

Preventing retail energy discounting on inflated base rates

1. Name and address of the rule change proponent

Name of Proponent: The Honourable Minister Josh Frydenberg MP, Minister for the Environment and Energy on behalf of the Australian Government.

Address of Proponent: Parliament House, Canberra, ACT.

2. Description of the proposed rule

In accordance with section 243 of the *National Energy Retail Law* (the NERL), we request the Australian Energy Market Commission (AEMC) make changes to the National Energy Retail Rules (the NERR) through the creation of a new 'Rule 15A'.

New rule 15A would prohibit a retailer from applying a discount to a market retail contract if the base rate against which the discount would be applied were higher than the equivalent standing offer prices of that retailer.

The rule is aimed at preventing a behaviour that is considered to be inherently confusing for the average consumer – the practice of applying discounts to rates that significantly exceed the base rate as represented by the retailer's standing offer. Because the base rate against which the discount applied is inflated, it can lead the consumer to believe the discount is of relatively greater value than it is.

This new rule is proposed to be incorporated into Part 2 of the NERR, which deals generally with customer retail contract requirements, including:

- Allowable or required contractual terms and conditions in retail contracts;
- Pre-contractual procedures that must be followed;
- The manner and basis on which customers are billed;
- How under or overcharging are dealt with;
- The use of security deposits;
- Termination of contracts;
- Transfer of customers and energy marketing practices.

While the NERR can limit the types of contractual terms which may be employed in small retail contracts, it does not currently deal specifically with discounting practices. To the extent discounting practices are regulated, this is done through the Retail Pricing Information Guidelines (RPIG) developed by the AER.

The purpose of the AER RPIG is to provide guidance to retailers in the presentation of standing offer and market offer prices, to assist small customers to compare what is offered by retailers.¹ To that end, if discounts are offered to customers, the RPIG specifies the manner in which the customer is provided with that information.

¹ See s61(2) of the NERL.

The RPIG requirements ensure a level of transparency when it comes to discounting practices, however, they are not best relied on when seeking to prohibit the use of particular contractual clauses. Limiting the manner in which a retailer may contract with a consumer more appropriately falls within the purview of the AEMC's rule making power, as it is clear that the AEMC has broad power to make a rule "regulating the activities of persons involved in the sale and supply of energy to customers."²

Specifically, the Government proposes the following rule would sit within Division 2 of Part 2 of the rules, which is focused on regulating specific terms and conditions of retail contracts. The proposed rule is as follows:

15A Market retail contract discounting practices

- 1) *In any market retail contract for the sale of electricity between a retailer and a small customer, the retailer must not include a provision that applies a discount to any amount the customer is billed under the contract if:*
 - a) *the daily supply charge levied under that contract exceeds the daily supply charge in the standing offer prices of the retailer; or*
 - b) *the usage charge levied under that contract exceeds the usage charge in the standing offer prices of the retailer; or*
 - c) *the demand charge levied under that contract exceeds the demand charge in the standing offer prices of the retailer.*³
- 2) *For the purposes of subrule (1), a charge levied under a market retail contract exceeds the charge in the standing offer prices of the retailer if it exceeds the equivalent charge for a standing offer with the same tariff structure.*
- 3) *For the purposes of subrule (1), the standing offer prices of the retailer are those which are generally available to the small customer in the region in which the customer is to consume electricity under the market retail contract.*

Example 1:

When comparing the daily supply charge for a market retail contract which employs a single rate tariff, the charge should be compared to the daily supply charge for the retailer's standing offer single rate tariff.

Example 2:

When comparing the usage charge for a market retail contract which employs a time of use tariff, the charge should be compared to the equivalent usage charge component (e.g. the peak and off-peak rate) for the retailer's standing offer time of use tariff.

The government further proposes that this new rule be subject to a civil penalty if a retailer fails to comply. Given non-compliance with this proposed rule could result in a retailer

² See s237(1)(a) of the NERL.

³ The Government notes that the terms 'daily supply charge', 'usage charge' and 'demand charge' are undefined in the law, regulations and rules, though some reference to these terms is made in the AER's retail pricing information guidelines. While these terms are commonly used and well understood in the industry, the AEMC may consider it appropriate to further define these terms for the purposes of this rule change.

improperly receiving a financial benefit, ensuring that breach of this rule can result in a financial penalty would represent an effective deterrent.

Timing of implementation

The Government considers this rule to be an important step in protecting consumers from potential detriment. To that end, Government proposes the rule be made under the expedited process set out in s252 of the NERL.

The Government would like the rule to start from 1 March 2018, but recognises that a reasonable period of transition is needed to allow retailers to make necessary changes in compliance with the new proposal.

The Government requests the AEMC consider an appropriate commencement and transitional approaches having regard to the potential impact of the new rule. The Government notes that it is intended that this rule only apply prospectively – that is, the new rule is not intended to impact on existing contracts.

