

Australian Energy Market Commission

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

Second Final Report

29 February 2008

**Commissioners**

Tamblyn  
Carver  
Woodward

## **Inquiries**

Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

**E:** [aemc@aemc.gov.au](mailto:aemc@aemc.gov.au)

**T:** (02) 8296 7800

**F:** (02) 8296 7899

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## **About the AEMC**

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

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## Foreword

The Australian Energy Market Agreement (AEMA) requires the Australian Energy Market Commission (Commission) to review the effectiveness of competition in the retail supply of electricity and gas in each jurisdiction that participates in the National Electricity Market, and to publicly report the results. Where competition is found to be effective, the jurisdictions agree to phase out retail price regulation. The reviews being conducted by the Commission of the effectiveness of retail competition in electricity and natural gas (gas) supply are an important element of the Ministerial Council on Energy's policy agenda directed to improving energy market competition and efficiency. The outcomes of these reviews will directly influence policy decision-making on the future regulatory frameworks that will be applied to energy retailing in each jurisdiction, including decisions regarding the need for retail price regulation in the future.

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

In accordance with the AEMA, the Commission now provides advice on ways to remove retail price regulation in this report, the Review of Effectiveness of Competition in the Electricity and Gas Retail Markets in Victoria - Second Final Report.

John Tamblyn  
Chairman

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## Abbreviations

ACCC	Australian Competition and Consumer Commission
AEMA	Australian Energy Market Agreement
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
BETTA	British Electricity Trading and Transmission Arrangements
CALC	Consumer Action Law Centre
CAV	Consumer Affairs Victoria
Commission	see AEMC
CUAC	Consumer Utilities Advocacy Centre
EIA	<i>Energy Industry Act 2000 (Vic)</i>
Energy Retail Code	<i>Energy Retail Code, ESC</i>
ERA	Economic Regulatory Authority of West Australia
ESC	Essential Services Commission (Victoria)
ESCOSA	Essential Services Commission of South Australia
EWOV	Energy & Water Ombudsman Victoria
First Final Report	<i>AEMC, Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria – First Final Report, December 2007, Sydney</i>
FRMP	Financially Responsible Market Participant
FTA	<i>Fair Trading Act 1999 (Vic)</i>
GIA	<i>Gas Industry Act 2001 (Vic)</i>
Host retailer	A retailer responsible under the EIA or the GIA for the supply of electricity or gas to customers in the geographic supply area allocated to that retailer. Currently the host retailers are: TRUenergy, Origin Energy and AGL.
Marketing Code of Conduct	<i>Code of Conduct for Marketing Retail Energy in Victoria, ESC</i>
MCE	Ministerial Council on Energy
National Framework Paper	<i>National Framework for Non-Economic Distribution and Retail Regulation – Consultation Paper prepared for the Retail Policy Working Group, June 2007</i>
NEL	National Electricity Law
New retailer	A retailer that is not a host retailer
OECD	Organisation for Economic Development
Ofgem	Office of Gas and Electricity Markets (UK)
Product Disclosure	<i>Guideline 19: Energy Product Disclosure, ESC</i>

Guideline	
QCA	Queensland Competition Authority
RPWG	Retail Policy Working Group
RoLR	Retailer of Last Resort
Rules	National Electricity Rules
TPA	<i>Trade Practices Act 1974 (Cth)</i>

## Executive Summary

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

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

### *Removal of retail price regulation*

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

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

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

<sup>2</sup> AEMA, clause 14.13.

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

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

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

1. The Commission recommends that the regulation of standing offer retail prices should cease from 1 January 2009 and that there be no extension of the existing reserve price powers in their current form under the *Electricity Industry Act 2000* (Vic) (EIA) and the *Gas Industry Act 2001* (Vic) (EIA) beyond their current expiry date of 31 December 2008.<sup>4</sup>
2. The Commission also recommends that a conditional statutory power for the Victorian Government to reinstate retail price regulation under specific conditions be provided for in the EIA and GIA. These conditions include a finding by the AEMC that competition is no longer effective, following a review of competition by the AEMC, and that reinstatement of price regulation is an appropriate policy response.

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

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

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

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

#### *Determination and publication by all retailers of their standing offer prices*

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

6. The Commission recommends that all retailers (new as well as host retailers) determine and publish standing offer prices and other terms and conditions to cover the retailers' obligations to offer to supply and sell energy and deemed supply arrangements. The Commission also recommends that retailers be required to publish in appropriate newspapers a summary notice advising consumers when standing offer prices are to change.
7. The Commission recommends that the Essential Services Commission of Victoria develop a guideline setting out the requirements regarding the format of the publication of retailers' own standing offer prices.
8. The Commission recommends that the Essential Service Commission gathers and publishes on its website current details of all retailers standing offer tariffs in an accessible format.

