A friendly goodbye: PIAC submission to IPART's Issues Paper, *Early termination fees – Regulating the fees charged to small electricity customers in NSW*

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Introduction

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights; and
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from the Trade and Investment, Regional Infrastructure and Services NSW for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

Energy + Water Consumers' Advocacy Program

This program was established at PIAC as the Utilities Consumers' Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Park and Village Service;
- Ethnic Communities Council NSW;
- Rural and remote consumers;
- Retirement Villages Residents Association;
- Physical Disability Council NSW; and
- Affiliated Residential Park Residents Association.

1. Early termination fees

Early termination fees (ETFs) are part of many energy supply contracts offered in NSW. The NSW Independent Pricing and Regulatory Tribunal (IPART) has been tasked with calculating a base ETF, excluding the cost of any inducements (for example, magazine subscriptions or football club memberships).

PIAC takes this opportunity to respond to IPART's Issues Paper, *Early Termination Fees – Regulating the fees charged to small electricity customers in NSW* (the Issues Paper). PIAC has written in a number of submissions that base ETFs should be banned, based on the negative impact they have on competition. While holding to this primary position, PIAC acknowledges the premise of this review. In light of that, PIAC's comments in this submission relate to:

- IPART's proposed approach in choosing which costs to include in the base ETF;
- calculating those selected costs;
- the impact of making a base ETF too high or too low;
- the option of requiring all retailers to offer a contract without an ETF; and,
- permitting retailers to recover the cost of any inducements (which may be less than its retail value).

PIAC submits that because the costs associated with early termination are low, any ETF cap should be set no higher than $20, the level set by the Victorian Essential Services Commission (ESC).

2. PIAC's preferred approach

2.1 PIAC's primary position on ETFs

PIAC's position is that all ETFs should be banned, with retailers only allowed to recover the cost of any inducements offered as part of a contract. PIAC's position is that the cost of such inducements should be recovered through an inducement recovery fee on a pro rata basis where customers terminate their contracts early. PIAC has put this position in its submissions to the Australian Energy Market Commission's (AEMC) review of the effectiveness of retail competition in NSW.[1]

PIAC takes the view that ETFs often create a disincentive for consumers to participate in the competitive market and take up better offers from other retailers. While the Issues Paper acknowledges that 'unreasonably high ETFs may create an unnecessary barrier to switching, reducing the benefits that competition can provide',[2] PIAC submits that many EFT has such an effect in dampening competition.

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1 Derum, O & Johnston, M, *Marking the market – PIAC submission to the AEMC Issues paper: Review of competition in retail electricity and gas markets in NSW,* 2013, available at: www.piac.asn.au/publication/2013/03/marking-market; and, Derum, O, *Where to and how? PIAC submission to the AEMC's Draft Report: Review of the effectiveness of competition in retail electricity and Natural gas markets in NSW*, 2013, available at www.piac.asn.au/publication/2013/08/where-and-how.

2 IPART, *Early Termination Fees – Regulating the fees charged to small electricity customers in NSW*, 2013, 32.

2.2 PIAC's preference from the options discussed

Without resiling from its primary position, PIAC accepts that IPART has been tasked by the NSW Government with setting a base ETF, and that this base is unlikely to be zero. PIAC, therefore, wishes to comment on its preferred approach for calculating ETFs from the two options put forward in the Issues Paper. The two approaches are:

- to include some of the costs that a retailer would have avoided if the customer had not signed the contract; and
- to calculate the costs that the retailer incurs as a result of the customer terminating the contract early.[3]

PIAC submits that IPART should take the latter approach when calculating ETFs, as this approach more closely aligns with the costs imposed by the early termination, which the retailer is not able to recover through other means.

In particular, PIAC notes that the first category above includes customer acquisition and retention costs (CARC).[4] The Issues Paper states that some of these costs 'may not have been incurred had the customer not signed the contract (for example, commissions paid to brokers)'.[5] While PIAC does not disagree with this statement, PIAC submits that the regulated retail electricity price, as determined by IPART in June 2013, contains a CARC allowance that allows retailers to recover these costs. IPART calculated this cost at $8 to $13/MWh and included this cost in the regulated price on top of the short-term efficient cost of supply.[6] In view of this, and in recognition that the regulated price acts as a benchmark for market offers, PIAC believes retailers are already well compensated for the cost of maintaining customers. Consumers should not be seen as a source of funds to be used to offset any risk to retailers. To do so would render a competitive market a high-cost, low-value proposition for the consumers of NSW.

