

Australian Energy Market Commission

**Review of the Effectiveness of Competition in
Electricity and Gas Retail Markets in Victoria**

Second Draft Report

19 December 2007

Commissioners

Tamblyn
Carver
Woodward

Inquiries

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

E: aemc@aemc.gov.au

T: (02) 8296 7800

F: (02) 8296 7899

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About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

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Foreword

The Australian Energy Market Agreement (Agreement) requires the Australian Energy Market Commission (Commission) to review the effectiveness of competition in the retail supply of electricity and gas in each jurisdiction that participates in the National Electricity Market, and to publicly report the results. Where competition is found to be effective, the jurisdictions agree to phase out retail price regulation.

The reviews being conducted by the Commission of the effectiveness of retail competition in electricity and natural gas (gas) supply are an important element of the Ministerial Council on Energy's policy agenda directed to improving energy market competition and efficiency. The outcomes of these reviews will directly influence policy decision-making on the future regulatory frameworks that will be applied to energy retailing in each jurisdiction, including decisions regarding the need for retail price regulation in the future.

The Commission has completed its review of competition in electricity and gas retailing in Victoria and has confirmed its preliminary finding that competition is now effective.

In accordance with the Agreement, the Commission now provides advice on ways to remove retail price regulation in this report, the *Review of Effectiveness of Competition in the Electricity and Gas Retail Markets in Victoria – Second Draft Report*. The Commission encourages all interested parties to make submissions and to participate in the opportunities presented for consultation to ensure the Commission's recommendations are informed by stakeholder views and experience, relevant factual market information and rigorous, evidence-based analysis.

John Tamblyn
Chairman

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Abbreviations

ACCC	Australian Competition and Consumer Commission
AEMA	Australian Energy Market Agreement
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
CALC	Consumer Action Law Centre
CAV	Consumer Affairs Victoria
Commission	see AEMC
CUAC	Consumer Utilities Advocacy Centre
EIA	<i>Energy Industry Act 2000 (Vic)</i>
Energy Retail Code	ESC <i>Energy Retail Code</i> , version 4
ERA	Economic Regulatory Authority of West Australia
ESC	Essential Services Commission (Victoria)
ESCOSA	Essential Services Commission of South Australia
EWOV	Energy & Water Ombudsman Victoria
First Draft Report	AEMC, <i>Review of the Effectiveness of Competition in Electricity and Gas Retail Markets - First Draft Report</i> , October 2007, Sydney
First Final Report	AEMC, <i>Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria – First Final Report</i> , December 2007, Sydney
FRMP	Financially Responsible Market Participant
FTA	<i>Fair Trading Act 1999 (Vic)</i>
GIA	<i>Gas Industry Act 2001 (Vic)</i>
Host retailer	A retailer responsible under the EIA or the GIA for the supply of electricity or gas to customers in the geographic supply area allocated to that retailer. Currently the host retailers are: TRUenergy, Origin Energy and AGL.
Issues Paper	AEMC, <i>Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper</i> , June 2007, Sydney
Marketing Code	ESC, <i>Code of Conduct for Marketing Retail Energy in Victoria</i> , October 2004
MCE	Ministerial Council on Energy
National Framework Paper	Allens Arthur Robinson, <i>National Framework for Non-Economic Distribution and Retail Regulation – Consultation Paper prepared for the Retail Policy Working Group</i> , June 2007
NEL	National Electricity Law
New retailer	A retailer that is not a host retailer

OECD	Organisation for Economic Development
Ofgem	Office of Gas and Electricity Markets (UK)
Product Disclosure Guideline	ESC, <i>Guideline 19: Energy Product Disclosure</i> , Issue 2
QCA	Queensland Competition Authority
RPWG	Retail Policy Working Group
RoLR	Retailer of Last Resort
Second Draft Report	AEMC, <i>Review of Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria, Second Draft Report</i> , December 2007, Sydney
TPA	<i>Trade Practices Act 1974</i> (Commonwealth)
Victorian Review	The AEMC's review of the effectiveness of competition in electricity and gas retail markets in Victoria

Summary

The Australian Energy Market Agreement (AEMA) requires the Australian Energy Market Commission (Commission) to review the effectiveness of competition in the retail supply of electricity and gas in each jurisdiction that participates in the National Electricity Market (NEM), and to publicly report the results.¹ Where competition is found to be effective, the jurisdictions agree to phase out retail price regulation.²

The Commission, in accordance with the terms of the AEMA and the request for advice from the Ministerial Council on Energy (MCE), has completed its review of the effectiveness of competition in electricity and gas retailing in Victoria (Victorian Review) and has concluded that there is effective competition in the retail supply of electricity and gas in Victoria. Accordingly, in this report, the *Review of Effectiveness of Competition in the Electricity and Gas Retail Markets in Victoria – Second Draft Report* (Second Draft Report) the Commission provides advice on ways to remove retail price regulation in Victoria. The recommendations and the rationale behind them are set out in Chapters 3 and 4 of this Second Draft Report, and are summarised below.

Removal of retail price regulation

The Commission is of the view that the process of effective competition in Victoria protects consumers against the exercise of market power as firms strive to deliver goods and services consumers demand at least cost and to improve their products, services and processes. There is evidence that the majority of customers are benefitting from the competitive process as firms continuously strive for competitive advantage against actual and potential rivals by improving their price and service offering in ways that better meet the preferences of energy consumers.

Removal of retail price regulation in Victoria can further extend the benefits of competition to consumers by enabling them to choose from a wider range of energy products and options (including tariff innovation) than is currently the case. Where competition is facilitating the delivery of efficient outcomes there is no need for retail price regulation. Indeed price regulation in an effectively competitive market is costly in terms of administration, compliance and the distortions it imposes on the effective functioning of the market. The latter was clearly evident this year when the failure of standing offer regulated prices to align with rising wholesale energy costs resulted in at least one retailer ceasing actively to market retail offers to potential customers.³ This approach to price regulation is reflected in the AEMA, which provides for the removal of retail price regulation where there is effective competition in the retail energy sector.

¹ The Economic Regulatory Authority (ERA) of Western Australia is required to undertake the review for its jurisdiction at an appropriate time.

² AEMA, clause 14.13.

³ For example, refer to Simply Energy's submission to the First Draft Report, p. 1.

While effective competition negates the need for price regulation, it does not eliminate the need for regulations dealing with other types of market failure, such as those addressed by prudential and consumer protection regulation. The competitive retail energy sector in Victoria is supported by a sound consumer protection framework that is made up of energy specific regulation covering a wide variety of issues including obligations on retailers to disclose detailed energy offer information to customers, as well as general consumer protection laws that prohibit, amongst other things, misleading, deceptive and unconscionable conduct. There are also detailed codes and laws regulating the direct marketing techniques favoured by energy retailers.

The combination of effectively competitive retail sectors and the established consumer protection framework provides an appropriate foundation for the recommendations set out in this Second Draft Report.

1. The Commission recommends that the regulation of standing offer retail prices should cease from 1 January 2009 and that there be no extension of the existing reserve price powers under the *Electricity Industry Act 2000* (Vic) and the *Gas Industry Act 2001*(Vic) beyond their current expiry date of 31 December 2008.⁴

Obligation to offer to supply and sell energy and deemed supply arrangements

While the Commission found no evidence of systemic problems regarding access to offers for the supply and sale of energy or participation in the competitive market during the course of the Victorian Review, it recognises that some consumers may not have access to the full benefits offered by an effectively competitive energy market, either because these consumers are less profitable to serve or because of personal circumstances which limit their participation in the market. In addition, the Commission recognises that access to electricity and gas supply services is essential for all sectors of the community. For these reasons, the Commission considers that the obligation to offer to supply and sell energy to residential customers should remain and that the obligation should lie in each case with the financially responsible market participant (FRMP) for the consumer's premises.

2. The Commission recommends that the obligation to offer to supply and sell energy to residential customers and existing deemed supply arrangements for residential customers remain in place.
3. The Commission recommends that the obligation to offer to supply and sell energy to a residential customer at a premises where there is an existing connection should rest with the FRMP for the relevant premises.

⁴ Price regulation could be reintroduced in the circumstances set out in clause 14.4(c) of the AEMA following a subsequent finding by the AEMA that competition has ceased to be effective and resumption of retail price regulation is an appropriate response.

Determination and publication by all retailers of their standing offer prices

The Commission recognises the current role of the regulated standing offer prices as a reference point or benchmark but also considers that the direct regulation of standing offer prices has the effect of deterring retailers from offering more diverse, innovative tariffs, products and services to customers. In the Commission's view, the publication by all retailers of their own standing offer prices (and other terms and conditions) will provide consumers with benchmark prices when assessing energy offers without resorting to the constraining effect of regulation on product and service development, innovation and price discounting. The Commission does not consider it appropriate to require the publication of all energy price offers, as this type of comprehensive price transparency can facilitate price coordination and discourage discounting. Some minimum requirements should be imposed regarding the format of publication to ensure reasonable uniformity of the published standing offer prices to enable customers to make informed judgements about the standing offer, particularly as tariff innovation in the future may make comparisons and judgements more complex.

4. The Commission recommends that all retailers (new as well as host retailers) determine and publish standing offer prices and other terms and conditions to cover the retailers' obligations to offer to supply and sell energy and deemed supply arrangements.
5. The Commission recommends that the Essential Services Commission, Victoria (ESC) develop a guideline setting out the requirements regarding the format of the publication of retailers' own standing offer prices.

Price monitoring

A regime of price monitoring is proposed for a transitional period following the removal of direct retail price regulation. The objective of price monitoring is to identify and publish trends in standing offer prices with a view to providing a timely indication of any potential future market failure. If concerns arise, this could trigger a further inquiry by the AEMC into the effectiveness of retail energy competition, in accordance with the requirements of the AEMA, providing the basis for policy decisions on appropriate responses to any demonstrated market failure.⁵

6. The Commission recommends the introduction of a price monitoring regime for standing offer prices for at least 3 years following the removal of retail price regulation.

⁵ AEMA, clauses 14.14(b) and 14.14(c).

Consumer awareness and education campaign

The objective of a consumer awareness and education campaign is to inform consumers of the changes that will take place and to highlight to them their rights under the consumer protection framework and their opportunities in the competitive energy retail sector.

7. The Commission recommends that, as part of the transition to the phase out of retail price regulation, a consumer awareness and education campaign be implemented.

During the Victorian Review, the Commission was presented with anecdotal evidence and case studies which indicate instances of mis-selling and associated marketing practices, such as high pressure selling or misleading or deceptive conduct. While the Commission has not been persuaded that mis-selling is systemic in energy retailing in Victoria, it considers that it is incumbent upon energy retailers to ensure their sales agents are not engaging in mis-selling or such other conduct that may mislead or deceive energy customers. This is a clear obligation under the retail licences. There is a substantial regulatory framework in place to protect consumers from this type of activity and retailers need sufficient incentives and deterrents to ensure that they are complying with that framework. The Commission considers that regulatory bodies such as the ESC and Consumer Affairs Victoria (CAV) have an important role to play in maintaining the integrity of the regulatory framework by investigating allegations of non-compliance with retailers' licence obligations and, where necessary, taking steps to enforce compliance. However, price regulation is not the appropriate policy to address issues relating to information disclosure, misleading and deceptive conduct, or high pressure selling.

The Commission has published its findings regarding the effectiveness of competition in its *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria – First Final Report* (First Final Report) in December 2007. In the course of finalising its findings, the Commission has had regard to observations from stakeholders on all aspects of its preliminary findings, including comments provided in submissions to the *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria – First Draft Report* (First Draft Report), and to other information gathering and analysis undertaken prior to the publication of the First Final Report.

With the publication of the Second Draft Report, the Commission is seeking comments from stakeholders on all aspects of its draft advice. The process for providing written submissions is set out in Chapter 1. In the course of finalising its advice prior to the publication of the Second Final Report, the Commission may undertake additional information gathering or analytical processes, and will have regard to the matters raised in submissions.

There are two matters upon which the Commission is specifically seeking views from stakeholders. They relate to:

- an additional requirement on retailers to publish their standing offer tariffs in newspapers; and

- the obligation to offer to supply and sell energy to new connection premises.

Detailed discussion of these two issues, including the Commission's draft analysis, is included in Chapters 3 and 4.

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1 Introduction

1.1 Requirements of the AEMA

The Australian Energy Market Agreement (AEMA) requires the Australian Energy Market Commission (Commission) to review the effectiveness of competition in the retail supply of electricity and gas in each jurisdiction that participates in the National Electricity Market (NEM), and to publicly report the results.⁶ Where competition is found to be effective, the jurisdictions agree to phase out retail price regulation.⁷

Where the Commission finds that competition is effective, it must provide advice to the jurisdiction on ways to phase out retail price regulation.⁸ This advice need not include the removal of “obligation to supply” arrangements and may involve a period of price monitoring and/or price agreements with retailers under appropriate oversight arrangements.⁹

Victoria is the first jurisdiction to be reviewed. The Commission has completed its review of the effectiveness of electricity and gas retailing in Victoria (Victorian Review), publishing its *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria – First Final Report* (First Final Report), in December 2007.¹⁰ The Commission’s finding, which is discussed in greater detail in Chapter 2 below, was that competition is effective in both electricity and gas retailing.

1.2 Purpose of Second Draft Report

The primary purpose of this report, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets – Second Draft Report* (Second Draft Report), is to set out the Commission’s advice to the Victorian Government and the Ministerial Council on Energy (MCE) on ways to phase out retail price regulation in Victoria.

In particular, the Commission must provide advice:

- on ways to phase out retail price oversight in Victoria, including a draft timeframe within which the phase out should occur; and
- on Victoria’s compliance with clauses 14.10 to 14.14 of the AEMA.¹¹

⁶ The Economic Regulatory Authority (ERA) of Western Australia is required to undertake the review for its jurisdiction at an appropriate time.

⁷ AEMA, clause 14.13.

⁸ *Ibid*, clause 14.11(c).

⁹ *Ibid*, clause 14.14.

¹⁰ A copy of the First Final Report is available from the Commission’s website – www.aemc.gov.au

¹¹ AEMA, clause 14.11(c) and letter dated 25 May 2007 from the Chair of the Ministerial Council on Energy, the Hon Ian McFarlane to the Chairman of the Commission, Dr John Tamblyn.

The advice on ways to phase out retail price regulation is set out in the remainder of the Second Draft Report, principally Chapters 3 and 4.

