Australian Government Rule Change Proposal to the Australian Energy Market Commission

Improving consumer outcomes and competition by regulating conditional discounting

1. Name and address of the rule change proponent

Name of Proponent: The Honourable Angus Taylor MP, Minister for Energy on behalf of the Australian Government.

Address of Proponent: Parliament House, Canberra, ACT.

2. Summary

The Australian Government submits this request to the Australian Energy Market Commission (AEMC) to change the National Energy Retail Rules (NERR), and make any requisite changes to the National Electricity Rules (NER) and the National Gas Rules (NGR) the AEMC considers necessary.

The nature and scope of the issues addressed by the proposal

This rule change proposal seeks to address the significant negative impact of grossly inflated conditional discounts on consumers, which are adding to confusion and impeding the ability of consumers to anticipate the true cost of their energy plan. By constraining consumers from meaningfully engaging in the market and predicting and managing their bills, the proliferation of inflated conditional discounts represents a diminishment of effective competition.

Offers advertising inflated conditional discounts can appear highly attractive, particularly where customers are actively seeking to reduce and manage their costs. However, with 27 per cent of all customers and 59 per cent of some vulnerable customers not meeting their discount conditions, this pricing strategy is clearly to the detriment of a significant number consumers and entrenches inequitable outcomes in the market. Our analysis indicates the resulting cost to an average customer of not meeting a pay-on time discount could be up to $755 per annum[1] inclusive of GST (or an increase on an annual bill of roughly 50 per cent) which is clearly not representative of the cost to retailers from late payment. Action must be taken.

The proposed rule would ensure conditional discounts for both gas and electricity retail offers are no higher than the reasonable cost savings that a retailer expects it will make if a consumer satisfies the conditions attached to the discount. The proposal is in line with Recommendation 33 of the Australian Competition and Consumer Commission (ACCC) in its July 2018 Retail Electricity Pricing Inquiry (REPI) and adds to the Australian Government's ongoing efforts to achieve the best outcomes for energy consumers.

Policy objectives

The REPI Final Report raised concerns with the risks associated with most retailers' over-reliance on discounts in the marketing of its products to consumers. The REPI Report identified three key areas of concern around existing marketing practices[2]:

1. Marketing based on discounts is confusing as it is often based on meeting conditions, and does not provide actual price information, meaning consumers cannot use discounts to estimate what they can expect to pay.

[1] Refer page 5 of this submission.
[2] ACCC (2018) Retail Electricity Pricing Inquiry – Final Report, Australian Government, p264.

2. Conditional discounts, frequently based on on-time payment, can impose significant penalties on those facing payment difficulties, leading to equity issues for low income or income insecure households.
3. Discounts are applied to different underlying tariffs and different parts of the bill, which is confusing consumers and hindering effective comparison of offers across the market.

Beyond the poor outcomes conditional discounts are yielding for consumers, the overreliance of applying inflated conditional discounts to inflated standing offer rates as a means of product differentiation is indicative of stagnation in innovation and competition in the retail energy sector.

