

Australian Energy Market Commission

## CONSULTATION PAPER

# National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014

13 February 2014

RULE  
CHANGE

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## **About the AEMC**

The Council of Australian Governments (COAG), through its then Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. In June 2011, COAG established the Standing Council on Energy and Resources (SCER) to replace the MCE. The AEMC has two main functions. We make and amend the national electricity, gas and energy retail rules, and we conduct independent reviews of the energy markets for the SCER.

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## Executive Summary

### Purpose of this paper

This paper seeks stakeholder comments on a rule change request to amend the National Energy Retail Rules (retail rules). The request seeks to prohibit retailers from including terms in their contracts that allow them to change prices during the fixed term or fixed benefit period of market retail contracts. The rule change request was submitted by the Consumer Action Law Centre (CALC) and the Consumer Utilities Advocacy Centre (CUAC).

CALC and CUAC consider that their proposed rule would encourage retailers to more efficiently manage risks for their customers and promote more confident consumer participation in retail energy markets.

This is the first time that the AEMC has received a rule change request to amend the retail rules. The retail rules are part of a broader set of regulations that together comprise the National Energy Customer Framework. This framework currently operates in Tasmania, the Australian Capital Territory, South Australia and New South Wales.

### Key concepts for the rule change request

There are two different kinds of retail contracts that are regulated under the retail rules. These are standard retail contracts and market retail contracts. They are regulated in different ways:

- **Standard retail contracts** – these are retail electricity or gas contracts that some retailers are required to offer. The terms of standard retail contracts are regulated under the retail rules and retailers cannot vary prices under these contracts more than once every six months. In some jurisdictions, the price of some standard retail contracts is also regulated.
- **Market retail contracts** – these are all retail electricity or gas contracts that are not standard retail contracts. Under the retail rules retailers have greater flexibility in the terms they can include in market retail contracts compared to standard retail contracts. This includes flexibility in the terms retailers can use in relation to how often they vary prices under market retail contracts. Market retail contracts can be:
  - Fixed term retail contracts – which are contracts that contain a term that specifies the date on which the contract will end or a method for calculating that date. For example, a two year contract where the contract ends at the end of the two years;

- Contracts with a fixed benefit period – which are contracts that contain terms that specify a benefit that is available for a specific period of the contract. For example, a contract that has a two year period with a ten percent discount from the rate of the standard retail contract, and the same contract continues after the discount ends; and
- Contracts that do not have a fixed term or benefit period.

For simplicity we will refer to fixed terms and fixed benefit periods together as “fixed periods”.

The rule change request only relates to retailers changing prices during fixed periods in market retail contracts. It does not relate to changes in prices in standard retail contracts.

### **Current requirements for price variations in market retail contracts**

Under the current retail rules, market retail contracts can contain terms that allow prices to change in fixed periods. The contract must also oblige the retailer to inform the customer of any price changes as soon as it is practical to do so, or at the latest in the next bill. There are no restrictions on the amount or number of price changes that a retailer can make during a fixed period in a market retail contract.

Retailers can charge their customers if the customer terminates certain retail energy contracts early. Retailers can only charge their customers for terminating a market retail contract if it is a contract with a fixed period and the contract is terminated during that fixed period. These “exit fees” cannot be more than a reasonable estimate of the costs to the retailer resulting from the early termination. New South Wales has also set a cap on the exit fees that can be charged by retailers in that jurisdiction.

### **Key issues for consultation**

The AEMC has identified some key issues for consultation to assist its consideration of the rule change request. These issues are considered in detail in chapters 5 to 8 of the consultation paper and include:

- **Allocation of costs and risks** –This includes considering:
  - the role of retailers in energy markets and the nature of the different risks they face;
  - the ability of retailers to efficiently manage each of the different risks they face; and

- whether the proposed rule would result in increased prices in contracts that have a fixed period. This may occur if retailers include an additional premium on prices for providing customers with price certainty. This premium would reflect the additional risks of managing changes in costs that may be difficult for retailers to manage.
- **Consumer participation and engagement** – This includes considering:
  - the role of transparent information in encouraging retailers to develop products that meet consumers’ preferences;
  - the role of exit fees and other transaction costs in hindering consumers from changing retail energy contracts after experiencing price changes during fixed period contracts; and
  - whether the proposed rule would improve the level of consumer participation and engagement in retail energy markets.
- **Competition between retailers** – This includes considering:
  - the role of competition between retailers in promoting efficient retail energy markets;
  - the impact of the proposed rule on different retailers and the effect this may have on the level of competition in retail energy markets; and
  - whether the proposed rule would result in a more limited variety of market retail contracts with fixed periods, or a removal of such contracts altogether from the market.
- **Consumer protection issues** – This includes considering:
  - the interactions between the current rules regarding price changes in fixed period contracts and the Australian Consumer Law; and
  - how the proposed rule may interact with jurisdictional consumer protections, such as the way the different jurisdictions regulate exit fees for market retail contracts.

We encourage stakeholders to consider and comment on these issues as well as any other aspects of the rule change request. We also ask stakeholders to consider whether there are any alternative approaches that may better address the issues raised by CALC and CUAC that could both maximise the potential benefits of the proposed rule and minimise its potential adverse impacts.

## **Rule-making powers of the AEMC under the National Energy Retail Law**

The AEMC cannot make or amend a retail rule if it is not satisfied that two legal tests under the National Energy Retail Law have been met. These tests are:

- that the new rule will or is likely to promote the long-term interests of consumers as required under the National Energy Retail Objective (NERO) (the NERO test); and
- where relevant, that the new rule is compatible with the application and development of consumer protections for small customers, including hardship customers (the consumer protections test).

The long-term interests of consumers lie at the heart of the NERO test. The NERO requires that efficiency in the investment, operation and use of energy services is the principal consideration for determining what is in the long-term interests of consumers. The Commission considers that, where feasible, competitive markets provide the best means of promoting the long-term interests of consumers.

The consumer protections test will be relevant to this rule change request. The Commission intends to consider the compatibility of the proposed rule with consumer protections under the National Energy Retail Law, the retail rules, general consumer law, and jurisdictional laws and regulations.

When the AEMC is considering a particular rule that has been proposed, it can decide to make the rule as proposed, make a more preferable rule, or make no rule at all if it considers that doing so would better serve the long-term interests of consumers.

### **Next steps**

Submissions on the consultation paper are due on 27 March 2014.

The expected timetable for the remainder of the rule change process is as follows:

- publication of the draft rule determination - August 2014;
- close of submissions on the draft determination - September 2014; and
- publication of the final rule determination - late 2014

This timeline has been extended beyond the usual rule making timeframe due to the complexity of the issues raised by the rule change request and the need to undertake additional stakeholder consultation. This will include undertaking meetings with a broad range of stakeholders and holding public forums, where appropriate.

# Contents

<b>1</b>	<b>Introduction .....</b>	<b>1</b>
1.1	Purpose of this paper.....	1
1.2	Timeline for the rule change process.....	1
<b>2</b>	<b>Background to the rule change request .....</b>	<b>3</b>
2.1	The National Energy Customer Framework .....	3
2.2	The role of the AEMC .....	4
2.3	The AEMC's rule change process .....	5
2.4	The relevant NECF provisions for this rule change request .....	6
2.5	Other work of the AEMC relevant to this rule change request .....	11
<b>3</b>	<b>Details of the Rule Change Request .....</b>	<b>13</b>
3.1	CALC and CUAC's concerns with the current rules .....	13
3.2	Proposed rule changes under the retail rules.....	16
3.3	CALC and CUAC's proposed scope of rule change request.....	17
3.4	CALC and CUAC's assessment against the NERO .....	17
3.5	Costs and benefits of the proposed rule identified by CALC and CUAC .....	18
<b>4</b>	<b>Assessment Framework .....</b>	<b>20</b>
4.1	Requirements under the Retail Law .....	20
4.2	The NERO test .....	21
4.3	Consumer protections assessment.....	24
4.4	Issues for consideration.....	27
<b>5</b>	<b>Allocation of Costs and Risks.....</b>	<b>28</b>
5.1	The role of retailers in retail energy markets .....	28
5.2	The risks and costs managed by retailers .....	28
5.3	Retailers' strategies for managing risks.....	32
5.4	Risk allocation in retail market offers.....	35
5.5	Implications of proposed rule .....	36
<b>6</b>	<b>Consumer Participation and Engagement.....</b>	<b>39</b>

6.1	Information and efficient retail energy markets .....	39
6.2	Barriers to participation .....	42
6.3	Impacts of the proposed rule.....	45
<b>7</b>	<b>Competition Between Retailers.....</b>	<b>46</b>
7.1	Retailers in a competitive market .....	46
7.2	Impact of the proposed rule on competition between retailers .....	47
7.3	Innovation in retail market offers .....	49
<b>8</b>	<b>Consumer Protection Issues.....</b>	<b>51</b>
8.1	Interactions between the rule change request and the ACL .....	51
8.2	Interactions between the rule change request and jurisdictional regulations .....	57
<b>9</b>	<b>Alternative Approaches to the Issues Identified in the Rule Change Request</b>	<b>60</b>
9.1	Impacts of the proposed rule.....	60
9.2	CALC and CUAC's alternative rules .....	61
9.3	Other alternative rules.....	63
<b>10</b>	<b>Lodging a Submissions.....</b>	<b>66</b>
10.1	Lodging a submission electronically .....	66
10.2	Lodging a submission by mail .....	66
	<b>Abbreviations and key terms.....</b>	<b>67</b>
<b>A</b>	<b>Consumer Protections and Retail Energy Market .....</b>	<b>68</b>
<b>B</b>	<b>Consumer Protections Relevant to this Rule Change Request .....</b>	<b>69</b>



# 1 Introduction

## 1.1 Purpose of this paper

On 23 October 2013 the Consumer Utilities Advocacy Centre and the Consumer Action Law Centre submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission).<sup>1</sup> The rule change request seeks to make amendments to the National Energy Retail Rules to prohibit retailers from including terms in their contracts that allow them to change prices during the fixed term or fixed benefit period of *market retail contracts*.

This is the first request that the AEMC has received to amend the National Energy Retail Rules since these rules first commenced on 1 July 2012.<sup>2</sup>

This consultation paper has been prepared to facilitate stakeholder consultation on the rule change request.

This paper:

- provides a summary of, and a background to, the rule change request;
- outlines the framework the AEMC intends to use in assessing the rule change request;
- sets out a number of questions and issues to facilitate consultation on the rule change request; and
- outlines the process for making submissions.

## 1.2 Timeline for the rule change process

The expected timetable for this rule change request is as follows:

- close of submissions on the consultation paper - 27 March 2014;
- publication of the draft rule determination - August 2014;
- close of submissions on the draft determination - September 2014; and
- publication of the final rule determination - late 2014.

We have extended the timeframe for the consideration of this rule change request beyond the AEMC's usual rule making timeframe due to:

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<sup>1</sup> CALC/CUAC rule change request, October 2013.

<sup>2</sup> The National Energy Retail Rules commenced in the Australian Capital Territory and Tasmania on 1 July 2012, followed later by South Australia on 1 February 2010 and New South Wales on 1 July 2013. The National Energy Retail Rules have not yet been adopted in Queensland or Victoria.

- the complexity of the issues raised by the rule change request; and
- the need to undertake additional stakeholder consultation, including undertaking meetings with a broad range of stakeholders and holding public forums, where appropriate. This is because the rule change request deals with issues relating to *market retail contracts* for small customers and it is also the first rule change request the AEMC has received relating to the retail rules.

## 2 Background to the rule change request

This chapter provides relevant background to the rule change request, including an overview of:

- the National Energy Customer Framework (NECF);
- the role of the AEMC;
- the process the AEMC is required to follow in considering rule change requests under the National Energy Retail Law (the Retail Law);
- the National Energy Retail Rules (retail rules or rules) that are relevant to this rule change request; and
- other work of the AEMC that is relevant to this rule change request.

### 2.1 The National Energy Customer Framework

This section provides an overview of the NECF. It is important to understand how the NECF operates as the rule change request proposes changes to the retail rules, that are a key component of the NECF.

The NECF commenced in July 2012 for Tasmania and the Australian Capital Territory, followed in 2013 by South Australia and New South Wales. The NECF establishes consumer protections and obligations regarding the sale and supply of electricity and natural gas to consumers, with a particular focus on residential and small customers. It covers a range of matters, including retailer and consumer relationships (e.g. contractual arrangements), and associated rights, obligations, and consumer protection measures (e.g. marketing, informed consent, security and privacy provisions).

The NECF is made up of the Retail Law, the National Energy Retail Regulations and the retail rules and amendments to the National Electricity Law and the National Gas Law necessary to implement the Retail Law and the retail rules. The Retail Law and the Regulations are legislative instruments implemented in each participating jurisdiction that set out the core framework of the NECF, including the provisions that provide the AEMC with the power to make changes to the retail rules. The retail rules provide more detailed provisions that regulate the rights and obligations of retailers and consumers in retail energy markets.

The consumer protections under the NECF are intended to complement and operate alongside consumer protections in other relevant laws. These protections include the national consumer protections under the Australian Consumer Law and also state and territory consumer protection laws. An overview of these consumer laws and, broadly, how these laws interact, is provided at **Appendix A**.

States and territories implement the NECF reforms in their own jurisdictional legislation. In doing so, the states and territories can specify parts of the NECF that do

not apply in their jurisdiction, and can also maintain other jurisdictional regulations that support or supplement aspects of the NECF reforms. Each jurisdiction that has implemented the NECF has also specified parts of the NECF that will not apply in their jurisdiction, and each also maintains some degree of additional jurisdictional regulation of retail energy markets.

Queensland has conditionally agreed to adopt the NECF in 2014, after consideration of consumer protection options for consumers outside of south-east Queensland.<sup>3</sup> Victoria is in the process of harmonising the Victorian Energy Retail Code with the NECF.<sup>4</sup> The Northern Territory and Western Australia have not yet agreed to implement the NECF reforms.

## **2.2 The role of the AEMC**

The AEMC is the rule maker for the Australian retail energy markets. The Commission makes and amends the retail rules.<sup>5</sup> The AEMC is also the rule maker for the National Electricity Market and elements of natural gas markets. The rules for those markets are set out in the National Electricity Rules and the National Gas Rules respectively.

In addition, the AEMC also conducts reviews of the Australian energy markets and provides advice to the Standing Council on Energy and Resources. The Standing Council on Energy and Resources is comprised of the state, territory and Commonwealth energy ministers.

In considering requests to amend the retail rules the AEMC is required to consider:

- whether the proposed amendments will or are likely to promote the National Energy Retail Objective. This Objective is to promote efficient investment in, operation and use of energy services for the long term interests of consumers with respect to price, quality, safety, reliability and security of energy supply;<sup>6</sup> and
- where relevant, whether the proposed amendments are compatible with the application and development of consumer protections for small customers.<sup>7</sup>

The AEMC must be satisfied of both of these tests under the Retail Law before it can make amend the retail rules or make a new rule.<sup>8</sup> The consumer protections test is

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<sup>3</sup> Queensland Government Department of Energy and Water Supply, The 30 Year Electricity Strategy Discussion Paper: Powering Queensland's Future, DEWS, 2013, p.10.

<sup>4</sup> For further information on this process please see the Essential Services Commission of Victoria web page for this project at:  
<http://www.esc.vic.gov.au/Energy/Harmonisation-of-Energy-Retail-Codes-and-Guideline>.

<sup>5</sup> This function of the AEMC is set out in section 221 of the Retail Law. The Rule making powers of the AEMC with respect to the retail rules are set out in Part 10 of the Retail Law.

<sup>6</sup> See section 236(1) of the Retail Law.

<sup>7</sup> See section 236(2)(b) of the Retail Law.

unique to amendments of the retail rules. A similar consumer protections test does not apply in relation to the AEMC's rule making powers for the National Electricity Rules or the National Gas Rules.

More detail on the requirements for the AEMC's consideration of changes to the retail rules and how the AEMC intends to approach the assessment of this rule change request is set out in chapter 4.

## **2.3 The AEMC's rule change process**

The rule change process begins when a person makes a request to change the retail rules (a rule change request).<sup>9</sup> The AEMC undertakes an initial consideration of the rule change request, which includes considering whether the rule change request:<sup>10</sup>

- appears to contain all the relevant information required in the National Energy Retail Regulations;
- appears not to be misconceived or lacking in substance; and
- is in relation to a matter that the AEMC has powers to make rules on under the Retail Law.

Taking into account these considerations, the AEMC then decides whether it will or will not "initiate" the rule change request.<sup>11</sup>

The usual process followed by the AEMC, once it decides to initiate a request, is to:

- publish a consultation paper setting out the background to the rule change request and the scope of the issues for stakeholder consultation;
- consult with stakeholders both formally (through stakeholders making submissions) and informally in relation to the matters outlined in the consultation paper and the rule change request;
- publish a draft rule determination that sets out the Commission's draft decision on whether or not a change to the rules should be made, the reasons for that decision, and if relevant, a draft of the amended rule;
- consult with stakeholders both formally (through stakeholders making submissions) and informally in relation to the draft rule determination; and

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<sup>8</sup> In addition to the two listed considerations, the AEMC is required to consider any relevant Ministerial Council on Energy (MCE) statement of energy policy (see section 236(2)(c)). There are no relevant MCE statements of energy policy that need to be considered for this rule change request.

<sup>9</sup> Broadly, any individual, corporation or governmental body other than the AEMC can submit a rule change request.

<sup>10</sup> See section 249 of the Retail Law.

- publish a final rule determination that sets out the Commission's final decision on whether a change to the rules will be made, the reasons for this decision, and if relevant, the final amended rule that will apply.

In making its rule determination the Commission can either make the proposed rule, make a more preferable rule, or make no rule.

Where a request for a rule raises issues of sufficient complexity or difficulty, the timeframe for making a draft rule determination or final rule determination may be extended.<sup>12</sup> As noted in chapter 1, the timeframe for the AEMC's consideration of this rule change request has been extended due to the complexity of the issues involved and the need to undertake additional stakeholder consultation.

## **2.4 The relevant NECF provisions for this rule change request**

The rule change request seeks to make changes that only relate to certain kinds of retail energy contracts regulated under the NECF. This section therefore discusses the different kinds of retail energy contracts that are used in retail energy markets and provides an overview of the relevant NECF regulations that apply to these different kinds of contracts.

There are two different kinds of retail contracts that are regulated by the NECF. These are, "standard retail contracts" and "market retail contracts".<sup>13</sup> Figure 2.1 provides an overview of the main differences between these two kinds of retail energy contracts.

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11 See section 249(2)-(6) of the Retail Law. If the AEMC decides to initiate a rule change request, it must publish a notice to that effect (in relation to which, see section 251 of the Retail Law).