The obligations arising from clauses 14.10 to 14.14 of the AEMA, on which the Commission is required to provide compliance advice, are, in summary, the jurisdiction's commitment to:¹²

- full retail contestability in accordance with the National Competition Policy Agreements;¹³
- meet social welfare and equity objectives through clearly specified and transparently funded community service obligations that do not materially impede competition;¹⁴
- where competition is not yet effective for a market, group of users or a region, impose retail energy price controls that do not, to the extent possible, further hinder the development of competition and ensure that the benefits outweigh the costs, and costs are minimised;¹⁵
- where competition is not yet effective for a market, group of users or a region and energy retail price controls are imposed, such energy retail price control will be retained under the existing arrangements or be transferred to the Australian Energy Regulator (AER) and the Commission at the discretion of each jurisdiction;¹⁶
- where competition is found to be effective, phase out retail price regulation; and¹⁷
- where a reserve price regulation power is retained, only exercise that power in accordance with a regulatory methodology promulgated by the Commission and be subject to review by the Commission of the effectiveness of competition in accordance with clause 14.11.¹⁸

As the Victorian Review is the first to be undertaken under the AEMA, and given the Commission's findings that competition is effective for the whole of the electricity and gas markets, users and regions that have been the subject of the Victorian Review, the compliance matters on which the Commission is required to advise are subject to practical limitations. Therefore, at this time, the Commission's advice relates to Victoria's compliance with clauses 14.10 and 14.11(b) of the AEMA.

¹² AEMA, clause 14.11(c).

¹³ *Ibid*, clause 14.10.

¹⁴ *Ibid*, clause 14.11(b).

¹⁵ *Ibid*, clause 14.12(a).

¹⁶ *Ibid*, clause 14.12(b).

¹⁷ *Ibid*, clause 14.13.

¹⁸ *Ibid*, clause 14.14(c).

Regarding clause 14.10 of the AEMA, the Commission is of the view that Victoria has demonstrated its commitment to full retail contestability in accordance with the National Competition Policy Agreements. Regarding clause 14.11(b), Victoria's community service obligations are clearly specified and transparently funded and, in the view of the Commission, do not materially impede competition.

Compliance with other clauses of the AEMA, such as clause 14.13 (commitment to phasing out retail price regulation) and 14.14(c) (exercise of a reserve price regulation power), will assume greater significance in the event that the Commission undertakes a second or subsequent review under the AEMA.

1.3 Input from stakeholders

Given the significance of the Commission's advice to the Victorian Government and the MCE concerning the future of retail price regulation, it is essential that the Commission test its recommendations through a process of open and informed public consultation.

To this end, the Commission invites public comment on the advice and recommendations made in the Second Draft Report. The Commission encourages submissions to address these matters, and any other matter that is considered pertinent to the Commission's advice.

The Commission intends to publish all submissions on its website. The Commission's approach to confidential information is explained in section 4.4 of the Statement of Approach.

1.4 Lodging Submissions

The Commission invites written submissions from interested parties in response to the First Draft Report by 5pm, 1 February 2008. Submissions may be sent electronically or by mail in accordance with the following requirements.

Lodging a submission electronically

The submission must be sent by email to submissions@aemc.gov.au.

The email must contain the phrase "Retail Competition Review – Second Draft Report" in the subject line or heading.

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

The submission must also be forwarded to the Commission via ordinary mail.

Upon receipt of the electronic version of the submission, the Commission will issue a confirmation email. If this confirmation email is not received within three business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

Lodging a submission by mail

The submission must be on letterhead (if an organisation), signed and dated by the respondent.

The submission should be sent by ordinary mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

The envelope must be clearly marked “Retail Competition Review – Second Draft Report”.

Except in circumstances where the submission has been submitted electronically, upon receipt of the hardcopy submission the Commission will issue a confirmation letter. If this confirmation letter is not received within three business days, it is the submitter’s responsibility to ensure successful delivery of the submission has occurred.

The Commission is subject to strict deadlines throughout the Victorian Review that impose immovable time constraints on the Commission. Accordingly, the Commission will have full regard to all submissions lodged within the specified time period but regrets that it may not be able to afford late submissions the same level of consideration. To ensure it is able to fully consider all submissions, the Commission strongly urges interested parties to provide their submissions by 1 February 2008.

1.5 Structure of the Report

Chapter 2 discusses the background and rationale for the recommendation to remove retail price regulation in Victoria. Chapter 3 sets out the Commission’s advice on ways to phase out retail price regulation. Chapter 4 covers the Commission’s advice on the consumer protection framework. Chapter 5 sets out some possible customer information initiatives that the Victorian Government may wish to consider. Chapter 6 outlines the immediate next steps for the Second Draft Report.

Finally, attached to the Second Draft Report is an appendix containing a summary of the energy consumer protection regime for small retail customers in Victoria.

2 Framework for Advice

2.1 Introduction

As discussed in Chapter 1, the Commission is required under the AEMA to review the effectiveness of competition in the retail supply of electricity and gas in each jurisdiction that participates in the NEM, and to publicly report the results.¹⁹ Where competition is found to be effective, the jurisdictions have agreed to phase out retail price regulation.²⁰ This chapter summarises the Commission's conclusions regarding effective competition and the rationale for removing retail price regulation, and sets out a framework for considering the process of phasing out retail price regulation in Victoria and the evaluation of any other complementary regulatory reforms which may be necessary.

2.2 Application of advice to residential customers

The Victorian Government has decided to remove retail price regulation for small business customers, effective 1 January 2008. In implementing this policy decision, the Commission notes that the legal obligation to offer to supply and sell energy to small business customers has also been removed. The Commission's recommendations in this advice are therefore confined to residential customers.

The Commission recognises, however, that small business customers share many of the characteristics of residential customers and there could be legitimate reasons for extending the recommendations in this advice to small business customers. The Commission considers that this is a matter for consideration and decision by the Victorian Government.

2.3 Rationale for removal of retail price regulation

Where competition is found to be effective, it should ensure that market prices reflect efficient costs and there is no need to maintain price regulation. Indeed, regulated prices will almost always provide an imperfect substitute for those prices determined in a competitive market and are likely to impose costs and distortions not present in a competitive market.²¹ Regulators have imperfect information and regulated prices often lack the flexibility of market prices. Regulated prices will generally either be too low, deterring investment, or too high, to the detriment of consumers. In a competitive market, prices are driven towards cost, retailers will have the incentive to provide products and prices which attract consumers and

¹⁹ The Economic Regulation Authority (ERA) of Western Australia is required to undertake the review for its jurisdiction at an appropriate time.

²⁰ AEMA, clause 14.13.

²¹ This view is also expressed by the Productivity Commission in one of its recent reports – Productivity Commission 2007, *Review of Australian's Consumer Policy Framework*, Draft Report, Canberra, Chapter 5, p. 97

resources will be allocated efficiently to reflect changing resource costs and customer preferences. Furthermore, retail price regulation imposes administrative and compliance costs on Government, and hence tax payers and consumers, and market participants.

It is important to distinguish between competition issues and non-competition issues. Where concerns arise regarding issues going beyond the operation and performance of the competitive energy market, such as the affordability of energy for low income households, these issues need to be addressed through appropriately targeted policies rather than by intervening to distort the efficient operation of the market. While energy affordability is a genuine concern, particularly if energy prices rise in the future, for example, due to the introduction of an emissions trading regime, investment shortfalls or scarcity of energy sector inputs, price regulation is not the answer and indeed could exacerbate the underlying causes of increased prices. Price regulation affects all market participants, not just those consumers experiencing hardship. A competitive market ensures that energy prices reflect the real resource costs of energy supply and sends appropriate price signals to firms regarding investment decisions and to consumers regarding their energy use. It would be inappropriate to subvert that process through introducing price regulation and distorting competitive market outcomes.

2.4 Findings on the effectiveness of competition

In the First Final Report the Commission concluded that competition is effective for both electricity and gas retailing in Victoria. The majority of energy customers are actively participating in the competitive market by exercising choice among available retailers and available price and service offerings. There is strong rivalry between energy retailers, facilitated by the current market structures and entry conditions.

The Commission's finding that competition is effective is supported by evidence of strong rivalry between retailers. Because the provision of energy is viewed as a homogenous, low engagement service for which extensive market research is not warranted, retailers have a strong incentive to be pro-active in seeking and retaining customers in competition with their rivals. There is evidence of vigorous marketing rivalry between retailers who are contacting customers directly, primarily through door-to-door sales and telemarketing. Such direct marketing has proven to be cost-effective from the perspective of both customers and retailers as a majority of customers are unlikely actively to search for superior energy contract arrangements in the absence of such an active approach to marketing on the part of retailers.

Retailers are offering customers discounted tariffs together with a range of non-price incentives in an effort to differentiate their energy services from those of their rivals. For example, many retailers are offering accredited GreenPower renewable energy products which appeal to many customers. However, the standing offer tariffs also constrain the way in which retailers are able to price their products and compete for

customers.²² When wholesale energy prices were rising during 2007, standing offer prices did not keep pace and at least one retailer stopped actively promoting market contracts to consumers because it was no longer profitable to offer prices below the standing offer.²³

The Commission's finding that competition is effective is also supported by evidence of customer behaviour. Customers are demonstrating a clear willingness to participate in the competitive retail market, particularly if approached directly by a retailer. While customers may undertake only limited search activity on their own behalf, they respond well to direct marketing and exhibit a high willingness to switch retailers, particularly in response to lower prices. Neither brand loyalty nor perceived switching costs seem to be significant deterrents. Indeed, the percentage of all domestic and small business customers in Victoria who have entered into a market contract is currently 60 per cent for electricity and 59 per cent for gas. The Commission expects these levels of participation to increase further as competition continues to develop.

The current conditions for entry into, and expansion within, the retail energy sector are also positive. There has been substantial new entry into energy retailing in Victoria since the commencement of full retail competition (FRC) from both established inter-state retailers and "de novo" entry. The current market conditions encourage efficient entry, thereby creating a credible threat of competition from actual or potential new retailers and constraining the pricing and output decisions of existing retailers. Finally, margins appear to have generally been sufficient to allow efficient entry and for retailers actively seeking customers to offer price and non-price incentives.

The Commission recognises there are legitimate concerns about those customers who, by virtue of their personal circumstances or the perception that they are unprofitable to serve, may not currently be able to access the full benefits of retail competition. The Victorian Government, in consultation with retailers and consumer groups, has developed and implemented a range of strategies to safeguard the interests of these customers. The Commission's advice assumes there will be no fundamental change in this regulatory framework. The Commission has the opportunity to provide advice to the Government regarding any additional measures that would enhance the ability of all classes of customers to experience the benefits of a superior competitive environment. Accordingly, the following chapters consider the retention of an obligation to offer to supply following the removal of retail price regulation, the implementation of a price monitoring regime, the nature and enforcement of consumer protection measures and possible enhancements to the energy product information regime in Victoria.

The Commission recognises the potential for problems relating to information disclosure and misleading and deceptive conduct to arise in the context of direct

²² Office of Gas and Electricity Markets (Ofgem), *Domestic Retail Market Report*, June 2007, Chapter 4, notes that British energy retailers are offering consumers a range of innovative tariffs which are proving popular.

²³ For example, refer to Simply Energy's submission to the *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets - First Draft Report*, October 2007.

marketing. It notes, however, that there are comprehensive consumer protection laws and codes in place in Victoria and that the Essential Services Commission, Victoria (ESC) and Consumer Affairs Victoria (CAV) have appropriate investigation and enforcement powers to address such conduct. It considers, therefore, that these problems should be addressed through the effective enforcement of consumer protection provisions and not through the ongoing regulation of prices.

On the basis of the evidence and analysis before it, the Commission's conclusion is that competition in electricity and gas retailing in Victoria is effective. The Commission considers that competition is relatively more effective for electricity than for gas, but that gas retailing is nonetheless effectively competitive as retailers are pursuing opportunities to secure gas customers in conjunction with marketing electricity, the number of gas products available is continuing to grow and access to wholesale gas products is improving. The Commission notes that amendments to the rules governing the operation of the wholesale gas market which were introduced in early 2007 have unintended consequences for the future competitiveness of gas retailing in Victoria. The Commission understands that steps are being taken to address this concern and suggests that the effectiveness of this response be kept under review.

A number of submissions to the *Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, June 2007 (Issues Paper) and the *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets - First Draft Report*, October 2007 (First Draft Report) stated that competition is effective *because* of the existence of a public standing offer tariff, which provides a benchmark for consumers to compare against market offers and a "price to beat" for retailers, and, further, that competition would be undermined if the standing offer was removed, as there is no comparison point for savings and consumers will have no confidence that they are receiving the best deal.²⁴

On the other hand, comprehensive price disclosure, and universal availability has the potential to facilitate coordinated pricing, facilitating agreement and to deter customer poaching through price discounting and "specials".²⁵ The UK regulator requires all tariff schedules to be published with a view to reducing consumers' search costs, but some commentators have been critical of this approach because it also provides information to firms about the behaviour of competitors, ensuring that competition is not too vigorous.²⁶

²⁴ For example, submissions from Consumer Action Law Centre to the First Draft Report, p. 8, and the Issues Paper, p. 15; Consumer Utilities Advocacy Centre submission to the Issues Paper p. 8; St Vincent de Paul submissions to the Issues Paper, p. 2 and the First Draft Report, p. 2; Alternative Technology Association, submission to the First Draft Report, p. 1.

²⁵ See, for example, D Genesove and W P Mullin, "Rules, Communication and Collusion: Narrative Evidence from the Sugar Institute Case", *The American Economic Review*, Vol. 91 No. 3, June 2001, p. 379; Svend Albaek, Peter Mollgaard and Per B Overgaard, "Government Assisted Oligopoly Coordination? A Concrete Case", *The Journal of Industrial Economics*, Vol. XLV, No.4, December 1997, p. 429; Jill Walker and Luke Woodward, "The Ampol/Caltex Australia Merger: Trade Practices Issues", *Trade Practices Law Journal*, Vol.4, No.1, March 1996, p. 21.

²⁶ Prof Stephen Davies, Prof Catherine Waddams Price and Cheryl Whittaker, "Competition Policy and the UK Energy Markets", *Consumer Policy Review*, Vol. 17, Jan/Feb 2007, p. 5.

The Commission has engaged Professor George Yarrow of the Regulatory Policy Institute, Oxford to prepare a report outlining the theoretical implications and practical experience in relevant countries of deregulated, competitive markets that have moved from a regulated or standard offer price to a situation where price is unregulated. The report will draw on both theoretical literature and experience in other countries and other industries to address the questions of whether the existence of a benchmark price is likely to result in:

- the distortion or enhancement of pricing, innovation, competitive behaviour and the efficiency of market outcomes compared to those that would occur in competitive markets where price is unregulated or no benchmark or reference price exists;
- retailers charging prices which are lower or higher than they would be in the absence of a benchmark or regulated price; and
- consumers making more or less informed and beneficial price /service decisions than they would have made in the absence of a benchmark or regulated price.

A copy of the terms of reference governing the preparation of Professor Yarrow's report is available on the Commission's website.

Professor Yarrow's report will be published on the Commission's website in mid-January 2008. Following its publication, the Commission encourages stakeholders and interested parties to provide any relevant written observations in relation to the report to the Commission by 5pm, Friday, 1 February 2008.

