013de59d9fdc9ca17dd?sv=34ed73749f41275d55efe19f48aae307>. AEMO, South Australian Fuel and Technology Report, January 2015, http://www.aemo.com.au/-/media/Files/PDF/2015_South_Australian_Fuel_and_Technology_Report.pdf, page 10

to change bids, that they would be unable to adequately focus on monitoring the market and updating bids during periods of intense activity in the market. Bids are valid for five-minute periods and must reflect the ability of each of the generation units to meet the offered generation if AEMO accept the bid and sets a dispatch target for that unit. There is an enormous amount of risk if bids do not accurately reflect the capabilities of each unit of the generation fleet required to run and balancing this with the need to generate for contracted volumes and/or retail load.³¹

In relation to the bidding in good faith rule change, the Commission also comments that:

"AER does not have the power to require any individual involved in conduct to appear before it and give oral evidence. This is a significant deficiency in the AER's powers in this context.

The ACCC considers that in order for the AER to effectively investigate and deter unlawful conduct in the wholesale market, amendments should be made to enable the AER to require individuals to give evidence before it, similar to the ACCC's powers under section 155(1)(c) of the CCA."³²

EnergyAustralia does not believe that such a step is necessary. This is a new rule change that has only been in effect for slightly more than 12 months. There are a set of amended regulations and new guidelines that generators must comply with and the AER has been active in engaging with the market to ensure that the requirements and expectations are clear. This means that AER now has available a great deal more information on bidding practices of generators than they have had in the past. Further, early analysis of bidding practices following the introduction of the rule change indicates improvements, such as the reduced incidence of last dispatch interval bidding driving price spikes.³³

The records generators are required to capture are contemporaneous, detailed and contain information of the timing of the relevant events and qualitative information (about market conditions and the decision to change a bid close to the dispatch interval). There are already penalties for both companies and individuals who do not comply with these provisions and these are significant deterrents. Giving the AER additional powers to require individuals to give evidence is unlikely to provide anything more than is already captured in the contemporaneous record. In addition, it doesn't appear that any generator is contravening the new bidding in good faith rules, so these powers appear disproportionate.

We consider that the Commission's current powers to investigate and enforce under the Competition and Consumer Act power are sufficient. If the behaviour under investigation appears to be anti-competitive or involve a misuse of market power then the Commission can investigate relying on those current powers.

³¹ It also appears not be to widely known among stakeholders of this inquiry that generators are frequently running at negative prices or prices lower than their short run marginal cost, and so must run above their short run marginal costs when they can to achieve adequate returns (including long run costs).

³² ACCC, Preliminary Report, page 94

³³ Russ Skelton & Associates, Report for the Australian Energy Council, 5-minute settlements – Assessing the Impacts, Submission to AEMC 5-minute settlement rule change directions paper, March 2017, pages 10-11

5. Vertical integration

In our earlier submission, we outlined why vertically integrated participants may take a different approach to hedging than non-vertically integrated participants. These differences are not a cause for concern.³⁴ In reading other submissions and commentary on electricity prices recently, we do not believe that there is a good appreciation of the role of vertically integrated electricity providers (known as 'gentailers'). In simple terms, as a gentailer, we will have incentives to maximise the supply of generation as we are primarily defending a price position for our retail customers. In certain circumstances, this will even create incentives to operate certain generation assets in our portfolio at a price close to or even below short run marginal cost. In contrast, a stand-alone generator is unlikely to have such incentives and instead can be expected to undertake price/volume trade-offs that can increase the market price outcomes, particularly during periods of high demand and/or low supply.

EnergyAustralia has had a strong history of making contracts available to both the market and retail customers and it cannot be assumed that a stand-alone generator would behave in the same way, particularly if they are incentivised by short term profit maximisation. EnergyAustralia generally contracts all excess capacity (i.e. capacity we do not require to mitigate outages and meet retail load). This has provided liquidity in the futures market and enabled other market participants to effectively hedge against spot price volatility for their retail portfolios.

The biggest challenge currently facing the wholesale electricity market is to deliver timely investment in the new generation capacity needed to maintain reliability, put downward pressure on prices and reduce emissions. Australia has an aging generation fleet and faces large scale closures over the next 10-15 years, the investment challenge is significant. Policy makers should be very cautious about imposing additional barriers to investment and/or limiting the pool of potential investors in this context.

6. Customer engagement

6.1. Changes to consumer protection regulatory frameworks

In section 4.6 of the Preliminary Report, the Commission briefly outlines the changes to the consumer protection framework being introduced to the UK energy sector and anticipates reviewing whether similar principle-based regulatory changes should be made to Australia's National Energy Retail Law (NERL). EnergyAustralia supports a review of the NERL, and National Energy Retail Rules³⁵ as well as the corresponding Victorian instruments (Energy Industry Act 2000 and the Energy Retail Code³⁶). This inquiry should seek to establish a single retail regulatory regime across the NEM States. If this cannot be achieved then further harmonisation is a critical, but inferior approach.