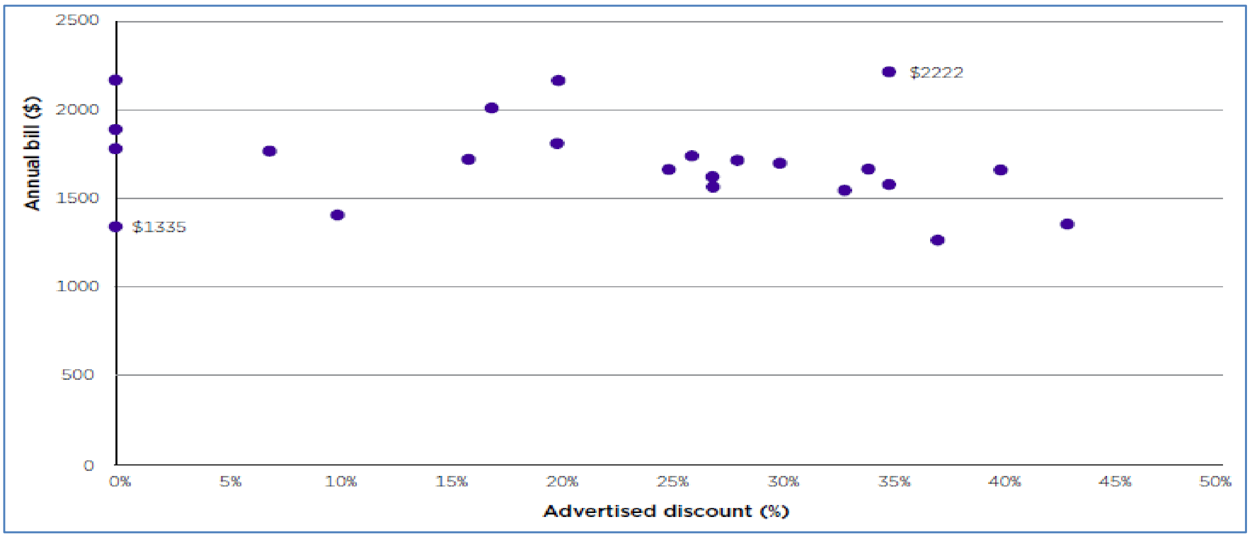
This rule change proposes limiting discounts off customer bills that are conditional on payment conditions (for instance pay on time and direct debit). The intent of the proposed rule is to:

1. Remove the excessive penalties on customers (particularly vulnerable customers) who pay after the due date, which are effectively resulting in those customers paying the highest prices in the market; and,
2. Improve the comparability of market offers by simplifying and reducing conditional discounts, thereby reducing barriers to effective consumer engagement and enhancing competition.

Supporting evidence and findings of other review processes

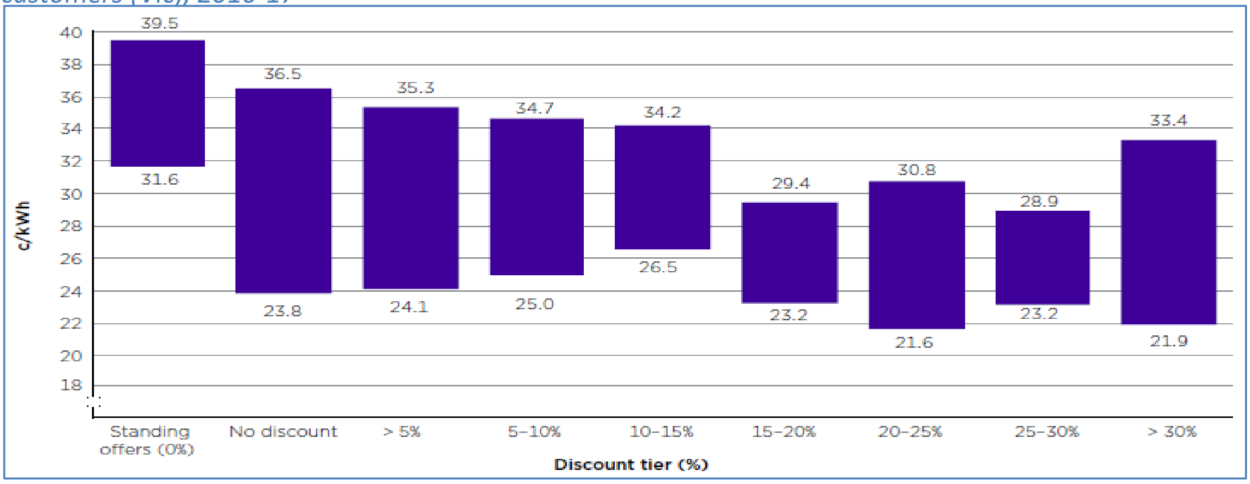
The size of conditional discounts attached to market offer products has increased from around 5 to 10 per cent in 2014 to up to 30 to 40 per cent in 2018.[3] The ACCC found that this increase in discounts (combining conditional and non-conditional discounts) has in many cases not coincided with similarly deep savings in the related retail electricity bill (as seen below).

