

## Senate Select Committee on Electricity Prices – ERAA Response to Questions on Notice

### Additional Senate Supplied Questions

1. You claim the Victorian model is a success story. However, the submission (#15) of Alan Pears cites AEMC data from 2011 that the Victorian retailing component of household electricity prices was higher – and increasing faster – than other jurisdictions; 25%, compared with 15%. How do you explain the AEMC data that the Victorian cost of retailing is higher than the national average?

The data referred to by Alan Pears in his submission to the Select Senate Committee is based the *AEMC's Final Report – Possible Future Retail Electricity Price Movements: 1 July 2011 to 30 June 2014*, that provides for possible future prices of electricity for Victoria. The analysis conducted by the AEMC was based on extrapolated estimates from published standing offers. Throughout the report, the AEMC draws caution to the estimates provided for Victoria by stating that “most residential customers are on market contracts and are supplied electricity at rates that can be 10 to 20 per cent lower than published standing offer contracts. Therefore, the residential electricity prices outlined in this report may not be representative of the actual prices applying in Victoria and should be treated as such.”<sup>1</sup> The AEMC then goes further to state that given “the high degree of customer switching between retailers in Victoria, the prices are likely to be representative of only a small proportion of the total number of residential electricity customers.”<sup>2</sup> As the retail component of a bill is only a small percentage of the total bill, the discounts that are applied in Victoria, and which apply to the total bill, are taken from the retail component of a bill. Therefore, the comparison made of Victoria to the national average is not representative of the market as the majority of residential customers are on market contracts which are 10 to 20 per cent below the data cited by the AEMC.

Other factors which should be considered include the Victorian Energy Efficiency Target (VEET) Scheme, which is included in retail energy costs in Victoria. The VEET Scheme very comprehensive, and explains why costs are higher in Victoria. However it should be noted that the VEET Scheme activities help customers deal with rising bills.

2. AGL’s energy managing director, Michael Fraser, notes for example the cost of obtaining new customers is expensive and rising – placing upward pressure on electricity prices. Is not the ‘churn’ between retailers (cited by ERAA as evidence of ‘competition’ in Victoria) and the associated marketing costs an additional upward pressure on household electricity bills?

According to the *AEMC's Final Report – Possible Future Retail Electricity Price Movements: 1 July 2011 to 30 June 2014*, churn is evidence of competition: “The proportion of residential customers that are being supplied on standing offer contracts compared to market contracts differs in each jurisdiction, and depends on such factors as the introduction and extent of retail competition (measured by the level of customer churn) in a jurisdiction.”<sup>3</sup>

<sup>1</sup> AEMC, 2011. *AEMC's Final Report – Possible Future Retail Electricity Price Movements: 1 July 2011 to 30 June 2014*, p.4.

<sup>2</sup> AEMC, 2011. *AEMC's Final Report – Possible Future Retail Electricity Price Movements: 1 July 2011 to 30 June 2014*, p.48.

<sup>3</sup> AEMC, 2011. *AEMC's Final Report – Possible Future Retail Electricity Price Movements: 1 July 2011 to 30 June 2014*, p3-4.

In Victoria, where competition is stronger, marketing costs are higher. This is the case in almost any industry where competitors are actively trying to win new customers. It is extremely rare to have increased competition without an increased cost of attracting and retaining new customers. The ERAA would caution against any policy that aimed to reduce marketing costs (via a decrease in competition), as these costs are much lower than the benefits of a competitive market. The variable costs associated with marketing to existing and new customers only contribute to a small proportion of the total costs attributable to retailing. When compared to the costs that combine to make up a customer's final delivered bill (inclusive of network, wholesale and green schemes and taxes) marketing costs are considered an insignificant contributor to recent rising energy prices.