12 See section 266 of the Retail Law.

13 See section 20(1) and (2) of the Retail Law.

**Figure 2.1 Overview of the main differences between standard and market retail contracts**

Standard retail contracts	Market retail contracts
Must be offered by some retailers	Not required to be offered by retailers
Prices regulated in some jurisdictions for some retailers	Prices are not regulated
Contracts must be based on "model terms" set out in the retail rules, subject to limited variations	Contract terms subject to limited minimum requirements (not model terms)
Prices cannot vary more than once every six months	No restriction on the number or size of price variations
Notification of price variation in the next energy bill	Notification of price variation as soon as practicable and no later than the next energy bill
Retailers cannot charge exit fees	Retailers can only charge exit fees during the fixed term or fixed benefit period and the exit fee cannot be more than a reasonable estimate of the costs to the retailer resulting from the early termination

As can be seen in figure 2.1, the NECF regulates these two kinds of retail contracts very differently. This rule change request relates only to the regulation of the terms and conditions of *market retail contracts* in the retail rules.<sup>14</sup> However, it is helpful to also understand the relevant regulations that apply in relation to *standard retail contracts*.

Further discussion of the different regulatory arrangements that apply to *standard retail contracts* and *market retail contracts* is set out below.

#### 2.4.1 Regulation of standard retail contracts

Each retailer is required to offer a *standard retail contract* to small customers for whom it is the designated retailer (that is, to make a "standing offer").<sup>15</sup> The provisions of the retail rules that regulate the terms of *standard retail contracts* provide a set of "model terms" that retailers are required to use, subject to certain alterations that are either permitted or required by the rules.<sup>16</sup>

Retailers may vary the "tariffs and charges" under *standard retail contracts* from time to time, but no more than once every six months. If tariffs and charges under a retailer's *standard retail contract* are also regulated by state or territory legislation, then any variation of tariffs and charges under those contracts must also be in accordance with

<sup>14</sup> These rules are set out in Division 7 of Part 2 of the retail rules.

<sup>15</sup> See sections 22(1) and 31 of the Retail Law. If a retailer is not the designated retailer for any small customers, it is not required to make a standing offer to any small customers.

<sup>16</sup> See sections 25(3) and 29 of the Retail Law and rule 12 of the retail rules.

that legislation.<sup>17</sup> In some jurisdictions, the price of *standard retail contracts* is also regulated if the contract is offered by the designated retailer for a small customer.<sup>18</sup> These requirements (including price regulation) apply to both existing and new *standard retail contracts*. The retailer must notify each customer affected of the variation in tariffs and charges when it sends its next bill to the customer and publish such variations on its website.

#### 2.4.2 Regulation of market retail contracts

A retailer may offer a *market retail contract* to any small customer (that is, to make a "market offer"). If a market offer is made to a small customer, the retailer is also required to advise the customer of the availability of the standing offer that is offered by the customer's designated retailer.<sup>19</sup>

The NECF provisions that apply to *market retail contracts* do not require any particular "model terms" to be used by retailers. The retail rules set out certain "minimum requirements" that *market retail contracts* must comply with. These include minimum requirements relating to tariffs and charges.<sup>20</sup>

In particular, rule 46 of the retail rules requires an energy retailer to:<sup>21</sup>

- set out in a *market retail contract* with a small customer all tariffs and charges payable by the customer;
- give notice to the customer of any variation to the tariffs and charges that affects the customer. This notice must be given as soon as practicable, and in any event no later than the customer's next bill; and
- set out in the contract the obligations with regard to the notice that the retailer must comply with where the tariffs and charges are to be varied.

These minimum requirements for *market retail contracts* do not relate to the amount or frequency of any variations in tariffs and charges. This differs from the requirements for *standard retail contracts* discussed above, which limit tariff variations to no more than once every six months.

The term "tariffs and charges" refers to the different kinds of prices that make up a retail energy retail bill. Typically, a retail bill will be made up of a fixed component (usually a flat daily supply charge), a variable component (usually a charge levied on

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<sup>17</sup> See section 23(2) and (5)(a) of the Retail Law.

<sup>18</sup> In Queensland all standard contracts are required to be offered at the regulated price.

<sup>19</sup> See section 33 of the Retail Law and rule 16(2) and (3) of the retail rules.

<sup>20</sup> See section 34(1)(b) of the Retail Law and rules 14(1) and 15(2) of the retail rules.

<sup>21</sup> This rule applies to *market retail contracts* other than "prepayment meter market retail contracts". A *prepayment meter market retail contract* is a contract with respect to a premises to which energy is supplied using mechanisms that operate to permit energy to flow after a for the energy is made prepayment. See section 2 of the Retail Law. Such contracts are not relevant to this rule change request.



each unit of energy used) and other fees such as late payment fees or fees charged for early termination of contracts.

For simplicity, we will refer to "tariffs and charges" collectively as "prices" for the remainder of this paper.

### **2.4.3 Fixed terms and fixed benefit periods (fixed periods) in market retail contracts**

*Market retail contracts* can include contracts that are "fixed term retail contracts" and contracts with a "fixed benefit period". A *market retail contract* can also fall into neither of these categories, but this rule change request relates specifically to the variation in prices in the fixed term of fixed term retail contracts, or in the fixed benefit period of a *market retail contract*.

*Standard retail contracts* cannot have a fixed term or a fixed benefit period.

A fixed term retail contract is a contract that contains a term that specifies the date on which the contract will end or a method for calculating that date.<sup>22</sup> At the end of the fixed term, the contract ends and the customer will need to either enter into a new contract or will automatically roll onto a new contract with the same retailer (depending on the terms of the contract).

A fixed benefit period on the other hand is a period of time within a *market retail contract* during which a specified benefit is available to the customer.<sup>23</sup> The fixed benefit period must either be specified or be able to be calculated at the start of that period. The benefit may be a specific discount on prices or some other benefit set out in the contract. At the end of the fixed benefit period, the availability of the benefit expires but the same contract usually continues. *Market retail contracts* that do not have an end date are often referred to as "evergreen contracts" and can include *market retail contracts* with a fixed benefit period.

Some examples that outline the differences between *market retail contracts* with fixed terms and fixed benefit periods are set out in Box 2.1.

#### **Box 2.1: Examples of market retail contracts with fixed terms and fixed benefit periods**

**Market Retail Contract A** - is a contract for the provision of gas to a customer for a period of two years. The price is set at a discount of 10 per cent below the retailer's standard offer rate. After the end of the two years the contract ends and the customer will be placed on the retailer's *standard retail contract*.

**Market Retail Contract B** - is a contract for the provision of gas to a customer. The contract does not have an end date, however the terms and conditions of the

<sup>22</sup> See rule 45A of the retail rules.

<sup>23</sup> See rule 45A of the retail rules.

contract state that for a period of two years the price will be set at a discount of 10 per cent below the retailer's standard offer rate. At the end of the two years, the same contract will stay in place, but the price paid by the customer will no longer be the discounted price.

**Market Retail Contract C** - is a contract for the provision of gas to a customer. The contract is for a period of three years. The price is set at a discount of 10 per cent below the retailer's standard offer rate. The terms and conditions of the contract also state that for a period of one year the price will be set at a discount of 15 per cent below the retailer's standard offer rate. After the end of the first year, the price paid by the customer will revert to a 10 per cent discount. After the end of the three years the contract will end and the customer will be placed on the retailer's *standard retail contract*.

Each of these contracts is a *market retail contract*. Market Retail Contract A is a fixed term retail contract with no fixed benefit period. Market Retail Contract B is a *market retail contract* with a fixed benefit period, but it is not a fixed term retail contract. Market Retail Contract C is a fixed term retail contract that also has a fixed benefit period.

The rule change request seeks to make amendments that would apply to both fixed terms and fixed benefit periods in *market retail contracts*.

For simplicity, we will refer to fixed terms and fixed benefit periods together as "fixed periods" for the remainder of this paper. The paper will also refer to *market retail contracts* that have a fixed period as "fixed period contracts".

#### 2.4.4 Exit fees

There are minimum requirements under the NECF for retailers charging exit fees to customers for the early termination of *market retail contracts*.

Exit fees cannot be charged in *standard retail contracts*.<sup>24</sup>

Exit fees can only be charged in a *market retail contract* that is a fixed period contract and the contract is terminated in that fixed period.<sup>25</sup> A contract that requires a customer to pay an exit fee for termination must set out the manner of calculating the exit fee. The amount of the fee must be a reasonable estimate of the costs to the retailer resulting from early termination.<sup>26</sup> If the contract does not meet these requirements, the terms of the contract applying the exit fee are deemed to be of no effect.

Some jurisdictions have separate regulatory requirements governing exit fees. For more information on these separate requirements, please refer to section 8.2 below.

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<sup>24</sup> See rule 70(4) of the retail rules.

<sup>25</sup> See rule 49A(1) and (5) of the retail rules.

<sup>26</sup> See rule 49A of the retail rules.

## **2.5 Other work of the AEMC relevant to this rule change request**

### **2.5.1 2014 retail competition review**

Under the 2014 retail competition review the AEMC is required to assess the level of competition for small customers in retail electricity and gas markets in the Australian Capital Territory, New South Wales, Queensland, South Australia, Tasmania and Victoria. The AEMC's analysis will also look at the experiences of residential and small business customers in these markets. The AEMC was requested to undertake this review by the Standing Council on Energy and Resources and recently published its proposed approach to this review.

The rule change request submitted by the Consumer Utilities Advocacy Centre and the Consumer Action Law Centre has a number of implications for competition in retail energy markets.<sup>27</sup> The Commission will consider relevant information gathered under the 2014 retail competition review in its consideration of this rule change request.

### **2.5.2 Distribution network pricing arrangements rule change request**

This rule change request is a consolidation of a rule change request received from the Independent Pricing and Regulatory Tribunal of NSW and a rule change request received from the Standing Council on Energy and Resources. This request relates to the determination of network tariff structures and pricing (including proposed additional consultation requirements) and the timing of the network determination process under the National Electricity Rules.<sup>28</sup> This rule change request commenced in November 2013 with the publication of a consultation paper.

The intent of the rule change request is to enable retailers and consumers to be engaged and consulted early in the distribution pricing process and to make distribution network pricing more cost-reflective and predictable. The proposed rule may improve retailers' abilities to predict or manage risks associated with changes in electricity network charges, which form a significant component of retail electricity prices. This is relevant to the rule change request submitted by the Consumer Utilities Advocacy Centre and the Consumer Action Law Centre because it would in effect require retailers to manage, among other things, the risk that network charges could change during the fixed period of a *market retail contract*.<sup>29</sup>

We note that the distribution network pricing arrangements rule change relates only to the National Electricity Market, whereas this rule change request relates to both electricity and natural gas retail markets. The Commission expects to publish a draft

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<sup>27</sup> These implications are discussed further in chapters 5 to 7 below.

<sup>28</sup> For more information see:  
<http://www.aemc.gov.au/Electricity/Rule-changes/Open/distribution-network-pricing-arrangements.html>.

<sup>29</sup> For a discussion of how risks associated with network costs are related to this rule change request, please see generally chapter 5.

rule determination on the distribution network pricing arrangements rule change request in August 2014 and the final rule determination by the end of November 2014.

## 3 Details of the Rule Change Request

### 3.1 CALC and CUAC's concerns with the current rules

The Consumer Action Law Centre (CALC) and the Consumer Utilities Advocacy Centre (CUAC) note that the current retail rules allow retailers to include terms and conditions in *market retail contracts* that allow them to vary prices during a fixed period.<sup>30</sup> Further, as retailers are also able to charge exit fees under the rules, CALC and CUAC consider that consumers may be discouraged from changing their retailer or contract following a price rise.<sup>31</sup> CALC and CUAC note that although the size of exit fees is limited under the retail rules to the reasonable costs incurred or to be incurred by the retailer, many fixed period contracts still impose significant exit fees.<sup>32</sup>

CALC and CUAC provide case studies showing that some retailers have entered into contracts with customers with low prices and have then raised prices during the fixed period, while still offering the lower prices to new customers.<sup>33</sup> CALC and CUAC consider that the customers are then locked into the higher prices because of exit fees. They also suggest that, due to the experience they have had, customers are likely to consider that if they changed retailers they would only be wasting their time and effort because the new retailer would also raise prices after they enter the new contract.<sup>34</sup>

CALC and CUAC consider that by allowing retailers to vary prices in *market retail contracts* the current rules give rise to a number of concerns, such as:

- inefficient allocation of risk in the market, as retailers are able to shift much of the risk of cost changes in the delivery of energy services to consumers by increasing the prices paid by customers;
- a lack of consumer confidence and engagement in the market, as consumers are discouraged from participating in retail energy markets. CALC and CUAC suggest this occurs because of the perception that retailers will vary prices after consumers enter a new contract and the transaction costs (such as exit fees and search costs) involved in switching to a new contract;
- inefficient pricing and consumption decisions in the market, as price rises may result in consumers using less energy than is efficient or paying retailers more than would be efficient; and

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<sup>30</sup> A summary of the current rules relating to price variations in *market retail contracts* is set out in chapter 2.

<sup>31</sup> See page 4 of the CALC/CUAC rule change request.

<sup>32</sup> See page 4 of the CALC/CUAC rule change request.

<sup>33</sup> See for example pages 19 and 20 of the CALC/CUAC rule change request. We note that the examples provided in the rule change request are from Victoria, a non-NECF jurisdiction. However, such conduct would also not offend the relevant provisions of the retail rules outlined in section 2.4 above.

<sup>34</sup> See page 38 of the CALC/CUAC rule change request.

- adverse impacts on the application of certain consumer protections, as the current rules may affect the protections available to individuals from unfair contract terms under the Australian Consumer Law.

We discuss these concerns as identified by CALC and CUAC below.

### 3.1.1 Risk allocation

CALC and CUAC state that *market retail contracts* that allow retailers to vary prices during fixed periods means that a range of risks are borne by consumers when they should be borne by retailers. Put another way, the risks associated with increases in the costs to retailers of providing energy services to customers can be passed on to consumers as increased prices, even during fixed periods.<sup>35</sup> The risks associated with those cost increases are therefore borne by consumers and not retailers. CALC and CUAC argue that it is not efficient for consumers to bear these risks.

In making this point CALC and CUAC argue that retailers are in a better position to manage these risks and if they were forced to manage them, the costs associated with those risks would be managed more efficiently. This in turn, they argue, would reduce the prices paid by consumers in the fixed periods of *market retail contracts*.<sup>36</sup>

### 3.1.2 Consumer confidence and engagement

CALC and CUAC consider that the current rules affect the level of consumer confidence and engagement in retail energy markets.

Specifically, CALC and CUAC consider that where retailers increase prices during the fixed period of *market retail contracts* their customers are discouraged from switching retailers or contracts, due to:

- the transaction costs involved in switching. This includes the presence of exit fees and the waste of search costs;<sup>37</sup> and
- other factors that affect consumer decision making, such as a bias to remain with their existing retailer and the perception that other retailers will be no better.<sup>38</sup>

CALC and CUAC note that the search costs associated with finding the most appropriate retail contract for a consumer can be significant, due to the complexity of the market and the limited comparability of different retail energy contracts. They state that where consumers have expended significant search costs in finding a retail contract, only for the price to rise later, confidence and participation in the market can be adversely affected. This is, they argue, because consumers will not spend further time and effort in finding the best retail contract for them because they expect that their

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<sup>35</sup> See page 11 of the CALC/CUAC rule change request.

<sup>36</sup> See page 11 and pages 16 to 17 of the CALC/CUAC rule change request.

<sup>37</sup> See pages 17 to 21 of the CALC/CUAC rule change request.

<sup>38</sup> See page 11 of the CALC/CUAC rule change request.

time and effort will be wasted as the new retailer will raise their prices after they switch to them.<sup>39</sup>

### 3.1.3 Inefficient pricing and consumption decisions

CALC and CUAC note that consumers enter into energy contracts bearing in mind the price and the volume of energy they intend to consume at that price. They consider that, after a price rise during the fixed period of a *market retail contract*, the consumer might react in a number of ways, including: by consuming less energy; paying more to consume the same amount of energy; or some degree of both of these responses.<sup>40</sup> CALC and CUAC argue that neither of these responses is efficient for the market or beneficial for consumers because:

- if the consumer responds by consuming less energy, then less energy is being consumed in the market than is efficient; and
- if the consumer responds by paying more and consuming the same amount of energy, this represents a transfer of wealth from the consumer to the retailer that would not have occurred if the market was efficiently priced.

CALC and CUAC's views are based on the assumption that initial prices are set below an efficient market price and are then raised by the retailer to above an efficient market price for energy. These views are also based on the assumption that consumers do not switch to a contract that represents a more competitive market price for energy following a price rise.

### 3.1.4 Australian Consumer Law

As noted in section 2.1 above, the consumer protections set out in the NECF are intended to operate alongside and complement existing consumer protections in the general law, including the Australian Consumer Law (ACL). The ACL includes provisions that provide consumers with protections from "unfair" terms in "consumer contracts".

These protections however do not apply if a Commonwealth, state or territory law requires or "expressly permits" these contract terms. This would mean, for example, that if a Commonwealth law expressly permits price variation clauses in *market retail contracts*, the "unfair" contract terms protections in the ACL would not apply.

CALC and CUAC consider that rule 46 of the retail rules (outlined in section 2.4.2 above) expressly permits retailers to include terms that allow for price variations

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<sup>39</sup> See pages 4 and 38 of the CALC/CUAC rule change request.

<sup>40</sup> See page 11 and see also the detailed discussion of this issue at pages 31 to 37 in Appendix 1 to the CALC/CUAC rule change request.

during fixed periods in *market retail contracts*.<sup>41</sup> Because of this, they argue that the protections from unfair contract terms under the ACL do not apply.<sup>42</sup>

CALC and CUAC consider that, if the relevant provisions of the ACL were to apply, it is likely that terms in *market retail contracts* allowing retailers to change their prices would breach those provisions of the ACL.<sup>43</sup> However, CALC and CUAC note that if consumers were given a right to terminate their contract at no cost following a price change, contract terms that allow price variations may not be considered as “unfair” under the ACL.

### 3.2 Proposed rule changes under the retail rules

CALC and CUAC's preferred outcome is the inclusion of a new rule 46A into the retail rules that would prohibit retailers from including terms in their contracts that allow them to vary prices during the fixed periods of *market retail contracts*.<sup>44</sup> CALC and CUAC's proposed rule is set out in Box 3.1 below.

#### **Box 3.1: CALC and CUAC's proposed new rule 46A**

##### 46A Fixed period market retail contract

1. This rule applies to market retail contracts with a fixed period.
2. For such market retail contracts, all tariffs and charges payable by the customer are not to change for the duration of the fixed term.
3. For avoidance of doubt, for contracts subject to this rule, the retailer is not able to vary the tariffs and charges that affect the consumer.

We understand that it is intended that the proposed rule would apply in relation to all fixed period contracts. That is, both “fixed terms” in *market retail contracts* and “fixed benefit periods” in *market retail contracts*.

While the proposed new rule 46A is the preferred option for CALC and CUAC, two alternative options have also been provided in the rule change request for the AEMC to consider. These are:

- prohibiting all changes to prices during the fixed period of *market retail contracts* except passing on “government charges” (such as costs associated with environmental policies). CALC and CUAC state that this option would also require appropriate further regulation to communicate the risks of changes in government charges to consumers;<sup>45</sup> and

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<sup>41</sup> See page 44 of the CALC/CUAC rule change request.

<sup>42</sup> See page 44 and more generally Appendix 2 to the CALC/CUAC rule change request.

<sup>43</sup> See Appendix 2 to the CALC/CUAC rule change request.

<sup>44</sup> See page 6 of the CALC/CUAC rule change request.

<sup>45</sup> See pages 6 to 7 of the CALC/CUAC rule change request.