Figure 1: Annual cost of offers ($) by advertised discount in Powercor distribution network (Vic), Jan 2018



[3] ACCC (2018) Retail Electricity Pricing Inquiry – Final Report, Australian Government, p257.

Figure 2: Range of average effective unit charges (c/kWh) by offer category for residential non-solar customers (Vic), 2016-17



Source: REPI Final Report, Pages 261 and 262.

Comprehensive reviews of the energy market, the ACCC Inquiry and the Independent Review of Victoria's Electricity and Gas Markets, both raised concerns around the adverse impact of conditional discounts, particularly for some consumers segments[45]. These issues were also reflected in many submissions to both reviews, from a range of different stakeholders.

This included that conditional discounts effectively see many consumers paying a disproportionately high penalty for not meeting the conditions of the retail contract which is not representative of the costs to the retailer from non-compliance with the condition.

For example, some current pay-on-time discounts identified can now be 45 per cent off usage charges or 35 per cent off usage and supply charges[6]. In such circumstances, missing the due date for payment for even a single bill can have significant impact on the amount a consumer will pay annually. Regular defaults on time payment would result in customers paying to the equivalent of that retailer'sstanding offer rate. We have calculated the example below in Table 1 based on the national weighted average usage for a representative customer (4,596 kwh) using an actual plan currently available in the market:

Table 1: Calculation of Conditionally Discounted Offer (GST inclusive)

	Offer 1 (usage only discount)	Offer 2 (total bill discount)
Usage Charge (c/kwh)	27.08[7]	32.00[8]
Supply Charge (c/day)	99.62	135.00
Conditional pay-on-time discount off usage charges	45%	-
Conditional pay-on-time discount off usage and supply charges	-	35%

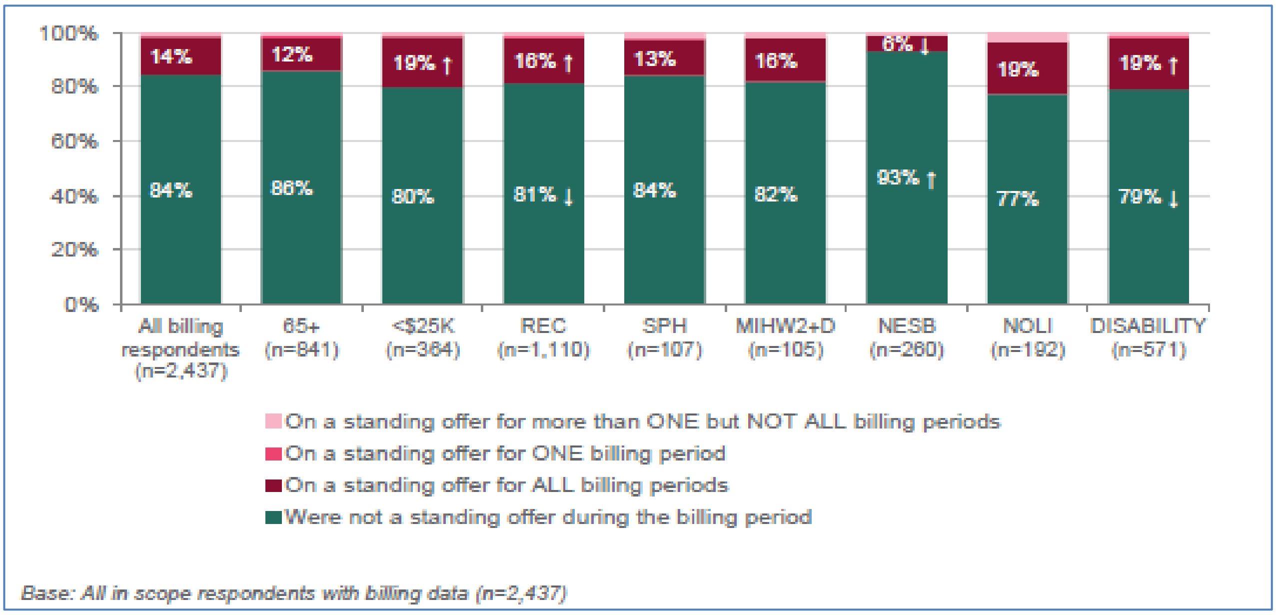
[4] ACCC (2018) Retail Electricity Pricing Inquiry – Final Report: Restoring electricity affordability & Australia's competitive advantage Australian Government, p264.
[5] Faulkner, Mulder, and Thwaites (2017) Independent Review into Electricity and Gas Markets in Victoria, p31.
[6] For example, Simply Energy, 'Simply RACV Plus 45 Plan' SIM78761MR, Citipower Network; Amaysim, 'Amaysim Electricity 2 – Peak Only Plan' AMA69563MR, CitiPower Network; GloBird Energy, 'GloSave Flat Rate (C1RB without Controlled Load) Plan' GLO76380MR, Citipower Network. While these offers are all in Victoria's Citipower network region, this are examples of the scope of the conditional discounting financial penalties customers can face in the NEM.
[7] Simply Energy, 'Simply RACV Plus 45 Plan' SIM78761MR, Citipower Network;
[8] GloBird Energy, 'GloSave Flat Rate (C1RB without Controlled Load) Plan' GLO76380MR, Citipower Network