### Transcript Questions

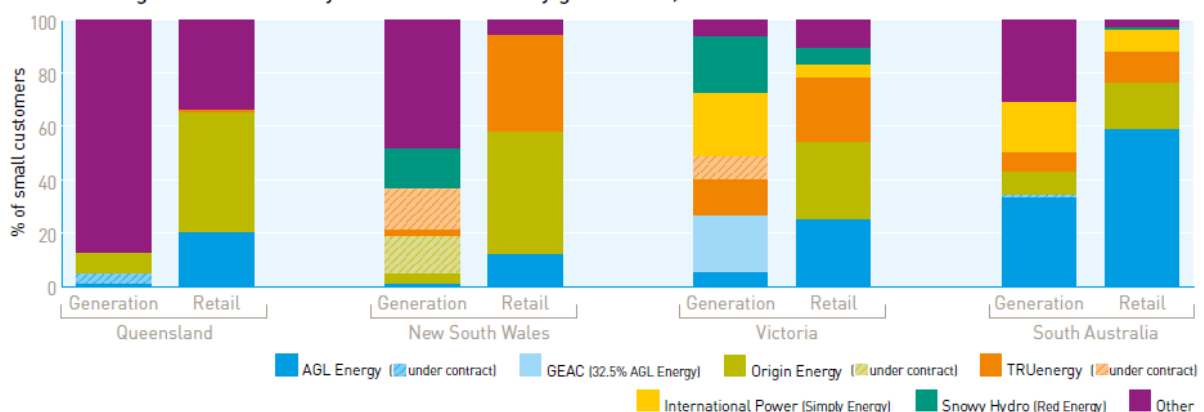
#### 1. What is the ownership between retailers and generators in the industry at present? (McEwen)

The latest AER State of the Market Report (2011) outlines the level of vertical integration in the market, as highlighted in the graph below<sup>4</sup>:

- Origin Energy, AGL Energy and TRUenergy control almost 30 per cent of generation capacity in the mainland regions of the National Electricity Market (NEM).
- The public electricity sector also exhibits vertical integration. The generator Snowy Hydro owns Red Energy, which operates in the New South Wales, Victorian and South Australian retail markets. The Tasmanian Government owns generation through Hydro Tasmania and maintains a retail presence through Momentum Energy.
- In addition, the Queensland and Tasmanian governments own joint distribution – retail businesses. The ACT Government has ownership interests in both the host energy retailer and distributor. Ring fencing arrangements aim to ensure operational separation of the retail and network arms of these entities.

Figure 5

Vertical integration—electricity retail and electricity generation, 2011



Note: Generation market share relates to installed capacity; retail market share is for small electricity customers.

Source: AER estimates.

<sup>4</sup> AER, 2011. *State of the Energy Market*, p.106-8.

The Australian electricity wholesale market is highly volatile with the spot market able to fluctuate to a maximum price of \$12,500 per megawatt hour. Whilst consumers are not exposed to these high prices through their existing retail tariffs, retailers are. Retailers therefore use vertical integration, in combination with other electricity derivative products, to manage help manage their exposure to such volatility. The AER State of the Market Report (2011) also outlines the rationale behind vertical integration: “Vertical integration provides a means for retailers and generators to internally manage the risk of price volatility in the electricity spot market, reducing their need to participate in hedge (contract) markets.”<sup>5</sup>

2. Provide us details of the form of self-regulation practices that you have, how you deal with disputes, the number of complaints you have had and whether you pass on some of the more egregious disputes on to regulators for formal action? (Xenaphon)

### Energy Assured

Energy Assured Limited is a self-regulated energy industry initiative to monitor and improve door to door marketing standards. It seeks to improve compliance by both energy retailers and energy marketing companies to promote consumer confidence in door to door sales, to improve the customer experience and reduce the incidence of sales issues.

Energy Assured manages a Code of Practice which has been authorised by the Australian Competition and Consumer Commission. The Code includes:

- A program to ensure sales agents are recruited, trained and assessed in a consistent manner across the industry
- A central register of accredited sales agents
- Monitoring sales agent behaviour such that a proven breach of Energy Assured’s standards may result in disciplinary measures and deregistration of the sales agent for five years
- Annual compliance audit of each energy retailer
- Imposing sanctions on energy retailers or marketing companies who fail to comply with the Code.