2.5 Principles of good regulatory practice

Given the Commission's finding that competition in electricity and gas retailing in Victoria is effective, the task of the Commission is to provide advice to the Victorian Government and the MCE on how to phase out price regulation and to consider other complementary measures. The Commission has been guided in the formulation of this advice by the principles of good regulatory practice.

The term "regulation" is used to describe the laws and other government-endorsed rules with which there is an expectation of compliance.²⁷ Economic regulation applies to the rules that govern the operation of markets, the rights and obligations of market participants, and the powers and obligations of market regulators. A market becomes subject to regulation where a government or some other authorised body develops and implements rules that govern the way some aspect of a market is to operate. Regulation serves a number of important purposes. Regulation can be used to increase economic efficiency where there would otherwise be market failure, for example insufficient competition and/or costs and benefits of production or consumption bypass the market (externalities). In these situations, unregulated markets may not allocate resources efficiently or provide the necessary incentives for cost and dynamic efficiency.

²⁷ Australian Government, *Best Practice Regulation Handbook*, Canberra, August 2007, p. 1.

Regulation can also be used to address broader social objectives, and there continues to be support for regulation that protects consumers, public health and safety, the environment and other significant interests.²⁸ In some cases these different objectives can overlap and regulation may address both objectives, for example environmental concerns may be addressed by internalising the external costs which production and consumption activities impose on the environment and providing consumer protection (for instance in relation to information disclosure or prohibiting misleading or coercive conduct) can facilitate competition. In other cases, however, different objectives will require different regulations and promoting one objective may conflict with another objective. It is therefore critical that the objectives of regulation are clearly established.

Regulation is not costless. The costs are measured in terms of both administration and compliance costs, and possible distortions to competitive market processes or undermining of other policy objectives. These costs are shared by governments, regulated businesses and consumers, and can impact upon national productivity.²⁹ The costs of regulation are likely to be exacerbated where the market failure that is sought to be addressed by regulation is poorly specified and targeted or the regulatory solution operates with unforeseen and unintended consequences.

In recognition of the positive impact that appropriate, targeted regulation can have – and the costs incurred as a result of unnecessary, imprecise or ill-defined regulation – considerable resources have been expended in recent years on developing principles and processes to ensure the development and implementation of effective, balanced regulation, both in Australia and overseas. In 2005, the Organisation for Economic Development (OECD) released its updated principles to help countries face the challenges posed by regulatory reform in the 21st century, which include eight factors that guide “good regulation” (see Box 2.1 below).³⁰

²⁸ Hilmer Committee, *National Competition Policy: Report by the Independent Committee of Inquiry*, August 1993, p. 189.

²⁹ See, for example, the Hilmer Committee, *National Competition Policy: Report by the Independent Committee of Inquiry*, August 1993, p. 189, which noted that “regulatory restrictions on competition impose substantial costs on consumers and society, through either cross-subsidies or reduced incentives for firms to innovate and improve their efficiency”. Also, Regulation Taskforce, *Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006.

³⁰ OECD, *Guiding Principles for Regulatory Quality and Performance*, Paris, 2005.

Box 2.1 OECD Principles of Good Regulation

The OECD's *Guiding Principles for Regulatory Quality and Performance* observes that good regulation should:

- serve clearly identified policy goals, and be effective in achieving those goals;
- have a sound legal and empirical basis;
- produce benefits that justify costs, considering the distribution of effects across society and taking economic, environmental and social effects into account;
- minimise costs and market distortions;
- promote innovation through market incentives and goal-based approaches;
- be clear, simple and practical for users;
- be consistent with other regulations and policies; and
- be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.

Source: OECD, *Guiding Principles for Regulatory Quality and Performance*, Paris, 2005, p. 3.

Considerable work has also been undertaken in Australia to ensure regulation is proportionate, effective and not unduly burdensome. In October 2006, the Taskforce on Reducing Regulatory Burdens on Business was appointed to identify practical options for alleviating the compliance burden on business arising out of Commonwealth Government regulation. One of the Taskforce's recommendations was that the Government endorse six principles of good regulatory process (see Box 2.2 below). These principles are now embodied in the *Best Practice Regulation Handbook* published by the Office of Best Practice Regulation.³¹

³¹ A copy of the Best Practice Regulation Handbook is available from the Office of Best Practice Regulation's website at www.obpr.gov.au.

Box 2.2 Taskforce recommendations on good regulatory process

Recommendation 7.1 of the Taskforce on Reducing Regulatory Burdens on Business called for the Australian Government to endorse the following six principles of good regulatory process:

- Governments should not act to address “problems” until a case for action has been established;
- A range of feasible policy options – including self-regulatory and co-regulatory approaches – need to be identified and their benefits and costs, including compliance costs, assessed within an appropriate framework;
- Only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted;
- Effective guidance should be provided to relevant regulators and regulated parties in order to ensure that the policy intent of the regulation is clear, as well as the expected compliance requirements;
- Mechanisms are needed to ensure that regulation remains relevant and effective over time;
- There needs to be effective consultation with regulated parties at all stages of the regulatory cycle.

Source: Regulation Taskforce, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006, p. 147.

It follows from the application of these principles that continued (or increased) regulation is unlikely to be appropriate where the costs of regulation outweigh the benefits. In the First Final Report, the Commission noted the importance of balancing the costs and benefits of regulation, observing that price regulation is only justified where markets are not effectively competitive, regulation can improve market outcomes and the benefits of regulation exceed the costs. Regulated prices are always imperfect and may deter competitive pricing, exploit consumers and/or distort investment decisions. Furthermore, they involve administrative and compliance costs. Prices determined in competitive markets will almost always be more efficient and avoid the costs of regulation. Accordingly, where competition is effective in promoting economic efficiency, there is generally no need for price regulation. As previously noted, this view is reflected in clause 14.11(a) of the AEMA, which requires the jurisdictions to phase out retail price regulation where competition is demonstrated to be effective.

To the extent it is permitted to do so by the terms of the AEMA and the MCE’s request for advice, the Commission has been guided in providing this advice by the principles of good regulatory practice and process propounded by the OECD and the Regulation Taskforce. In considering the options for phasing out price regulation, the requirements for other energy market regulation going forwards, such as the obligation to supply and consumer protection provisions and any price monitoring

regime, the Commission has considered the objectives of each regulatory instrument, options for achieving that objective and the costs and benefits of regulation.

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3 Advice on ways to phase out retail price regulation

3.1 Introduction

Having found that competition is effective in the retail supply of electricity and gas in Victoria, this Chapter sets out the Commission's recommendations regarding the removal of retail price regulation for residential customers in Victoria. It contains a series of recommendations regarding changes or additions to the current regulatory framework for the publication of standing offer prices. It also addresses price-related measures to support the transition to an unregulated retail pricing regime. Its proposals for certain refinements to the consumer protection regime, including measures to assist consumers transition to an unregulated pricing regime, are presented in Chapter 4.

Chapters 3 and 4 are largely focused on policy advice. Accordingly, it will be necessary for the ESC to review current energy regulatory instruments, such as the *Energy Retail Code* (Energy Retail Code), for any detailed consequential changes that are necessary to implement these policy recommendations and to ensure the maintenance of current customer protection standards. There is one exception to this policy advice in that Chapter 3 contains a suggestion for Retailer of Last Resort (RoLR) prices.

The Commission has concluded that energy retailing in Victoria is effectively competitive, which in turn imposes disciplines upon, and creates incentives for, market participants that benefit consumers. The competitive market operates in the context of a comprehensive energy consumer protection framework. Together, the consumer protection framework and the competitive market provide a sound basis for the removal of retail price regulation. The Commission has assumed the continuation of this sound basis in making the recommendations in this chapter.

Both the general consumer protection law and the energy regulatory framework apply to the marketing and retail supply and sale of energy in Victoria. A description of some of the important features of this framework is set out in **Appendix A**. The recommendations made below do not diminish this framework in any way. Effective regulation and enforcement of consumer protection arrangements is a necessary underpinning for the operation of effective energy market competition. If implemented, the recommendations below and in Chapter 4 should enhance consumer outcomes as they will increase transparency of the standing offers while facilitating price flexibility and encouraging further competitive activity through price discounting and tariff innovation.

3.2 Current form of retail price regulation in Victoria and the safety net arrangements

Under section 13 of the *Electricity Industry Act 2000* (Vic) (EIA) and section 21 of the *Gas Industry Act 2001* (GIA) the Government of Victoria has the reserve power to determine retail prices.³² This power has not been exercised since 2002.

Against this background, retail price regulation in Victoria is an informal arrangement that takes the form of price paths agreed between the host retailers and the Government of Victoria. The price paths provide for agreed annual movements in the average prices for services to small retail customers on a standing offer contract. The agreed price paths then determine the prices that are actually charged to these customers. These prices are published in the Government Gazette and on the host retailers' websites.

The price paths form part of what is commonly referred to as the 'consumer safety net arrangements'. Under the existing regulatory framework, the consumer safety net arrangements comprise the terms and conditions of the standing offer that are approved by the ESC in addition to the agreed price path prices. In short, the host retailers must offer to supply and sell electricity or gas to residential customers in their previous franchise areas at approved prices (in the form of the agreed price paths) and on approved terms and conditions. The terms and conditions must be consistent with a number of the provisions of the Energy Retail Code (in addition to complying with general law and other statutory requirements). Once approved by the ESC, the other terms and conditions are also published in the Government Gazette and on retailers' websites.

The consumer safety net arrangements are directed to the objective of ensuring the right of access, for residential customers, to electricity and gas supply of a reliable quality on reasonable terms and conditions.

3.3 Recommendations regarding how retail price regulation can be phased out

The combination of effective competition and the established consumer protection arrangements provide an appropriate foundation for the Commission to recommend the removal of retail price regulation in Victoria. Removing retail price regulation would involve separating the agreed price paths from the other elements of the 'consumer safety net arrangements' (being the obligation to supply and sell energy to certain customers on other terms and conditions approved by the ESC) that were established with the introduction of full retail competition in Victoria. It would not involve changing the safety net arrangements in any other way. The Commission also recommends in Section 3.3.1 below that host retailers determine and publish their own standing offer prices in the place of the current regulated retail prices.

³² Section 13 of the EIA and section 21 of the GIA provide for the Governor in Council may regulate tariffs for the sale and supply of energy to prescribed customers or a class of prescribed customers. This is known as the "reserve power" but has not been exercised by the Government since 2002. The provisions are due to expire on 31 December 2008.

The Commission recommends that the regulation of standing offer retail prices cease from 1 January 2009 and that there be no extension of the existing reserve powers in the EIA and GIA beyond the current expiry date of 31 December 2008.³³ The Commission notes the following issues related to this recommendation:

- the current extended price paths are due to expire on 31 December 2008;
- a number of detailed implementation and transition tasks will need to be addressed, some of which are set out in this advice;
- a number of retailers need to determine the implication for their market contracts which vary prices in line with variations to the regulated retail prices; and
- consideration of the development and implementation of an appropriately timed consumer awareness and education campaign is also recommended below.

In the remainder of this Chapter, the Commission recommends a number of changes or additions to the current regulatory framework including the publication by all retailers of their own standing offer prices.

3.3.1 All retailers (host and new) to determine and publish their own standing offer prices

The Commission recommends that a legal obligation be placed on all retailers (host and new) to determine and publish their own standing offer prices, and other terms and conditions.

The Commission considers that this requirement (together with the price monitoring regime proposed below) will address the concerns of some consumer representative groups that the removal of regulated retail prices would leave customers without price benchmarks against which market offers could be compared. Publication of their own standing offer prices and terms and conditions by all retailers will provide points of comparison against which consumers can assess market offers and facilitate an appropriate level of price transparency.

However, while price transparency can assist consumer choice, under certain market conditions it can also act to deter price discounting and facilitate price coordination. These potentially negative effects of price transparency are more likely to occur where all prices are posted and universally available and where other conditions are conducive to coordinated conduct in a market. In the context of energy retailing in Victoria, there is currently active competition between a range of host and new entrant retailers and it is likely that there would be some publication of rates in any case. The Commission is recommending that the standing offer prices be published in such a way that makes comparisons easier for consumers and hence facilitates consumer choice and retailer rivalry. At the same time, the Commission is not

³³ Price regulation could be reintroduced in the circumstances set out in clause 14.4(c) of the AEMA following a subsequent finding by the AEMC that competition has ceased to be effective and resumption of price regulation is an appropriate response.

recommending that retailers be required to publish market contract prices on offer, or requiring all prices to be universally available, as this could run the risk of deterring discounting and facilitating price coordination.³⁴

Having recommended the removal of retail price regulation the Commission considers that the requirement that all retailers determine and publish their own standing offer prices is consistent with, and supports, the recommendations regarding the obligation to offer to supply and sell energy and deemed supply arrangements in Chapter 4. In the Commission's view, this requirement meets many of the principles of good regulation including consistency with other regulations and policies, compatibility with competition and benefits which more than justify the costs involved.

3.3.2 Guideline regarding format for publication of standing offer prices

The energy regulatory framework specifies how energy market offers are presented, including detailed requirements setting out how prices, fees and other charges are presented to consumers. There are no such requirements regarding how standing offer prices are presented to residential customers. This is probably due to the fact that standing offer prices are currently the product of an agreement between host retailers and the Victorian Government, with the Government endorsing the prices that are ultimately published.

This will not be the case on the removal of retail price regulation and all retailers will be required to determine and publish their own standing offer prices. The Commission recommends that the ESC develop and implement a guideline regarding how the retailers' own standing offer prices should be published to enable residential customers to make informed judgements about the standing offer, particularly as tariff innovation in the future may make comparisons and judgements more complex.³⁵

The guideline should detail the requirements for publishing standing offer prices. As a minimum the guideline should specify:

- how each relevant tariff and its various elements should be described;
- for each relevant tariff type the annual expenditure based on predetermined consumption levels (such as 3MWh per year, 8MWh per year and 11 MWh per year); and
- any discounts or other benefits for payment by certain methods.

³⁴ The UK regulator has been criticised for requiring comprehensive price transparency for these reasons. See S Davies, C Waddams Price & C Whittaker 2007 and Harker & Waddams Price "Introducing Competition & Deregulating the British Domestic Energy Markets" *CCP Working Paper*, 2006, pp 6-20

³⁵ The Commission considers it would be appropriate for the AER to perform this function once a national framework for retail regulation has been established and transferred to the AER.

The guideline can be amended over time so that it will continue to be effective in assisting consumers to make informed judgments.

The making of such a guideline is consistent with the principles of good regulation such as having a clear objective, consistency with other regulations and policies, and benefits which justify costs.

3.3.3 Additional publication requirements

Currently, standing offer prices are published in the Government Gazette, on retailers' websites and are made available to customers in hard copy upon request.

While publication of standing offer prices on retailers' websites and making hard copies available on request are considered appropriate disclosure methods, the Commission is of the view that publication in the Government Gazette does not fulfil transparency and wide circulation requirements as few consumers will be aware of this publication or have access to it.