Discounted annual bill	$1,048.14	$1,276.26
Undiscounted annual bill	$1,608.21	$1,963.47
Annual penalty for a customer from not meeting condition (excl. GST)	**$560.07**	**$687.21**
Annual penalty for a customer from not meeting condition (incl. GST)	**$616.08**	**$755.93**

In circumstances where a representative customer misses paying on time, under a highly discounted plan like this they could be **$755 worse off** – adding around 50 per cent to their annual bill. This amount is clearly not representative of any material cost a retailer accrues with late payment.

Over recent years there has been a significant shift in the number of customers from standing offers to market offers. Research conducted by Colmar Brunton for the ACCC indicates that most consumers, regardless of income, are more likely to be on a market instead of a standing offer.[9] Considering a large proportion of market products include conditional discounts with high percentage discounts this presents a significant financial risk for customers that face difficulty meeting electricity bills.

Figure 3: Standing offer by income - survey of electricity customers



Notes: REC –Households who received an electricity concession (billing data); SPH – Sole parent households (1 aged over 18 and 1 or more aged under 18); MIHW2+D – Middle income households ($50,000-$99,999) with 2 or more dependents; NESB – Respondents that speak a language other than English at home; NOLI – Households with no internet access or limited use of the internet to compare/buy goods and services.
Source: Colmar Brunton (2018) Consumer outcomes in the retail electricity market, p37.

In many respects discounts conditional upon on-time payment can be equated to an interest fee on debt. The effect of these conditional discounts is that customers who fail to meet these conditions are obliged to pay a notional one-off 'interest rate' type payment on the debt accrued. The resulting outcome for many consumers that do not meet the conditions of their electricity contract is they could pay up to 50 per cent interest immediately upon defaulting on their payment conditions. These terms are equivalent to the types of terms seen with financial products like short term loans or store based credit, rather than an essential utility service.