Where there are identified difficulties or detriments for customers under current retail market practices, then changes to these frameworks can help to uplift and maintain

³⁴ EnergyAustralia, Submission to the inquiry into retail electricity supply and pricing issues paper, 30 June 2017, pages 8-9

³⁵ There is a complex web of laws, regulations, guidelines and procedures across the NEM, see: AEMC, Interaction between National Energy Customer Framework and jurisdictional statutory instruments for ACT, NSW, Qld, SA, Victoria and Tasmania (as at 1 August 2017), <http://www.aemc.gov.au/Energy-Rules/Retail-energy-rules/Guide-to-application-of-the-NECF#What%20is%20the%20NECF>

³⁶ <https://www.esc.vic.gov.au/container/energy/29290-energy-retail-code-2/>

standards. It's advisable that these frameworks are reviewed periodically where there are changes occurring in the market (i.e. to business models, entry of new and non-traditional retailers, and to technology). We note there has not been a comprehensive review of the National Energy Consumer Framework since it was introduced in 2012-13.

Recently, there have been many regulatory consultations around retail exemption frameworks across all NEM States. These have sought to clarify the different regulatory standards and frameworks associated with non-traditional retailers. EnergyAustralia's position on these reviews is that creating a level playing field is important for competition and supporting customers' needs. Many retail-like entities on the periphery of the industry are in competition with traditional retailers, but are exempt from ensuring their customers have access to Ombudsman schemes and rebate (concession) schemes and are excluded from having to comply with certain consumer protection regulations.

There are many ways in which these frameworks can be updated to resolve the issues outlined above, but in our view, any effective review of regulatory frameworks should consider: how the energy industry is evolving; what issues ought to be addressed to achieve the desired end state; and where the line should be drawn between the energy industry and other industries that retail to customers on energy-related products or services.

Arguably, where there have been few identified customer-facing problems or issues with competition, there may be grounds for a reduction or removal of energy-specific regulation. Where there is still a need for regulation, it would be beneficial to consider whether the regulations could be less prescriptive to allow for innovation, a variety of business models and a range of methods of delivery of products and services to customers. For example, the content of retail energy bills is highly regulated, but they confuse customers and retailers are unable to make any substantial improvements. Replacing bill content regulations with a higher-level requirement that bills must be clearly laid out and understandable to an average customer may be a more appropriate and effective way of drafting the regulations.

The change to the regulatory frameworks being rolled out in the UK is founded on a principles-based regulatory approach. The Commission gave the example that one of the enforceable principles being introduced in the UK is 'fairness'. While this will likely meet consumers' needs, it also comes with several difficulties that do not appear to have been ironed out yet in the UK. These challenges are:

- **What are the activities that the fairness test or other principles would be applied to?** There is a possibility that regulatory coverage could be extended to new and unintended areas if not well thought through? For example, would bill increases be seen to contravene the fairness in pricing test if a customer had reduced their usage? When is it fair for a retailer to cease supply to a customer who had been avoiding paying their bills, and when is it not fair?
- **Is each principle clearly defined?** Retailers are very conscious of their compliance obligations and typically see a high risk in setting up systems and processes to meet a standard that the regulator will not deem compliant. This could be costly and risk not meeting the intended objectives of introducing a principles-based framework. It is clear from the UK submissions to Ofgem, that retailers are currently uncomfortable with what a 'fairness test' entails and how it would be applied in practice. We find that we and all other retailers are having very similar discussions with the Essential Services Commission of Victoria on

their new Payment Difficulty Framework.³⁷ How can a clear line be drawn and communicated to everyone without leading to an influx of customer complaints and driving up compliance review effort for retailers and the regulator?

- **There will inevitably be a step change in moving to any vastly different regulatory framework.** If the first two issues are not resolved effectively, then retailers will initially need to guess at what they need to comply with. Possibly, these issues will resolve as regulated parties and the regulator get used to the new regime, but it is damaging to consumers and industry if a regulatory framework is working effectively for any significant length of time.

Given the issues above and our first-hand experience of considering the vagaries of trying to comply with a principle like 'fair and reasonable', we urge caution in how a principles-based framework is set up.

One recent, positive example of the introduction of a new regulatory framework, is the approach used by the AER in setting up their Sustainable Payment Plans (SPP) Guideline.³⁸ This is an optional guideline that retailers sign up to and provides an incentive for retailers to underline their commitment to do the right thing by customers. It allows retailers to define the lower level details of how they will meet the principles outlined in the guideline. This guideline is very different to the Essential Services Commission of Victoria's (ESC's) Payment Difficulty Framework. The AER SPP Guideline was considerably easier to establish and implement, better balances the cost of regulation against its objectives, and could be more readily developed if a subsequent review shows that it's not working as intended.