3. Explanation of the proposed rule

The proposed rule is aimed at preventing the practice of inflating the key components of an electricity bill, while offering a discount on those rates.

A number of examples are proposed to be provided in the rule which will assist retailers in understanding and complying with the new requirements, however, in simple terms, no discount can be offered to a consumer for any market offer in which the supply or usage charges are higher than the equivalent standing offers prices of the retailer.

The rule relies on the term ‘standing offer prices’, which is already defined in the NERL as meaning:

“...all of the tariffs and charges that a retailer charges a small customer for or in connection with the sale and supply of energy to a small customer under a standard retail contract.”

Subrule (3) provides further clarification in relation to the meaning of ‘standing offer prices’. As a given retailer may offer different standing offers in different regions, the intention of subrule (3) is to clarify that the comparison should be made between the market offer made to the small customer and the standing offer prices that would be generally available to that customer in the region the customer will consume electricity.⁴

The Government notes that the intention is to prevent discounting on rates that are in excess of the standing offer of the retailer that is available at the time agreement is entered into. That is to say, it is not intended that the prohibition apply to a contract that exists at the time the rule is commenced. This would ensure that retailers could not inadvertently breach the rule if,

⁴ An alternative construction could be considered by the AEMC – the region closest to the region in which the consumer is to consume electricity. In this way, the application of the rule would not be unintentionally limited if an equivalent standing offer tariff structure were not generally available to the consumer.

over the course of an existing contract, the retailer’s standing offer were lowered below the retailer’s market offer prices.

As drafted, the application of the rule applies to circumstances in which the tariff structures of the market and standing offers of a retailer are equivalent – this is intended. While retailers can offer a wide variety of market offer tariff structures, most retailers offer single rate and time of use standing offer tariff structures. As such, it is expected that most available market offer tariff structures will have a comparable single rate or time of use equivalent standing offer against which a comparison may be made.

To the extent that the proposed rule does not encompass market offer tariff structures for which an analogous standing offer tariff also exists, the Government requests the AEMC consider whether a more preferable rule should be made. The government notes, however, that any further expansion of the scope of the rule should be careful to avoid discouraging retailers from offering TOU tariffs – this would not be a desirable outcome. The Government recognises that the availability of such tariffs, and cost-reflective pricing generally, will ultimately aid in lowering network costs, and may thereby put downward pressure on retail prices. A rule change which risked fewer TOU offerings in the market could ultimately be more detrimental than the behaviour proscribed by the proposed rule.

4. Statement of issues

Nature and Scope of the Issue

Retail energy markets are changing, with more consumers than ever before on retail market contracts. Retailers are also increasingly expanding the range of retail market offers available to consumers in recent years. According to the AER’s Retail Market Performance Report 2016, around 50 per cent of customers are on retail market offers in the NEM; however, this varies significantly between jurisdictions (Table 1).

Table 1 Percentage of residential electricity customers on market and standing offers

State	Market Contract	Standard Contract
NSW	77%	23%
QLD	52%	48%
SA	87%	13%
TAS	11%	89%
ACT	23%	77%

Source: Quarter 3 2016-17 retail statistics, AER.

With 28 electricity retailers offering hundreds of different retail offers across the NEM, consumers are confronted with a vast array of options and providers. As retailer offers continue to expand and innovate, the possibility that consumers may find it difficult to determine whether certain types of offer are in their best interest.

Retailers commonly offer discounts as a way to signal to consumers that their prices are lower than their competitors, and research indicates that discounts are an important factor in

influencing a consumer's choice of retailer.⁵ That said, the way discounts are presented to consumers can be confusing. In its retail electricity pricing inquiry preliminary report, the Australian Competition and Consumer Commission (ACCC) has noted that many some stakeholders consider discounts to be confusing or misleading, or at the very least that discounts makes offers more difficult to assess.⁶

Given the complexity and variability of available offers, behaviour that has the potential to mislead or confuse a consumer can easily result in consumer detriment. In relation to discounting practices, the ACCC has taken action against retailers for misleading representations. An example of this is the 2015 matter of the *ACCC v Origin Energy Limited*.⁷ In that case, which concerned behaviour similar to that which is covered by the proposed rule change request, the Federal Court found a false or misleading representation had been made in contravention the Australian Consumer Law (ACL).

The Government believes that while behaviour that is clearly contrary to existing protections in the Australian Consumer Law may be addressed through the Courts, there may be circumstances in which it may be difficult to clearly demonstrate, to the legal standard required by a Court, that the ACL has been contravened. In this respect, the ACCC has noted:

“Even if a ‘discount’ does not meet the threshold to be considered misleading or deceptive under the ACL, it could still be very confusing for consumers. This is particularly the case when there is no consistent form of presentation or application of discounts.”⁸

The Government believes that the practice of discounting off rates above the standing offer could at the very least be considered confusing in certain circumstances, and it may therefore have the potential to result in consumer detriment.