9 Colmar Brunton (2018) Consumer outcomes in the retail electricity market, p37.

The ACCC found that customers both on concession and in hardship are most likely to fail to meet conditions of the offer and achieve the related discounts. The ACCC notes only 41 per cent of hardship concession customers achieve conditional discounts, compared to 76 per cent of non-concession customers. [10]

This means there is a risk that a number of hardship concession customers on market offers are likely to be paying something equivalent to standing offer rates, which the AEMC found can be between $273 and $832 more expensive than the cheapest standing offer[11]. This is particularly of concern when you consider it alongside issues with hardship policies applied by retailers and the AEMC view that there is inconsistent and inadequate protections for hardship customers in the retail market.[12] There is also the issues of the number of customers being excluded from hardship programs that have no access to appropriate retailer support.[13]

Policy options considered

1. *Principles-based regulation and responsible retailer practices (Recommendation from the Victorian review into retail electricity and gas markets)*

One option is to move regulation to a principles based approach and require retailers to ensure their products suit the customer's needs and circumstances. Under the *National Consumer Credit Protection Act* (2009) credit charges associated with products like financial services like credit cards and loans, credit providers must conduct lending responsibly this includes:

- making reasonable inquiries about a customer's financial situation, requirements and objectives;
- taking reasonable steps to verify their financial situation; and
- deciding whether the credit contract the customer is asking for is 'not unsuitable' for their financial situation.

There are no such provisions for energy retailers under the NERR with regard to ensuring customer suitability for certain contracts. While requiring retailers to ensure products are better suited to customers' needs may be one way to redress the impact of conditional discounts on vulnerable households, such a rule is likely significantly more difficult to both apply and enforce than limits on the level of discounts.

2. *Banning discounts all together*

Another option is to ban discounts in their entirety from retail electricity market offers. Prohibiting discounts would address the confusion associated with multipart pricing and remove the risk of high priced penalties on vulnerable consumers. But banning discounts, while simple in practice, would remove a means by which retailers can reduce costs, such as the levels of debt carried by a retailer on behalf of their customer base.

[10] ACCC (2018), p264.
[11] AEMC, 2018 Retail Energy Competition Review, Page 76
[12] AEMC (2018) National Energy Retail Amendment (strengthening protections for customers in hardship) draft rule 2018, p13.
[13] ACCC (2018), p312.

3. Setting a simple percentage cap on discounts

There are two main ways that the rules could limit conditional discounts the first is to set a hard cap of say 10 per cent and the other is to leave the figure open to some discretion and assess it against reasonable costs criteria.

Both the simple cap and the reasonable costs limit on conditional discounts would achieve the policy intention of simplifying multi part discounted offers and protecting those customers with payment difficulties.

However, a simple cap may not reflect the individual circumstances of a particular retailer. For example, the costs of a consumer not meeting a pay on time or direct debit condition may be greater for certain retailers than for others.

Further, the detraction of the simple cap, like the banning of discounts, would be that retailers would provide limited scope for innovation.

4. Limiting discounts to reasonable costs (preferred option)

The Commonwealth considers the limiting of conditional discounts the preferred option as it provides certainty for retailers. The other advantages of this approach are:

- it allows retailers to continue to compete on discounts
- makes market offers easier to compare due to the reduced role of conditional discounts in final market offer prices;
- it allows retailers to still incentivise consumers to pay on time, paying by direct debit, receiving e-bills etc.;
- protects vulnerable consumers from unsuitable retail products while still allowing for retailers to recoup reasonable costs where a consumer does not meet the conditions;
- does not add to retailer compliance responsibilities like adding additional obligations to ensure retailers as assessing consumer circumstances and suitability.

This rule change proposal adopts the ACCC approach and the Victorian independent Review recommendation (4e) to limit conditional discounting.

Proposed rule design – preferred approach

In terms of implementation, we recommend that the rule requires the AER to publish a guideline on what constitutes reasonable conditional discounts within a market offer. Section 61 of the National Energy Retail Law (NERL) enables the AER to set Retail Pricing Information Guidelines (RPIGs) about the *presentation* of offers and prices. However, it is not clear whether this could include setting limits around the 'reasonableness' of a discount, which may relate more to the composition and actual pricing of offers. We suggest the AEMC may wish to consider whether the RPIGs can accommodate this additional element.