### Members

<b>Energy Retailers</b>	AGL Energy	Alinta Energy	Australian Power & Gas
	Lumo Energy	Momentum Energy	Neighbourhood Energy
	Origin Energy	Red Energy	Simply Energy
	TRUenergy	Energy Retailers Association of Australia	
<b>Energy Marketers</b>	Aegis	Appco Group	ASAP
	Chameleon Marketing	Communicom	CPM
	Genius Marketing	K.K. Sales & Marketing	OZ Green Homes <sup>#</sup>
	Redwood BC	Sales Etiquette <sup>#</sup>	Sales Solutions
	Salmat	The SMART Group	TSA

As at 26/9/12 # Marketers commencing late October 2012

Energy retailers and energy marketing companies strive to maintain good quality sales practices, however before Energy Assured launched, the retailers acted independently to manage agent behaviour. This initiative brings the energy retailers and energy marketing companies together and

<sup>5</sup> AER, 2011. *State of the Energy Market*, p.106.

introduces consistent recruitment, training and accreditation practices. It allows energy retailers and energy marketers to access sales agent history to ensure sales agents who have been deregistered do not move to another member company. As at 15 October 2012 a total of 92 sales agents have been deregistered.

### **Complaints**

Energy retailers are required to report all door to door complaints to Energy Assured monthly and to identify those complaints which are under review by an Ombudsman. Based on the ratio of complaints to doors knocked, the level of door to door complaints is 3 complaints for every 10,000 offers made. Energy assured has entered into Memoranda of Understanding with the state Ombudsman offices and works closely with the Ombudsman offices to look at current and emerging issues.

### **Regulators**

Energy Assured provides quarterly updates to Regulators about the scheme including the number of warning notices and sanctions issued to members. Any sanctions deemed to be Level 3 or above are reported to the relevant regulator(s). At 15 October 2012, 3 warning notices and one (level 2) sanction have been issued to members.

### **Improving the sales experience for customers**

Energy Assured has introduced a number of measures to improve the sales experience. One of these is the verification call. For every sale the customer speaks to an independent call centre who asks questions to ensure the customer understands the offer, that they are changing retailer, that the customer's rights including the cooling off period have been explained and that the customer has been informed about Energy Assured. If the operator does not believe the customer can provide explicit informed consent eg has not been given correct information, or has difficulties such as insufficient language skills to provide consent, then the sale is terminated.

Other steps to improve the sales experience include:

- Recruitment - every sales agent has to provide 100 points of identification and pass a criminal history check
- Training – a consistent training program with an assessment component
- On field supervision – sales agents are accompanied by a experienced sales agent until they are competent to sell unsupervised
- Assessment – before selling unsupervised, the sales agent must pass a formal competency assessment by an Assessor (independent to the Experienced Sales Agent)
- Ongoing assessment – 5% of all sales agents must be formally assessed each month. Every sales agent is re-assessed annually
- Ongoing refresher training – sales agents undergo regular refresher training/product information sessions
- Every retailer is subject to an external audit annually (KPMG).

### **Stakeholder engagement and Code improvement**

Energy Assured meets regularly with Regulators, Ombudsman, Consumer Groups, Fair Trading offices and government to keep them updated about the scheme and to listen to feedback.

There is a formal stakeholder workshop held every six months where all stakeholders are invited to discuss aspects of the Code.

There is a formal review of the Code every two years and this is due to be completed in the second quarter of 2013.

### **Independent Code Panel**

An independent Code Panel has been established to hear appeals by sales agents, endorse member sanctions and hear appeals on member sanctions. The Code Panel also provides advice to the Code Manager about the scheme.

3. Could you provide the view of your association on the review of the limited merits review regime—that is, the interim stage 2 report by Professor Yarrow, Mr Egan and Dr Tamblyn and the serious concerns they have raised about the way the rules are structured? (Xenaphon)

The ERAA approves the broad views expressed in the Interim Stage 2 report, as we would any review that seeks to ensure the regulation of energy networks is in the long-term interests of consumers. The ERAA provided verbal evidence to the panel indicating this support.