- removing the current rule 46 (which they argue expressly allows retailers to include price variation clauses in their fixed period contracts) so that the ACL provisions relating to “unfair” terms in consumer contracts will then apply.<sup>46</sup> CALC and CUAC argue that this would allow consumers to exit fixed period contracts following price variations without paying exit fees.<sup>47</sup>

CALC and CUAC note that the second of these options is their least preferred alternative option, as it requires consumers to change their behaviour by taking action to exit their contract.<sup>48</sup> CALC and CUAC note that analysis of consumer behaviour suggests that consumers may not take this action in practice and as a result consumers may continue to be exposed to poor practices by retailers.<sup>49</sup>

### **3.3 CALC and CUAC's proposed scope of rule change request**

CALC and CUAC provide some commentary on other issues that they consider are outside the scope of this rule change request.<sup>50</sup> These issues are broadly related to consumer behaviour and participation in the market (including switching) and mirror reforms currently being progressed in the United Kingdom (UK) by the UK energy regulator, Ofgem. The matters include:

- notification issues related to price variations;
- how consumers exit fixed period contracts (including exit fees); and
- whether fixed term contracts roll into another fixed term contract or onto a particular default rate.

### **3.4 CALC and CUAC's assessment against the NERO**

As discussed in chapter 2, in making any rule or amending any rule, the AEMC must be satisfied that the proposed rule will or is likely to contribute to the National Energy Retail Objective (NERO).

CALC and CUAC consider that their proposed rule will meet the NERO as it will:

- encourage retailers to efficiently manage risks on behalf of their customers, rather than passing on those risks through price variations to consumers who do not have the information or resources to manage those risks efficiently;<sup>51</sup>

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<sup>46</sup> We note that this view is based on CALC and CUAC's view that rule 46 impacts the application of the unfair contract terms provisions of the ACL.

<sup>47</sup> See page 7 and more generally Appendix 2 to the CALC/CUAC rule change request.

<sup>48</sup> See page 7 of the CALC/CUAC rule change request.

<sup>49</sup> See page 7 of the CALC/CUAC rule change request.

<sup>50</sup> See page 28 of the CALC/CUAC rule change request.

<sup>51</sup> See pages 10 and 12 of the CALC/CUAC rule change request.

- encourage competitive pricing by retailers because retailers will be unable to offer prices that are below competitive rates and subsequently raise prices above competitive rates;<sup>52</sup>
- provide consumers with certainty and transparency regarding the price and conditions of their contract concerning price rises;<sup>53</sup> and
- minimise the loss of transaction costs for consumers associated with switching retailers by providing accurate and transparent information about the price and conditions of their contract. This in turn will reduce barriers to consumers participating and exercising choice in the market.<sup>54</sup>

Each of the above matters, CALC and CUAC argue, promote more confident consumer participation and competition in retail energy markets, and contribute to the achievement of the NERO.<sup>55</sup>

CALC and CUAC also argue that, in light of the matters listed above, the proposed rule will or is likely to contribute to effective consumer protections. Therefore, CALC and CUAC consider that the proposed rule would clearly satisfy the requirement under the Retail Law that any amendments to the rules be consistent with the application and development of consumer protections.<sup>56</sup>

### **3.5 Costs and benefits of the proposed rule identified by CALC and CUAC**

CALC and CUAC argue that consumers will receive the principal benefits from the proposed rule, which will include:

- reduced costs for consumers, as retailers rather than consumers will be required to manage the risks associated with changes in the costs of providing energy services;<sup>57</sup>
- reduced search costs and other transaction costs for consumers;<sup>58</sup> and
- reduced prices overall for consumers, as greater price transparency will place increased competitive pressure on retailers.<sup>59</sup>

CALC and CUAC note that the proposed rule may cause an increase in retail energy prices. However, they note that such prices would better reflect the "true cost" of

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<sup>52</sup> See pages 9 to 10 of the CALC/CUAC rule change request.

<sup>53</sup> See page 9 of the CALC/CUAC rule change request.

<sup>54</sup> See page 10 of the CALC/CUAC rule change request.

<sup>55</sup> See page 9 of the CALC/CUAC rule change request.

<sup>56</sup> See page 9 of the CALC/CUAC rule change request.

<sup>57</sup> See page 27 of the CALC/CUAC rule change request.

<sup>58</sup> See page 27 of the CALC/CUAC rule change request.

<sup>59</sup> See page 27 of the CALC/CUAC rule change request.

supplying energy. This is because, with prices fixed during fixed periods under the proposed rule, energy prices would be more easily comparable, more transparent and would therefore better enable competition to work effectively to encourage efficient pricing over the long term.<sup>60</sup>

CALC and CUAC also state that the rule change may result in additional costs for retailers and provide the example of costs incurred in redrafting contracts to comply with the proposed rule. CALC and CUAC however do not consider that such costs will be significant because retailers already change contract terms and conditions on a regular basis.<sup>61</sup>

CALC and CUAC note that although they have not conducted an exhaustive cost-benefit analysis, in their view the benefits of this rule change would outweigh the costs.<sup>62</sup>

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<sup>60</sup> See page 27 of the CALC/CUAC rule change request.

<sup>61</sup> See page 27 of the CALC/CUAC rule change request.

<sup>62</sup> See page 27 of the CALC/CUAC rule change request.

## 4 Assessment Framework

This chapter:

- sets out the requirements under the Retail Law that the AEMC must satisfy in considering the rule change request; and
- in light of those requirements, provides the Commission's proposed approach to the assessment of the rule change request.

### 4.1 Requirements under the Retail Law

Any change to the retail rules, whether it be the proposed rule, or a more preferable rule, must satisfy two tests under the Retail Law.

Firstly, the Commission's assessment must consider whether the rule will or is likely to promote the NERO (the "NERO test").<sup>63</sup> The NERO states:<sup>64</sup>

"The objective of this 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."

The AEMC must also, where relevant, satisfy itself that the rule is "compatible with the development and application of consumer protections for small customers, including (but not limited to) protections relating to hardship customers" (the "consumer protections test").<sup>65</sup>

Where the consideration of the consumer protections test is relevant in the making of a rule, the Commission must be satisfied that both the NERO test and the consumer protections test have been met.<sup>66</sup> If the Commission is satisfied that one test, and not the other, has been met, the rule cannot be made.

There may be some overlap in the application of the two tests. For example, a rule that provides a new protection for small customers may also, but will not necessarily, promote the NERO.

It should also be noted that where the Commission is satisfied that a proposed rule would satisfy both tests, it is not automatically required under the Retail Law to make the rule. The Commission retains discretion as to whether or not to make a proposed rule. The Commission can also make a rule that is different from the proposed rule if it

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<sup>63</sup> In accordance with section 236(1) of the Retail Law.

<sup>64</sup> See section 13 of the Retail Law.

<sup>65</sup> See section 236(2)(b) of the Retail Law.

<sup>66</sup> That is, the legal tests outlined in section 236(1) and 236(2)(b) of the Retail Law.

is satisfied that, having regard to the relevant issues, the more preferable rule will or is likely to better contribute to the NERO.<sup>67</sup>

The Commission is also required to consider any relevant MCE statement of policy principles in determining where a change to the retail rules is required.<sup>68</sup> As yet, no relevant MCE statements of policy principles have been made.

## 4.2 The NERO test

This section sets out the Commission's intended approach to its consideration of the NERO test.

The long-term interests of consumers lie at the heart of the NERO test. The NERO requires that efficiency in the investment, operation and use of energy services is the principal consideration for determining what is in the long-term interests of consumers.<sup>69</sup>

The Commission considers that, where feasible, competitive markets provide the best means of promoting efficiency. Competition can be defined as a process of independent rivalry, where two or more parties (rivals) compete to supply a good or a service to consumers.

Where competition is effective, retailers will have strong incentives to provide products and services that consumers value and set prices that reflect costs. They will also seek out ways to lower costs and invest and innovate to meet changing consumer preferences. Retailers that do not effectively compete in this way risk losing profits and being forced to exit the market.

The rule change request seeks to make changes to the rules that govern the operation of retail energy markets. Given the importance of competition in driving efficient outcomes in markets, a key consideration of the AEMC in assessing this rule change request is the degree to which the proposed rule is likely to either promote or hinder competition.

The Commission intends to use the following criteria to assess whether the proposed rule is likely to promote the NERO. These criteria, which reflect the characteristics of well-functioning competitive markets, are:

- efficient allocation of costs and risks;

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<sup>67</sup> See section 244 of the Retail Law.

<sup>68</sup> See section 236(2) of the Retail Law.

<sup>69</sup> "Efficiency" has three components. *Allocative efficiency*, which can be seen where goods and services are provided that meet the needs and preferences of consumers and are based on prices that reflect as closely as possible the costs of supplying an additional unit of a good or service. *Productive efficiency*, which can be seen where the minimum value of resources are used to produce a given set of goods and services (i.e. goods are provided at "least cost"). *Dynamic efficiency*, which can be seen where *allocative* and *productive efficiency* are sustained over time with changing technology and consumer tastes and preferences. Investment and innovation are integral to *dynamic efficiency*.

- effective consumer engagement and participation;
- provision of a range of products and services consumers value; and
- independent rivalry and competition between retailers.

The following sections outline how we intend to approach our assessment of each of these criteria under the NERO.

#### **4.2.1 Efficient allocation of costs and risks**

CALC and CUAC suggest that, under current *market retail contracts*, retailers are transferring risks to consumers that would be more efficiently managed by the retailers themselves.<sup>70</sup>

In general, consumers would not be required to bear cost rises that could be more efficiently managed by retailers if the competitive process was working effectively. In a competitive market there should be few incentives for retailers to pass risks on to consumers where retailers are themselves better able to manage these risks. Not managing these risks (and therefore passing on inefficient costs) would expose the retailers to the competitive threat that other retailers would have lower costs and those other retailers would therefore secure greater market share and profits. In other words, the competitive process should discipline the behaviour of all retailers in the market to reflect efficient costs by efficiently managing or passing on risks in their market offers.

The AEMC intends to consider whether the efficient allocation of risks between retailers and consumers is being adversely affected by the current rules that allow price variation clauses in fixed period contracts.

In chapter 5 of this paper we provide further information on some of the main issues that will underpin this assessment. We also set out the key costs and risks that retailers need to manage in offering *market retail contracts* and the tools available for them to do so.

#### **4.2.2 Effective consumer engagement and participation**

A competitive retail energy market can only promote efficiency if consumers actively participate in the market by making informed choices. Their participation in the market (through actions like changing their retailer or contract) provides retailers with the information and incentives to develop products that better meet consumer preferences, including lowering prices to their efficient level.

To participate in the market with confidence and in a way that sends appropriate signals to retailers about consumer preferences, consumers need to have access to clear and relevant information about retail offers. A lack of awareness or understanding about the available options or nature of the product (e.g. the extent to which a retailer

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<sup>70</sup> See section 3.1.1 above.

can vary prices on a *market retail contract*) increases the prospect of consumers entering into contracts that may not meet their preferences. This could result in sending the wrong signals to retailers about consumers' preferences, which could in turn affect the type of future offers provided by retailers.

Lack of appropriate transparency in the market, together with additional barriers to participation (such as exit fees and search costs) could cause consumers to lose confidence in and fail to engage with the market. This in turn would undermine effective retail competition.

Typically in competitive markets retailers should have incentives to provide consumers with sufficient information to evaluate their product offerings, as this provides an opportunity to differentiate themselves from their competitors and secure increased market share.

The AEMC intends to consider the impact of the current retail rules regarding price variations in *market retail contracts* on the transparency and information required for consumers to make informed consumption and product decisions. The AEMC intends also to consider the impact of the current rules on consumer participation and decision making where prices have risen during the fixed period of *market retail contracts*.

#### **4.2.3 Provision of a range of products and services consumers value**

Competitive markets are characterised by the provision of products and services that meet consumers' preferences. Consequently, if consumers prefer fixed price energy products, then retailers should be willing to offer such products in a competitive retail energy market. Consumers would, however, need to be willing to pay retailers a premium for managing the associated risk on their behalf. Increased certainty would come at an increased cost to consumers, even in a highly competitive market.

The proposed rule would prohibit retailers from including terms in their contracts that allow them to vary prices during the fixed period of *market retail contracts*. A potential consequence of this is that retailers may find it too risky to offer fixed period contracts to consumers. This could limit consumers' choice in retail energy markets.

In its assessment of the rule change request the Commission intends to consider whether the competitive market should be relied on to deliver fixed price products or whether changes to the retail rules should be made to deliver this outcome.

This is discussed further in chapter 5.

#### **4.2.4 Independent rivalry and competition between retailers**

If retail energy markets lack sufficient competition, consumers may become locked into contracts that do not meet their needs, but from which they have little incentive to move due to a lack of desirable alternatives. In these circumstances, retailers will have little incentive to provide contract terms that meet their customers' preferences because they know their customers are unlikely to find a better alternative offer.

The proposed rule is likely to impact different retailers in different ways. The additional costs and risks that will need to be managed by retailers under the proposed rule may favour larger and more established retailers. The additional costs and risks that would need to be managed by retailers may also make it more difficult for new retailers to enter energy markets.

The AEMC intends to consider the proposed rule in light of current levels of competition in retail energy markets and the impact it may have on the future level of competition.

#### **Question 1      NERO test**

**Are there any other matters that the AEMC should consider in its assessment of the NERO test?**

### **4.3      Consumer protections assessment**

This section sets out the Commission's intended approach to its consideration of the consumer protections test.

The consumer protections test<sup>71</sup> is relevant to the consideration of this rule change request.

The Commission will therefore be required to satisfy itself, in accordance with the consumer protections test under the Retail Law, that any rule it makes is compatible with the development and application of consumer protections for small customers, including (but not limited to) protections relating to hardship customers.

There are a number of key elements to the Commission's consideration of the consumer protections test. These elements are:

- the meaning of "compatible" with consumer protections;
- the meanings of "development" and "application" of consumer protections; and
- the scope of the meaning of "consumer protections".

Given that the Commission is required to "satisfy itself" that the test has been met, the Commission has a degree of discretion in how it considers and gives weight to the different matters and issues relevant to its consideration.

We set out our proposed approach to each of these elements below.

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<sup>71</sup> Set out in section 236(2)(b) of the Retail Law and discussed in further detail in section 4.1 above.



#### **4.3.1 Compatibility with consumer protections**

The Commission proposes to give the word "compatible" its ordinary meaning, as it is not defined in the Retail Law. In simple terms, the consumer protections test could be interpreted as: can the rule be made without causing problems for, or conflicting with, the development and application of consumer protections for small customers?

#### **4.3.2 Development and application of consumer protections**

The Commission is required to consider both the "development" and the "application" of consumer protections.

Considering the "application" of consumer protections will examine consumer protections as they currently exist and how they are presently applied. The Commission proposes in this regard to consider:

- whether a new rule would be compatible with currently applicable consumer protections; and
- whether a new rule would clarify (and not be inconsistent with) currently applicable consumer protections.

The consideration of the "development" of consumer protection requires a forward looking assessment. In this regard, the Commission proposes to consider:

- whether a new rule is likely to be compatible with the future legislative development of consumer protections; and
- whether a new rule is likely to be compatible with consumer protections (either within or outside the Retail Law and retail rules) that may be developed through other regulatory avenues over time, such as judicial decisions.

#### **4.3.3 Scope of consumer protections to be considered**

The Commission proposes to consider whether any new rule is compatible with the development and application of:

- relevant consumer protections provided within the NECF;
- relevant consumer protections under the general law (for example, the Australian Consumer Law);
- relevant consumer protections provided under retail energy laws and regulations of jurisdictions participating in the NECF (which currently includes Tasmania, the Australian Capital Territory, South Australia and New South Wales); and
- to the extent relevant and to be given appropriate weight, relevant consumer protections under the retail energy laws and regulations of jurisdictions not yet

participating in the NECF (which currently relevantly includes Queensland and Victoria).

A table setting out the sources of relevant consumer protections in these categories is provided at **Appendix A**.

We note that the Commission is not required to take into account the consumer protections specific to non-NECF jurisdictions. This is because the retail rules and any changes the Commission decides to make to them will only apply in those jurisdictions that have implemented the NECF.

However, the Commission considers it would be prudent to also consider the consumer protections in non-NECF jurisdictions that have noted an intention to harmonise their retail energy regulations with the NECF or an intention to implement the NECF at some point in the future (e.g. Victoria and Queensland). This is particularly important given the overarching purpose of the NECF is to provide, in time, a uniform set of retail rules for Australian energy markets.

The Commission is not required to consider consumer protections other than those that are or may be affected by the proposed rule. As such, the Commission will focus on those consumer protections (in the categories listed above) affected by the issues outlined by CALC and CUAC and the proposed rule, including:

- consumer protections with respect to price variations in the fixed period of *market retail contracts*;
- consumer protections with respect to the information requirements surrounding price variations in the fixed period of *market retail contracts*; and
- consumer protections with respect to potential barriers to consumer participation (such as exit fees) following price variations in fixed periods in *market retail contracts*.

A table setting out the relevant consumer protections in these categories that the Commission proposes to consider as relevant to this rule change request is provided at **Appendix B**.

#### **Question 2      Consumer protections test**

**a) Is the scope of the consumer protections that the Commission intends to consider appropriate for this rule change request?**

**b) Should the Commission consider any other factors in assessing the rule change request against the consumer protections test under the Retail Law?**

#### **4.4 Issues for consideration**

CALC and CUAC have raised a number of concerns in their rule change request. Taking into consideration the Commission's proposed assessment framework and the potential implementation of the proposed rule, we have identified a range of issues that we are seeking stakeholder comments on. We outline these issues, including relevant background information, and a number of questions for stakeholder comment in chapters 5 to 9 of this paper.

The issues outlined in chapters 5 to 9 are provided for guidance only. Stakeholders are encouraged to consider and comment on these issues as well as any other aspects of the rule change request or this paper, including the proposed assessment framework.

## 5 Allocation of Costs and Risks

This chapter outlines:

- background to the role of retailers in the energy market, the nature of the risks that retailers manage and the strategies available for retailers to manage those risks;
- issues regarding whether price variation clauses in *market retail contracts* are affecting how risks are allocated between retailers and consumers in energy markets; and
- the potential impacts of the proposed rule on the efficiency of the allocation of risks in energy markets.

### 5.1 The role of retailers in retail energy markets

The principal role of the retailer in energy markets is to manage risks on behalf of its customers. In a competitive market, there should be strong incentives for retailers to manage risks in the most efficient way for their customers. Where a retailer manages risks more efficiently than its competitors, the costs for that retailer are reduced and the retailer is able to either recover higher returns or offer more competitive contracts and gain market share.

A competitive market should allocate the task of managing different risks to the party that can manage each particular risk most efficiently. That is, to the party in the best position to minimise the costs associated with that particular risk.

Contracts are a key means through which risks are allocated and managed between parties. Under the retail rules, retailers are able to vary prices during fixed periods in *market retail contracts* and the customer must be notified as soon as practicable or, at the latest, in the next retail bill. This allows retailers to develop *market retail contracts* that allow them to pass variations in costs on to consumers.

### 5.2 The risks and costs managed by retailers

Retailers are required to manage a range of different risks and costs in providing retail energy contracts.