In either scenario, the application of an AER guideline should allow for a reasonable level of flexibility in how retailers continue to design market products and allow the market and other stakeholders to help inform guideline design. This approach should reduce the risk of unintended consequences.

Additional rule features include:

- Precluding retail offers from including both a conditional pay-on-time discount and a late fee to stop retailers for both charging late fees as well as withdrawing pay on time discounts.

- Ensuring retailers must, at the request of the AER, provide advice as to how their market offers comply with conditional price discount rule.

In addition, we request the AEMC make the recommendation of imposing civil penalties on retailers where a conditional discount is determined not to be reflective of reasonable costs. The Australian Government considers this is necessary and will incentivise compliance.

While this rule would limit the size of conditional discounts, competitive market offers will still be available for consumers. The Government expects the market would respond to this rule change by focussing their advertising and competitive efforts on innovative or emerging tariff structures (e.g. a single low, undiscounted rate which is being embraced by a growing number of retailers), or on guaranteed discounts.

Details of the manner in which the proposed amendments will operate in the NERR is set out in the proposed rule below.

The Australian Government also considers similar issues are present in the retail gas market, and therefore the proposed rule should apply to all energy offers. This is consistent with the generally approach taken in the NERR, which largely applies rules to both fuel types.

How the proposal addresses the issues

We consider the best and simplest option is to place reasonable limits on discounts thereby balancing efficiency gains associated with reducing overall retailer debt with limiting the level of financial detriment experienced by those in payment difficulty. The new rule will also importantly improve overall market transparency.

By limiting the value of conditional discounts to reasonable costs, consumers will be protected from the significant financial impact of not meeting requirements such as paying on time, or by direct debit, which can essentially amount to a sizeable and disproportionate penalty. This will also minimise a customer's exposure to a significant financial shock, better enable consumers to anticipate and manage their energy bills and provide greater clarity to consumers about the nature of their energy offer.

The new rule will require the AER to develop a guideline as to the design, types of costs and potential financial limits that may be associated with conditional discounts. The rule would allow retailers to offer customers some benefit for paying on time or meeting other payment conditions like regular electronic funds transfer against their account, but would require these discounts comply with guidelines developed by the AER.

3. Description of the proposed rule

In accordance with section 243 of the NERL, the Australian Government requests the AEMC amend Rule 45A of the NERR and make new rules, Rule 46C and Rule 46D:

Rule 45A (new definitions)

conditional price discount means the amount by which a price otherwise payable under a contract is, or would be, reduced as a consequence of complying with one or more provisions of the contract.

conditional price discount guideline means the guidelines made by the AER under Rule 46C.

pay-on-time condition means a condition of a contract requiring payment of any amount by a specified date.

Rule 46C Conditional Price Discounts (new rule)

(1) A retailer must not include a term or condition in a market retail contract with a small customer that applies a conditional price discount (however described), unless:

(a) the contract includes details of the amount and manner of calculation of the conditional price discount;

(b) the contract clearly details the conditions under which the customer will receive the conditional price discount;

(c) the value of the conditional price discount does not exceed an amount which is a reasonable estimate of the costs to the retailer resulting from a customer's failure to comply with the conditions specified under subrule (1)(b); and

(d) the conditional price discount complies with the conditional price discount guidelines.

(2) For the purposes of subrule (1)(c), the costs to the retailer are the reasonable costs incurred or to be incurred by the retailer, but do not include costs based on lost supply or lost profits.

(3) If a condition under subrule (1)(b) is a pay-on-time condition, the contract may not additionally impose a fee for late payment if a customer fails to comply with the pay on time condition.

(4) At the request of the AER, a retailer must promptly provide the AER with information evidencing the reasonableness of the retailer's estimate of the costs specified under subrule (1)(c).