6.2. Commercial comparators

While comparator sites are only one of many sales channels retailers use, they remain appealing to customers because they are readily accessible on the internet and offer an easy-to-use interface to facilitate comparison of offers from many energy retailers. There is a risk though that customers place more faith in this comparison than is warranted, or that comparators are exempted from the retail requirements that apply to retailers around the marketing of offers. This may lead to the information not being presented by comparators in a simple, open and transparent way.

To avoid this risk, we share the Commission's view that further refinement of the Energy Comparator Code of Conduct (ECCC) could ensure that commercial comparison services are improved for consumers. EnergyAustralia understands that there are currently nine signatories to the ECCC; an initiative developed by the Consumer Policy Research Centre (previously the Consumer Utilities Advocacy Centre) with the objective to improve online comparator practices.

Retailers have extremely stringent regulatory requirements with respect to how offers are presented, the information made available on our website, translation services, and transparency around offers, discounts fees, etc. We appreciate this information is required to ensure customers can make informed decisions and we agree it is in the best

³⁷ Essential Services Commission (Victoria), Submissions to the Draft guidance note – Payment difficulty and disconnection, Nov 2017, <https://www.esc.vic.gov.au/document/energy/54913-draft-guidance-note-payment-difficulty-disconnection/>. We note that the Payment Difficulties Framework is a typical prescriptive set of regulations and is not a principles-based framework. However, it does include the principle of 'fair and reasonable' treatment of customers.

³⁸ Australian Energy Regulation, AER Sustainable Payment Plans Framework, <https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/aer-sustainable-payment-plans-framework>

interests of customers. Comparators, should not be held to a lesser standard as they play a significant role in assisting customers navigate the retail market.

We support a significant review of the ECCC to ensure it meets the Commission's guide for comparator website operators and suppliers, as well as the guidelines for developing effective voluntary industry codes of conduct. As a minimum, we agree that the ECCC should:

- outline all relevant affiliations;
- outline clearly the basis for the recommendation to customers;
- disclose all the commissions and fees for the services provided, including disclosure of the structure of those commissions and fees and the effect that commissions have on the recommendation to customers;
- include complaints handling procedure or penalties for non-compliance; and
- improve transparency and positive outcomes for consumers (e.g. reduce the possibility of misleading behaviour).

6.3. Concessions

Providing support and effective solutions for vulnerable customers is a priority for EnergyAustralia. We are pleased to see that the Commission has prioritised concessions as one of three areas where it considers immediate action should be taken.³⁹ Concessions form part of the social welfare system provided by State governments to assist eligible customers with their energy costs. Currently these payments are credited to the customers' energy bills by energy retailers in accordance with administrative agreements between each State government and retailers.

Each State has its own regulatory concessions framework and the structure of concession varies considerably between them. EnergyAustralia administers approximately 19 different concessions across NEM States using our customer contact and billing system. This adds significant additional complexity to the required functionality of the system because the key design parameters of these programs are different. The cost of providing and maintaining the billing system is significant and is directly related to level of operational complexity required. These costs are shared across the entire customer base as reflected in customer bills.

Given the fundamental objective of each of the different concessions is to support vulnerable customers there are clearly opportunities to create administrative efficiencies (and therefore reduce costs to customers) by harmonising the State-based concessions frameworks. However, we query the more general role of retailers in administering welfare payments on behalf of government. At the very least we believe there should be a comprehensive review of energy concessions schemes and a move towards a streamlined national approach. Our view, as discussed below, is that a more tailored concession framework is better administered by government agencies.

Given the changing nature of the energy market it would also be reasonable for a review to assess concession schemes to determine if they are appropriate or if another form of social welfare would better support consumers to manage living costs.

³⁹ ACCC, Preliminary Report, pages 155-156

6.3.1. National harmonisation of concessions

If the administration of the concession frameworks is to remain with retailers, then EnergyAustralia recommends that all NEM States take steps to identify options to harmonise the delivery to concessions customers to achieve improved outcomes for concessions customers, reduce retail costs for retailers and improve efficiencies for governments.

Currently, the operation of jurisdictional concession programs carries a significant cost for retailers. With different concessions programs for each State, the administrative and cost burden of audit programs is significant and fundamentally inefficient. These costs are passed back to customers via retail charges. The scheme rules are sometimes vague in interpretation and difficult to apply in practise. Over the period from 2012-2016, despite operating our concessions programs in good faith, we estimate the cost of compliance was in excess of [REDACTED].