The requirements for retailers to publish standing offer prices on their websites and to make available their standing offer prices in hard copy on request should continue to apply. In the place of publication of standing offer prices in the Government Gazette, the Commission is considering the merits of an obligation to be imposed on retailers to require them to publish their standing offer prices in newspapers circulating in the areas to which their standing offer prices apply. The Commission sees advantages and disadvantages in such a requirement and seeks comments from stakeholders to inform its consideration of this issue.

Compared to publication in the Government Gazette, potential benefits of publication of standing offer prices in newspapers include greater accessibility and wider notification, particularly with respect to customers without internet access. The practice is consistent with practices adopted in other jurisdictions, such as New South Wales, for amending standing offer prices. In an environment of without retail price regulation retailers may be able to amend their prices more frequently than annually (depending on the other terms and conditions of the standing offer contract). Publication of those prices on each occasion in a newspaper would improve the transparency of any changes and encourage retailers to focus on the necessity, and timing of, such changes. It is arguable that in an environment without retail price regulation consumers may take an increased interest in standing offer prices and any amendments to them.

On the other hand, there are disadvantages with such an approach, including additional costs and the administrative burden on retailers in arranging for publication of standing offer prices in newspapers. It is arguable that publication of standing offer prices in newspapers may not promote greater or more meaningful access to information as residential customers may not read public notices in newspapers. Increased use of, and access to, computers (and therefore the internet) mean that interested customers can obtain the standing offer prices from their retailers' websites. In addition, customers can obtain copies of standing offer prices from retailers upon request.

The Commission seeks the views of stakeholders as to whether the additional requirement of publication of standing offer prices in newspapers should be placed upon retailers. In particular, the Commission seeks stakeholder views as to whether the benefits of this publication requirement would outweigh the costs.

3.4 Price monitoring

The MCE's request for advice to the Commission and the AEMA contemplate that the removal of retail price regulation may involve a period of price monitoring. Also it need not prevent the reintroduction of a reserve price regulation power at some future time should effective competition cease, provided that the power is only exercised in accordance with the requirements of the AEMA and reflects the findings and recommendations of a prior review by the AEMC of the effectiveness of competition.

The Commission recommends that a form of price monitoring of retailers' published standing offer prices be adopted for a transition period of at least three years following the removal of retail price regulation.

The objective of price monitoring is to identify and publish trends in standing offer prices with a view to providing a timely indication of any future deterioration in the effectiveness of retail competition in the energy retail sectors. If concerns about the effectiveness of retail competition are identified through the monitoring of retailers' standing offer prices this could trigger a further inquiry by the AEMC into the effectiveness of retail competition in accordance with the requirements of the AEMA. The AEMC's findings and recommendations would provide the basis for policy decisions on appropriate responses to any significant deterioration in the effectiveness of competition which could include reintroduction of retail price regulation in appropriate circumstances.³⁶

The proposed price monitoring regime is described in more detail below following a consideration of some comments from stakeholders related to this issue.

3.4.1 Submissions from stakeholders

In its submission to the First Draft Report the Consumer Action Law Centre (CALC) expressed concern that, should pricing regulation be removed, consumers with the least opportunity actively to engage in the market (for example due to their low income and vulnerable status) will be disadvantaged and will no longer be assured of price protection in the purchase of an essential service. CALC suggested an alternative form of regulation through implementing pricing principles to protect those consumers who will no longer be ensured price protection.³⁷

³⁶ Price regulation could be reintroduced in the circumstances set out in clause 14.4(c) of the AEMA following a subsequent finding by the AEMC that competition has ceased to be effective and resumption of price regulation is an appropriate response.

³⁷ CALC submission to the First Draft Report, p.3

While not supporting price monitoring, in its submission in response to the First Draft Report the Energy & Water Ombudsman (EWOV) stated that it would be useful to have a point of reference on what happens to market contract prices if regulated price control is to be phased out.³⁸

AGL supported a price monitoring regime that is non-interventionist and does not become a *de facto* retail price review.³⁹ TRUenergy considered that a price monitoring regime must provide restrictions on the use of reserve powers to regulate prices and, similarly to AGL, must not be used to threaten reintroduction of a price setting arrangement. TRUenergy proposed a process whereby an independent review was conducted to identify the exercise of market power prior to the reinstatement of market price regulation.⁴⁰ Origin Energy stated that there was no need for the regulation of retail energy prices where there is effective competition, that there was a need to distinguish competition and non-competition issues and there was a need to clarify policy goals particular regulations were targeting.⁴¹ In its submission to the Issues Paper, GridX supported price monitoring as a transitional measure.⁴²

The Commission acknowledges these concerns and provides comments on them below in the context of considering measures to accompany the removal of retail price regulation. The Commission considers that one such measure should be the introduction of a price monitoring regime, and its essential features are described below. The Commission is of the view that a price monitoring regime is the most appropriate measure in an environment where there is effective competition, rather than other measures such as pricing principles. In the Commission's view, pricing principles and any related compliance obligations would become another form of price regulation, which is unnecessary in an effectively competitive retail energy sector.

3.4.2 Rationale for price monitoring of standing offer prices

As noted above, the objective of price monitoring in the Victorian gas and electricity retail markets is to monitor and publish the trend in prices paid for energy by those customers who are not party to a market contract, being those customers on standing offer contracts and deemed supply arrangements. These customers are generally those who have not actively engaged with the market by switching to a market contract for retail energy supply and may be more exposed to the risk of inappropriate pricing.⁴³ Although in an effectively competitive market such

³⁸ EWOV submission to the First Draft Report, pp.4-5

³⁹ AGL submission to the First Draft Report, p.4

⁴⁰ TRUenergy submission to the First Draft Report, p.3

⁴¹ Origin Energy submission to the First Draft Report, p.12

⁴² GridX submission to the Issues Paper, p. 4

⁴³ Similarly, it has been observed that energy retailers in the UK have tended to charge higher prices in their "home" territories than elsewhere, finding it more profitable to make higher margins on a smaller base of sticky home consumers than to make a lower margin on a larger number of consumers. (See S Davies, C Waddams Price & C Whittaker, 2007. The most recent Ofgem report found

behaviour is not expected, this group of customers is the most exposed to the potential exercise of localised market power. Accordingly, the prices charged to these customers should be monitored, at least for a transition period, to provide transparency for consumers and policy makers. Price monitoring will identify any potentially inappropriate pricing and exercise of transient market power, if it occurs, and will inform the need for a further competition review.

The Commission notes that the ESC already monitors market contract developments through its annual retail performance report. In the Commission's view additional price monitoring of the market contract prices and offers for electricity and gas is not warranted.

The form of price monitoring explained below will be facilitated with minimal additional costs by the publication by all retailers of their own standing offer prices, and other terms and conditions as recommended by the Commission above.

3.4.3 Essential elements of a regime for price monitoring of standing offer prices

The Commission recommends an incentive based approach to price monitoring that draws on the current arrangements in Victoria. It assumes the publishing and posting by all retailers of standing offer prices and other terms and conditions. The price monitoring approach recommended consists of:

- The annual monitoring and public reporting of the standing offer prices for all retailers should be for a minimum of three years.
- The monitoring and reporting is to be based on a factual observation of the published standing offer prices.
- Until the establishment of a national framework for retail regulation, the monitoring and reporting is to be conducted and published by the ESC and presented to the Government of Victoria.
- The Government may request a further review by the AEMC (under the provisions of the AEMA) if there are concerns in the future in relation to the direction of the standing offer prices that may indicate changes in competitive market behaviour and outcomes.
- The use of legislative powers to regulate retail prices in the future should be a last resort and should be used only following a review by the AEMC which determined that competition was no longer effective and that direct retail price regulation would be an appropriate response. This process would be consistent with the requirements of the AEMA.

These elements are explained in more detail below.

that these price differences have reduced as competition continues to develop and retailers face a shrinking home consumer base (*Ofgem, Domestic Retail Market Report, June 2007*)

3.4.3.1 Monitoring and public reporting

Monitoring and public reporting of retailers' standing offer prices is recommended annually for a minimum of three years. The three year monitoring period will facilitate consumer confidence that retailers are being constrained by market competition under the new arrangements. Following conclusion of the three year period the Victorian Government may consider continuing monitoring for a further period if required.

3.4.3.2 Factual reporting

The reporting of the standing offer prices should focus on factual matters and refrain from making assessments of the consistency of reported price trends with expected competitive market outcomes. Instead, any changes in reported price trends that may indicate changes in competitive market behaviour and discipline would be identified and could be the subject of questioning by the Government. There would remain, however, a credible threat of a full market review and the potential for policy action by the Government as a further discipline in the pricing behaviour of retailers.

The pricing issues to be monitored and reported on include:

- trends for each retailer's standing offer prices, adopting the approach of the ESC in the market performance reports, which would involve assessing standing offer price impacts on customer bills based on defined consumption level(s);
- changes in the pricing structures for the standing offer prices; and
- each retailer's explanation of the impacts on bills by consumption level.

The Commission does not recommend that the monitoring role be extended to movements in wholesale electricity and gas prices. A principal role of energy retailers is to manage wholesale price risk on behalf of their customers and managing that risk is a critical dimension on which retailers can compete. Retailers employ a wide variety of hedging strategies and there is no simple or necessary correlation between wholesale and retail prices in an effectively competitive market. Monitoring retailers' wholesale costs would involve high compliance and administration costs with little obvious benefit, particularly in the absence of credible public contract price data.⁴⁴ Energy contract portfolios are traded and varied daily and their component parts and value cannot be represented in simple averages. Furthermore, energy contract portfolios provide for supply to all of a retailer's customers and are not targeted to different customer classes such as small customers. This suggests that estimating wholesale prices for the obligation to offer to supply and sell energy to small customers (and deemed supply arrangements) is necessarily an arbitrary and uncertain exercise.

⁴⁴ In the Commission's view, the publicly available AFMA data is not representative for these purposes.

3.4.3.3 Monitoring role

The role of monitoring and reporting should be conducted by the ESC. The ESC prepares and publishes an annual retail performance report.⁴⁵ The reporting of standing offer prices could be incorporated within this existing report.

The Commission considers it would be appropriate for the AER to perform this function once a national framework for retail regulation has been established and transferred to the AER, should the Victorian Government wish to receive continued monitoring reports on the standing offer prices. The proposed reporting by the ESC (and, ultimately, the AER) provides appropriate separation of roles between reporting on the market and reviewing the effectiveness of competition, which would be a function of the AEMC.

3.4.3.4 Further competition reviews

As already noted, the Victorian Government can request a further competition review by the Commission if the standing offer price monitoring report suggests a deterioration in the effectiveness of competition. In this regard any trends in the standing offer prices that could not be explained by observable market conditions could trigger a request by the Victorian Government for information from the retailers concerned. If the Victorian Government is not satisfied with the response, it could request the AEMC to undertake a further review (consistent with the process set out in the AEMA). The ESC's performance report will also provide systematic information on relevant aspects of the performance of the market.

3.4.3.5 Reserve power

As stated above in section 3.2, under the current legislative arrangements, the Victorian Government has reserve powers to regulate prices. The Commission notes that the provisions establishing these reserve powers are due to expire on 31 December 2008. In accordance with the requirements of the AEMA, the Commission recommends that legislative powers to regulate prices should be allowed to expire on 31 December 2008 and would only be reintroduced if, following a competition review by the AEMC:

- there is an adverse finding by the AEMC regarding the continuing effectiveness of competition; and
- the reintroduction of price regulation is recommended to be the appropriate response.

The Commission considers that:

- the publication of standing offer prices by retailers ;

⁴⁵ For example, see ESC, *Energy Retail Business Comparative Performance Report for the 2005-06 Financial Year*, November 2006.

- the public monitoring and reporting of those prices;
- the threat of competitive responses from rivals; and
- the potential for a competition review by the AEMC and an appropriate policy response by the Government,

together provide adequate incentives for, and disciplines on, retailers to set cost reflective prices. The approach is not overly intrusive as information is obtained by the regulator from public sources.

In this regard the Commission considers that the recommendations for price monitoring are consistent with the principles of good regulation. For example, it will serve a clear policy goal. Of the other possible measures to be introduced as a transition measure it will minimise costs and avoid market distortions. It is clear, consistent with other regulations and policy and is compatible with the promotion of competition.

3.5 Retailer of Last Resort Prices

Electricity and gas retailers in Victoria may be subject to an obligation that requires them, in certain circumstances, to supply and sell electricity or gas to certain customers of another retailer on tariffs, terms and conditions approved by the ESC.⁴⁶ The tariffs, terms and conditions of that supply are to be approved by the ESC and published in the Government Gazette. This is the RoLR obligation and it is triggered when an existing retailer's licence is revoked or a retailer loses its right to operate in the relevant wholesale market. The RoLR and the relevant customer are deemed to have entered into a contract on the terms and conditions approved by the ESC and published in the Government Gazette. The term of the contract is for a limited period.

The gas and electricity legislation in Victoria confers on the ESC a broad discretion to develop and implement electricity and gas RoLR schemes.⁴⁷ In February 2006, and after substantial review, the ESC published its final decision regarding an energy RoLR scheme for Victoria.⁴⁸ A summary of the decision is included in the First Final Report. The decision contained outcomes on a number of issues including the assignment of RoLR responsibility and terms and conditions and pricing for a RoLR event. The following outcomes are relevant to this advice:

- The RoLR responsibility lies with the host retailers only.
- The standing offer terms and conditions that apply under the EIA and GIA, including the provisions of the Energy Retail Code, will form the basis of the

⁴⁶ Under section 49D of the EIA and section 51D of the GIA, electricity and gas retail licences may include a requirement to supply or sell electricity to *relevant customers* (ie small retail customers) to whom electricity is supplied or sold under another licence.

⁴⁷ Sections 49A-49K of the EIA and sections 51A-51K of the GIA.

⁴⁸ ESC, *Energy Retailer of Last Resort – Final Decision*, June 2006.

terms and conditions for the provision of RoLR services to relevant customers (being small retail customers). Any departure from these terms and conditions will require the ESC's approval.

- The RoLR tariff for relevant customers will comprise:
 - the standing offer tariff under the safety net provisions of the EIA and GIA; and
 - a one off, up front RoLR supply fee of \$44 for electricity RoLR customers and \$30 for gas RoLR customers (escalated by the Consumer Price Index) for the recovery of incremental energy and retail operating costs above those incorporated in the standing offer tariff.

The ESC's decision contemplates the removal of retail price regulation and recognises that in those circumstances the RoLR prices for relevant customers would need to be reviewed.⁴⁹ The ESC will need to decide on RoLR prices to apply once retail price regulation is removed.⁵⁰

The Commission notes that the ESC also decided on a set of criteria for determining the appropriate RoLR prices. They were that the RoLR prices:

- not be tied to particular circumstances that are assumed to apply at the time of a RoLR event, but should be flexible enough to cope with a wide range of circumstances;
- protect financial flows within the energy industry and take account of reasonable risks and costs associated with the provision of RoLR services;
- protect the interests of customers; prices should be simple, understandable and ensure that RoLR customers pay a fair price and that the RoLR recovers the costs it incurs to provide the RoLR service;
- minimise the administrative costs required to finalise, implement and operate the RoLR scheme;
- maximise regulatory certainty by facilitating transparent and robust regulatory decision making;
- ideally, continue to insulate customers from volatility in wholesale electricity prices; and
- ideally, be capable of being implemented using existing data and systems capabilities.