Rule 46D Conditional Price Discount Guidelines (new rule)

(1) The AER must make guidelines in accordance with the retail consultation procedure which may specify:

(a) what types of costs that can be reflected in a conditional price discount;

(b) how a retailer must calculate reasonable costs associated with a conditional price discount;

(c) information a retailer must publish with respect to its conditional price discounts; and

(d) any additional information which the AER considers would be reasonably required by a small customer to assess the conditional price discount energy offers available to it and which is held by the retailer.

(2) The AER may amend the conditional price discount guidelines in accordance with the retail consultation procedure.

Reasonable Cost Estimate

It is clear the current magnitude of discounts is far from a reasonable reflection of the cost impact of non-compliance. For example, while discounts conditional upon on-time payment can represent up to 43 per cent of usage charges, specific fees for late payment are generally between $10 and $15.

The concepts of 'reasonable' costs and charges are relatively common in the NERL and NERR. For example:

- South Australian derogations to the NERL provide for a retailer imposing a fee for late payment which "must not exceed the reasonable costs of the retailer in recovering an overdue amount"[14].
- Distributors are to reimburse customers for reasonable costs incurred in providing any quotes or evidence to the distributor in respect of a claim[15].
- In particular circumstances, retailers may provide historical billing data to a customer subject to a reasonable charge[16].
- Retailers can provide information provided to customers concerning the rights, entitlements and obligations of small customers subject to a reasonable charge where information is requested more than once in any 12 month period[17].
- In particular circumstances, retailers may provide electricity consumption information to a customer subject to a reasonable charge[18].
- Retailers can recover "fair and reasonable termination charges and meter removal charges" from a prepayment meter small customer in certain circumstances[19].

The existing provisions of the rules relating to early termination charges also embrace the concept of reasonable costs and bear the most similarity to the proposed rule. Specifically:

- At rule 49A, early termination charges in a fixed term retail contract are a "reasonable estimate of the costs to the retailer resulting from the early termination"[20] which "do not include costs based on lost supply or lost profits"[21].

Determining the financial impact from non-compliance with a particular type of condition is already accepted by the rules. The Government considers that, equally, the rules should embrace the concept that contract conditions (effective penalties) associated with payment after a due date can also meet a reasonable cost compliance obligation that is enforced by the AER.

[14] National Energy Retail Law (South Australia) Act 2011, s24
[15] NERL, s194
[16] NERR, rule 28(2)
[17] NERR, rule 56(4)
[18] NERR, rule 56A(3)
[19] NERR, rule 145(2)
[20] NERR, rule 49A(1)(b)
[21] NERR, rule 49A(2)

The rule proposes the AER develop guidelines relating to conditional price discounting to assist retailers and provide further guidance on reasonable costs, which may vary depending on the type of condition associated with the discount. In its rule change review process, the AEMC may also wish to consider the types of costs that may be included in the concept of 'reasonable costs' for various types of conditions (e.g. pay-on-time, direct debit, online sign-up etc). The costs could include:

- Administrative costs of customer service and engagement where payment is not made under the required conditions (where they apply);
- The cost of debt for the expected period of non-payment of the average customer;
- The cost of regulatory compliance with the conditional discount rule (e.g. the cost of policy development and publication)

4. Contribution to the National Energy Retail Objective, National Electricity Objective and National Gas Objective

The Australian Government views this rule change proposal as, fundamentally, promoting the efficient operation of energy, electricity and natural gas services in the long term interests of consumers. The proposal aims to improve the transparency of retail energy pricing arrangements. Complex pricing structures have been found to serve as a significant barrier to effective consumer engagement in the market and can reduce the price benefits household and small business receive from shopping around. Improving transparency and simplicity of pricing structures is therefore supportive of effective competition.

The rule change enables consumers to make more empowered and informed decisions noting conditional discounts have the potential to confuse consumers about the benefits of their offer and their expected bills. The proposal may also ensure many consumers are able to better plan for their energy bills by limiting potential exposure to unforeseen costs and disproportionate late fees to the extent possible, in this way curbing the potential for bill shock. The proposed rule encourages improvements in equity, consumer understanding of, and confidence in, the retail energy market, and is clearly in the long-term interests of consumers.

