

Mr Rod Simms
Chairman
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601

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Submitted electronically to: retailelectricityinquiry@acc.gov.au

Dear Mr. Simms

Thank you for the opportunity to provide a submission in response to the Issues Paper for the Inquiry into Retail Electricity Supply and Pricing.

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

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

Introduction

While characterised as a policy area in its own right, energy sits firmly at the crossroads of a broader range of considerations. Economic, social and environmental factors all shape the debate on energy policy, and unfortunately, in recent times, politicisation and not just policy has weighed heavily on the regulation of the energy market. Attempts to address all of these elements, while well intentioned, have led to conflicting policy outcomes and the creation of frameworks where generation, network and retail prices are higher than desirable.

As the intermediary between the end user and the entire upstream energy market, retailers face a range of costs which relate to activities well beyond simply charging for the electrical energy a customer uses. As such, the focus of media and political attention is on the end price faced by consumers, often with insufficient analysis of the constituent components of this price or the factors which influence the price. Furthermore, much of the analysis which breaks retail electricity tariffs into its components of wholesale, network and retail pays only scant attention to exactly what the customer is getting for their money.

Energy Costs

Australian's have traditionally enjoyed relatively affordable and reliable electricity supply. For the majority of this century, wholesale prices have been relatively stable however, policy uncertainty, particularly with regard to the Renewable Energy Target, since around 2013 has driven increasing volatility, leading to a situation where the forward price for energy currently sits at around \$100 per MWh. The wholesale price reflects the underlying value of the commodity being traded and consequently is the initial building block on which retail prices are set.

Retailers manage wholesale risk and insulate customers from price volatility. This is done by contracting with suppliers in advance in order to manage the variability in wholesale spot prices. To minimise their exposure and ensure that their supply covers their load profile, retailers include a mixture of long-term and short-term contracts as well as contracts for base load and peak periods. It stands to reason that the greater the volatility in markets, the greater the premium demanded in such contracts to ensure that retailers (and by extension their customers) are adequately protected.

While analysis of wholesale prices largely focus on average spot prices over a period of time, the price of forward contracts is a more appropriate estimation 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 in one go to service their retail portfolio as the quantity of energy required cannot be 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. 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.

Momentum agrees with the assertion that retail prices are higher than desirable but we do not consider that they have been artificially inflated in any way. 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. In a market in which the spot price can reach up to \$14,000/MWh the considerable risk that retailers take on behalf of the customer cannot be dismissed. Because of this risk, it is inaccurate to consider average wholesale prices as an

approximation of the cost of energy as a number of reports which been cited in the media have tended to do.¹

Figure 1 (below) shows the significant increase in Victorian futures prices over the past 12 months. Prices in other states have followed a similar upwards trajectory since September 2016, although they have plateaued slightly in recent times. Retailers are heavily scrutinised for increasing prices, generally once a year, despite the fact that the cost of their key input has increased steadily over the period as a result of the shift in supply demand fundamentals.



Figure 1: Source ASX

Above all, most analysis of wholesale prices treats retailers as homogenous entities and does not factor in their strategic considerations or the range of risk profiles. Generators and retailers make choices between spot exposure and hedge exposure as part of risk management in the NEM. These choices result in different costs arising from interacting with the market, however are all ultimately aimed at making each retailer as competitive as possible.

While we contend that the costs of purchasing wholesale energy in the market are generally underestimated, and acknowledge that in the current climate of policy uncertainty wholesale prices are unsustainably high, we consider that the wholesale market is generally functioning as expected within the bounds National Electricity Rules and the Australian Competition and Consumer Act. While it stands that market participants will seek to maximise revenue through their bidding behaviour, we believe that the wholesale market is governed by regulatory frameworks which allow for enforcement action against parties who seek to misuse market power.

We also note that the AEMC has implemented mechanisms to ensure the integrity of the wholesale market including the Bidding in Good Faith rule. This rule, enacted in 2016, amends provisions in the National Electricity Rules to prohibit false or misleading offers and to ensure that rebids are made as soon as practicable.

Networks

¹ 2CME 2015, A critique of the Victorian retail electricity market

In August 2012, then Prime Minister Julia Gillard attributed increases in the cost of electricity to ‘gold plating of networks’ in reference to the amount spent by transmission and distribution systems operators to ensure that poles and wires are up to the standard required to deal with very infrequent demand peaks. We agree that incentives exist for networks to overinvest in largely redundant capacity in order to maintain system reliability during critical peaks, however we have a view that this has been done to the expectations of Australians about reliability and has been facilitated by the regulatory frameworks developed in a political landscape.

Steps to address these concerns regarding network investment have been taken, with the AER issuing its Regulatory Investment Test and associated Guidelines to ensure that non-network options are considered as part of distributor planning processes. Uncertainty still exists, however, around how well the regulatory framework is serving consumers with regard to networks as is evidenced by recent court action surrounding the AER’s NSW distribution price determinations. We support moves to drive further efficiency within networks and to ensure that network planning processes allow for the implementation of non-grid solutions where these are the most cost effective option.