Recommendation 1

PIAC recommends that IPART calculate the ETF cap based on the costs the retailer incurs as a result of the customer ending a supply contract early.

PIAC also notes that because the allowance customer acquisition and associated costs are included in the benchmark regulated price, it has an impact on the price of market contracts—albeit to varying extents. This means that while retailers may not recover all customer acquisition costs directly from an individual customer who terminates their contract early, consumers who stay beyond a contract term will offset this shortfall. Retailers should therefore recover their average costs. PIAC submits that if ETFs are charged to consumers based on costs imposed by individual termination, this would need to be offset by a loyalty rebate to consumers who stay beyond the period for which such costs are recovered.

3. Calculating costs of early termination

The Issues Paper lists two costs that retailers incur when customers terminate their contracts early. These are: costs related to energy purchase portfolio adjustment; and, some administrative

3 Ibid 16.
4 Ibid 18.
5 Ibid.
6 IPART, *Final report – Review of regulated retail prices for electricity: From 1 July 2013 to 30 June 2016*, 117.

costs associated with the early termination.[7] PIAC takes the view that neither of these costs is significant and any base ETF calculated by IPART should, therefore, be modest.

3.1 Energy purchase portfolio adjustment costs

In its recent submission to the AEMC's Draft Report of its Review of the effectiveness of competition in retail electricity and natural gas markets in NSW, PIAC argued that retailers put in place hedging arrangements that should be able to withstand the loss of single customers.[8] PIAC takes the view that these arrangements are highly sophisticated and are designed to manage the potential risk of large spikes in the spot price of electricity. As a result, the impact of a single customer leaving the retailer should not impose a significant cost that needs to be recovered.

In addition, as noted by the Issues Paper, energy retailers purchase energy for a future period when they acquire new customers.[9] Assuming that customers are more likely to look at alternative suppliers when the price is rising, if a customer then terminates a contract the retailer will be left with an agreement to purchase energy at an older, lower price. Such contracts would be 'in the money' (allowing a retailer to purchase energy at below current market rates). These contracts could be reallocated, potentially to a new customer paying a higher price. This reallocation would offset any costs associated with early termination.

PIAC submits that if customers were asked to pay ETFs to cover these costs, retailers would face no risks associated with early termination, while standing to gain the reward from contracts to purchase energy from generators that are economically favourable ('in the money'). It would not be equitable to impose this scenario on customers of an essential service.

3.2 Administrative costs associated with early termination

PIAC argues that the administrative costs associated with early termination of a contract should not be significant. The Issues Paper notes that customers in NSW 'tend to change retailers at the next meter reading, reducing the range of costs to finalise an account'.[10] Other costs associated with early termination, such as returning any security deposits, would be incurred regardless of whether termination happens early or at the end of a contract.

PIAC also notes that the Victorian ESC found that such administrative costs (and energy purchase portfolio adjustment costs) are 'small and uncertain'.[11] The ESC chose to set the regulated ETF at $20 to create a small disincentive for early termination.[12] The impact of ETFs on incentives to participate in the competitive market is discussed below. However, PIAC submits that the ESC's finding shows that any regulated ETF should be set at no more than the level in Victoria.

Recommendation 2

PIAC recommends that IPART set the base ETF cap at no more than $20.

7 IPART, above n 2, 19.
8 Derum, O, *Where to and how? PIAC submission to the AEMC's Draft Report: Review of the effectiveness of competition in retail electricity and Natural gas markets in NSW*, 2013, 11.
9 IPART, above n 2, 25.
10 Ibid 26.
11 Ibid14.
12 Ibid.

4. Consequences of incorrectly calculating the base ETF

4.1 Setting the base ETF cap too high

As previously stated, PIAC opposes ETFs on retail energy contracts, except where consumers have been offered up-front inducements, because their presence creates a disincentive for consumers to enter the competitive market and seek a better offer. The Issues Paper acknowledges the potential adverse impact of 'unreasonably high' ETFs, which may 'reduc[e] the benefits that competition can provide'.[13]

In addition, PIAC believes that the existence of a cap on the base ETF will have a benchmarking effect on the market, similar to the effect of the regulated electricity price. While the cap sets an upper limit for the ETF (excluding inducement costs), the presence of a regulated offer means that most other examples in the market are defined relative to this level. Further, as the Issues Paper acknowledges, there is a risk that consumers will assume that because there is a regulated cap on ETFs, such fees are 'all the same anyway'.[14]

4.2 Setting the base ETF cap too low

While PIAC does not believe early termination of contracts imposes significant costs on retailers, PIAC accepts that if there are genuine costs that retailers are not able to recover through contract fees, they will recover these costs through increased prices. In addition, if the cap is set below a level that allows retailers to recover the costs of early termination, it is likely that all retailers will set their fee at the maximum allowable level.