The costs retailers face can be broadly grouped into the following segments:

- **Competitive market costs:** which include the costs of purchasing energy (electricity or gas) in wholesale markets from generators of electricity or suppliers of gas and the retail costs incurred in the sale of electricity or gas to consumers.

Wholesale energy costs also include a range of other market services and fees, such as services provided by electricity generators to ensure the secure and safe operation of wholesale energy markets. The retail component of competitive market costs covers the direct costs that a retailer incurs in running its business, such as IT, billing system and marketing costs. The retail component also includes the cost of capital and a return for the retailer's investment in its business and the risks the retailer assumes in providing retail services;

- **Regulated network costs:** which are the costs of transporting energy from generators or suppliers to consumers. These include costs associated with the building and operation of electricity transmission and distribution networks and gas pipeline networks, including a return on capital. These costs are regulated by the Australian Energy Regulator as these are monopoly services so cannot be provided on a competitive basis; and
- **Government policy costs:** which include costs resulting from policies of the Commonwealth and/or state and territory governments. The majority of these costs arise from environmental policies or programs that directly impact energy markets. These include: the current carbon pricing mechanism,<sup>72</sup> the Renewable Energy Target, which includes the large-scale renewable energy target<sup>73</sup> and the small-scale renewable energy scheme<sup>74</sup> and the various state and territory feed-in tariff<sup>75</sup> and energy efficiency schemes.<sup>76</sup>

As illustrated in figure 5.3 below, government policy costs are imposed on different participants in energy markets. All of these costs are ultimately recovered from consumers in retail energy bills.

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<sup>72</sup> The carbon pricing mechanism was introduced in July 2012 and placed an initial price of \$23 for each tonne of carbon dioxide (or equivalent) emitted by liable entities, increasing by 2.5 per cent above inflation each year until 30 June 2015. From 1 July 2015, the mechanism is to convert to an internationally linked emissions trading scheme, with prices determined by the market. We note that the Commonwealth Government has introduced legislation to remove the carbon pricing mechanism from 1 July 2014.

<sup>73</sup> The large-scale renewable energy target requires a set portion of Australia's projected average demand to be met by large-scale renewable energy sources. The policy has a current target of 41,850 GWh of energy to be supplied by large-scale renewable generation in 2020.

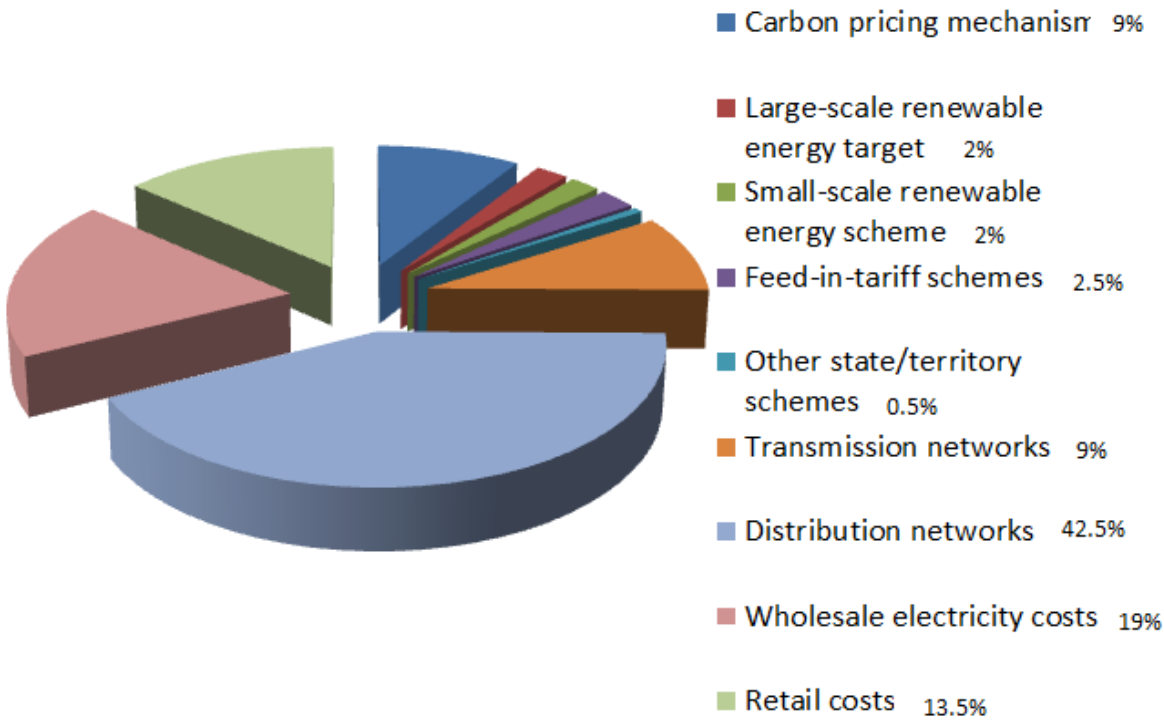
<sup>74</sup> The small-scale renewable energy scheme operates in a similar way as the large-scale renewable energy target, but focuses on small-scale renewable generation, such as small-scale solar PV.

<sup>75</sup> Several state and territory governments have introduced a number of feed-in tariff schemes. These are designed to encourage the uptake of small scale rooftop solar generation by providing a tariff payment to subsidise the investment in the solar panels.

<sup>76</sup> These schemes operate in New South Wales, South Australia, Victoria and the Australian Capital Territory. Broadly there are two kinds of energy efficiency schemes. Such schemes either oblige retailers to purchase and surrender certificates created by other parties who have undertaken energy savings activities, or place direct obligations on retailers to meet specified energy efficiency targets.

The breakdown of the above costs in an average Australian electricity retail bill for residential customers is represented in figure 5.1 below.<sup>77</sup>

**Figure 5.1      Breakdown of costs in average Australian residential retail electricity bills**



In residential retail gas contracts there is a similar range of costs (other than most government policy costs) that are recovered from consumers by retailers.

A retailer's ability to manage risks varies for the different costs that make up a retail energy bill. A good example of this is seen in retailers' differing abilities to manage the two broad categories of government policy costs. That is, government policies that impose costs by direct regulation and those that impose costs through market based mechanisms.

Box 5.1 below provides further detail on the different types of government policy costs faced by retailers and their ability to manage them.

**Box 5.1:**

**Government policy costs and retailer management of risks**

Government policy costs can be imposed either by direct regulation or by market based mechanisms.

Direct regulation involves governmental bodies imposing particular obligations on energy market participants that the participant must comply with in a

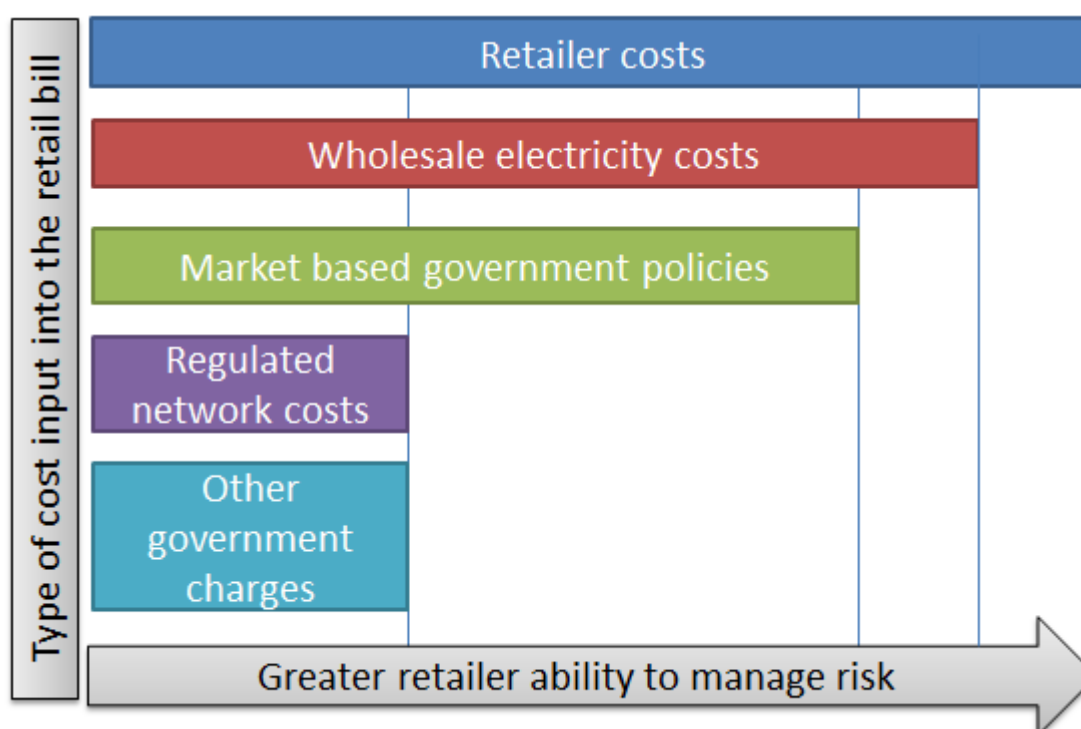
<sup>77</sup> The data for this figure is sourced from the table on page 12 of the 2013 Residential Electricity Price Trends report. See: <http://www.aemc.gov.au/market-reviews/completed/retail-electricity-price-trends-2013.html>.

particular way. With this kind of regulation, there is often few ways in which retailers (or the market participant that the obligation is imposed on) can manage the costs of the regulation. Feed-in-tariff schemes are a form of direct regulation.

Under market based mechanisms, obligations are placed on a category of market participants (such as, retailers) to meet broad targets. Under these mechanisms participants have flexibility in how they meet their targets, which enable participants to find ways to do so at lowest cost. Financial products are generally also developed to help market participants manage and smooth the costs of compliance with market based mechanisms. As a result, with market based mechanisms, retailers generally have a greater ability to manage the associated risks. The carbon pricing mechanism is a market based mechanism.

Figure 5.2 below illustrates the different degrees to which retailers generally can manage different risks, including the different degrees to which retailers can manage the risks associated with both categories of government policy costs.

**Figure 5.2 Ability of retailers to manage different cost components in a retail electricity bill**



The different degrees to which retailers are able to manage these different costs is broadly because retailers have different risk management tools available to them for these different costs. For some costs retailers will have little or no ability to manage the risk. The different risk management tools available to retailers are explained further in section 5.3 below.

## 5.3 Retailers' strategies for managing risks

Retailers use different strategies and tools to manage the costs that make up a retail bill and the risks that those costs will increase or be volatile. This section discusses a number of different strategies that can be used by retailers to manage these risks.

In this paper, a retailer's ability to "manage" a risk means, in a general sense, it's ability either to directly control the relevant cost, to accurately predict movements in the cost or to hedge against movements in the cost.

### 5.3.1 Competitive market costs

Retailers have direct control over their retail operating costs and the returns they choose to recover. They can reduce operating costs through implementing new or innovative operating processes and strategies. This could include, for example, using call centres in countries where wage rates are lower or installing more efficient billing and management systems. Another way retailers can reduce their costs on a per unit basis is by increasing their customer numbers. This spreads fixed operating costs across a greater number of customers.<sup>78</sup>

Wholesale energy costs vary as the balance between supply and demand changes.<sup>79</sup> That balance is influenced by a range of factors, including temperature variations (which affects the demand for energy for heating and cooling) and the level of available network capacity. Retailer strategies for managing wholesale energy costs include:

- obtaining "hedging"<sup>80</sup> contracts in financial markets that lock-in prices for a particular volume of energy;
- contracting directly with energy generators or suppliers for the energy produced from particular facilities at a particular price;<sup>81</sup> and
- investing in electricity generation or gas production or supply facilities so that the retailer can manage the cost of production internally (which is known as

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<sup>78</sup> This is also known as using "economies of scale" to manage or reduce costs.

<sup>79</sup> Wholesale electricity prices in the spot market can vary between -\$1,000 and \$13,100 and wholesale natural gas prices in the spot markets which also vary between market floors and caps.

<sup>80</sup> A hedging contract broadly allows retailers and energy suppliers to agree a price for a particular volume of energy at some point in the future so that, regardless of the spot price in the wholesale market at that point in time, when the contract is settled (or "netted") the retailer will pay the specified rate and the supplier will receive the specified rate for each unit of energy. Such contracts can be structured in a wide variety of ways depending on the needs of the parties to them.

<sup>81</sup> These contracts are called "power purchase agreements" in the electricity market or "off-take agreements" in the natural gas market.



"vertical integration").<sup>82</sup> This would include situations where a retailer chooses to build its own gas production plant or wind farm.

The particular strategy or combination of strategies chosen by a retailer to manage their wholesale costs will depend on the risk appetite of the retailer and their strategic objectives. The efficient management of a retailer's wholesale energy costs can be a significant competitive advantage, as wholesale energy costs comprise a significant portion of consumers' retail energy bills.

### **5.3.2 Regulated network cost**

Retailers are charged by network businesses for the use of their services. Retailers however have a limited ability to influence or manage electricity network charges or gas pipeline access charges which are generally set through a five year "regulatory determination" process by the Australian Energy Regulator. Through this process network or pipeline access charges can vary substantially from one year to the next, as well as from one five year regulatory period to the next. As outlined in figure 5.1, network costs comprise a substantial proportion of overall retail energy bills, with network costs comprising around 50 per cent of the average annual Australian residential electricity bill.<sup>83</sup>

There are currently limited tools available for retailers to hedge this variability or smooth out network or pipeline costs over multiple years of the five year regulatory period or between such periods. Retailers could seek to manage these costs to a limited degree by engaging in demand side participation activities to reduce peak demand, which could contribute to lower network charges or gas pipeline charges over the longer term. Retailers could also engage in the process used to determine network and pipeline charges, which could assist in influencing the level of network and pipeline charges. However, as a result of this limited ability to manage network or pipeline charges, retailers typically pass through changes in such charges directly to consumers.

The AEMC is currently working on a rule change request regarding the determination of electricity network tariff and pricing structures and the timing of the electricity network determination process under the National Electricity Rules. The outcome of this rule change request may influence the ability for retailers to predict or manage risks associated with changes in network prices in electricity markets, particularly within regulatory periods. For more information on that rule change and how it relates to this rule change request, see section 2.5.2.

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<sup>82</sup> The retailer therefore effectively becomes exposed to wholesale spot prices on both the supply and purchase side of the equation.

<sup>83</sup> See page 12 of the 2013 Residential Electricity Price Trends report. See: <http://www.aemc.gov.au/market-reviews/completed/retail-electricity-price-trends-2013.html>.

### 5.3.3 Government policy costs

As noted above, different government policies place obligations on different participants in the energy supply chain. As such, retailers will have different levels of ability to directly manage the risks associated with such costs.

Figure 5.3 below sets out the different kinds of government policy costs that retailers face, the participants in the supply chain affected by these costs, and the options available to retailers to manage the risk that these costs may vary.

**Figure 5.3 Cost and risk management tools for retailers to manage government policy costs**

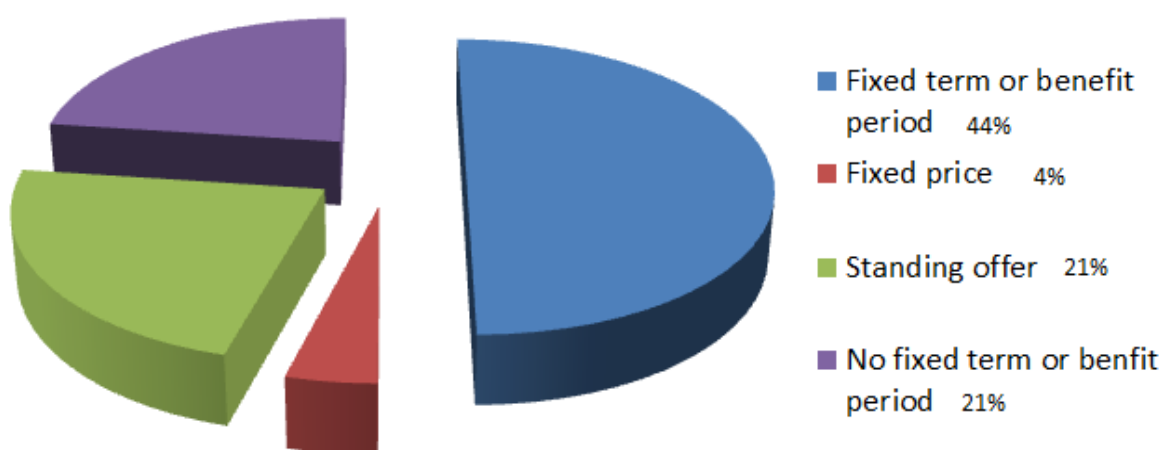
Government Policy	Party affected	Retailers' risk mitigation options include
Carbon pricing mechanism	Electricity generators and gas suppliers with greenhouse gas emissions above the relevant threshold	<ul style="list-style-type: none"> <li>• Purchasing risk minimising (hedging) products in financial markets.</li> <li>• Purchasing low carbon energy directly from suppliers.</li> <li>• Minimising the cost of carbon in energy production facilities that they own (either by owning low carbon energy production facilities or by managing the cost of carbon efficiently in financial markets)</li> </ul>
Large-scale renewable energy target	Retailers	<ul style="list-style-type: none"> <li>• Purchasing risk minimising (hedging) products in financial markets.</li> <li>• Investing in large scale renewable energy production facilities.</li> </ul>
Small-scale renewable energy scheme	Retailers	<ul style="list-style-type: none"> <li>• Purchasing risk minimising (hedging) products in financial markets.</li> <li>• Reducing the cost of compliance with the scheme by offering innovative small scale renewable energy products to customers.</li> </ul>
State/territory feed-in-tariff schemes	Network businesses	<ul style="list-style-type: none"> <li>• There are no options available to retailers to manage risks associated with feed-in tariff costs imposed on network businesses and passed through to retailers.</li> </ul>
State/territory energy efficiency schemes	Retailers	<p>Depending on the type of energy efficiency scheme involved, options could include:</p> <ul style="list-style-type: none"> <li>• purchasing risk minimising (hedging) products in financial markets; and</li> <li>• reducing the cost of compliance by offering innovative efficiency products and services to customers.</li> </ul>
Taxation (including GST)	All participants	<ul style="list-style-type: none"> <li>• There are no options available to retailers to manage risks associated with taxation of either retailers or other market participants.</li> </ul>

## 5.4 Risk allocation in retail market offers

The rule change request seeks to implement a rule that would restrict retailers from including terms in their *market retail contracts* that allow price variations during fixed periods. This would effectively require retailers to manage the risk of cost changes in all components in retail energy bills for the duration of any fixed term or benefit period.

As noted above, risks are allocated between retailers and consumers by the terms of the contracts between them. There are a range of *market retail contracts* available that allocate risk in a range of different ways. Figure 5.4 below sets out the proportional breakdown of retail electricity contracts currently available in Sydney, NSW by type.<sup>84</sup>

**Figure 5.4**      **Retail contracts currently available in Sydney, NSW**



In a competitive market, retailers that better meet the needs of consumers in the products they offer will gain a competitive advantage. Different consumers will have different priorities, and this should be reflected in the range of *market retail contracts* offered by retailers to the market.