National harmonisation of concessions programs would involve making the rules, calculations and processes consistent across all States across the following elements:

1. **Structure of concessions** - EnergyAustralia supports a single concession design across all NEM jurisdictions. From a welfare perspective, we do not have a preference on the concessions structure that will be of most assistance to customers.

A daily rate does not discriminate against energy efficiency or solar generation and provides a minimum level of support for vulnerable households. All States except Victoria currently utilise a fixed daily rate. The benefit of a fixed daily rate over a percentage is the ease of calculation, predictability and simplicity of communication to customers. While a percentage calculation is conceptually simple and may improve equity, it is still confusing for customers. For example, customers may not understand what dollar rebate to expect, or if the rebate is calculated before or after GST, discounts or other components of their bill (e.g. charges associated with a meter technician visit).
2. **Eligibility** - There are currently vast differences between States in eligibility rules and these would ideally be consistent. Many schemes have detailed requirements around the back-dating of concessions that could also be streamlined.
3. **Verification** - We support the process currently undertaken by most States where the customer provides their retailer with concession card details. Retailers then verify the data with Centrelink and make automated payments. The number of different systems and the lack of automated interfaces complicate the initial and ongoing verification check to provide customers with the concession that they are entitled to. This results in poor customer experience, increased administrative overheads and greater risk of errors between the retailer and government departments. A nationally consistent verification process would reduce administrative complexity, improve the customer experience and minimise the scope for errors.
4. **Administration of concession agreements** - All States have different concession agreements that outline the rules above and any reporting or audit requirements. Each agreement must be separately executed and monitored. Ideally, the agreements would be coordinated and consistent across jurisdictions and seek to minimise administrative overheads. Although, it would be acceptable if the concession rates differed by State.

6.3.2. Suggested changes to concessions frameworks

An alternative to seeking national consistency is to remove the State regulated concession framework from the remit of a nationally regulated market. Historically, the energy concessions framework was managed by the relevant State government in their capacity as State-owned retailer energy enterprises. However, as there are now a large number of retailers, the associated State-based concessions frameworks have in concert transitioned to a privately administered welfare system, the administration costs of which are funded by the entire customer base. We believe that State governments should revisit this situation and consider returning to providing concessions to customers via a government-administered system. This could perhaps be achieved through a central body such as Centrelink or the Australian Tax Office, which already receive a great deal of information about customers that is relevant to their welfare status.

Key benefits to customers and governments in moving to a government-administered energy concessions framework include:

1. **Ability to tailor concession to individual customer circumstances** – e.g. income levels, household situation, health needs, number of children etc.
2. **Reducing retail costs** - The current administration of concessions schemes is very inefficient, meaning customers are paying more. Any energy retailer with residential customers must each create systems and processes to make concessions available to customers and therefore the overheads in managing the concessions framework proliferate accordingly. Reducing the number of organisations in the 'business' of providing, verifying and claiming concessions will not only reduce the current costs of delivering concessions, but will also ensure customers receive prompt relief.

Recently the NSW government announced a regulatory reform package which aims to improve the affordability of energy for concessions customers. While we see the clear benefit to these groups of customers we note that the increased rebates are accompanied by extensive new reporting obligations requiring retailers to implement significant system upgrades to enable this reporting to occur. A stated aim of the new reporting obligations is to assist the NSW government identify whether its concession scheme is appropriately targeted. An alternative view is that if these schemes were administered by the State, then they would have the information necessary to analyse the effectiveness of the welfare system.

3. **Improving the privacy of customer information** - Much of the information attached to the delivery of concessions is sensitive and private information. This information is not core to the business of retail energy companies. Customers too would prefer not to give this information to an energy retailer. The sharing of customer data with additional parties, as the customer moves retailers, increases the likelihood of a privacy breach. We contend that the governments that have designed the welfare system and the associated eligibility criteria are best placed to administer concession schemes. Governments bodies are also better placed than retailers to promptly identify and contact customers who are missing out on assistance.
4. **Barrier to switching retailers** - We also note that the current administration of the concession frameworks creates a barrier to switching for concessions customers. The extensive information such customers must provide to a retailer

(each time they switch) to satisfy the concessions requirements, means that it may be easier for a customer to remain with their existing retailer. This disadvantages those who may want to shop around.

While we appreciate that handing back the administration of the concessions framework will mean additional work for governments, it will achieve reductions in other regulatory areas (e.g. the audit and compliance functions). In any event we think there is scope for governments to align this work with other existing welfare systems at minimum cost to the taxpayer (and reduce cost to all electricity customers). The costs of concession schemes should also be part of the scope of a national review into concessions.

Removing the State-based concession customers from retailers, will also reduce the need for States to agree a nationally consistent framework. Each State can continue to manage the concessions amounts directly with their constituents and in accordance with their budget requirements, removing the need to work with all retailers with residential customers to ensure they comply with the requirements.