⁴⁹ *ibid*, pp. 34-35

⁵⁰ The St Vincent de Paul society submission to the First Draft Report also referred to the importance of standing offer prices in the RoLR context, p. 2

In the Commission's view, these criteria provide a good basis for the ESC to decide on RoLR prices in a competitive environment without retail price regulation. Measured against these criteria, the retailers' own published standing offer prices may be appropriate RoLR prices. The use of these prices would not only meet the ESC's criteria, but would also reduce the risk that determination by the ESC of different RoLR prices may introduce a regulated benchmark price, even though its application is intended to be limited. Further, the use of retailers' own standing offer prices would be consistent with the principles of good regulation. It is a clear, simple and practical approach. It is consistent with other regulations and practices and it is compatible with competition.

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4 Advice on consumer protection issues

4.1 Introduction

Chapter 3 set out the basis of the Commission's recommendations on how to remove retail price regulation in the light of the finding that energy retail competition is effective in Victoria. It also described the price related measures the Commission has recommended to support the transition to an unregulated retail pricing regime.

This chapter sets out the Commission's recommendations regarding some consumer protection issues associated with the removal of retail price regulation. It also addresses a number of concerns raised in submissions with respect to the application of the consumer protection framework in Victoria and sets out the Commission's responses to those concerns.

4.2 Obligation to offer to supply and sell energy and deemed supply arrangements

This section sets out the Commission's recommendations regarding amendments to the obligation to offer to supply and sell energy, and the administration of the deemed supply arrangements under the EIA and the GIA.

4.2.1 Obligation to offer to supply and sell energy

While recommending the removal of retail price regulation, the Commission is of the view that the other elements of the safety net arrangements should remain in place. The Commission recommends that the obligation to offer to supply and sell energy on reasonable terms and conditions to residential customers should continue to apply following the removal of retail price regulation. The Commission recommends that the obligation to offer to supply and sell energy to a customer should apply to the financially responsible market participant (FRMP) for the relevant premises. However, the Commission is seeking stakeholders' views regarding the obligation to offer to supply and sell energy to new connections.

The Commission makes these recommendations for the reasons and on the basis set out below.

4.2.1.1 Rationale for retaining the obligation to offer to supply and sell energy

The Commission recognises that there are legitimate concerns in relation to those residential customers who, by virtue of their personal circumstances or the perception that they are unprofitable to serve, may not currently be able to access the full benefits of competition. This point was also made in some of the submissions in

response to the First Draft Report.⁵¹ Recognising the essential nature of electricity and, to a lesser extent, gas supply the Commission considers that the regulatory arrangements should continue to ensure that residential customers have access to the supply and sale of energy on reasonable terms and conditions. The Victorian Government and the ESC, in consultation with retailers and consumer groups, has developed and implemented a regulatory framework designed to safeguard the interests of these consumers.

A central feature of this framework is the obligation to offer to supply and sell energy on fair and reasonable terms. Currently, this means that for residential customers the host retailer has the obligation to offer to supply and sell energy to those customers at 'regulated prices' and on terms and conditions approved by the ESC.

Together with protections afforded by other instruments such as the Energy Retail Code and effective competition itself, the Commission is of the view that retaining the safety net arrangements (other than retail price regulation) will provide a fair and reasonable basis for supply to those consumers who may not access the maximum benefits of competition.

It should be noted that under clause 14.4(a) of the AEMA the parties agree that the phase out of retail price regulation need not include the removal of 'obligation to supply' arrangements. The most recent consultation paper on the proposed national framework for non-economic distribution and retail regulation for the Retail Policy Working Group (RPWG) prepared by Allens Arthur Robinson (National Framework Consultation Paper) includes recommendations that contemplate a national retail energy regulatory framework that includes an obligation on certain nominated retailers to offer to supply and sell energy to small customers.⁵²

4.2.1.2 Who should have the obligation to offer to supply and sell energy?

Currently the obligation to offer to supply and sell energy rests with the host retailers through orders made under the EIA and the GIA. Increasingly, though, the concept of a host or incumbent retailer attached to a particular area is becoming less relevant as the market develops. Alternative models for the obligation to offer to supply and sell energy have been considered in other forums. In particular, the National Framework Consultation Paper covered this issue in some detail and discussed alternative obligation to supply models. That paper did not recommend who should have the obligation to supply, but rather recommended that the decision

⁵¹ CALC submission to the First Draft Report, p. 8, requested that the advice deal with the situations where competition is not effective. The St Vincent de Paul Society's submission to the First Draft Report, p. 4, nominated certain groups that might not benefit from competition and suggested a separate protection regime for each – regional, rural, rental, credit risk and financially vulnerable customers.

⁵² National Framework Consultation Paper, pp. 5-18

be left up to individual jurisdictions. Submissions made in response to the Commission's First Draft Report also considered this issue.⁵³

The major models for the obligation to offer to supply and sell energy to residential customers canvassed in submissions from retailers and in the National Framework Consultation Paper are:

- host retailer / franchise – the obligation is assigned to each host retailer for all relevant premises/supply points in the retailer's former franchise area (currently applies in Victoria);
- universal - all retailers participating in a jurisdiction have the obligation with regard to all relevant premises/supply points in the jurisdiction;
- defined area – all retailers participating in a defined area (for example, a distribution network area) have the obligation imposed on all relevant premises/supply points in that defined area; and
- FRMP – the obligation is assigned to the FRMP for the relevant premises/supply point. For new connections a retailer or retailers will be given the obligation to offer to supply and sell energy (refer to Section 4.2.1.3 below).

Each model has been assessed against the following criteria, assuming that no retail price regulation is in place and all retailers are publishing standing offer prices and other terms and conditions that would apply under the obligation to offer to supply and sell energy:

- ensuring universal access to supply on reasonable terms and conditions for residential customers;
- equitable allocation of responsibilities between retailers;
- impacts on market entry conditions for new retailers; and
- consistency with the work of the RPWG on the national framework for retail and distribution regulation.

Of the models canvassed, the FRMP model appears best to meet the criteria above, particularly the second and third criteria. The FRMP model allows the obligation to offer to supply and sell energy to be allocated to new retailers in line with growth in their share of the market. Correspondingly, it diminishes the obligation to offer to supply and sell energy for the host retailers in line with the reduction in their market shares in their former franchise areas. The universal and defined area models create obligations that may be disproportionate to some retailers' shares of the market. In addition, these two models have the potential to be a barrier to entry for new retailers because of the increased wholesale risk and administrative costs that would be incurred with such a broad obligation.

⁵³ Submissions to the First Draft Report from AGL p. 3, TRUenergy p. 2, and Origin Energy pp. 12-15.

In contrast to the other models, the FRMP model also sits comfortably with the existing deemed supply arrangement obligations provided for in the EIA and GIA. Under the deemed supply arrangements the existing retailer or FRMP has the obligation to supply energy to the premises for which it is financially responsible (this is discussed further below in Section 4.2.2). It follows that the FRMP should also have the obligation to offer to supply and sell energy to the premises for which it is financially responsible.⁵⁴

For these reasons, the Commission recommends that the obligation to offer to supply and sell energy to a residential customer's premises follow the existing FRMP. The FRMP model is consistent with the work of the RPWG on the national framework for retail and distribution regulation. It is the model that was adopted for the introduction of full retail competition in Queensland. It is also consistent with the principles of good regulation. It is a clear and simple approach to the obligation, it imposes costs which are unlikely to be higher than under the alternative options and which are more likely to be fairly distributed, it is consistent with other regulations and policies and it is compatible with competition.

4.2.1.3 Designated retailer for new connections

In recommending the adoption of the FRMP model, it is also necessary to make a recommendation regarding the obligation to supply and sell energy to residential customers at new connections (New Connection Obligation). Under the FRMP model, there is a designated retailer or designated retailers with the New Connection Obligation.

Currently, the New Connection Obligation rests with the host retailers as part of their general obligations set out in orders made under the EIA and the GIA. As with the obligation to offer to supply and sell energy generally, the concept of a host or incumbent retailer attached to a particular area is becoming less relevant as the market develops. In this regard other options for the New Connection Obligation should be explored together with the host retailer model.

The four models for the New Connection Obligation are similar to those discussed above in Section 4.2.1.2 and are set out as follows:

- host retailer – the New Connection Obligation is assigned to each host retailer for all relevant premises/supply points in the retailer's former franchise area (currently applies in Victoria);
- universal – the New Connection Obligation is assigned to all retailers participating in a jurisdiction for all relevant premises/supply points in the jurisdiction;

⁵⁴ As noted in the National Framework Consultation Paper, p. 8, the FRMP model simplifies the application of deemed supply arrangements for new retailers in that it will be required to have standing offer terms and conditions and these can be used as the basis for deemed supply arrangements. In addition it may address concerns about what should happen at the end of the term of a deemed supply arrangement in that the deemed supplier will also be the retailer required to supply on standing offer terms.

- defined area – the New Connection Obligation is assigned to all retailers participating in a defined area (for example, a distribution network area) for all relevant premises/supply points in that defined area; and
- distributor tender – the relevant distributor tenders out to interested retailers the right to provide the New Connection Obligation.⁵⁵ Any revenue obtained by distributors from this tender process could be taken into account during the distributor pricing determination process.

Each model has been assessed assuming that no retail price regulation is in place, and all retailers are publishing standing offer prices and other terms and conditions that would apply under the obligation to offer to supply and sell energy, against the following criteria:

- ensuring universal access to supply on reasonable terms and conditions to small customers;
- equitable allocation of responsibilities between retailers;
- impacts on market entry conditions for new retailers; and
- consistency with the work of the RPWG on the national framework for retail and distribution regulation.

During the course of the Victorian Review stakeholders did not directly comment on the New Connection Obligation. Those retailers, who recommended that the general obligation to offer to supply and sell energy should be more evenly allocated, did not specifically state that the New Connection Obligation should be extended to new retailers. Similarly, new retailers are not seeking to adopt the New Connection Obligation. The Commission understands that few new retailers choose to offer to supply and sell energy to residential customers at new connections under a market contract. In this regard, the continuation of the host retailer model may be appropriate for a certain period.

While the host retailer model represents the status quo and is currently managing the New Connection Obligation, the concept of a host retailer is becoming increasingly irrelevant due to the amount of customer switching and changes in market share occurring in the Victorian retail energy sectors. While the continuation of the status quo appears to confer a benefit on the host retailer and to perpetuate the host retailer concept, designating the host retailers as the retailers with the New Connection Obligation remains the default option.

The universal model and, to a lesser extent, the defined area model would create obligations disproportionate to some retailers' shares of the market. In addition, these two models have the potential to be a barrier to entry for new retailers because

⁵⁵ In Victoria there appears to be no regulatory prohibition on a new retailer supplying and selling energy to new connections so long as the retailer meets the market and regulatory requirements to enable the new retailer to supply and sell energy in these circumstances.

of the increased wholesale risk and administrative costs that would be incurred with such a broad obligation, particularly in the case of gas.

For these reasons, the Commission is of the view that the universal model should be disregarded as an option. It would be an unreasonable burden on a retailer, even with a substantial customer base, to be required to make an offer to supply and sell energy to a customer in a distribution network area that the retailer has not chosen to enter. There is a possibility that, due to the wholesale risks and administrative costs, offers made to residential customers by a retailer not operating in a distribution network area would not be competitive.

The defined area model might be suitable if the New Connection Obligation was applied to retailers who met a predetermined customer number or consumption load threshold for the defined area. Including a requirement to meet a threshold would mean that only new retailers of a certain size, who choose to supply the mass market, would have the New Connection Obligation.

The disadvantages with the defined area model relate to the difficulties associated with determining the threshold for participation by retailers. Setting the threshold for the defined area model would need to consider that retailers must have sufficient customer numbers or consumption load in a defined area in order to accommodate customers acquired in the context of new connections. If a retailer's load is relatively small, the retailer may not have adequate wholesale and risk management arrangements in place to support supply obligations that the retailer cannot control or predict with any degree of certainty. This consideration is particularly pertinent for gas where retailers are exposed to a number of different wholesale charges. In addition, there may be implementation issues and practical difficulties in deciding when a retailer actually meets the threshold. This would involve continual scrutiny and analysis by a regulator or other appropriate authority. These issues and difficulties may outweigh the benefits of this model.

Of the models canvassed, the distributor tender model appears to meet the criteria above, particularly the second and third criteria. The distributor tender model allows new retailers to adopt the New Connection Obligation when those new retailers consider it is appropriate and in line with the development of their businesses. By facilitating this kind of self selection, the New Connection Obligation can be applied to those retailers who value it most highly. From a public policy perspective the distributor tender model is preferable as it promotes and supports a competitive retail energy sector. There are, however, practical considerations that may result in this model not being appropriate at this stage in the development of the retail energy sector. For example, if only the host retailers choose to participate in the tender process, then it may not be worth the administrative costs.

From the discussion above, the two models that are likely to be appropriate for the New Connection Obligation are the host retailer model (the status quo) or the distributor tender model. To inform its consideration of this issue, the Commission seeks comments from stakeholders on the advantages and disadvantages of the host retailer and distributor tender models from both the consumer and market competition perspectives. For example, are residential customers being disadvantaged by the New Connection Obligation only being applied to the host retailers? Similarly, are new retailers and potential new entrant retailers

disadvantaged by this model as well? Are the implications for customers and retailers better under the distributor tender model and is it a feasible model in practice?

The Commission seeks the views of stakeholders as to the advantages and disadvantages of the following two aforementioned models for the New Connection Obligation:

- host retailer model; or
- distributor tender model

4.2.2 Deemed supply arrangements

As stated above, while recommending the removal of retail price regulation, the Commission is of the view that the other elements of the safety net arrangements should remain in place. The Commission recommends that the obligation to supply and sell energy on reasonable terms and conditions should continue to apply following the removal of retail price regulation. Another aspect of the supply obligation are the deemed supply arrangements that apply under the EIA and GIA.

Under the EIA and GIA, there are circumstances where a contract is deemed to exist between a residential customer and the retailer financially responsible for the supply point at that customer's premises. Briefly, the circumstances are:

- Where a customer has never entered into a contract with a retailer;
- Where a customer commences to take supply of energy at a premises without having entered into a contract for the supply and sale of energy; and
- Where a customer cancels a contract during the "cooling off period", but the customer continues to take supply without entering into a further contract with the existing retailer or another retailer.⁵⁶

The Commission recommends that the deemed supply arrangement obligations remain in place for the reasons and on the basis set out below.