However, PIAC submits that under such a scenario, retailers would begin to compete on price rather than fees. PIAC takes the view that this is a more desirable outcome, as consumers are more easily able to understand and compare different price levels, as opposed to weighing price levels (which vary with consumption) against fixed-rate fees. Such competition on the basis of price would also be in keeping with IPART's stated position in the Issues Paper, that 'competition is more effective than regulation in driving prices towards efficient costs'.[15]

5. Requiring all retailers to offer a contract with no ETF

The Issues Paper discusses the approach taken in South Australia, where all retailers are required to have an offer without an ETF.[16] PIAC would support the introduction of this requirement in NSW. While any such offer is likely to have an increased price, consumers would be able to make a choice based on features that are most important to them.

PIAC notes that many retailers currently have market offers without an EFT.[17] PIAC submits that because these products already exist, most retailers would not need to take any action in order to

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13 Ibid 32.
14 Ibid 32.
15 Ibid 30.
16 Ibid 15.
17 Australian Government, *Energy made easy,* www.energymadeeasy.gov.au, as at 28 August 2013.

comply with a requirement to offer a contract without an ETF. In short, PIAC cannot see any detrimental impacts on product diversity, or the competitive market generally, that would stem from requiring retailers to make such a product available.

Recommendation 3

PIAC recommends that all energy retailers operating in NSW be required to offer a contract without an ETF.

6. Recovering the costs of inducements

PIAC notes that the issue of the cost of inducements is not specifically part of IPART's terms of reference for this review, and that the *National Energy Regulation (Adoption) Amendment (Early Termination Charges and Site Specific Conditions) Regulations 2013* (the Regulation) permits retailers to recover the cost of inducements as well as charging the base ETF being calculated by IPART as part of this review.[18] Nonetheless, PIAC wishes to make the following comments about how the cost of any inducements is calculated.

The Regulation permits retailers to charge the base ETF set by IPART as well as 'the inducement costs of the retailer'.[19] PIAC submits that the cost of any inducements that retailers are permitted to recover is therefore the cost they incurred, not the recommended retail price of an inducement. When purchasing goods, discounts generally apply for buying in bulk. For example, if a retailer purchases 10,000 magazine subscriptions to provide as inducements, the per unit price incurred by the retailer will be lower than that for a single subscription purchased by a consumer.

Accordingly, PIAC recommends that the inducement costs of retailers be monitored to ensure that in the event of early termination, retailers only recover the actual cost of the inducement, not the value of a single unit. This task should be performed by IPART.

Recommendation 4

PIAC recommends that IPART monitor the conduct of retailers to ensure, that in the event of early contract termination by a consumer, retailers recover no more than the actual cost of any inducement, rather than a stated value above that paid by the retailer.

PIAC also recommends that retailers should be required to clearly state the cost of the inducement that will be recovered from the customer. This would allow consumers to make their own decisions about whether the inducement that is on offer is worth the amount that will be recovered over the life of the contract. This information should appear on the Energy Price Fact Sheet for the offer.

Recommendation 5

PIAC recommends that retailers be required to clearly inform customers of the cost of an inducement that will be recovered over the term of an energy supply contract. This information should appear on the Energy Price Fact Sheet for the offer.

18 *National Energy Regulation (Adoption) Amendment (Early Termination Charges and Site Specific Conditions) Regulations 2013,* cl 49AA(2)

19 Ibid.

7. Conclusion

PIAC's primary position is that base ETFs should be banned on energy supply contracts for residential consumers. Nevertheless, PIAC accepts that IPART has been directed by the NSW Government to set a base ETF.

Among the options canvassed in the Issues Paper, PIAC argues that IPART should calculate the base ETF using the costs that the retailer has incurred as a result of a customer terminating a contract early. PIAC submits that these costs are not significant, and IPART should therefore set the base ETF no higher than the $20 set by the Victorian Essential Services Commission. PIAC further recommends that retailers only be allowed to cover the true cost of any inducements offered with contracts. Consumers should be clearly informed of this amount on the Energy Price Fact Sheet for the offer in question.