How the proposed rule will address the stated concern

Preventing the behaviour of discounting on offers above standing rates would avoid any need to engage in detailed legal deliberations as to whether the behaviour contravenes the ACL. In this way, there is no need for consumers or the ACCC to engage in unnecessarily costly, complex and time-consuming legal arguments.

Moreover, a specific prohibition is a far clearer signpost to retailers on their legal obligations and would amount to a simpler and stronger deterrent than the status quo. In essence, with a clear prohibition in place there would be less risk to the consumer. As such, the Government considers that the rules should be modified to limit the practice.

⁵ Newgate Research, AEMC: Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets, June 2016, p. 33.

⁶ ACCC Retail Electricity Pricing Inquiry: Preliminary Report, p128: <https://www.accc.gov.au/publications/accc-retail-electricity-pricing-inquiry-preliminary-report>.

⁷ See: Australian Competition and Consumer Commission v Origin Energy Limited [2015] FCA 55 (9 February 2015) <http://www.austlii.edu.au/au/cases/cth/FCA/2015/55.rtf>

⁸ ACCC Retail Electricity Pricing Inquiry: Preliminary Report, p128: <https://www.accc.gov.au/publications/accc-retail-electricity-pricing-inquiry-preliminary-report>.

Other options

Variation of the Retail Pricing information Guidelines

One alternative to the proposed rule change would be to bolster the AER's Retail Pricing Information Guideline (RPIG).

In August 2015, the AER considered how discounts should be reflected in RPIG as prepared by the regulator in accordance with the Retail Law⁹. In adjusting the guidelines, the AER noted that discounts materially impact the price paid by consumers.

The AER established a new section in the Guidelines specifically addressing discounts (in all their forms) and how they impact customers' ability to compare offers. The revised Guideline, in effect from 1 February 2016, requires retailers to detail the following in their retail price fact sheets:

1. the amount and/or percentage of the discount
2. for percentage discounts, what portion of the customer's bill the discount applies to (for example, whether the discount is off usage, the supply charge or the whole bill)
3. the base level
4. where information on the base level can be found (for example, on the retailer's website or Energy Made Easy)
5. for dual fuel offers, which fuel(s) the discount applies to.¹⁰

The guideline also requires the retailer, if a representation is made in marketing or advertising about a specific discount rate (that is, the amount and/or percentage of the discount), to clearly indicate the additional details above (requirements 2-5). Each discount must be named and described using language that is clear, simple and widely understood.

The Government notes that the AER is engaged in a range of efforts to improve the quality and transparency of information in the retail market. While the Guidelines could be further bolstered in relation to the practice of applying discounts to inflated market rates, the Government considers that this option does not detract from the merits of making this rule. Indeed the rule change itself would have the effect of significantly curtailing the behaviour which any improvement to the Guidelines would seek to address.

There is little to justify the practice of applying discounts to inflated market rates – the practice appears to exist primarily to entice consumers into contracting with a retailer on the basis that believe they are getting a better deal than is otherwise the case. The Government therefore considers that preventing the practice through a rule change is strong enhancement to the existing consumer protections under the NERL.

⁹ NERL S 61 refers

5. Contribution to the National Energy Retail Objective

The National Energy Retail Objective, as stated in the National Energy Retail Law, is:

“...to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy.”

Misleading or confusing behaviour in the retail market results in consumers paying more for electricity services than they otherwise would. The type of behaviour that this rule is proposed to prevent would result in allocative inefficiency.

In mitigating the possible negative effects on the market, this proposed rule thereby ensures the efficient operation of the energy services which is inherently in the long term interests of the consumer.

Given the second arm of the rule-making test in s236(2)(b) of the NERL, it is also noted that the implementation of this proposed rule is inherently compatible with the development and application of consumer protections for small customers. The prevention of misleading conduct in the market is a core measure aimed at protecting consumers.

6. Benefits, costs and implications of the proposed rule

Benefits

As stated above, the practical benefit of making this rule is that it will protect consumers against an inherently problematic marketing practice. This, in turn will result in more efficient operation of energy services in the retail market, which is consistent with the long-term interests of consumers. A further key benefit of the rule is that it will build consumer trust in the market and limit the risk of bad consumer experiences.

Risks, Implications and Treatment

Risk	Treatment
<i>The rule change does not extend beyond scenarios in which there is equivalence between market and standing offer structures.</i> <i>This could encourage retailers to circumvent the rule by altering tariff structures.</i>	The impact of the proposed rule and any behaviour change which results will be monitored to ensure effectiveness. If necessary, further rule change proposals may be considered if significant concerns arise post implementation.
<i>Reducing the ability of retailers to contract with customers as they choose and therefore impacting their ability to compete.</i>	This rule change proposal will limit certain types of contracting and marketing behaviour. In this respect, it is noted that the whole purpose of the rule is to mitigate the risk of consumers signing up to deals that are not in their financial interest.