The range of *market retail contracts* currently available in Sydney NSW and shown in figure 5.4 above allocate different degrees of risk to consumers.<sup>85</sup> As noted in chapter 2, the terms of *standard retail contracts* are largely set by regulation. All other offers made by retailers are *market retail contracts*, which provide retailers with greater flexibility in relation to the terms they can offer and how these terms can be varied. Most *market retail contracts* are fixed period contracts (that is, contracts with a "fixed term" or a "fixed benefit period") that allow retailers to vary prices during that fixed period.

<sup>84</sup> These are the results of a search of the Energy Made Easy website as at 10 January 2014. 53 retail electricity contracts were identified.

<sup>85</sup> That is, contracts with different terms regarding the ability for retailers to increase prices during fixed periods.

In Sydney NSW only two contracts are currently offered to fix prices for the duration of the fixed period. This may suggest that different consumers in the market have different appetites for bearing risks, and the market is functioning well by making a range of different products available.

The Energy Price Fact Sheets for the two fixed price products currently available in Sydney NSW note the following terms concerning future price rises:

- Fixed Price Offer A - states that "during the Energy Plan Period we will not vary the energy rate or supply/service to property components of the Charges, but may vary all other components of the Charges by notice to you".
- Fixed Price Offer B - states that there will be no price rises to electricity rates for two years, no rises in those rates before fixing, and no government, network or Consumer Price Index pass-through charges for the next two years.

There are two important points to note here:

- both of these market offers are offered by major retailers that operate across jurisdictions and are significantly vertically integrated; and
- there is a large difference in the clarity of information readily available to consumers regarding the way that prices may rise during the fixed period of their *market retail contracts*. For example, it would appear to be more difficult for consumers to understand the level of risk that prices may rise in the future under Fixed Price Offer A.

It is evident from the terms of the available range of market offers that retailers generally manage some risks (e.g. risks associated with wholesale market costs) and may not manage others (e.g. regulated network costs and government policy costs). However, it is also evident that there are a small number of market offers that manage more, if not all, risks for consumers. Although we note that it is unclear to what extent retailers have varied prices in practice under these fixed price products.

### **Question 3      Risk allocation in market retail contracts**

**Do the current rules result in an inefficient allocation of risks between retailers and consumers in retail energy markets?**

## **5.5      Implications of proposed rule**

The proposed rule would effectively regulate the level of risk that retailers are required to bear. The proposed rule would require retailers to bear additional risks, which is likely to impose additional costs on retailers. This in turn is likely to affect the prices offered by retailers to consumers.

If retailers are unable to raise prices during fixed periods, a likely option for dealing with this additional risk is to build an additional premium into the prices for such

contracts (a "risk premium"). This risk premium accounts for the possibility that the costs of providing energy services may increase by more than the retailer expects. This premium would reflect the additional risks of managing changes in costs that may be difficult for retailers to manage. Generally, the longer the fixed period, the greater the risk to retailers and the greater the size of the risk premium required.

Risk premiums can be seen in a number of industries that fix prices for particular periods. One example is in mortgage offers where fixed rate mortgages are usually more expensive than the variable rate alternatives.<sup>86</sup> The interest rate for fixed rate mortgages reflects the risk of interest rates rising over the period that the interest rate is fixed for. Generally, interest rates increase as the fixed rate period increases in length, reflecting the higher risk premium required.

The same can be seen in the current market offers that fix prices for the duration of the fixed period of the contract. Such offers are approximately eight per cent more expensive than equivalent market offers that do not fix prices for the duration of the fixed period.<sup>87</sup> This price difference could be seen as an indication of the level of the risk premium required by retailers to manage these additional risks.<sup>88</sup>

For consumers, the risk premium can be seen as the cost of price certainty in their energy bills. It should also be noted that if retailers are unable to include terms in fixed period contracts which allow them to vary prices, consumers would be unable to benefit from any falls in the costs of providing retail energy services as fixed prices will mean that prices can neither rise nor fall.

An alternative option for retailers if the proposed rule is adopted may be for them to cease to offer contracts with a fixed period, or to only offer contracts with a shorter fixed period, so that they are not required to take on the additional risks under the proposed rule. Such an outcome would reduce consumer choice.

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<sup>86</sup> This is not always the case, for example, where regulated interest rates are expected to fall significantly over the fixed term of a mortgage, the fixed rate price may be lower than the current variable price.

<sup>87</sup> Note, this information is based upon information in relation to alternative offers from those retailers that offer fully fixed price market offers and is based on prices compared on the website [www.energymadeeasy.gov.au](http://www.energymadeeasy.gov.au) for Sydney, NSW on 10 January 2014.

<sup>88</sup> In retail energy markets, risk premiums may also be charged by retailers for offering flat tariff structures compared to flexible tariff structures where tariffs vary with the level of demand and the costs of supplying energy. This is because retailers are bearing additional risks associated with changes in the costs of supplying energy by charging customers a flat tariff that does not account for these changes in its costs. This issue was discussed in detail in the AEMC's Power of choice review final report. See: AEMC, 2012, final report, Power of choice review- giving consumers options in the way they use electricity, 30 November 2012, p. 165.

**Question 4      Risk premiums**

- a) If the proposed rule is made, would risk premiums be built into fixed period contracts?
- b) How significant would these risk premiums be and would these risk premiums create a permanent increase in the price of fixed period contracts?

## 6 Consumer Participation and Engagement

The long term interests of consumers are likely to be served where there is effective competition in retail energy markets. The results of effective competition can be seen in:

- prices that trend to efficient costs over time;
- a quality of service that matches consumers' expectations; and
- a range of products and services that meet consumers' preferences.

Effective competition requires active participation in the market by both retailers and consumers. In particular, to participate and make decisions in a way that promotes effective competition and the outcomes listed above, consumers need to be aware, informed and engaged. A key issue for this rule change therefore is the impact of the current rules and the proposed rule on consumer participation and engagement in retail energy markets.

This chapter considers:

- whether retailers' behaviour under the current rules regarding price variations negatively impacts consumer participation and engagement; and
- whether the proposed rule will or is likely to promote participation and engagement by consumers.

### 6.1 Information and efficient retail energy markets

Transparency plays an important role in markets. If consumers' expectations and preferences are to be met, retailers need to be able to understand what consumers' preferences are. Consumers tell retailers what they want through the decisions that they make (for example, by choosing one retailer over another or one product over another). However, if consumers do not have all the relevant information, time or understanding to make an informed decision, retailers will not be able to assess what consumers want based on the decisions they make in the market. Retailers will then not have the information they need to price and develop products in a way that is consistent with consumer preferences.

For this rule change there are two key areas in which consumers may have limited information or knowledge concerning their retail contracts that may affect retailers' abilities to develop products to meet consumers' preferences. These are:

- that when entering fixed period contracts, some consumers may believe that the prices will be fully fixed for the duration of the contract when in fact they are not; and

- that even where consumers know that prices can rise during the fixed period, some do not know that alternative fixed price products are currently available.

Examples of these two possibilities and their potential implications are outlined in Box 6.1. As these examples only outline two possible scenarios, we note that some consumers may react in different ways to the examples outlined.

**Box 6.1: Examples relating to consumer preferences and transparency in market offers**

Consumer A enters into a two year fixed term contract that allows the retailer to vary prices, but believes that the price is fixed for the duration of the two year contract. Network costs rise and the retailer passes on those costs to Consumer A by raising the price by approximately five per cent. Consumer A decides not to find a new contract because of the time and effort it would take and because significant exit fees would need to be paid. The retailer however does not receive the message through this interaction that Consumer A's preference is for a contract that provides Consumer A with price certainty for the duration of a fixed term.

Consumer B enters into a fixed term contract that allows the retailer to vary prices and is not aware that fully fixed offers exist. Even if Consumer B values certainty in energy prices, Consumer B cannot change to a fixed price offer because Consumer B is unaware that such offers exist. This means that Consumer B cannot effectively inform the retailer of Consumer B's preference for certainty in energy costs.

In both of these examples, consumers are impeded from making decisions that communicate to retailers that their preference is for certainty over lower prices. This affects competition in the market because retailers will be less able to develop products over time that meet consumer preferences.

These examples also highlight that transparency and comparability of information about products is very important for a competitive market to exist. Because both Consumer A and Consumer B do not have the information they need to make informed decisions about their product choices, retailers are less able to develop products that meet their needs.

It is also possible that consumers entering fixed period contracts generally do understand that, in those contracts, prices may rise during the fixed period unless it is one of the contracts on the market that provides a fixed price over the fixed period of the contract. In this scenario, consumer decisions (based on transparent information) and market competition is forcing retailers to develop products that meet consumers' preferences. However, if this is the case, the fact that there are very few fully fixed price offers on the market (see figure 5.4 above) could indicate that few consumers value price certainty more than they value the potential for lower prices.

There is limited information regarding which of the above scenarios is the more accurate reflection of consumer views and perceptions (or indeed if each scenario is



true to some extent). However, some data provided by Roy Morgan Research, outlined in Box 6.2, to assist the AEMC in its preparation of the recent Review of Competition in the Retail Electricity and Natural Gas Markets in NSW<sup>89</sup> could lead at least to the preliminary view that consumer preferences are not being met. Indeed, one explanation for the results could be that some consumers are entering into fixed period contracts believing the prices to be fixed when in fact they are not.

**Box 6.2: Consumer satisfaction in NSW**

Research undertaken by Roy Morgan Research for the AEMC recently found that, overall, customers that switched energy retailers in NSW were more likely than not to be satisfied with the new energy company (57 per cent for electricity and 65 per cent for gas).<sup>90</sup> Dissatisfaction rates after switching were 13 per cent for electricity consumers and five per cent for gas consumers.<sup>91</sup>

Of the dissatisfied consumers, 17 per cent of electricity consumers said that their dissatisfaction was due to price rises after signing or switching to a new contract (with no gas consumers citing this reason).

When questioned on a range of experiences with retailers, eight per cent of electricity consumers and four per cent of gas consumers stated that the actual price charged did not match the prices quoted. 15 per cent of electricity consumers and seven per cent of gas consumers stated that they were told things about the terms and conditions of the contracts with retailers that did not turn out to be true.<sup>92</sup>

We note that the data provided in Box 6.2 above is only relevant to NSW. As a result, the Commission cannot put significant weight on these statistics with respect to the proposed rule which concerns all NECF states and territories and potentially those states and the territory that may become NECF participants in the future. As noted in section 2.5.1 above, the AEMC's 2014 retail competition review will examine consumer views across all NECF jurisdictions and also Victoria and Queensland. This will provide more information on whether the views of consumers in NSW noted in Box 6.2 above are consistent across a range of states and the Australian Capital Territory. The results of market research for this competition review will, where relevant, be taken into account by the Commission in its assessment of this rule change request.

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<sup>89</sup> For more information on this review, please refer to the project web-page at: <http://www.aemc.gov.au/Market-Reviews/Completed/nsw-retail-competition-review.html>.

<sup>90</sup> See page 28 of the Survey of Residential Customers of Electricity and Natural Gas in NSW: Effectiveness of Retail Competition, Roy Morgan Research, February 2013 (the 2013 Roy Morgan Retail Competition Survey). This report is available of the AEMC website at: <http://www.aemc.gov.au/market-reviews/completed/nsw-retail-competition-review.html>.

<sup>91</sup> See page 28 of 2013 Roy Morgan Retail Competition Survey.

<sup>92</sup> See page 44 of the 2013 Roy Morgan Retail Competition Survey.

### **Question 5      Transparency and market retail contracts**

a) When entering fixed period contracts, do some consumers believe that the prices will be fully fixed when in fact they are not? If so, what proportion of consumers are likely to fall into this category?

b) Are there some consumers that are not aware that fixed period contracts with fully fixed prices are available on the market? If so, what proportion of consumers are likely to fall into this category?

## **6.2      Barriers to participation**

As noted above, a key way in which consumers participate in the market and let retailers know their preferences is by changing retailers or contracts. Consumers participating in this way is called "switching". Switching is also a key component of competitiveness in markets as it forces retailers to produce products that better meet consumer preferences or they risk losing market share and profits. Further information on recent switching rates for electricity and gas retail markets is set out in Box 6.3.

There are, however, a number of matters related to the core issues raised by CALC and CUAC that may inhibit switching. Of these factors, we will focus on some key transaction costs for consumers, including:

- **Search costs:** consumers may expend significant time and effort in seeking out alternative offers. These costs cannot be recovered once a consumer commits to a particular market offer; and
- **Exit fees:** these are typically a fixed charge associated with terminating a fixed period contract during the fixed period of that contract.

### **Box 6.3:      Switching rates in retail energy markets**

Switching rates can be an indicator of the level of competition in the market. However, at the same time, switching rates must be carefully interpreted. For example, high switching rates may show high levels of competition or they may simply reflect that a jurisdiction has only recently opened the retail market to competition. Similarly, low switching rates may reflect poor levels of competitive participation, or it may also reflect good service delivery by retailers in that jurisdiction.<sup>93</sup>

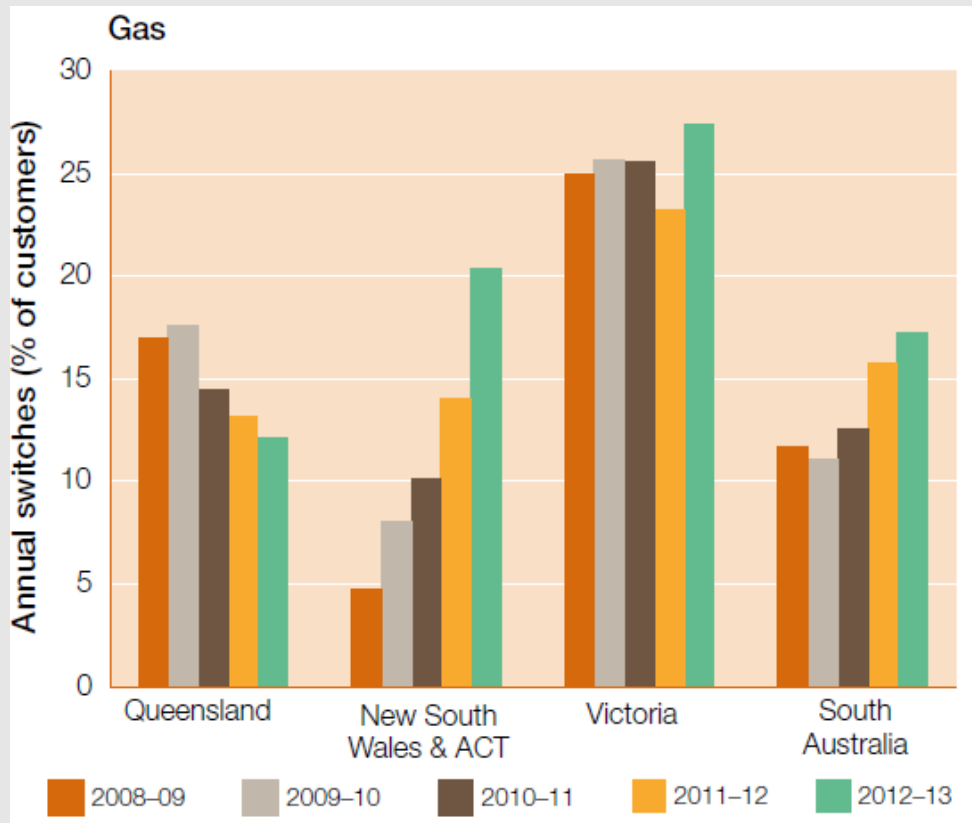
Annual switching rates to July 2013 for electricity and gas are set out in figures 6.1 and 6.2 below.<sup>94</sup>

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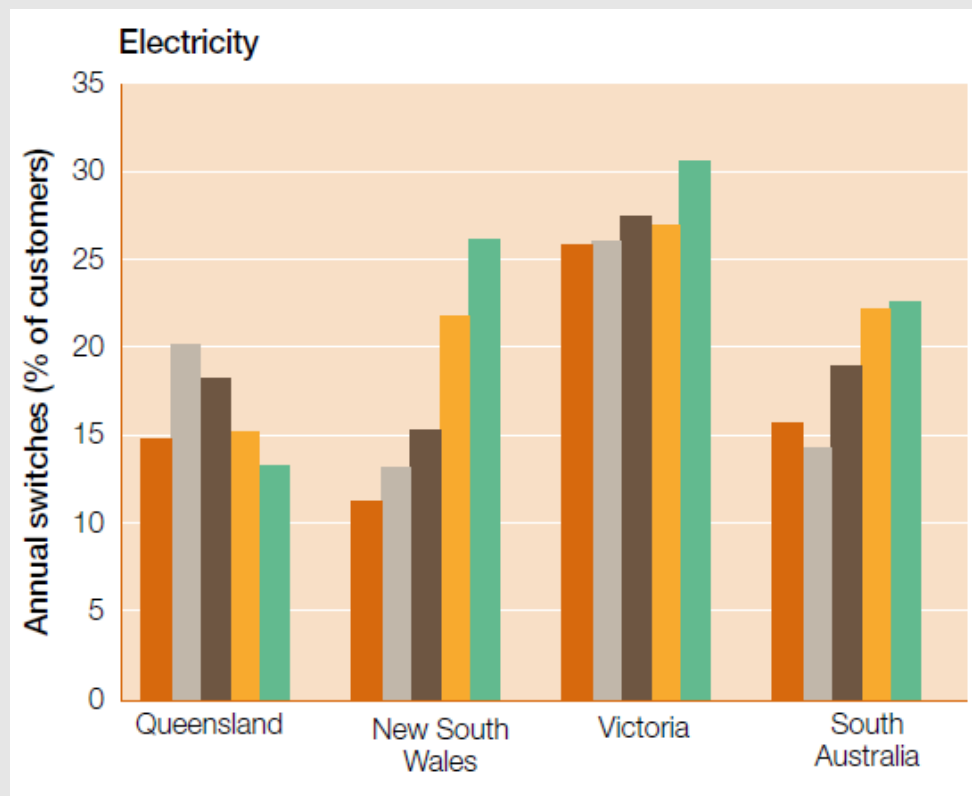
<sup>93</sup> See page 127 of State of the Energy Market, Australian Energy Regulator (2013).

<sup>94</sup> We note that these figures have been sourced from page 128 of State of the Energy Market, Australian Energy Regulator (2013).

**Figure 6.1 Gas switching rates - 2008 to 2013**



**Figure 6.2 Electricity switching rates - 2008 to 2013**



The switching trends in electricity and gas largely mirror each other in each jurisdiction. Switching rates in NSW and South Australia over the period 2008 to 2013 increase and are relatively high when compared to the other jurisdictions. Switching rates in Victoria are the highest of all of the jurisdictions surveyed and are relatively steady over the same period. Switching rates in Queensland over the same period decrease significantly (particularly for gas).

These differences largely reflect differences in retail market structures across the jurisdictions. This includes differences in the timing in the introduction of full retail contestability which allowed retailers to also offer *market retail contracts* in addition to *standard retail contracts*.

Both search costs and exit fees are potential barriers to consumers changing their retailer or contract. These potential barriers may mean that consumers may not change their retailer or contract even if they have experienced price rises that put the price they are paying above that of other comparable market offer. Given this, these barriers to switching could also inhibit consumers from placing competitive pressure on retailers in the market.