Until such time as retailers, or potentially other providers, are able to develop products which provide a predictable return without reliance on the underlying network tariff structure, consumers will ultimately be subjected to retail pricing which largely reflects the distribution tariffs imposed on them by the networks. Technologies including small scale photo voltaic generators, battery storage and advanced metering are fundamentally shifting consumer interaction with the networks (via their retailer) however for the majority of customers the standard network tariffs will be passed through by their retailer.

Retail Costs

Billing a customer for the energy which they consume is the most basic function of the retailer. A widely held view among consumers, the media and others outside the industry that this is the “sole” role of the retailer has led to a tendency to question retail margins.

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. Achieving the appropriate focus on each of these factors and managing the requirements of multiple stakeholders is challenging and often costly.

Given that the retailer has a direct relationship with the customer, involvement in the delivery of concessions and the administration of environmental policy through mechanisms such as the Renewable Energy Target and various state based efficiency scheme is not necessarily inappropriate. However, the implementation of policy is not the core business of energy retailers, and represents a significant cost driver, particularly in areas of frequent policy change.

A transition to the National Energy Customer Framework (NECF) in a number of states has provided a degree of stability to the retail regulatory framework. However, there is still constant regulatory risk in relation to concessions and energy efficiency which are not covered by the NECF. The costs associated with regulatory risk remain higher in Victoria due to the opacity of regulatory processes and the fact

that there is no separation between the author and the enforcer of the regulatory framework (the Essential Services Commission of Victoria) as is the case in NECF states.

While unable to comment on the financial returns of its competitors, Momentum is confident that the ACCC will uncover sufficient evidence to suggest that strong retail competition is keeping profit margins low.

Competition in the Electricity Retail Market

In the intensely competitive retail market, retailers seek efficiency in their operations in order to attract customers with the lowest prices. The existence of around 40 authorised retailers in the NEM suggests that barriers to entry are low, and it is our view that the competitive tension between retailers keeps margins low.

Competition has evolved significantly in the NEM since retail contestability started in Victoria in 2002. Where retailers once sought to differentiate themselves solely on the basis of fairly esoteric add-ons such as free movie tickets, football club memberships or magazine subscriptions, the evolution of the market, including key enabling technologies such as advanced metering and distributed solar generation, have allowed retailers to truly innovate. That said, there is still a prevailing view that all retailers are offering essentially the same product, and while the electrical energy sold is indistinguishable from one retailer to the next, each business offers a unique proposition and is competing to forge an identity and customer base in a crowded market.

Momentum prides itself on ‘making energy more human’. To do this, we offer consumers a more personalised customer experience, transparent retail offers and of course the lowest pricing possible. We believe that there is a demand for this approach which is not being met by other participants in the market.

Making energy more human involves empowering our customers to choose the most appropriate product to suit their needs and level of sophistication. While we are aware that many energy users are keen to lower their costs by participating in reforms such as cost reflective network tariffs, we have also developed products for customers who are unable to respond to price signals of this sort and prefer to be insulated from any bill-shock which they might otherwise experience if their consumption patterns were not optimised to their network tariff.

Our philosophy also applies to our approach toward fees and charges. Momentum customers are not, as a matter of practice, charged for receiving hard copy bills or making payment via particular channels. Retailers do incur costs as a result of particular customer choices, and we believe that it is completely valid for other retailers to pass these through to customers if they choose to do so, as long as customers are adequately informed of this fact. We acknowledge that this can result in a cheaper outcome for those customers whose preferences align with the cheapest option for the retailer (typically electronic billing paid by direct debit). We do not believe however, that customers should be made to jump through hoops to qualify for the best possible electricity deal and the way we do business reflects this.

Our philosophy is one of Momentum's points of difference in the market. It is the way in which we compete to meet customers' needs. Other businesses have positioned themselves differently to attract particular segments, and provided that each retailer complies with applicable regulatory obligations and treats their customers fairly we believe that there is no right or wrong approach.

As mentioned earlier in this submission, all retailers are subject to the same network costs and, although contractual arrangements and hedging strategies differ, are all essentially purchasing energy from the same market. This leaves the retail operating costs as the only cost component which can be managed. Even here, some of the costs are identical from one retailer to the next. These include license fees and environmental charges. Of the total cost stack which is ultimately passed through to the customer, the retailer has direct control over only a small portion and in order to attract customers with low prices, the pressure to achieve operational efficiencies is immense. Doing so while attempting to penetrate the market with effective marketing and innovating new products is a challenge, the magnitude of which is not appreciated by those outside the industry.

With Victoria, NSW, South Australia and Queensland all ranked between "super-hot" and "very warm" markets for customer churn², to stand still in the Australian energy market is to lose significant numbers of customers, and could result in failure. Retailers will continue to compete to bring the best possible price and proposition to consumers.