4.2.2.1 Rationale for retaining deemed supply arrangements

The Commission accepts the practical requirements behind the existence of these deemed supply arrangements and the need for their continuation following the removal of retail price regulation. Many aspects of the rationale for retaining the obligation to offer to supply and sell energy also apply to the deemed supply arrangements.

Recognising the essential nature of electricity and, to a lesser extent, gas supply the Commission considers that the regulatory arrangements should continue to ensure

⁵⁶ Sections 37, 39(1) and 39(2) of the EIA. Sections 44, 46(1) and 46(2) of the GIA.

that residential customers have access to the supply and sale of energy on reasonable terms and conditions for a certain period of time even though they may not have entered into a contract (whether a market contract or standing offer contract). This has been part of the regulatory framework that has been designed to safeguard the interests of these customers.

Recommendations made in the National Framework Consultation Paper envisage that these circumstances will also be covered in the national framework for retail regulation.⁵⁷

4.2.2.2 Terms and conditions applying to deemed supply arrangements

Currently, the standing offer prices and other terms and conditions apply to the deemed supply arrangements in addition to the obligation to offer to supply and sell energy.⁵⁸ While historically, only host retailers have published standing offer prices and other terms and conditions, it should be noted that the retailer may be a host retailer or a new retailer for two of the three circumstances listed above. To date new retailers have not published prices and other terms and conditions because they do not have the obligation to offer to supply and sell energy (the obligation to make a standing offer). However, these retailers do have supply obligations in respect of the deemed supply arrangements for “move ins” and “cooling off period” cancellations. As new retailers increase their market shares, their deemed supply arrangement obligations will also increase.

Currently, the prices and other terms and conditions of the deemed supply arrangements between new retailers and their customers are uncertain as they have not been published. As a matter of practice, it is understood that new retailers will charge either the standing offer price applicable to the premises or the market contract price that was charged to the previous customer at the premises, depending on the circumstances.

In Chapter 3 the Commission has recommended that new retailers determine and publish their own standing offer prices and other terms and conditions. Rectifying the apparent oversight with regard to the conditions for deemed supply arrangements is another reason for applying this requirement to new retailers. Accordingly, the Commission recommends that the retailers’ published standing offer prices be the prices that apply to their deemed supply arrangements. It is also necessary if the FRMP model for the obligation to offer to supply and sell energy is adopted in Victoria (this is discussed above). Publication of standing offer tariffs by all retailers will also facilitate price comparisons by consumers and the price monitoring regime recommended in Chapter 3.

⁵⁷ National Framework Consultation Paper, pp. 19-20.

⁵⁸ Sections 37(1), 39(1) and 39(2) of the EIA. Sections 44(1), 46(1) and 46(2) of the GIA.

4.3 Transition to the removal of retail price regulation - Consumer awareness and education campaign

The Commission recommends that, as a transition measure, a consumer awareness and education campaign should be implemented prior to the removal of retail price regulation. The rationale for, and the elements of, the consumer awareness campaign are discussed below.

4.3.1 Rationale for a consumer awareness campaign

The removal of retail price regulation in the retail energy market in Victoria as recommended in Chapters 3 and 4 is a substantial reform of the energy regulatory framework. Communication of the changes to all stakeholders, and in particular residential customers, is necessary to ensure awareness and to maintain confidence in the market. In this regard, the Commission notes the consumer awareness campaign currently being conducted in the context of the removal of price regulation for small business customers in Victoria. That campaign involves both retailers and Government, and encompasses press releases and bill messages from both the ESC and the retailers.

There are many energy specific as well as general consumer protection measures already in place in Victoria. However, notwithstanding this extensive regulatory framework, a number of submissions received from consumer groups stated that significant instances of marketing and selling misconduct continue to occur in the Victorian energy retail sectors. These matters are discussed in detail below in Section 4.4.

One aspect of the marketing misconduct referred to in submissions relates to alleged breaches of information requirements, such as incorrect information being given to customers and customers being told they have to sign a contract before being supplied with requested information. A fundamental feature of a competitive market is that consumers have access to adequate information in order to participate in that market. However, submissions have suggested that some consumers may not be aware of their rights to information and other relevant consumer protections. For example, the Consumer Utilities Action Centre (CUAC) pointed out that customers are unaware of their rights to request and receive information in many cases, yet the regulatory regime relies heavily on the customer taking the initiative to find relevant information. In CUAC's view, the regulatory regime fails if consumers are unaware of their rights to request and receive information.⁵⁹

In this context, a consumer awareness and education campaign can also serve another purpose. The removal of retail price regulation and the resulting need to communicate information in relation to any changes to consumers presents a timely and appropriate opportunity to ensure that residential customers are aware of their rights under the regulatory framework. The objective of a consumer awareness and education campaign is to inform residential customers and to improve their access to information available to assist them in decision making in a retail sector where

⁵⁹ CUAC submission to the First Draft Report, p. 4.

search costs may be relatively high. If residential customers are aware of the information that they can access, this will assist them when responding to energy offers presented via direct marketing approaches. Direct marketing may not achieve its potential as an integral tool of the competitive market if residential customers are unaware of their rights to information or if retailers are ignoring the laws and obligations that apply to the direct marketing sales channels.

The Commission agrees that the effectiveness of the regulatory framework relies on residential customers being aware of their rights to request and receive information in relation to energy offers. An effective consumer awareness and education campaign may address the concerns of some consumer representative groups that customers are not well informed and are unaware that they can, for example, obtain market offer information from retailers without first having to enter into a contract with them.⁶⁰

4.3.2 Consumer awareness and education campaign

The Commission recommends an appropriately targeted and timely consumer awareness and education campaign to inform residential customers of the changes being made to energy retailing (and what remains the same) as part of the removal of retail price regulation and emphasise their ongoing rights under the consumer protection framework. The consumer awareness and education campaign should inform residential customers about:

- the formal changes that will take place, such as retailers replacing the existing regulated prices with their own standing offer prices and explain the implications of these changes;
- their rights under the consumer protection framework;
- the benefits of seeking alternative offers and information from retailers and other sources regarding their energy options; and
- the options available to them for seeking redress or complaining about marketing or selling misconduct.

As a separate, although related matter, retailers will need to provide some market contract customers with information in addition to that described above. For example, under a number of market contracts, the prices are varied in line with variations to the relevant regulated retail prices. Often, these market contracts will include an alternative price variation mechanism in case retail price regulation is removed during the term of the market contract, but this is not always the case, particularly with older contracts. If there is no regulated retail price, then it will be necessary to determine and communicate an appropriate alternative price variation provision for these contracts.

⁶⁰ *Ibid.*

4.4 Compliance issues

There are many energy specific as well as general consumer protection measures already in place in Victoria. However, notwithstanding this extensive regulatory framework, a number of submissions received from consumer groups stated that significant instances of marketing and selling misconduct continue to occur in the energy retail sectors in Victoria.

4.4.1 Issues raised in submissions

Direct marketing is a common feature of competitive retail energy markets around the world and Victoria is no exception. Direct marketing can be an efficient and rational approach by competitive retailers in a market characterised by a low level of consumer engagement and search or switching costs that may be perceived to be high relative to the expected benefits. Direct marketing can play an important role in providing consumers with information, reducing their search costs and encouraging them to switch to a better retail offer. However, there is also the potential for inappropriate direct marketing activity to mislead consumers and to pressure them into decisions they would not otherwise make. It is imperative that retailers take seriously their licence obligations in these respects by ensuring that their sales staff do not engage in such conduct and that there is effective monitoring of compliance with, and enforcement of, those obligations by relevant regulatory bodies.

During the course of the Victorian Review, the Commission found no evidence to suggest that there are widespread or systemic problems with sales and marketing misconduct such as high pressure selling or misleading or deceptive conduct, particularly given the number of market contracts made and marketing contacts that have taken place. This view was based on compliance reports issued by the ESC and data from the EWOV. However, both the Commission's own consumer survey and various submissions indicated that there is room for improvement in the quality of information provided to consumers.

A number of submissions also indicated that there is evidence of some significant instances of marketing misconduct in Victoria which may not all be captured by reported statistics.⁶¹ In its submission, EWOV stated that one complaint can be representative of a systemic issue on the basis that it can be indicative of unreported instances of similar conduct.⁶² Some examples of specific behaviour referred to in the submissions are:

- transfers without consent;
- incorrect information being given to customers;
- customers requesting information but being told that they have to sign a contract in order to obtain it; and

⁶¹ For example submissions to the First Draft Report from CALC, pp. 6-7 and CUAC, p. 3 and EWOV, pp. 2-4.

⁶² EWOV submission to the First Draft Report, p. 2.

- door to door marketing practices that involve high pressure selling techniques.

The Footscray Community Legal Centre conducted a small survey of public housing estate residents in western Melbourne, which indicated similar concerns.⁶³

CALC stated that the marketing activity of many retailers has involved widespread breaches of the energy specific regulation as well as the FTA and TPA.⁶⁴

CUAC pointed out that customers are unaware of their rights to request and receive information in many cases, yet the regulatory regime relies heavily on the customer taking the initiative to obtain relevant information and to complain about any misconduct. In CUAC's view, the regulatory regime fails if consumers are unaware of their rights to request and receive information.⁶⁵

4.4.2 Consumer protection provisions

Currently, the issues raised and summarised above are addressed through information and disclosure requirements and other consumer protection provisions, some of which are highlighted below.

A summary of some of the major energy specific consumer protection provisions are contained in **Appendix A**. In particular, energy retailers are required to make information about their market offers available to customers in accordance with both the ESC's *Guideline No. 19: Energy Product Disclosure* (Product Disclosure Guideline) and *Code of Conduct for Marketing Retail Energy in Victoria* (Marketing Code).

The Product Disclosure Guideline includes the obligation to provide an offer summary in writing to a small customer on request and when providing the customer the terms, or information about the terms, of a new retail contract. Such offer summaries must be a separate document to the full contractual terms and conditions and must include fairly detailed information about the energy offer. The requirements contained in the Product Disclosure Guideline appear to be generic enough to encompass any changes to pricing structures, offers and discounts that may be precipitated by the removal of retail price regulation. In any event these instruments can be amended and modified over time to cater for a changing retail environment. This is discussed further below in Section 4.5.

The substantive source of mechanisms to protect energy consumers in Victoria are contained in the *Trade Practices Act 1974* (Cth) (TPA) and the *Fair Trading Act 1999* (Vic) (FTA). The relevant legislation contains provisions dealing with:

- misleading or deceptive and unconscionable conduct;
- false or misleading representations; and

⁶³ The results of the survey are discussed in the Footscray Community Legal Centre's submission to the Issues Paper.

⁶⁴ CALC submission to the First Draft Report, p. 6.

⁶⁵ CUAC submission to the First Draft Report, p. 4.

- harassment and coercion.

The FTA also regulates additional classes of conduct that are not targeted by the TPA and which may detrimentally affect Victorian consumers, such as:

- use of and reliance on unfair terms in consumer contracts;
- false billing; and
- contact (door-to-door) and non-contact (internet, mail order etc) sales.

If a retailer does not comply with the FTA and TPA the enforcement options available to regulators include enforceable undertakings, prosecutions, injunctions to restrain or require certain conduct and infringement notices.

The Marketing Code also reinforces a number of the provisions of the FTA and TPA. Amongst other things, it requires retailers to:

- refrain from engaging in misleading or deceptive conduct, unconscionable conduct or making false or misleading representations.
- ensure that all relevant facts are provided and are not exaggerated, use words and images that promote customer comprehension and use best endeavours to ensure that information provided to consumers is truthful and when supplied directly to individual consumers, relevant to that consumer's circumstances.
- ensure that any comparisons made are clear, factually correct and easily understood by consumers and that they do not omit important information that should be disclosed.
- ensure that the inclusion of rebates and/or concessions is made clear to consumers and any prices that exclude rebates and concessions are disclosed.
- provide specific information to consumers before they enter into a contract and provide consumers with a reasonable opportunity to consider this information.
- provide specific information to consumers before they enter into a contract and provide consumers with a reasonable opportunity to consider this information.

If these provisions are not complied with then, in addition to potentially being in breach of the FTA or TPA, the offending retailer can be in breach of its licence conditions, and may be subject to penalties or, ultimately, cancellation of its licence.

Taken together, these provisions impose clear obligations on retailers when marketing directly to consumers to provide consumers with complete and accurate information before a contract is made.

4.4.3 Commission's response to submissions

4.4.3.1 Relationship to retail price regulation

There is a comprehensive energy consumer protection framework in Victoria which is directed to preventing conduct of the kind referred to in submissions, to providing remedies and to imposing penalties when such conduct occurs. It is the most appropriate mechanism for protecting customers against inappropriate marketing and selling practices, including conduct that may contravene retailers' licence obligations. The consumer protection framework reflects the policy goal of improving information provision and deterring misleading, deceptive and coercive selling practices. There are compliance costs for firms, but these are likely to be relatively small compared to the overall benefits for consumers and the market as a whole.

While the Commission acknowledges the serious nature of the complaints referred to in submissions, continuing price regulation is not an effective answer to market conduct of this kind. The purpose of price regulation is not to protect consumers against selling and marketing misconduct. Rather, price regulation is directed at protecting consumers from the exercise of market power in markets where competition is not effective. In a competitive environment, price regulation can distort the entire market at high cost and does not have any impact on inappropriate direct marketing activity. In this context, the principles of good regulation are not met through the continuation of retail price regulation.

As the submissions refer to instances that have taken place or are presently taking place, the existing retail price regulation has clearly not prevented them from occurring. Rather, this conduct needs to be addressed through appropriately targeted and cost effective regulation of compliance with the relevant codes and laws.

4.4.3.2 What is the appropriate level of consumer protection regulation and enforcement?

None of the submissions appear to refer to conduct that is not covered by the current consumer protection regime. On the basis of the issues raised in submissions and referred to above, a case has not been made for additional consumer protection regulation. Indeed, in the absence of a complete review of the energy consumer protection framework, the introduction of additional forms of regulation, such as more detailed information requirements or further conduct obligations, may not serve to improve consumer decision making or to reduce the incidence of mis-selling.

To the extent that such conduct continues on a scale greater than that being reported by the complaint handling and enforcement bodies, the appropriate response would be more effective incentives for retailer compliance with current requirements, more effective monitoring of compliance with relevant codes and laws by regulatory bodies, and targeted enforcement action where serious contraventions occur.

The Commission has recommended the implementation of a consumer awareness and education campaign that reinforces consumer awareness of their rights. While

improving consumer awareness of their the rights is critical to ensuring more effective participation in the market by consumers, it is also important to improve the effectiveness of retailers' participation in the market by minimising instances of misconduct. Retailers must face effective incentives not to engage in misleading or deceptive conduct or to pressure consumers into a particular choice. These incentives will depend on the risk of detection and the likely penalty for such conduct. Furthermore, publicity about breaches of the consumer protection regulations can have an adverse effect on a retailer's reputation and demand for its services. Ensuring that consumers are aware of their rights will help with detection but, as EWOV has indicated, it is likely that many consumers do not complain about misconduct. This makes it all the more important that enforcement action is taken and sufficient penalties are imposed when breaches of the law and relevant codes are detected.