The current rules regarding price rises in *market retail contracts* interact with these barriers to participation in a number of ways. We will examine two particular barriers that the current rules may impact. These are that, following a price rise in a fixed period:

- the existence of exit fees may restrict consumers from seeking a more competitively priced contract; and
- the experience of the price rise and the existence of price variation clauses in most other *market retail contracts* may stop some consumers from switching. This may occur due to the perception that similar price rises will occur again with the new retailer, wasting any potential further search costs.

Clearly both of the above scenarios, if they exist in the market, would restrict at least to some extent competitive behaviour and switching by consumers. If that is the case, there is a risk that retailers could increase prices in fixed periods by a greater amount than would be the case if these barriers to participation were smaller or did not exist. This would occur because of the reduced pressure on retailers to price their products competitively when raising prices during fixed periods as a result of the reduced risk that consumers will change their retailer or contract.

The Commission is seeking stakeholder comments on the extent to which the above issues may impact competition in retail energy markets. We also note that these issues may occur to different degrees for electricity compared to gas retail markets and also across different states and territories.

**Question 6      Barriers to consumer participation and engagement**

- a) Does the ability for retailers to vary prices lead to a perception for consumers that changing to a new retailer or contract would waste search costs?
- b) To what extent might the existence of exit fees and other transaction costs affect consumer behaviour after a price variation in a fixed period of a *market retail contract*?

**6.3      Impacts of the proposed rule**

CALC and CUAC consider that making the proposed rule would be beneficial to consumers by making information about future prices in fixed periods more transparent. That is, all consumers would, if the rule is made, know that for the duration of the fixed period that the price will remain unchanged.

A possible impact of the proposed rule is downward pressure on prices due to increased certainty for consumers regarding future prices. Factors contributing to this downward pressure could occur as:

- competitive pressures on prices are increased because prices are more easily comparable by consumers;
- the benefits of switching are more certain, which should improve the ability of consumers to make decisions by weighing up the costs (such as exit fees) and the benefits (the fixed price) of switching contracts; and
- consumers' preferences are communicated to retailers more clearly because of consumers' increased understanding of the products they are purchasing.

These potential benefits of the proposed rule will need to be weighed against the potential costs (e.g. increased prices due to the risk premiums required by retailers). Chapter 9 of this paper, amongst other matters, contains further detail on the costs and benefits of the proposed rule and seeks stakeholder comments on the overall balance of these costs and benefits.

**Question 7      Impact of proposed rule on consumer participation and engagement**

- a) Would the proposed rule improve the level of consumer participation and engagement in retail energy markets?
- b) To what extent would the proposed rule place downward pressure on prices in retail energy markets due to improved consumer engagement and participation?

## 7 Competition Between Retailers

This chapter discusses issues concerning the impact of the proposed rule on rivalry and competition between retailers. In particular, we outline some background to the way that retailers currently compete and enter into energy markets. We also seek stakeholder views on the ways in which the proposed rule may impact on retail competition, including how it may affect the range of offers provided by retailers.

### 7.1 Retailers in a competitive market

One of key requirements for effective competition in retail energy markets is a range of retailers participating in the market. With more retailers in the market, more pressure is placed on them to meet consumers' preferences. A greater number and variety of different retailers encourages them to provide a variety of offers to consumers to meet the range of consumer preferences and also places downward pressure on prices over time.

Australia's retail energy markets are relatively concentrated in terms of market share. Three or fewer retailers account for more than 90 percent of electricity market share in Queensland, New South Wales and the Australian Capital Territory.<sup>95</sup> In Tasmania, as full retail contestability is yet to commence, alternative retailers are unable to enter the market and offer *market retail contracts* to small customers. As a result, one retailer currently has all of the electricity retail market share.<sup>96</sup>

In most states, similar market share ratios to those in retail electricity markets also apply in the retail gas markets.<sup>97</sup> An exception to this is that in Queensland there are only two retailers operating in the retail gas markets, whereas many more operate in the retail electricity markets. Also, in Tasmania two retailers operate in the retail gas markets, while only one retailer operates in the retail electricity market.

The highest penetration of smaller retailers in retail gas and electricity markets is in Victoria, followed by South Australia.<sup>98</sup> The market share of retailers in Australian retail gas and electricity markets is represented in figure 7.1 below.<sup>99</sup>

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<sup>95</sup> See page 120 of State of the Energy Market 2013, Australian Energy Regulator.

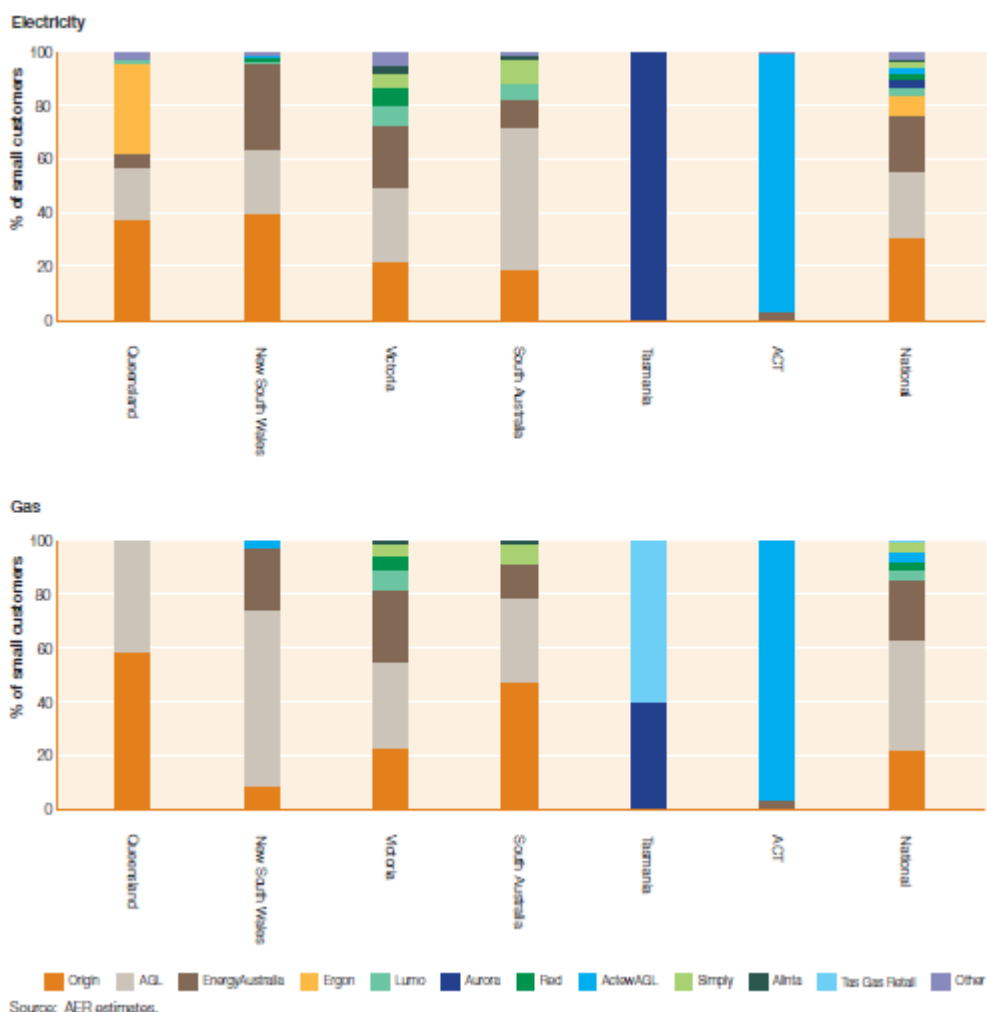
<sup>96</sup> The Tasmanian Government has indicated that from 1 July 2014 retail electricity competition will be permitted in Tasmania for households and small businesses. This will mean that new retailers will be able to enter the retail market and offer *market retail contracts* to households and small businesses. As of 1 January 2014, these customers are able to choose a market offer with the incumbent retailer, Aurora Energy.

<sup>97</sup> See page 122 of State of the Energy Market 2013, Australian Energy Regulator.

<sup>98</sup> See page 120 of State of the Energy Market 2013, Australian Energy Regulator. We also note that of these states, Victoria is a non-NECF jurisdiction. We note that these are the only two jurisdictions in which retail price regulation has been removed because in those jurisdictions competition between retailers is considered to be effective.

<sup>99</sup> This figure is sourced from page 122 of State of the Energy Market 2013, Australian Energy Regulator.

**Figure 7.1**      **Retailer market share in Australian energy markets in August 2013**



A small number of large retailers controlling the majority of market share in a jurisdiction does not necessarily signify a lack of competition between retailers. Indeed, it may signify that large incumbent retailers are meeting consumers' preferences in those jurisdictions in a competitive market. This argument could be reinforced by considering that some jurisdictions, where large incumbent retailers control the majority of market share, also have relatively high switching rates as shown in figures 6.1 and 6.2.

The Commission will also have regard to the 2014 retail competition review (as noted in section 2.5.1 above) in its consideration of the current level of competition between retailers in Australian retail energy markets.

## 7.2 Impact of the proposed rule on competition between retailers

The proposed rule may impact on the level of competition between retailers in retail energy markets. This is because the rule may affect different retailers in different ways. In particular, some retailers may face higher costs than others in order to comply with the proposed rule.

As noted in section 5.2 above, retailers currently face a number of costs and risks that are either managed for consumers, or passed on to consumers. We also provided in section 5.3 some background on the options available to retailers to manage these risks and costs, noting that retailers have a greater ability to manage some cost risks (e.g. wholesale energy costs and their own internal costs) and a lesser ability to manage other risks (e.g. network and pipeline costs and direct government regulatory costs). If forced to manage all risks, larger retailers may be in a better position to manage those risks more efficiently, and therefore at lower cost, making them more competitive than smaller retailers.

For example, a large and market leading retailer may have access to the full suite of risk management tools, such as:

- greater internal capacity to analyse risk and predict future price changes in different cost components of the retail bill;
- greater capacity to spread the costs associated with managing the increased risks across a larger number of customers on fixed period contracts;<sup>100</sup>
- greater capacity to spread risk across customers that are on different kinds of retail energy contracts; and
- increased ease of access to financial markets.<sup>101</sup>

The ability to spread risk across customers on different contracts could impact both customers on fixed period contracts and customers on other forms of retail energy contracts. A retailer that has a higher proportion of customers on contracts that do not have a fixed period may be able to more easily shift the additional risk they are required to manage from their customers on contracts with fixed periods and onto those customers on contracts without fixed periods. A retailer's ability to do this may be limited by the level of competition in retail energy markets.

A shift of risk from customers on fixed period contracts to other contracts would be in the form of price variations for customers that are on contracts without fixed periods. Smaller retailers may have a smaller proportion of customers that are on contracts without fixed periods. As such, the option to spread risk between different types of contract may not be available to them.

Smaller retailers, and particularly newer entrants in retail energy markets, may not have ready access to all of these risk and cost management tools that would help reduce the costs of complying with the proposed rule. They may therefore only be able to offer *market retail contracts* with fixed periods that:

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<sup>100</sup> That is, greater ability to utilise economies of scale.

<sup>101</sup> Costs for retailers to participate in retail energy markets can be high, particularly for new entrants. Financing these costs requires access to financial markets. Larger and more established retailers are likely to be in a better position to access funds from financial markets at lower cost due to their size and the value of the assets available to them to post as surety for engaging in such financial markets.



- are less competitively priced and build in larger risk premiums than their larger more established competitors; or
- impose a relatively higher risk on the retailer that its costs will rise by an amount that would make the business unprofitable or unviable.

Further, potential new entrants in retail energy markets may perceive fixed period contracts as being too risky and therefore decide not to enter the market. As shown in figure 5.4 above, such contracts currently represent the greatest proportion of *market retail contracts* on offer. Such contracts may also currently be significantly relied on by new entrants to consolidate their market share and cash-flows, while providing them with low risks associated with costs because of their current ability to vary prices. If this lower risk pathway to entering energy markets as a retailer is no longer available, fewer new entrants may enter the market.<sup>102</sup>

If the proposed rule makes smaller and newer retailers less competitive or more risky, the market share and competitiveness of larger and more established retailers could become more consolidated and entrenched over time. This could over time reduce the competitive pressure on retailers in energy markets to develop products that meet consumers' preferences. We also note that alternatively new entrants may still enter the market, but decide not to offer fixed period contracts.

The Commission notes that the two retailers that currently offer fully fixed price offers for fixed periods are both large and well established retailers. This may suggest that smaller and newer retailers have less capacity to offer such contracts. Conversely, it could also indicate that smaller retailers consider that their customers are unlikely to be interested in such offers.

#### **Question 8      Competition between retailers**

- a) How would the proposed rule affect larger retailers compared to smaller retailers?**
- b) Would the proposed rule make it more difficult for new entrants to enter retail energy markets?**

### **7.3      Innovation in retail market offers**

As the objective of the proposed rule is to require retailers to offer prices which are fixed for the duration of fixed period, the proposed rule would have clear impacts on the kinds of offers available to consumers in retail energy markets.

Under the existing rules, retailers can choose which risks they will manage for their customers and which risks they will pass-through in each particular *market retail*

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<sup>102</sup> Another consequence may be that the new retailers that do enter the market might be likely to be existing large brands not currently operating in energy markets.

*contract* that they offer. This allows for a range of different pricing structures, with consumers bearing different levels of risk.<sup>103</sup>

Under the proposed rule however all pricing structures offered to consumers would need to be priced on the basis that all retailers will manage all risks for the duration of any fixed period. Consumers would therefore not be able to choose between market offers with fixed periods in which they bear different levels of risk. As noted in chapter 5, this would also mean that consumers would not benefit from any falls in the costs of providing retail energy services as fixed prices will mean that prices can neither rise nor fall.

Another consequence of the proposed rule may be that retailers reduce the length of fixed period contracts offered to consumers, or indeed remove such offers from the market altogether. The risks for retailers, if required to manage all risks for the duration of the fixed period, increase the longer the duration of the contract. A retailer is more likely to know what its costs will be in six months time than in 36 months time. Current *market retail contracts* with price variation clauses offer fixed periods of up to three years in length.<sup>104</sup> Current fully fixed price market offers however are for a maximum of two years in length.<sup>105</sup>

Reducing the range of market offers available to consumers reduces the options available to retailers to compete against each other in innovative ways for the business of consumers. Further, less variety in market offers is likely to reduce the likelihood that consumers' preferences are being met. A number of consequences for the efficiency and competitiveness of retail energy markets could arise from this, including:

- consumers may be more likely to make inefficient product decisions by choosing retail energy contracts that do not meet their preferences;
- consumers may be more likely to consume more or less than would be efficient as a result of choosing a contract that does not meet their preferences; and
- consumers may engage and participate less in retail energy markets.

#### **Question 9      Innovation in retail market offers**

**a) If the proposed rule is made, are retailers likely to withdraw or offer shorter fixed period offers from the market?**

**b) If the proposed rule is made and the range of market offers available is reduced, what effect will this have on retail competition and prices in retail energy markets over the long term?**

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<sup>103</sup> See for example the range of different offers represented in figure 5.4 above.

<sup>104</sup> Note that this refers to fixed price market offers available in Sydney, NSW on 10 January 2014.

<sup>105</sup> Again, this refers to fixed price market offers available in Sydney, NSW on 10 January 2014.

## 8 Consumer Protection Issues

As noted in chapter 2, as well as assessing this rule change request against the NERO test, the AEMC is also required to assess this rule change request against a consumer protections test.<sup>106</sup> Under the consumer protections test the AEMC may not make an amendment to the retail rules unless it is satisfied that the proposed rule is compatible with the development and application of consumer protections for small customers, including (but not limited to) protections relating to hardship customers.

This chapter examines the interactions between this rule change request and:

- the ACL; and
- jurisdictional consumer protections.

### 8.1 Interactions between the rule change request and the ACL

The ACL is a national set of consumer protections implemented by the Commonwealth government and all states and territories. As noted in chapter 2 above, the ACL is one of the sources of consumer protections that operates alongside the NECF.

There are two key issues that concern the interaction of this rule change request with the ACL. These issues relate to:

- whether the provisions in the ACL relating to "unfair" contract terms in consumer contracts apply to price variation clauses in *market retail contracts*; and
- whether the "misleading and deceptive conduct" provisions in the ACL apply to the conduct of retailers in varying prices in fixed periods in *market retail contracts*.

#### 8.1.1 Unfair contract terms

The ACL provides limited protections for certain consumers where a contract term is "unfair".<sup>107</sup> These provisions are important because price variation clauses in *market retail contracts* with fixed periods could be considered by a court to be unfair. If that is the case, those price variation clauses will be void under the ACL. However, there is some uncertainty regarding whether these protections apply, and it is clear that the protections will not apply to all "small customers" that the consumer protections in the NECF apply to. This section will set out:

- an overview of the unfair contract terms provisions in the ACL;
- how the unfair contract terms provisions in the ACL apply to small customers;

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<sup>106</sup> See section 4.3 above.

<sup>107</sup> See Part 2-3 of the ACL.

- the impact of the minimum requirements for price variations under the retail rules on the application of the unfair contract terms provisions in the ACL;
- the impact of the use of "model terms" in *market retail contracts* on the application of the unfair contract terms provisions in the ACL; and
- the implications for the Commission's assessment of the rule change request.

## Overview of the unfair contract terms provisions in the ACL

The protections for consumers from contract terms that are "unfair" apply to consumers that have entered into "consumer contracts". A consumer contract is defined as:<sup>108</sup>

“a contract for a supply of ... services ... to an individual whose acquisition of the ... services ... is wholly or predominantly for personal, domestic or household use or consumption”

Therefore, the unfair contract terms provisions of the ACL can only apply to "individuals" and not corporations because of the scope of the definition of consumer contracts.

Under the ACL, if a contract is provided to the consumer on a "take it or leave it" basis<sup>109</sup> and contains a term that is “unfair”, the term is void. This means that the contract will remain in place, however any terms in the contract that are "unfair" will not apply.

Under the ACL, for a term to be "unfair" it must, in essence:<sup>110</sup>

- cause a significant imbalance in the parties' rights and obligations;
- cause a detriment to the disadvantaged party if it was to be relied on by the advantaged party; and
- not be reasonably necessary to protect the legitimate interests of the advantaged party.

All three of these requirements must be met for a term to be considered "unfair" under the ACL.

The ACL also sets out a list of examples of the kinds of terms in consumer contracts that may be unfair.<sup>111</sup> The list includes an example of a term that permits one party

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<sup>108</sup> See section 23(3) of the ACL.

<sup>109</sup> That is, a "standard form contract".

<sup>110</sup> See section 24 of the ACL. This inquiry can only be made with regard to the particular contract terms and in the particular circumstances of the matter.

<sup>111</sup> See section 25 of the ACL.

(but not the other party) to vary the terms of a consumer contract.<sup>112</sup> This does not necessarily mean that all such terms in consumer contracts would be considered to be unfair under the ACL, as a term would also need to meet the three requirements for unfair terms outlined above.

Further information regarding the unfair contract terms provisions in the ACL is available in the guide to the relevant provisions provided by the Australian Competition and Consumer Commission.<sup>113</sup>

In the sections below we discuss the limitations and further uncertainties regarding the application of the unfair contract terms provisions in the ACL in the context of this rule change request.