As a second tier retailer, Momentum has competed hard to build a customer portfolio. While it is true that retailers with an incumbent base have only one way to go in terms of customer numbers, smaller retailers face challenges relating to the relative lack of sophistication in IT systems and lower staff numbers resulting in less specialisation. Despite the strong rate of customer switching in the market, retailers with an incumbent base have the luxury of 'sticky' customers who are not price sensitive and can be relied upon to provide a dependable revenue stream. Customers who have switched to a second tier retailer have demonstrated a willingness to seek out a better electricity deal and are likely to do so again if their new retailer does not meet their needs.

Another issue facing second tier retailers is that a vast number of the costs associated with energy retailing are fixed rather than variable based on the quantity consumed. 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 electricity. 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. Larger retailers are able to spread these costs across a greater customer base whereas smaller retailers may need to absorb some of this cost in order to stay competitive.

Barriers to competition between electricity retailers

Momentum considers that energy retailers are on essentially level footing in the market and do not face significant impediments to competition. We are however concerned that the regulatory

² Lewis, Philip E. (2016), World Energy Retail Market Switching Analysis and Rankings 2012 - Utility Customer Switching Research Project, VaasaETT, May 2016.

framework is not providing a competitively neutral environment for retailers to compete with other sellers of non-grid supplied energy.

The number of 'exempt sellers' within the national market has grown steadily with the AER's exemption registry showing that they now outnumber authorised retailers.³ Momentum supports a regulatory framework which promotes the deployment of new technologies and business models which do not fit the scope of 'traditional retailer' activities. However, we believe that in some instances holders of retail exemptions benefit from a lower bar in terms of the customer protections which they must offer to consumers.

The AER's exempt seller guidelines ensure a reasonable baseline of consumer protections, and both authorised and exempt sellers are required to conform to the requirements of Australian Consumer Law. Exempt sellers, however, do not face a number of additional overheads which directly relate to customer protections. Either these protections, including customer access to dispute resolution schemes right through to restrictions on how offers are presented, are vital to customer wellbeing or they are not. Requiring one class of provider to invest in providing customer protections while the other is exempt is not an equitable outcome.

Barrier to customers in choosing a retail electricity service

Competitive outcomes have been generally good for consumers, however, it may have indirectly led to customer confusion through the amount of choice available in the market. As outlined above, there appears to be a prevailing view that all retailers are offering the same proposition, and we believe that many retailers rely on this perception, advertising deep discounts to attract customers without making it absolutely clear that these discounts are conditional (on paying on time for example), what the pre-discount rates are, or to which components of the rates the discount applies.

We feel that by choosing to market in this manner, and not allowing an easy basis for comparison of prices, some retailers are not acting in the best interests of consumers and are doing little to warrant their trust. As a result of this approach by a number of retailers, many consumers lack trust in the industry. This environment of low consumer engagement provides fertile ground for retailers to engage in the type of lazy marketing practices which have led to the current mistrust of the retail energy industry and further fuels the cycle.

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, a number of 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. We would welcome regulatory reform in this space so that retailers are able to compete without having to operate through these channels.

Making informed choices

As previously outlined, Momentum has a philosophy of making energy more human. Among other things, this involves ensuring that our product offerings are, in our opinion, easy to understand and

³ An equivalent register does not currently exist in Victoria.

contain meaningful information for consumers. We consider that Momentum is a leader in terms of transparency in a market where this trait is not always evident. This presents a challenge for consumers in that they are often unable to easily compare like for like. We are cognisant that the ACCC is aware of this scenario with Commissioner Delia Rickard coining the phrase “discount off what” to describe the situation.

Such is the low level of engagement and in some instances energy literacy, that Momentum’s transparent approach is often to its own detriment as many consumers balk at the fact that Momentum does not offer a discount. This is sometimes despite the fact that our rates, even with the competitor’s discounts factored in, are lower.

Much has been said about the need for consumer education to create awareness around how to compare electricity offers, and for truly independent comparator services to allow customers to seek out the best deal. In the years since the Australian Energy Market Commission issued the 2013 NSW Consumer and Stakeholder Research Report, widely regarded as one of the most in-depth looks at customer perceptions and sentiment, very little has changed. This report sought to inform a communications blueprint to increase customer engagement, and while Momentum agrees that there is a need for accurate information from a trusted source such as Government, customers will continue to be cautious of the industry while particular practices continue.

We believe that customers can benefit greatly if they make informed choices and we urge them to seek out the information required to do so. We believe that the information and tools that customers need to maximise their utility do exist and can be accessed however we are unsurprised that few choose to engage with an industry which often appears to take them for granted.

Summary

The cost of energy is posing a challenge for an increasing number of Australians. We understand the focus on the retail sector, notwithstanding the reality that the majority of the costs of supplying electricity to customers are outside the retailers’ control. Active participation by consumers will lead to improvements in service and offerings and empower customers to make decisions to lower their costs. Unfortunately we feel that this is unlikely to occur organically and may require external stimulus.

We would welcome the opportunity to provide the ACCC with further detail on these matters. If you wish to discuss any of the issues raised in this submission in further detail, please contact me on (03) 8651 3565 or email to joe.kremzer@momentum.com.au

Yours sincerely

Joe Kremzer

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