Given the second arm of the rule-making test in s 236(2)(b) of the NERL, it is also noted that the implementation of this proposed rule is inherently compatible with the development and application of consumer protections for small customers. Measures to improve outcomes for vulnerable households and encourage and facilitate consumer understanding about their energy bills are well aligned with existing consumer protections in the NERL and NERR and under the Australian Consumer Law.

5. Benefits, costs and implications of the proposed rule

Benefits

As stated above, the practical benefit of making this rule is that it will operate to protect consumers from the significant and disproportionate financial impact of not meeting particular conditions and enable consumers to better anticipate and manage their energy bills. Simplifying the complexity in retail energy offers created by the conditionality of grossly inflated discounts has the additional benefit of encouraging greater consumer engagement. The changes should also reduce the potential for billing disputes that can be referred to state based ombudsmen services, benefiting both customers and retailers. A more general benefit of the rule is that it will build consumer trust in the market and limit the risk of bad consumer experiences.

Regulatory impact assessment: risks, implications and treatment

Issue	**Treatment**
Risk that the rule increases the costs of market offers	The ACCC found the most common form of competition between retailers to be headline percentage-based discounts, the majority of which are conditional. The Australian Government expects that this rule change will change the nature of market offers but the most salient change will be a move away from conditional discount price structures. It is anticipated that more customers with credit issues may be placed on different offers to those with better credit histories. Considering the 1 in 4 customers that fail to meet their discounts are currently paying up to 50 per cent more on the electricity bills we see this outcome as being fairer and more manageable for those consumers. It is not anticipated that retailers would increase market offers for desirable customers if this rule is passed as retailers will still need to compete to attract and retain ‘low cost’ customers.
Lack of incentive for customer compliance with conditions which have a financial impact on retailers	Under the proposed rule, retailers will still be allowed to attract conditional discounts to market offers, but the quantum of such discounts will be limited by reference to the reasonable costs to the retailer of a consumer’s failure to meet the relevant conditions. Limiting the quantum of the discount should will maintain an incentive for customers to, for example, pay on time or by direct debit, while ensuring retailers can recoup the reasonable losses for non-compliance.
Cost of providing evidence to the AER regarding the value of the conditional price discount	An obligation to provide evidence to the AER to justify that the conditional discount reflects reasonable costs imposes a small cost on the retailer. Ultimately, the cost posed by the reporting obligation, are far outweighed by the detrimental impact to competition and consumers from the current discounting practive. The Government considers that any cost associated with this obligation is small and can be readily absorbed by retailers as a part of its other regulatory reporting obligations.

	The preferred approach is considered to imply the lowest compliance costs of the options considered in the paper.
Difficulty in determining reasonable costs	The rule proposes that the AER can create guidelines on reasonable costs in accordance with usual process for consultation with retailers and other stakeholders. .

6. Additional Considerations

In respect of the proposed rule, the AEMC may wish to consider:

- the imposition of civil penalties on retailers for including conditional discounts in a retail energy offer which do not reflect the reasonable cost of non-compliance with the condition;
- whether it may be appropriate to require the AER to develop guidelines on conditional price discounts to assist retailers prepare a statement of methodology for their assessment of reasonable costs, and what other types of issues these guidelines may address;
- whether the existing RPIGs can accommodate these new proposed elements;
- what types of costs relevant to a compliance with a condition may be covered by the concept of 'reasonable costs'; and
- whether the rule should also enabling the AER to set specific price cap limits on the value of conditional discounts.

While the Government considers the matters discussed in this rule change proposal can largely be addressed through changes to the NERR and guidelines, the AEMC may also need to consider issues covered under the NGR and the NER.

If the AEMC considers that changes are required to the NGR or NER to support the issues raised in this rule change proposal, these should be in scope of the AEMC's review.