### **How the unfair contract terms provisions in the ACL apply to small customers**

The protections for consumers from contract terms that are "unfair" cannot be applied to all "small customers" as defined under the Retail Law.

As discussed above, the unfair contract terms provisions in the ACL only apply in relation to "individuals". As a result, the class of consumers protected by those provisions is narrower than the class of "small customers" under the Retail Law. In addition to individuals who acquire customer retail services for personal, domestic or household use, the category of "small customers" is defined in the Retail Law also to include:

- companies that purchase energy principally for personal, household or domestic use (under the definition of "residential customer"); and
- business customers (whether individuals or companies) that consume energy at business premises below the upper consumption threshold.<sup>114</sup>

In light of this, if the Commission was to make a rule clarifying that the ACL provisions with respect to unfair contract terms does apply, there will still be a number of small customers to which the relevant ACL provisions do not apply (and indeed never could have applied). Those small customers include companies that are residential customers or business customers that consume energy below the relevant consumption threshold for their jurisdiction.

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<sup>112</sup> See section 25(1)(d) of the ACL.

<sup>113</sup> See <http://www.accc.gov.au/publications/a-guide-to-the-unfair-contract-terms-law>.

<sup>114</sup> We note that this threshold is different in each jurisdiction. For example the threshold for electricity consumption typically ranges in each jurisdiction between 100 MWh and 160 MWh of electricity consumed per annum.

## **Impact of the minimum requirements for price variations under the retail rules on the application of the unfair contract terms provisions in the ACL**

There are exceptions to the application of the unfair contract terms provisions of the ACL. Because of this, in certain circumstances, the unfair contract terms provisions of the ACL may not apply to terms in *market retail contracts* that allow retailers to vary prices during fixed periods.

One of these exceptions is that if a term in a consumer contract is required or "expressly permitted" by a law of the Commonwealth, a state or a territory, the protections for consumers from unfair contract terms do not apply.<sup>115</sup>

There are a number of different interpretations regarding whether the retail rules concerning variations in *market retail contracts* "expressly permit" price variation clauses in *market retail contracts*.

### **Interpretation 1**

As noted in section 3.1.4 above, CALC and CUAC consider that rule 46 of the retail rules "expressly permits" terms in *market retail contracts* that allow retailers to vary prices during the fixed period of *market retail contracts*. As a result of this, CALC and CUAC suggest that the unfair contract terms provisions of the ACL do not apply to such clauses. If this is the case, individuals that are small customers would not be able to rely on the ACL to void these terms in *market retail contracts*.

### **Interpretation 2**

The Commission notes that a second interpretation could lead to the conclusion that rule 46 does not impact on the application of the unfair contract terms provisions of the ACL. Rule 46 of the retail rules only refers to the notification requirements that retailers must follow where they vary prices under *market retail contracts*. It does not specify requirements relating to the frequency or size of any price variations that retailers are able to make.

As a result, it could be considered that rule 46 of the retail rules implies that price variation clauses are permitted, but does not "expressly" permit them. In order for the relevant provisions of the ACL to not apply, rule 46 would need to expressly allow price variation clauses in *market retail contracts*.<sup>116</sup> Under this interpretation, the unfair contract terms provisions in the ACL would apply to individuals with price variation clauses in their market retail contracts.

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<sup>115</sup> See section 26(1)(c) of the ACL.

<sup>116</sup> See section 26(1)(c) of the ACL. The Commission also considers, however, that it is arguable on one reading of Rule 46 together with section 34(3) of the Retail Law that such price variation clauses are

### Interpretation 3

Alternatively, a third interpretation could lead to the view that the unfair contract terms provisions do not apply. Section 34(3) of the Retail Law provides retailers with the power to include terms and conditions in their *market retail contracts* on any matters, except the terms and conditions that the retail rules specify must not be included. As the retail rules do not specify that *market retail contracts* cannot contain price variations clauses, it could be considered that price variation clauses are "expressly permitted" in *market retail contracts* under section 34(3) of the Retail Law. Under this interpretation, the unfair contract terms provisions in the ACL would not apply.

### Conclusion

The Commission notes that there is some uncertainty regarding whether the unfair contract terms provisions of the ACL apply to price variation clauses in *market retail contracts*. This uncertainty is further heightened as the application of these provisions in the ACL have not been tested by the courts in relation to price variation clauses in *market retail contracts*.

### Impact of the use of "model terms" in market retail contracts on the application of the unfair contract terms provisions in the ACL

There is another more limited circumstance in which the unfair contract terms provisions of the ACL may not apply to price variation clauses in *market retail contracts*. This more limited exception also relies on the condition that if a term in a consumer contract is expressly permitted by a law, the protections for consumers from unfair contract terms do not apply.

This potential exception is that, if a price variation clause in a *market retail contract* is the same or substantially the same as the corresponding price variation clause in the model terms of the *standard retail contract*, the protections from unfair contract terms under the ACL may not apply.

As discussed in chapter 2, the retail rules contain model terms, including terms relating to price variations, that retailers are required to use in *standard retail contracts*. The price variation clause in the model terms for *standard retail contracts* in the retail rules is:

"8.2 Changes to tariffs and charges

- a) If we vary our standing offer prices, we will publish the variation in a newspaper and on our website at least 10 business days before it starts. We will also include details with your next bill if the variation affects you.
- b) Our standing offer prices will not be varied more often than once every 6 months."

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expressly permitted. Although the Commission does not see this as the correct view, there is a not insignificant risk that the Commission's view would not be upheld by a relevant court.

Under the retail rules, retailers are not required to use these model terms in their *market retail contract*. However, rule 14(2) of the retail rules expressly permits the inclusion in *market retail contracts* of terms that are "the same or substantially the same" as those in *standard retail contracts*.<sup>117</sup> As a result, it could be considered that the retail rules expressly permit retailers to use the model terms regarding price variations in their *market retail contracts*.

As discussed above, the Commission notes that because this matter has not been considered by a court, there is some degree of uncertainty regarding this view.

### **Implications for the Commission's assessment of the rule change request**

As set out above, there is degree of uncertainty as to whether the unfair contract terms provisions in the ACL apply to price variation clauses in *market retail contracts*. Further, the application of the unfair contract terms provisions may also depend on the extent to which price variation clauses in *market retail contracts* reflect the model terms in *standard retail contracts*. If the unfair contract terms of the ACL do apply to price variation terms, some small customers will be protected (e.g. individuals) and some small customers will not be protected (e.g. companies).

The Commission considers that these matters are relevant factors for its consideration of the consumer protections test outlined in chapter 4. The Commission intends to consider whether removing or limiting any existing uncertainties and exceptions in the application of the unfair contract terms provisions in the ACL would be consistent with the application and development of consumer protections for small customers.

The Commission intends also to consider these matters in its assessment against the NERO test. That is, whether the long term interests of consumers could be promoted under the NERO by removing or limiting the current uncertainties and exceptions in the application of the unfair contract terms provisions in the ACL.

#### **Question 10      Application of the unfair contract terms provisions in the ACL**

- a) If the unfair contract terms provisions in the ACL generally apply to price variation clauses in *market retail contracts*, should these provisions be relied on to address the issues raised by CALC and CUAC?**
- b) Should changes be made to the retail rules to clarify whether the unfair contract terms provisions in the ACL apply to price variation clauses in *market retail contracts*?**

### **8.1.2      Misleading and deceptive conduct**

The ACL also protects consumers against certain claims or conduct of retailers that is misleading or deceptive. It is illegal under the ACL for a business to make statements

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<sup>117</sup> The *standard retail contract* provisions are set out in full in Schedule 2 to the retail rules.



that are incorrect or likely to create a false impression. For example, a business must not make false or misleading claims about the quality, value, price, age or benefits of goods or services, or any associated guarantee or warranty. When assessing whether conduct is likely to mislead or deceive, the key consideration is whether the overall impression created by the conduct is false or inaccurate.

These protections are relevant to this rule change because consumers may already be protected from the kind of conduct raised as an issue by CALC and CUAC under the misleading and deceptive conduct provisions of the ACL. For example, a retailer that enters into fixed period contracts with consumers on discounted pricing (knowing that prices will soon rise) may in their conduct be giving consumers the false impression that prices will be lower under that energy contract than an alternative contract. Small customers may already be protected from such conduct by the misleading and deceptive conduct provisions of the ACL.

The ACL provisions protecting consumers from misleading or deceptive conduct are not limited to the protection of individuals.<sup>118</sup> These protections extend to all "small customers" as defined in the Retail Law. As a result, the misleading and deceptive conduct provisions of the ACL will apply to the representations and conduct of retailers in varying prices during fixed periods in *market retail contracts* for all small customers, not just for individuals.

**Question 11      Misleading and deceptive conduct and other ACL provisions**

- a) Should the misleading and deceptive conduct provisions of the ACL be relied on to effectively address the issues raised by CALC and CUAC?
- b) Are there any other consumer protections under the ACL that are relevant to this rule change request?

## **8.2      Interactions between the rule change request and jurisdictional regulations**

As noted in chapter 2 above, there is a degree of difference across the states and territories in relation to how the NECF has been implemented. For example, jurisdictions that implement the NECF can choose to not adopt parts of the NECF in their jurisdiction. Jurisdictions can also maintain their own jurisdictional consumer protections that will apply in addition to the NECF. Further, jurisdictions that have not implemented the NECF reforms can also maintain their own consumer protections that apply in relation to retail energy markets.

One area where this has occurred and that is relevant to this rule change request is how the different jurisdictions regulate exit fees when *market retail contracts* that have a fixed period are terminated. Figure 8.1 below shows the regulations that apply in relation to

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<sup>118</sup> This is because these provisions cover all conduct that takes place in trade and commerce.

exit fees for *market retail contracts* in each jurisdiction and the source of the relevant consumer protection.

**Figure 8.1 Regulation of exit fees in each jurisdiction**

State	Source of protection	Regulation of exit fees
New South Wales	National Energy Customer Framework	Contract must contain details of the amount and manner of calculation of the exit fee. Exit fee must be a reasonable estimate of retailers' costs of the termination.
New South Wales	National Energy Retail Law (Adoption) Regulation 2013	Retailers must waive exit fees for hardship and certain other customers experiencing financial difficulty. From 1 March 2014, retailers must not charge a fee above a set cap (currently \$130 if the contract is terminated in the first year \$45 thereafter).
South Australia	National Energy Customer Framework	Contract must contain details of the amount and manner of calculation of the exit fee. Exit fee must be a reasonable estimate of retailers' costs of the termination.
Tasmania	National Energy Customer Framework	Contract must contain details of the amount and manner of calculation of the exit fee. Exit fee must be a reasonable estimate of retailers' costs of the termination.
Australian Capital Territory	National Energy Customer Framework	Contract must contain details of the amount and manner of calculation of the exit fee. Exit fee must be a reasonable estimate of retailers' costs of the termination.
Victoria	Retail Energy Code	Contract must contain details of the amount and manner of calculation of the exit fee. Exit fee can only be made up of the pro-rata costs of procuring the customer plus \$20 (which is a set amount to compensate for certain administrative costs).
Queensland	Electricity Act 1994	If prices are increased above the regulated tariff, the retailer must notify the customer of its ability, for a period of 20 days, to exit the contract without paying an exit fee.
Queensland	Electricity Industry Code	Contract must include the amount or manner of calculation of the exit fee. Exit fee must be a reasonable estimate of the retailers' costs of the termination.

As outlined in figure 8.1, South Australia, Tasmania and the Australian Capital Territory apply the NECF consumer protections concerning exit fees in *market retail contracts*, and do not have any additional jurisdictional regulations. New South Wales applies the NECF provisions and a number of additional protections, including a cap and a moratorium on exit fees for certain hardship customers. Victoria has not

implemented the NECF reforms, but regulates exit fees in a way that is very similar to the NECF. Queensland, which has also not implemented the NECF reforms, both regulates exit fees in a way that is very similar to the NECF and applies a moratorium on exit fees for 20 days where prices rise above the regulated tariff.

These differences in the regulation of exit fees between jurisdictions are relevant to a consideration of the proposed rule in the following ways:

- Barriers to switching: as discussed in chapter 6 above, exit fees are a key barrier to consumers switching after experiencing a price rise during a fixed period of a *market retail contract*. As a result, the extent of the impact of exit fees as a barrier to consumers switching from contracts with fixed periods after prices rise will be different in each jurisdiction;
- Implementation of a more preferable rule: any more preferable rule that seeks to address exit fees to improve the ability of consumers to deal with price variations in *market retail contracts* will need to take into account the differing arrangements in each jurisdiction; and
- Consumer protections test: any more preferable rule that makes changes to the regulation of exit fees will need to satisfy the consumer protections test. That is, the Commission will need to be satisfied that any changes to the retail rules are compatible with the application and development of the consumer protections that are currently in place in each jurisdiction.

## **9 Alternative Approaches to the Issues Identified in the Rule Change Request**

As noted in section 4.1 above, the Commission has the ability to make a more preferable rule if it is satisfied that, having regard to the relevant issues, it's more preferable rule will or is likely to better contribute to the NERO than the proposed rule. The Commission may also make changes to the drafting of the proposed rule. For example, drafting changes may be made if the Commission considers that these changes would improve the clarity of the proposed rule or would improve how it is implemented.

The discussion of issues relating to the proposed rule has identified that there are likely to be a number of benefits for consumers from the proposed rule. However, there is the potential that there could also be a number of adverse impacts on the long-term interests of consumers.

This chapter draws out a number of these issues. It also seeks stakeholder comment on whether there are any alternative approaches that better address the issues raised in the rule change request to both maximise the potential benefits of the proposed rule and minimise its potential adverse impacts.

### **9.1 Impacts of the proposed rule**

In this paper we have identified the following potential benefits of the proposed rule:

- some risks relating to changes in the costs of providing retail energy services may be managed more efficiently by retailers rather than being passed on to consumers;
- search costs may be reduced for consumers if retail energy products become simpler to understand;
- competitive pressures on price may be increased in retail energy markets because prices are more easily comparable by consumers;
- the benefits of switching may be more certain because both the costs of switching (i.e. exit fees) and the benefits (the lower price or better terms of the alternative contract) are fixed; and
- consumers' preferences are better reflected in retail energy products, which is because consumers' preferences are better communicated to retailers due to increased consumer understanding of the products they are purchasing and more effective consumer participation and engagement.

The possible costs of the proposed rule that we have identified include:

- increased prices in fixed period contracts due to the possible inclusion of an inefficient risk premium on such contracts;

- customers are unlikely to receive the benefits of any falls in the costs of providing retail energy services as fixed prices will mean that prices can neither rise nor fall;
- more pronounced increases in costs for smaller and new entrant retailers as they may be less able to manage increased cost risks. This may reduce the level of competition and rivalry between retailers in retail energy markets;
- increased barriers to entry into retail energy markets for new retailers, which may reduce the potential of new retailers entering the market and consolidate the incumbency and market power of existing retailers; and
- a reduction in the range of *market retail contracts* available, which may reduce the ability of consumers to choose a contract that meets their preferences. This may occur due to the potential reduction in the level of competition in retail energy markets discussed above.

#### **Question 12      Impacts of proposed rule**

**a) Taking into consideration the potential benefits and costs of the proposed rule, on balance how would the proposed rule affect competition in retail energy markets?**

**b) Considering the issues identified by CALC and CUAC, is the proposed rule a proportionate and appropriate response to address these issues?**

## **9.2      CALC and CUAC's alternative rules**

As noted in section 3.2, CALC and CUAC have proposed two alternative rule changes in their rule change request. In short, these are:

- to restrict retailers from varying prices during fixed periods, except to pass on any changes in "government charges"; and
- to remove rule 46 of the retail rules so that the protections in the ACL against unfair contract terms in consumer contracts will then apply.

These alternatives proposed by CALC and CUAC are further discussed below.

### **9.2.1      Limited pass-through of retailer costs**

In section 5.2 we outlined the range of costs that make up a retail energy bill, and the range of risks that retailers currently manage for consumers or pass on to consumers through changes in the price of their *market retail contract*. We also discussed the range of tools available to retailers to manage risks associated with changes in the different costs of providing retail energy services.

We also noted that managing additional risks is likely to require retailers to build an additional risk premium into the prices of *market retail contracts*. As retailers are likely

to have greater ability to manage some risks than others, a possible alternative to the proposed rule would be to require retailers to manage some risks and not others. Retailers could therefore pass through to consumers some increases in their costs (e.g. the cost of a new renewable energy policy) and not other costs (e.g. an increase in network or pipeline costs).

CALC and CUAC consider that “government charges” are less predictable and therefore it is more appropriate for retailers to pass through these costs to consumers. However, this may not take into account that, as noted in section 5.2 above, retailers will have a greater ability to manage risks associated with some government policies, and a lesser ability to manage risks associated with other government policies. As such, it may be more efficient for retailers to manage some government policy risks (e.g. market mechanism based government policies) and not others (e.g. regulation based government policies).

CALC and CUAC consider that retailers are in a better position than consumers to understand future movements in network and pipeline costs. Because of this, they consider that it is appropriate and more efficient for retailers to manage the risks associated with network and pipeline costs on behalf of consumers. But even if retailers have a better understanding of where such costs might be headed in the years ahead, they may still have limited tools available to them to manage the risks associated with changes in network and pipeline costs.

Given this, requiring retailers to manage the risks of changes in network and pipeline costs could impose significant risks on retailers. The size of this risk for retailers is compounded because network and pipeline costs represent a significant proportion of energy retail bills.

As noted in section 5.1 above, the core role of retailers in retail energy markets is to manage risks for their customers and retailers are best placed to manage some risks and costs that make up retail energy bills. For example, retailers have many tools available to them to manage their own internal costs and to manage wholesale energy costs.

We also note that while currently some costs are passed through to consumers and others are not, retailers should still bear competitive pressures to minimise all of those costs they can manage. Retailers that can effectively manage controllable costs and risks will still have an advantage over their competitors, as these retailers will be able to offer their products at lower prices.

### **Question 13      Limited pass-through of costs**

**a) Would a rule that requires retailers to manage all costs aside from some limited cost pass-throughs better meet the NERO than the proposed rule?**

**b) If so, which types of costs should retailers be allowed to pass-through to consumers and why?**

### 9.2.2 Application of the unfair contract terms provisions in the ACL

The second alternative rule proposed by CALC and CUAC is only relevant if it is considered that the unfair contract term protections under the ACL do not apply as a result of the current Rule 46 of the retail rules. As we have noted in chapter 8, one interpretation of the law can lead to the conclusion that the unfair contract term provisions in the ACL may apply to price variation clauses in *market retail contracts*. However, these provisions may not be relevant where:

- the price variation clause is substantially the same as the corresponding clause in the *standard retail contract* model terms; or
- *market retail contracts* have been entered into by small customers that are not individuals (e.g. small customers that are also business customers or corporations purchasing energy as residential customers).

This means that even if the retail rules were clarified to confirm that the unfair contract provisions in the ACL apply, they would not apply to all consumers that are currently affected by the issues identified by CALC and CUAC under the retail rules.