Where marketing misconduct is reported, the Commission expects that regulators do respond appropriately and in a timely manner. Regarding the issues raised in submissions, regulators may wish to consider whether their existing approaches to compliance and enforcement should be reviewed to identify possible areas of improvement, having regard to a future market environment without retail price regulation. In the Commission's view, there is an adequate consumer protection framework including remedies available for non-compliance. This framework should be enforced where instances of non-compliance are notified, investigated and supported by the evidence.

4.5 Enhancements to regulatory instruments

The Commission notes the views expressed in submissions from consumer groups in particular regarding the importance of clear and transparent information and, significantly, information being made available on comparable terms. The ESC's current product information and offer description disclosure requirements effectively specify the kinds of information required to be made available to consumers. In general, the Commission is not recommending changes to the existing information disclosure guidelines, other than to note that where required by other recommendations, such as the adoption of a published standing offer, applicable publication guidelines will need to be developed.

The Commission also notes that changes to tariff structures or innovation in the kinds of products developed by retailers following the removal of price regulation may necessitate a reassessment of the content of information provision guidelines in the future in order to ensure that they adequately encompass the kind of information that needs to be available to consumers in an effective but evolving market. Submissions from retailers have supported the proposition that innovation in the market will be encouraged by the removal of price regulation. Bundled utility products, such as those already being offered by Dodo Power and Gas which combine telecommunications and energy services, are recent examples of market

innovation, and it can be assumed that more innovation will follow the removal of price regulation.⁶⁶

⁶⁶ Ofgem's latest retail market report indicates that British energy retailers are increasingly providing a range of new and innovative tariffs, such as fixed and capped rates, tracker tariffs and cheaper online deals (See Ofgem *Domestic Retail Market Report*, June 2007).

5 Possible enhancements to product information for consideration

5.1 Introduction

The purpose of this chapter is to highlight some possible enhancements to information mechanisms for consumers to assist them in assessing and comparing energy offers. These enhancement options are presented for consideration by the Victorian Government.

In order for consumers to gain equitable access to the competitive market they need access to product information that is easy to understand and available on comparable terms. Based on consultation and submissions received, there is strong support amongst market participants for the implementation or the maintenance of tools that enable consumers effectively to compare retail offers.

Consultation undertaken by the Commission with representatives from the Australian Securities and Investment Commission and Choice magazine emphasised the importance of ensuring that information available to consumers is transparent and comparable. Also, there should be mechanisms which can facilitate product and service comparison.

Comparison services have been a longstanding feature of the energy market in the United Kingdom. There are currently twelve internet-based energy price comparator services that are accredited by energywatch, some of which have been operating for over five years. Comparison or estimator tools and calculators are widespread in other industries, notably financial services and mobile telecommunications, driven in part by a comparatively greater degree of product complexity, differentiation and innovation and corresponding demand from consumers for product information and explanation.

5.2 Existing energy comparative tools

Currently, the ESC, the Essential Services Commission of South Australia (ESCOSA) and the Queensland Competition Authority (QCA) provide online offer comparison or estimation tools, which can be accessed through their respective websites, as a means of enabling consumer access to energy offer information. The three comparison mechanisms employ one of two different approaches to providing information to consumers, either resulting in a comparison of a customer's existing supply arrangements with a new offer, or an estimate of charges payable, based on historical consumption, under a range of possible offers in the marketplace. Both models also present an indication of the possible comparative savings available to a consumer.

The ESC energy comparator provides a comparison of the charges payable under a new market offer with the consumer's current supply arrangement, based on information provided by the consumer about current billing and usage and the new offer. The comparator allows consumers to enter offer-specific elements such as

contract length or discounts, however it does not attempt to ascribe an actual value to these as part of its calculations.

The model adopted by ESCOSA does not rely on consumers having a new energy offer to hand, but instead provides estimates of annual energy costs under various available plans and estimated annual savings, based on information provided by the consumer about current usage. The ESCOSA estimator does not directly factor in contract terms or discounts, although it does note applicable direct debit rebates or one off joining bonuses. The QCA estimator is based on the ESCOSA model and employs a similar front and back end. A notable difference is the ability to tailor the calculation of estimated potential savings by selecting the user's current contract. The QCA comparator notes additional benefits applicable to each offer.

5.3 Potential shortcomings of existing models

Online comparators have been criticised by some for being unable to incorporate or value non-price factors, such as non-price goods and services or plan-specific terms and conditions, into an estimate of payable charges or comparison of two or more products.⁶⁷ There are also concerns about the level of access to internet-only tools amongst consumers without access to a computer or without the requisite degree of computer literacy; this is particularly an issue for disadvantaged consumers or the elderly.⁶⁸

The approach to online comparison implemented by the ESC is quite sophisticated; however that sophistication increases both the time investment on the part of the consumer (the ESC advises that obtaining a comparison report will take 20 to 30 minutes) in obtaining an estimate and the complexity of the interface comparator itself. The fact that the comparator relies on having an "offer in hand" is a potential hindrance to its widespread usage amongst consumers, given that previous research and the Commission's own consumer and retailer surveys have shown that the majority of switching decisions are currently made "on the doorstep" as a result of direct selling. Effectively, the ESC comparator, in its present form, is primarily of use to the currently small proportion of consumers who actively seek out offers from retailers.

The Commission understands a number of companies are investigating the feasibility of online energy comparison tools as a commercial venture, and in light of this, the ESC has not further developed its online comparator. Similarly, CALC has noted that it is aware that a number of "internet brokerage tools" are under development, but that "their ability to succeed will depend on whether all retailers agree to participate". CALC has stated that "it is our understanding that the primary delay in establishing these tools has been because retailers do not want to participate, with some of the incumbent retailers preferring to maintain their competitive

⁶⁷ See, for example, Origin's submission to First Draft Report, p. 3.

⁶⁸ See CALC submission, p. 8.

advantage by not enabling consumers to have transparent information to aid them to switch.”⁶⁹ At the time of writing, the future of these alternative services is unclear.

The ESCOSA and QCA model is less complicated and time consuming for the consumer because it relies on the provision of a smaller amount of information, but consequently does not provide a less comprehensive price comparison report with less scope for customisation by the user. By not requiring the user to have an offer upon which to base the comparison, the ESCOSA model is potentially more relevant to a wider range of consumers and of more value during initial information gathering on the part of consumers. However, as pointed out in a submission from CALC, the ESCOSA model does not easily “enable users to understand important non-price terms and conditions”.⁷⁰

5.4 Areas for further consideration

The Commission is not in a position to make specific recommendations about the implementation of comparator tools or the exact specifications of any such tool. The Victorian Government may wish to investigate in more detail alternative options for improving consumers’ access to comparable information. As mentioned above, energy comparators have been the subject of some degree of criticism. However, the interactive possibilities of online tools and the level of sophistication that can be incorporated into them arguably outweigh the possible negatives.

Both approaches to the provision of comparative information about energy market offers have their advantages and disadvantages. The more detailed and time intensive ESC model, requiring customers to have an offer in hand, will be of great benefit to already engaged consumers (i.e. those that are proactively seeking offers from retailers), although it may be less useful as a means of encouraging consumers to engage with the process of actively seeking an energy retailer, particularly if their only exposure to the retail offers is through “door to door” marketing. Conversely, the ESCOSA/QCA model, which provides an estimate of costs under available offers, will be of more value in prompting customers to undertake initial enquiries and driving engagement with the competitive process, before they approach, or are approached by, a retailer. The level of detail this approach may by necessity omit, however, could limit its longer term usefulness for some consumers.

Online tools in the financial services and telecommunications sectors encompass both product comparison and calculation functions. Similar to the process for energy comparators/estimators, product comparison tools provide recommendations based on desired variables as entered by the user (e.g. usage, monthly cost in the case of telecommunications, loan amount, term for financial services). A list of the best fit products are then displayed. The amount of detail available varies between services, though most allow the user to click through to more detailed information. In the telecommunications area, simple browsing (without the input of specific variables) of available plans is also an option available to users of some services. Generic

⁶⁹ CALC p. 8.

⁷⁰ CALC p. 8.

calculation tools are more prevalent in the financial services sector, reflecting the nature of the products involved.

Consumer demand for information is likely to be greater in telecommunications and financial services, as both sectors are characterised by a high degree of consumer interest or motivation, continual product innovation and variation and greater tariff complexity. There is correspondingly greater scope for presenting information in a variety of ways than there is for retail energy products (in telecommunications there are wider variety of possible variables that could be factored into a product comparison report relative to energy). The natural downside to the degree of possible sophistication is the potential for excessive information, or confusing information, to be presented to the user.

6 Moving forward

6.1 Second Final Report

The publication of the Second Draft Report marks the commencement of the consultation period regarding the advice on ways to phase out retail price regulation. The process for lodging submissions is set out in Chapter 1 of the Second Draft Report.

At the conclusion of the consultation period, the Commission will consider the submissions made and the results of any other consultation undertaken. It will then publish a final report setting out its advice on ways to phase out retail price regulation (Second Final Report). The publication of the Second Final Report is scheduled for the end of February 2008.

6.2 Professor Yarrow's report

As referred to in Chapter 2, the Commission has engaged Professor George Yarrow to provide a report to the Commission on the theoretical implications and practical experience in relevant countries of deregulated, competitive markets that have moved from the situation of having a regulated or standard offer price, particularly one which is higher than competitive prices are expected to be, to effectively or workably competitive markets where price is unregulated. It is anticipated that the Report will be published by the Commission in mid January 2008 to inform submissions made in response to this Second Draft Report and the Commission's preparation of the Second Final Report. The Commission also encourages stakeholders and interested parties to provide any relevant written observations in relation to the report by 5pm, Friday, 1 February 2008.

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A Energy Regulatory Framework

This appendix provides an overview of the regulatory framework that applies to energy retailing in Victoria, focusing on:

1. minimum terms and conditions for energy contracts;
2. disconnection;
3. financial hardship policies;
4. information requirements;
5. marketing conduct; and
6. complaints procedures

There are a number of energy-specific regulatory measures in Victoria. These are chiefly contained in one or more of the following:

- EIA (and accompanying Orders in Council);
- GIA (and accompanying Orders in Council);
- Energy Retail Code;
- Marketing Code; and
- various guidelines issued by the ESC.

Minimum terms and conditions

Terms and conditions in standing offer contracts concerning disconnections, the provision of information about customer rights and entitlements, access to premises for meter reading, and confidentiality of customer information must comply with those specified by the ESC (which are contained in the Energy Retail Code). Any term or condition that is inconsistent with a term or condition specified by the ESC is void to the extent of the inconsistency, and is deemed to be replaced by the term or condition contained in the Energy Retail Code.⁷¹

The Energy Retail Code also contains a number of other terms and conditions that are not specified as matters for approval by the ESC under the energy legislation. However, it is a condition of the licences issued to host retailers that the terms and conditions of a standing offer must not be inconsistent with these terms and conditions.⁷² These relate to matters such as billing, credit management, contract

⁷¹ Sections 36(1) and (2) of the EIA and sections 43(1) and (2) of the GIA.

⁷² The retail licences issued to AGL, Origin Energy and TRUenergy provide that each term or condition of the Energy Retail Code is a term or condition with which a contract for the sale of gas or electricity must not be inconsistent.

consent and variation, the term and termination of the contract, complaints and dispute resolution, and privacy and confidentiality (together, the “minimum service standards”).

By virtue of the same licence conditions, market contracts, whether offered by a host retailer or a new retailer, are required to contain non-price terms and conditions that are consistent with those set out in the Energy Retail Code. If a term or condition of the Energy Retail Code is incorporated by reference into the energy contract, it is taken to be expressly dealt with.

The Energy Retail Code specifies that no variations may occur between the Energy Retail Code and energy market contracts, aside from certain clauses which may be altered with the explicit informed consent of the customer. These specific clauses are described in the Energy Retail Code.⁷³ Any other variation to the clauses contained in the Energy Retail Code will result in those clauses becoming void and replaced by the relevant clause from the Energy Retail Code.

The FTA⁷⁴ contains restrictions that apply to contracts in terms of liability limitation. The Energy Retail Code specifies that energy contracts may not be altered in any way that limits the liability of the retailer to the customer for any breach by the retailer of the energy contract or for any negligence by the retailer in relation to the energy contract. Energy contracts may not be altered to require the customer to take precautions to minimise the risk of loss or damage to any equipment, premises or business of the customer which may result from poor quality or reliability of energy supply.⁷⁵

Retailers must not include an indemnity or other term or condition in an energy contract which allows the retailer to collect greater amounts than allowed under common law or statute for any breach by the customer of their energy contract or any negligence by the customer in relation to their energy contract.⁷⁶

Disconnection

The process a retailer must follow before it is permitted to disconnect a customer is set out in the Energy Retail Code.⁷⁷ This process is summarised in the figure below.

⁷³ Energy Retail Code, clause 19.1.

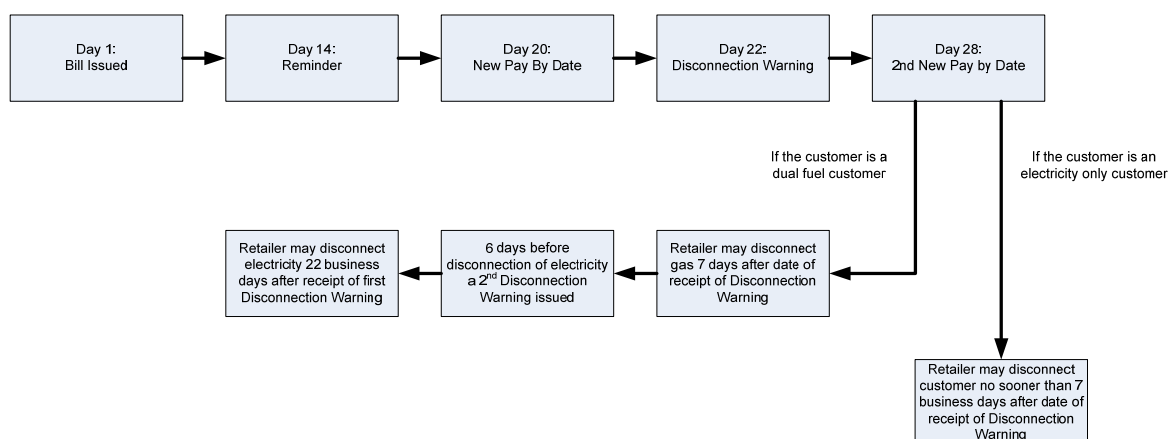
⁷⁴ Section 32X, FTA.

⁷⁵ Energy Retail Code, clause 16(a).

⁷⁶ *Ibid*, clause 17.

⁷⁷ *Ibid*, clause 13.1.