As a result, if a more preferable rule is made so that the unfair contract terms provisions of the ACL are relied on to address the issues raised by CALC and CUAC, further changes to the retail rules may be required to ensure that:

- the changes apply similar consumer protections for *market retail contracts* entered into by small customers that are not individuals; and
- the unfair contract terms provisions apply even where the relevant price variation clause is substantially the same as the model terms for *standard retail contracts*.

We note that further discussion of the application of the unfair contract terms provisions of the ACL is provided in section 8.1, including relevant questions for stakeholder comment.

### 9.3 Other alternative rules

We would also like to receive stakeholder comments on any alternative approaches to those identified by CALC and CUAC that may better address the issues outlined in their rule change request. Below we set out a short list of alternative approaches and provide some brief commentary on the issues that could be faced under these approaches.

It should be noted here that the approaches below are provided only to assist stakeholders in considering potential alternatives and do not represent any views or conclusions reached by the Commission.

These potential alternative approaches include:

- Creating a prescriptive list of costs that can and cannot be passed through to consumers by retailers during fixed periods in *market retail contracts*. Such an approach could set out the costs that are more efficiently managed by retailers and those that cannot be efficiently managed by retailers and so may be passed on to consumers. This approach is similar to that proposed by CALC and CUAC, but could potentially allow retailers to pass through a broader range of costs to consumers rather than only changes in government charges.

However, as this approach would effectively prescribe the level of risk that retailers and consumers should each bear, the range of market offers available to consumers could be reduced. Further, retailer compliance with this approach could be administratively difficult for regulators to monitor.

- Allowing consumers a limited amount of time to switch retailers or contracts without paying an exit fees following a price variation. We note that Queensland currently allows customers to exit contracts without paying exit fees for 20 days if prices are increased above the regulated tariff rate. This approach could increase competitive pressures on retailers to limit price variations during fixed periods.

This approach may require consumers to bear additional search costs associated with finding a new contract that may better meet their preferences

- Requiring retailers to provide more information to consumers about how prices could vary under *market retail contracts*. This approach could improve the transparency of information available to consumers when they are deciding which contract to switch to, which could promote greater consumer engagement and participation in retail energy markets. This in turn could improve retail competition, as consumers are able to make decisions on a more informed basis.

However, retailers would be required to provide such information on a consistent basis. The level and type of information that retailers would be required to provide would also need to be carefully considered so that it enables consumers to make more informed decisions, while not imposing significant compliance costs on retailers. Enforcing and monitoring this type of information requirement could be difficult in practice. However, the costs of implementing this approach and its impact on the price of *market retail contracts* could be more limited than other alternative approaches.



**Question 14      Other alternative rules**

- a) Are there any alternative approaches that could better address the issues raised by CALC and CUAC and minimise the potential costs of the proposed rule?**
- b) If so, what could these alternative approaches include and what would be the potential costs, benefits and impacts of these alternatives?**

## **10 Lodging a Submission**

The Commission has published a notice under section 251 of the Retail Law for this rule change request inviting written submission. Submissions are to be lodged online or by mail by 27 March 2014 in accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on Rule change proposals.<sup>119</sup> The Commission publishes all submissions on its website subject to a claim of confidentiality.

All enquiries on this project should be addressed to Sarah Lau on (02) 8296 7800.

### **10.1 Lodging a submission electronically**

Electronic submissions must be lodged online via the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), using the "lodge a submission" function and selecting the project reference code "RRC0001". The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

On receipt of the electronic submission, the Commission will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

### **10.2 Lodging a submission by mail**

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Or by Fax to (02) 8296 7899.

The envelope must be clearly marked with the project reference code: RRC0001.

Except in circumstances where the submission has been received electronically, on receipt of the hardcopy submission the Commission will issue a confirmation letter.

If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

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<sup>119</sup> This guideline is available on the Commission's website.

## Abbreviations and key terms

AEMC	Australian Energy Market Commission
ACL	Australian Consumer Law
CALC	Consumer Action Law Centre
Commission	See AEMC
CUAC	Consumer Utilities Advocacy Centre
Fixed benefit period	See section 2.4.3
Fixed period	This means either a "fixed term" or "fixed benefit period" in a <i>market retail contract</i>
Fixed period contract	This means a <i>market retail contract</i> that has a "fixed term" or a "fixed benefit period"
Fixed term	See section 2.4.3
Market retail contract	See section 2.4.2
Market offer	See section 2.4.2
NECF	National Energy Customer Framework
NEM	National Electricity Market
NERO	National Electricity Retail Objective
Retail Law	National Energy Retail Law
Retail rules	National Energy Retail Rules
Rules	See retail rules
Standard retail contract	See section 2.4.1
Standing offer	See section 2.4.1

## A Consumer Protections and Retail Energy Market

Figure A.1 Consumer protections map

NSW	ACT	SA	Tasmania	Victoria	Queensland
<p><b>AUSTRALIAN CONSUMER LAW (ACL)<sup>1</sup></b></p> <p>The ACL is a single national consumer law that replaces a number of existing national, state and territory laws. Consumer protections in the ACL which will be relevant include:</p> <ul style="list-style-type: none"> <li>the prohibition against misleading and deceptive conduct generally</li> <li>the prohibition against unconscionable conduct, including in business transactions</li> <li>unfair contract terms provisions</li> <li>the prohibition against misleading and deceptive conduct in relation to goods or services</li> <li>the prohibition against bait advertising</li> <li>unsolicited agreement provisions</li> </ul>					
<p><b>NATIONAL ENERGY RETAIL LAW (RETAIL LAW)<sup>2</sup></b></p> <p>The Retail Law provides for a national framework for distribution and retail regulation.</p> <p>Consumer protections in the Retail Law which will be relevant include:</p> <ul style="list-style-type: none"> <li>requirements for standard retail contracts, including in relation to variation;</li> <li>minimum requirements for market retail contracts; and</li> <li>AER oversight of the presentation of standing and market offers</li> </ul>				<p><i>Electricity Industry Act 2000 (Vic) (EIA (Vic))</i></p> <p>This Act provides for publication of tariffs and variation of them. Retailers are required to comply with the terms of relevant codes, which include the <i>Electricity Retail Code</i></p>	<p><i>Electricity Act 1994 (Qld) (EA (Qld))</i></p> <p>This Act provides for terms and conditions relevant to standard and negotiated contracts. It also provides parameters around the early termination of negotiated retail contracts.</p>
<p><b>NATIONAL ENERGY RETAIL RULES (retail rules)</b></p> <p>Consumer protections in the retail rules that may be relevant include:</p> <ul style="list-style-type: none"> <li>the terms and conditions for standard retail contracts;</li> <li>prohibition from charging an early termination fee on a standard retail contract; and</li> <li>prescribed minimum terms and conditions for market retail contracts, including in relation to the charging of early termination fees.</li> </ul>				<p><i>Electricity Retail Code Vic (ERC Vic)</i></p> <p>This code provides for terms of market contracts, their variation and termination.</p>	<p><i>Electricity Industry Code Qld (EIC Qld)</i></p> <p>This code provides for terms of market contracts, their variation and termination.</p>
NSW has made relevant modifications to the rules.	No relevant modifications	No relevant modifications	No relevant modifications		

<sup>1</sup> The ACL is applied all jurisdictions as a law of that State or Territory by each of *Fair Trading Act 1987 (NSW)* (section 28), *Fair Trading Act 1992 (ACT)* (section 7), *Fair Trading Act 1987 (SA)* (section 14), *Australian Consumer Law (Tasmania) Act 2010* (section 6), *Fair Trading Act 1989 (Qld)* (section 16), *Australian Consumer Law & Fair Trading Act 2012 (Vic)* (section 8)

<sup>2</sup> The Retail Law has been applied in NSW, ACT, SA and Tasmania as a law of that State or Territory: *National Energy Retail Law (NSW) Act 2013*, *National Energy Retail Law (ACT) Act 2012*, *National Energy Retail Law (SA) Act 2012*, *National Energy Retail Law (Tas) 2012*

## B Consumer Protections Relevant to this Rule Change Request

NSW	ACT	SA	Tasmania	Victoria	Queensland
<b>ACL</b>	<b>ACL</b>	<b>ACL</b>	<b>ACL</b>	<b>ACL</b>	<b>ACL</b>
As set out in Table A	As set out in Table A	As set out in Table A	As set out in Table A	As set out in Table A	As set out in Table A
<b>Retail Law and retail rules</b>	<b>Retail Law and retail rules</b>	<b>Retail Law and retail rules</b>	<b>Retail Law and retail rules</b>	<b>Jurisdictional requirements</b>	<b>Jurisdictional requirements</b>
<u>Contract terms and conditions</u>	<u>Contract terms and conditions</u>	<u>Contract terms and conditions</u>	<u>Contract terms and conditions</u>	<u>Contract terms and conditions</u>	<u>Contract terms and conditions</u>
Standard retail contract must adopt model terms and conditions set out in Schedule 1 of the retail rules ( <i>Retail Law s25, retail rules rule 12</i> )	Standard retail contract must adopt model terms and conditions set out in Schedule 1 of the retail rules ( <i>Retail Law s25, retail rules rule 12</i> )	Standard retail contract must adopt model terms and conditions set out in Schedule 1 of the retail rules ( <i>Retail Law s25, retail rules rule 12</i> )	Standard retail contract must adopt model terms and conditions set out in Schedule 1 of the retail rules ( <i>Retail Law s25, retail rules rule 12</i> )	Offers to domestic or small business customers must be on terms and conditions approved by the ESC and tariffs published a month before they are to be effective (s 35 <i>ELA(Vic)</i> )	Standard retail contract must adopt terms and conditions as set out in industry code (set out in <i>Electricity Industry Code</i> ) (s52 <i>EA (Qld)</i> )
No prescribed terms and conditions for market retail contracts. However, all tariffs and charges must be set out in market retail contract.	No prescribed terms and conditions for market retail contracts. However, all tariffs and charges must be set out in market retail contract.	No prescribed terms and conditions for market retail contracts. However, all tariffs and charges must be set out in market retail contract.	No prescribed terms and conditions for market retail contracts. However, all tariffs and charges must be set out in market retail contract.	How a new market contract is created is prescribed in the <i>Energy Retail Code</i> (cl 19.1)	No prescribed terms and conditions for negotiated contracts. However, all tariffs and charges must be set out in negotiated contracts (s55 <i>EA Qld</i> )
<u>Variation of tariffs and charges</u>	<u>Variation of tariffs and charges</u>	<u>Variation of tariffs and charges</u>	<u>Variation of tariffs and charges</u>	<u>Variation of tariffs and charges</u>	<u>Variation of tariffs and charges</u>
Can be varied in a standard retail contract, but no more than once every 6 months (s23(2),	Can be varied in a standard retail contract, but no more than once every 6 months (s23(2),	Can be varied in a standard retail contract, but no more than once every 6 months (s23(2),	Can be varied in a standard retail contract, but no more than once every 6 months (s23(2),	Can be varied for domestic or small business customers but no more than once every 6 months.	Can be varied in a standard retail contract (see clause 8.3 of standard terms of standard retail

NSW	ACT	SA	Tasmania	Victoria	Queensland
(5) <i>Retail Law</i> )	(5) <i>Retail Law</i> )	(5) <i>Retail Law</i> )	(5) <i>Retail Law</i> )	(s35(3), (3A) <i>ELA(Vic)</i> )	contract set out in Annexure B, <i>EIC Qld</i> )
Can be varied in a market retail contract. Contract is to set out obligations in relation to notice with which retailer must comply. ( <i>retail rules</i> rule 46(3), (5))	Can be varied in a market retail contract. Contract is to set out obligations in relation to notice with which retailer must comply. ( <i>retail rules</i> rule 46(3), (5))	Can be varied in a market retail contract. Contract is to set out obligations in relation to notice with which retailer must comply. ( <i>retail rules</i> rule 46(3), (5))	Can be varied in a market retail contract. Contract is to set out obligations in relation to notice with which retailer must comply. ( <i>retail rules</i> rule 46(3), (5))	Can be varied in a market retail contract, but variation must be agreed in writing unless the nature or structure of tariff changes is a term or condition of the market retail contract, so long as the customer gave explicit informed consent to the including of such terms in the contract (cl 20 <i>ERC Vic</i> )	Can be varied in a negotiated contract. Contract is to set out obligations in relation to notice with which retailer must comply. (cl 4.12.6 <i>EIC Qld</i> )
<u>Notice of variation</u>  Variation of tariffs and charges in standard retail contract must be published in a newspaper and on retailer website, 10 days before it takes effect. Notice to be given to customer in next bill. ( <i>Retail Law</i> s23(3), (5))  Notice of variation to market retail contract to be given to customer as soon as possible but no later than next bill ( <i>retail rules</i> rule 46(4))	<u>Notice of variation</u>  Variation of tariffs and charges in standard retail contract must be published in a newspaper and on retailer website, 10 days before it takes effect. Notice to be given to customer in next bill. ( <i>Retail Law</i> s23(3), (5))  Notice of variation to market retail contract to be given to customer as soon as possible but no later than next bill ( <i>retail rules</i> rule 46(4))	<u>Notice of variation</u>  Variation of tariffs and charges in standard retail contract must be published in a newspaper and on retailer website, 10 days before it takes effect. Notice to be given to customer in next bill. ( <i>Retail Law</i> s23(3), (5))  Notice of variation to market retail contract to be given to customer as soon as possible but no later than next bill ( <i>retail rules</i> rule 46(4))	<u>Notice of variation</u>  Variation of tariffs and charges in standard retail contract must be published in a newspaper and on retailer website, 10 days before it takes effect. Notice to be given to customer in next bill. ( <i>Retail Law</i> s23(3), (5))  Notice of variation to market retail contract to be given to customer as soon as possible but no later than next bill ( <i>retail rules</i> rule 46(4))	<u>Notice of variation</u>  Varied tariffs published a month before they are to be effective (s35(3) <i>ELA(Vic)</i> )  Varied tariffs published a month before they are to be effective (s35(3) <i>ELA(Vic)</i> )	<u>Notice of variation</u>  Variations are to be contained in the first bill that includes the variations (see clause 8.3 of standard terms of standard retail contract set out in Annexure B, <i>EIC Qld</i> )  Notice of variation to negotiated contract to be given to customer as soon as possible but no later than next bill (cl 4.12.6 <i>EIC Qld</i> )



NSW	ACT	SA	Tasmania	Victoria	Queensland
<u>Termination fees</u>	<u>Termination fees</u>	<u>Termination fees</u>	<u>Termination fees</u>	<u>Termination fees</u>	<u>Termination fees</u>
Cannot be charged for ending standard retail contract ( <i>retail rules</i> rule 70(4))	Cannot be charged for ending standard retail contract ( <i>retail rules</i> rule 70(4))	Cannot be charged for ending standard retail contract ( <i>retail rules</i> rule 70(4))	Cannot be charged for ending standard retail contract ( <i>retail rules</i> rule 70(4))	N/A	Terms and conditions of standard retail contract (Annexure B, <i>EIC Qld</i> ) do not provide for termination fee to be included in contract
Can only be charged for ending a fixed term/ fixed benefit period market retail contract if it is a reasonable estimate of costs associated with termination <u>and</u> the market retail contract sets out amount/ manner of calculation ( <i>retail rules</i> rule 49A(1))	Can only be charged for ending a fixed term/ fixed benefit period market retail contract if it is a reasonable estimate of costs associated with termination <u>and</u> the market retail contract sets out amount/ manner of calculation ( <i>retail rules</i> rule 49A(1))	Can only be charged for ending a fixed term/ fixed benefit period market retail contract if it is a reasonable estimate of costs associated with termination <u>and</u> the market retail contract sets out amount/ manner of calculation ( <i>retail rules</i> rule 49A(1))	Can only be charged for ending a fixed term/ fixed benefit period market retail contract if it is a reasonable estimate of costs associated with termination <u>and</u> the market retail contract sets out amount/ manner of calculation ( <i>retail rules</i> rule 49A(1))	Can only be charged for ending a fixed term market retail contract/ evergreen market retail contract (by maturity date) if contract sets out amount/ manner of calculation <u>AND</u> subject to a formula contained in the <i>Energy Retail Code</i> (cl 24.1 and 31, <i>ERC Vic</i> )	Can only be charged for ending a fixed term negotiated contract if it is a reasonable estimate of costs associated with termination <u>and</u> the negotiated contract sets out amount/ manner of calculation. (cl 4.4.2(d) <i>EIC Qld</i> )  No termination fee can be charged where the tariff increase will be more than notified prices and the customer elects to terminate the contract because of such tariff change (s55 <i>CAEA 1994</i> ) see above
Can be charged for the termination of a fixed benefit period, even if it coincides with the end of a fixed term market retail contract ( <i>retail rules</i> rule 49A(4))	Can be charged for the termination of a fixed benefit period, even if it coincides with the end of a fixed term market retail contract ( <i>retail rules</i> rule 49A(4))	Can be charged for the termination of a fixed benefit period, even if it coincides with the end of a fixed term market retail contract ( <i>retail rules</i> rule 49A(4))	Can be charged for the termination of a fixed benefit period, even if it coincides with the end of a fixed term market retail contract ( <i>retail rules</i> rule 49A(4))	see above	see above

NSW	ACT	SA	Tasmania	Victoria	Queensland
<p>Must be waived for hardship customers or other customers in receipt of specified welfare vouchers or rebates (<i>NSW retail rules</i> rule 73A)</p> <p>Early termination fees will be subject to regulation by IPART (<i>NSW retail rules</i> rule 49AA – to commence 1 March 2014)</p>				<p>Early termination fee must be determined by reference to and not exceed retailer's unamortised direct costs of securing customer which are the pro rata costs of procuring the customer and an effective \$20 administrative fee (cl 31, <i>ERC Vic</i>)</p>	
<p><u>Presentation of standing and market offers</u></p> <p>Price facts sheets need to comply with <i>AER Retail Pricing Information Guidelines</i>. (s61 <i>Retail Law</i>)</p> <p>Retailer to provide price fact sheet to the AER (s363 <i>Retail Law</i>)</p>	<p><u>Presentation of standing and market offers</u></p> <p>Price facts sheets need to comply with <i>AER Retail Pricing Information Guidelines</i>. (s61 <i>Retail Law</i>)</p> <p>Retailer to provide price fact sheet to the AER (s363 <i>Retail Law</i>)</p>	<p><u>Presentation of standing and market offers</u></p> <p>Price facts sheets need to comply with <i>AER Retail Pricing Information Guidelines</i>. (s61 <i>Retail Law</i>)</p> <p>Retailer to provide price fact sheet to the AER (s363 <i>Retail Law</i>)</p>	<p><u>Presentation of standing and market offers</u></p> <p>Price facts sheets need to comply with <i>AER Retail Pricing Information Guidelines</i>. (s61 <i>Retail Law</i>)</p> <p>Retailer to provide price fact sheet to the AER (s363 <i>Retail Law</i>)</p>	<p><u>Presentation of standing and market offers</u></p> <p><i>Energy Industry Guideline No 19: Energy Price and Product Disclosure</i> specifies the minimum requirements for retailers to assist customers to access relevant information in relation to retailers' market contracts and prescribes the manner in which retailers must enable customers to easily compare offers between retailers.</p>	<p><u>Presentation of standing and market offers</u></p> <p>Price facts sheets need to comply with <i>AER Retail Pricing Information Guidelines</i>. (cl 8.2 <i>EIC Qld</i>)</p>