Figure A.1



A retailer is prevented from disconnecting any customer for non-payment of a bill where:

- the amount payable is less than any amount approved by the Commission (this amount is not publicly available);
- the customer has made a complaint directly related to the non-payment of the bill to EWOV or another external dispute resolution body and the complaint remains unresolved;
- the customer has formally applied for a Utility Relief Grant and a decision on the application has not been made; or
- the only charge the customer has not paid is a charge not for the supply or sale of energy.⁷⁸

A retailer must not disconnect a customer:

- who cannot pay due to financial hardship unless the retailer has assessed the customer's position and offered assistance (i.e. a payment plan);
- if the customer's supply address is registered by the relevant distributor as a life support machine supply address; or
- unless requested by the customer, after 2pm on a weekday, or any time on a Friday, a public holiday or the day before a public holiday.⁷⁹

A retailer must pay compensation to any customer that it wrongfully disconnects in the amount of \$250 per day for each whole day the customer was disconnected.⁸⁰

⁷⁸ *Ibid*, clause 14.

⁷⁹ *Ibid*, clauses 13.2 and 14.

⁸⁰ Section 40B of the EIA and section 48A of the GIA.

Claims for compensation are decided using the retailer's internal dispute resolution processes.⁸¹ Aggrieved customers may appeal to EWOV to mediate a solution, who may refer cases it cannot resolve to the ESC.

Financial hardship policies

The EIA and GIA require energy retailers to develop, publish and implement financial hardship policies and to submit them to the ESC for approval.⁸² The legislation requires a financial hardship policy to include:

- flexible payment options for payment of bills;
- provision for the auditing of a domestic customer's electricity or gas usage (whether wholly or partly at the expense of the retailer);
- flexible options for the purpose of supply of replacement electricity or gas appliances designed for domestic use from the retailer or a third party nominated by the retailers; and
- processes for the early response by both the retailer and domestic customers to electricity or gas bill payment difficulties.

Further guidance about what is required to be included in a financial hardship policy are contained in the energy legislation and the ESC's *Guideline No 21: Energy Retailers Financial Hardship Policies*. It provides that the ESC expects that a financial hardship policy will, amongst other things:

- reflect the notion that a domestic customer in financial hardship has the intention but not the capacity to make a payment within the timeframe required by the retailer's usual payment terms;
- provide details of the processes and criteria to enable a domestic customer in financial hardship to identify himself or herself to, be referred to, or be identified by the retailer, and the processes and criteria that will apply to assess the options available to that domestic customer; and
- offer fair and reasonable payment options to the domestic customer.

Retailers must publish the details of their financial hardship policies on their websites in a way that is easy for customers to access, and must provide details of the policy to a customer or financial counsellor on request. Financial hardship policies must be subject to periodic review. Requests to the ESC for approval of a new or amended policy must be accompanied by a statement as to the nature, impact and reason for the change.

⁸¹ Marketing Code, clause 10.1 and *Operating Procedure Compensation for Wrongful Disconnection*, clause 5.1.

⁸² Section 43 of the EIA and section 48G of the GIA.

Information Requirements

Energy retailers are required to make information about their market offers available to customers in accordance with both the Product Disclosure Guideline and the Marketing Code. All retailers are required to produce and publish a product information statement for each of their market offers on their websites.⁸³

A product information statement must be updated within five business days of any change to the information presented in the statement. On request, such statements must be provided in writing, and specified retailers must maintain adequate records to substantiate compliance with this requirement.⁸⁴

The product information published on retailers' websites must be easy for customers to access. Where a retailer determines that there is no tariff available for the customer based on the information provided, it must communicate this to the customer. Where more than one tariff may apply, a retailer must either provide a product information statement for one of the potentially applicable tariffs or for each potentially applicable tariff or indicate that it is not clear on the basis of the information provided which product information statement applies.⁸⁵

In addition to product information statements retailers must also provide an offer summary in writing to a small customer on request and when providing the customer the terms, or information about the terms, of a new retail contract. Such offer summaries must be a separate document to the full contractual terms and conditions and must include certain information, excluding the eligibility criteria and disclaimers.⁸⁶ Retailers may include more than the minimum information requirements in the offer summaries, although such information should be appropriate and not excessive.

The Marketing Code requires retailers to provide customers with certain information before they enter into a contract including information on billing, tariffs, rights to cancel the contract, period of the contract and a commission or fee for the market representative.⁸⁷

Retailers are required to provide the customer with a reasonable opportunity to consider this information before entering into the contract. After a customer has entered into a contract, retailers are required to send the following information to the customer within two business days, unless already provided:⁸⁸

- The full terms, conditions and applicable costs of the contract including the period of the contract;

⁸³ Product Disclosure Guideline, clause 2.4.

⁸⁴ *Ibid*, clause 2.6.

⁸⁵ *Ibid*, clause 2.3.

⁸⁶ In relation to any fixed fees or charges relating to the supply of energy, the offer summary must also include the number of days in the period to which the charge relates.

⁸⁷ Marketing Code, clause 6.3.

⁸⁸ *Ibid*, clause 6.3.

- Advice to the consumer that they have a right to cancel the contract, and a retailer contact point which the consumer may require for further information, or to cancel the contract;
- Government energy assistance schemes which may be available to the consumer;
- How to make a complaint to, or enquiry of, the retailer and details of the Energy and Water Ombudsman of Victoria; and
- The existence and general scope of the Marketing Code and how to access the Marketing Code compliance procedures.

In addition to the obligations around marketing activity, retailers must also obtain explicit informed consent before transferring a customer to a market contract.⁸⁹ The ESC considers consent to be explicit and informed where it is given in writing, electronically or verbally, and where the retailer has fully and adequately disclosed, in plain English, all matters relevant to the consent such that the customer was likely to be aware of what the consent applied to.⁹⁰ Retailers are required to keep a record of any explicit informed consent given by a customer for at least as long as the retailer has any related contract with the customer.⁹¹

In addition to the above, retailers must also include at least the following information in a customer's bill:⁹²

- The relevant tariff or tariffs applicable to the customer;
- Whether the bill is based on a meter reading or is wholly an estimated bill;
- Whether the bill is based on any substituted data;
- The total amount of electricity (in kWh) or of gas (in MJ) or of both consumed in each period in respect of which a relevant tariff applies to the customer;
 - Where the customer's meter measures and records consumption data only on an accumulation basis, the bill must include the dates and total amounts of the immediately previous and current meter readings, estimates or substitutes
 - If the retailer elects to include meter readings or accumulated energy usage from an interval meter on the bill, it must include the meter readings or accumulated energy usage based on quantities read or collected from the corresponding meter accumulation register(s);

⁸⁹ Marketing Code, clause 7.1.

⁹⁰ Essential Services Commission, *Guideline No. 10 Confidentiality and Informed Consent Electricity and Gas*, May 2002, clause 5, pp. 8-9. A customer will not be considered capable of giving consent if he or she is not capable of understanding issues, forming views based on reasoned judgement and/or communicating his or her decision. Minors are assumed not to be competent to provide consent unless the retailer can establish that the preconditions to the validity of such a contract are satisfied.

⁹¹ *Ibid*, clause 6, pp. 9-10.

⁹² Energy Retail Code, clause 4.2

- If the retailer directly passes through a network charge to the customer, the separate amount of the network charge;
- The amount payable for electricity and/or gas;
- The amount of arrears or credit and the amount of any refundable advance provided by the customer;
- A graph showing the customer's energy consumption for the period covered by the bill and, where data is available:
 - The customer's energy consumption for each billing period for the last 12 months; and
 - A comparison of the customer's consumption for the period covered by the bill with the customer's consumption for the same period of the previous year.

This information is designed to allow customers to compare more easily any offers they do receive with their current arrangements.

The Energy Retail Code requires retailers to provide a copy of their charter upon a customer's request and at the time of commencement of a new energy contract or transfers to the retailer from another retailer.⁹³ The charter must contain all details of the rights, entitlements and obligations of retailers and customers. Further to this, retailers must provide copies of the Energy Retail Code upon request and also provide non-English or large print versions upon request.

A retailer must provide information to a customer on tariffs the retailer may offer to the customer as well as any variation to tariffs that may affect the customer.⁹⁴

The FTA contains reference to contract cancellation periods.⁹⁵ Pursuant to the FRA, the Energy Retail Code details the specifics of a "cooling off" period as they apply to energy customers.

The Energy Retail Code states that following signing of a contract, a customer has between 5 to 10 business days to cancel a new energy contract.⁹⁶ The shorter time frame applies to an energisation contract (for electricity) or a supply point unplugging/installation for gas. The 10 business day period applies to all other contracts.⁹⁷

⁹³ Energy Retail Code, clause 26.2.

⁹⁴ *Ibid*, clause 26.4.

⁹⁵ Section 63, FTA.

⁹⁶ Energy Retail Code, clause 23.1.

⁹⁷ *Ibid*, clause 23.1(b).

Marketing Conduct

The Marketing Code reproduces key provisions of the TPA and FTA, specifically those provisions covering misleading and deceptive behaviour and unconscionable conduct. Further, it supplements these legislative requirements by addressing such matters as training and auditing.⁹⁸

The Marketing Code requires retailers, among other things, to:

- Refrain from engaging in misleading or deceptive conduct, unconscionable conduct or making false or misleading representations;
- Ensure that all relevant facts are provided and are not exaggerated, use words and images that promote customer comprehension and use best endeavours to ensure that information provided to customers is truthful and when supplied directly to individual customers, relevant to that customer's circumstances;
- Ensure that any comparisons made are clear, factually correct and easily understood by customers and that they do not omit important information that should be disclosed;
- Ensure that the inclusion of rebates and/or concessions is made clear to customers and any prices that exclude rebates and concessions be disclosed;
- Provide specific information to a customer before they enter into a contract and provide the customer with a reasonable opportunity to consider this information;
- Comply with the restrictions placed upon off premises marketing as laid down in the Fair Trading Act, with certain further defined provisions,;
- Comply with the restrictions placed upon telephone marketing as laid down in the Fair Trading Act, with certain further defined provisions;
- Maintain "no contact" lists of customer who do not wish to be contacted by marketing representatives; and
- Maintain records of all off-premises marketing visits and all phone marketing calls.⁹⁹

The requirement for electricity retailers to abide by the Marketing Code is a component of standard electricity retail licences¹⁰⁰ and standard gas retail licences.¹⁰¹ The administration and implementation of the Marketing Code is the

⁹⁸ Marketing Code, Introduction 1.1.

⁹⁹ *Ibid*, clause 5.

¹⁰⁰ See for example the electricity retail licences, available at www.esc.vic.gov.au, for TRUenergy (clause 14.1(d)), Origin Energy (clause 14.1(d)) and Dodo Energy (clause 15.1(b)(viii)).

¹⁰¹ See for example the gas retail licences, available at www.esc.vic.gov.au, for AGL (clause 15.1(f)), Dodo Energy (clause 17.1(g)) and Origin Energy 15.1(f).

responsibility of the ESC.¹⁰² Customer redress is provided through retailers' internal dispute resolution mechanisms and, if not resolved internally, by EWOV.

Marketing representative training

The Marketing Code requires retailers to take all reasonable steps to ensure that their marketing representatives have adequate training in and understanding of the Marketing Code as well as an understanding of:¹⁰³

- Customer protection laws as set down in the TPA, FTA and other relevant legislation;
- What can be considered to be misleading, deceptive or unconscionable conduct and false representation (including an understanding of coercion and harassment);
- Basic contractual rights and the meaning and importance of the need for a customer's explicit informed consent to a contract;
 - Product knowledge including: Tariffs, billing procedures, payment options;
 - Eligibility requirements for concessions, rebates or grants;
 - Knowledge of retailer's policies for customers experiencing financial hardship;
 - Availability of instalment plans; and
- Customer service skills including dealing with customers with special needs and those without or with limited English language skills.

Retailers are required to provide ongoing training to their marketing representatives on these matters.

Consent audit

The Marketing Code requires retailers to conduct an annual consent audit of customers who have entered into a contract with the retailer.¹⁰⁴ The audit requires retailers to contact randomly selected customers who have entered into a contract with the retailer within the past 14 days and ask them if:

- He or she understands that he or she has entered into a contract;
- He or she has consented to the contract; and
- He or she understands the cooling-off period that exists on entering into a contract.

¹⁰²Marketing Code, clause 1.1.

¹⁰³*Ibid*, clause 4.1.

¹⁰⁴*Ibid*, clause 7.3

The audit must be conducted during periods of marketing activity.

If a customer who is contacted as part of the audit indicates that they did not understand that they had entered into the contract, or did not consent to the contract and wishes to terminate it, the retailer will:

- ensure the contract is terminated;
- request the customer to supply to the retailer any information about the marketing activities of the retailer which may suggest failures in the methods, systems or knowledge of marketing representatives; and
- audit the marketing activities of the marketing representative who marketed the terminated contract. This audit shall examine the previous five customer contracts generated by the marketing representative before the terminated contract, and the five customer contracts generated after the terminated contract. Contracts in this case are contracts that are market contracts and were formed off the business premises of the retailer.

If the response of the customer alone, or in combination with the responses of other customers, suggests on reasonable grounds failures in the methods, systems or marketing representatives engaged by the retailer, the retailer shall take all reasonable steps to remedy the failures and to ensure that they do not reoccur.

Retailers are to keep records of actions taken pursuant to these audits.

Complaint Procedures

Retailers are required to have an internal process for handling customer complaints arising from the retailer's marketing activities. This process is to comply with the Australian Standard of Complaints Handling and must be provided to customers at no cost.¹⁰⁵

If the retailer does not resolve the issue raised in a way satisfactory to the customer, the retailer is required to provide the customer with reasons as to its decision. Reasons must be provided in writing upon request.

If the complaint has not been resolved to the customer's satisfaction within 1 month of the complaint being lodged, the retailer must also provide information on further action the customer may take with EWOV.

Retailers must make available information which promotes customer understanding of the complaints process and which defines the timeframe within which a complaint will be addressed.

EWOV has power to handle complaints made against gas and electricity companies. Energy legislation¹⁰⁶ in conjunction with retail licences¹⁰⁷ requires licensees to enter

¹⁰⁵ *Ibid*, clause 1.1.

¹⁰⁶ Section 28 EIA, section 36 GIA.

into a customer dispute resolution scheme approved by the ESC. The EWOV scheme, established by contract between retailers and other market participants, is currently the principal scheme in Victoria (another scheme has been approved for disputes with large customers).

On receipt of a customer complaint, EWOV must confirm that the retailer has had the opportunity to consider the complaint. EWOV may make a binding determination (for example, that a retailer pay compensation, provide the relevant energy services or amend a charge in relation to a service).¹⁰⁸

¹⁰⁷ For example, clause 16 of Origin Energy's electricity retail licence ("Dispute resolution").

¹⁰⁸ EWOV does not have jurisdiction to handle complaints about certain matters (such as the setting of prices or tariffs, any matters specifically required by legislation to be considered by the ESC or events beyond the reasonable control of a retailer).

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