#### *Price monitoring*

A regime of price monitoring is proposed for a transitional period following the removal of direct retail price regulation. The objective of price monitoring is to identify and publish trends in standing offer prices, which would be an input into timely identification of any potential future material deterioration of competition and

pricing discipline. If concerns arise, this could trigger a further inquiry by the AEMC at the request of the Victorian Government into the effectiveness of retail energy competition, in accordance with the requirements of the AEMA, providing the basis for policy decisions on appropriate responses to any demonstrated market failure.<sup>5</sup> Where appropriate, such AEMC inquiries could be conducted quickly, so that, together with the conditional reserve pricing power under Recommendation 2, the Victorian Government would be in a position to respond quickly should competition cease to be effective.

9. The Commission recommends the introduction of a price monitoring regime for standing offer prices for at least 3 years following the removal of retail price regulation.
10. The Commission recommends that the Victorian Government have the ability to request a review at either short notice or according to an accelerated time frame.

#### *Consumer awareness and education campaign*

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

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

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

The Commission published its findings regarding the effectiveness of competition in its *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in*

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<sup>5</sup> See clauses 14.14(b) and 14.14(c) of the AEMA.

*Victoria – First Final Report* (First Final Report) in December 2007. In the course of finalising its findings regarding the effectiveness of competition and its recommendations to the MCE and the Victorian Government, the Commission has had regard to observations from stakeholders on all aspects of its preliminary findings, including comments provided in submissions to the First Draft Report and the Second Draft Report, and to other information gathering and analysis undertaken prior to the publication of the First Final Report and the Second Final Report.

# 1 Introduction

## 1.1 Requirements of the AEMA

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

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

Victoria is the first jurisdiction to be reviewed. The Commission has completed its review of the effectiveness of electricity and gas retailing in Victoria, publishing its *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria – First Final Report* (First Final Report), in December 2007.<sup>10</sup> The Commission’s finding, which is discussed in greater detail in Chapter 2 below, was that competition is effective in both electricity and gas retailing.

## 1.2 Purpose of Second Final Report

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

In particular, the Commission must provide advice:

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

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

<sup>7</sup> AEMA, clause 14.13.

<sup>8</sup> AEMA, clause 14.11(c).

<sup>9</sup> AEMA, clause 14.14.

<sup>10</sup> A copy of the First Final Report is available from the Commission’s website – [www.aemc.gov.au](http://www.aemc.gov.au)

<sup>11</sup> Clause 14.11(c) of the Australian Energy Market Agreement and letter dated 25 May 2007 from the Chair of the Ministerial Council on Energy, the Hon Ian McFarlane to the Chairman of the Commission, Dr John Tamblyn.

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

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

- full retail contestability in accordance with the National Competition Policy Agreements;<sup>13</sup>
- meet social welfare and equity objectives through clearly specified and transparently funded community service obligations that do not materially impede competition;<sup>14</sup>
- where competition is not yet effective for a market, group of users or a region, impose retail energy price controls that do not, to the extent possible, further hinder the development of competition and ensure that the benefits outweigh the costs, and costs are minimised;<sup>15</sup>
- where competition is not yet effective for a market, group of users or a region and energy retail price controls are imposed, such energy retail price control will be retained under the existing arrangements or be transferred to the Australian Energy Regulator (AER) and the Commission at the discretion of each jurisdiction;<sup>16</sup>
- where competition is found to be effective, phase out retail price regulation; and<sup>17</sup>
- where a reserve price regulation power is retained, only exercise that power in accordance with a regulatory methodology promulgated by the Commission and be subject to review by the Commission of the effectiveness of competition in accordance with clause 14.11.<sup>18</sup>

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

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<sup>12</sup> AEMA, clause 14.11(c).

<sup>13</sup> AEMA, clause 14.10.

<sup>14</sup> AEMA, clause 14.11(b).

<sup>15</sup> AEMA, clause 14.12(a).

<sup>16</sup> AEMA, clause 14.12(b).

<sup>17</sup> AEMA, clause 14.13.

<sup>18</sup> AEMA, clause 14.14(c).

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

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

### 1.3 Input from stakeholders

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

To this end, the Commission sought public comment on the advice and recommendations made in the *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets - Second Draft Report* (Second Draft Report). The Commission encouraged submissions to address the recommendations and any other matter that was considered pertinent to the Commission's decision making process. The Commission received 17 submissions from a range of stakeholders, including retailers, consumer representative groups and distributors.<sup>19</sup> All submissions received by the Commission have been published on its website, subject to any claims for confidentiality.<sup>20</sup> Material contained in submissions has informed the Commission's consideration of the substance of its final recommendations, and builds on earlier rounds of consultation undertaken by the Commission.

### 1.4 The Yarrow Report

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

- the distortion or enhancement of pricing, innovation, competitive behaviour and the efficiency of market outcomes compared to those that would occur in

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<sup>19</sup> Submissions were received from AGL, Alinta, Alternative Technology Association, Victoria Electricity, Australian Power and Gas, Consumer Action Law Centre, Consumer Utilities Advocacy Centre, Energy and Water Ombudsman Victoria, Energy Retailers Association of Australia, Ergon Energy, Energy Supply Association of Australia, Origin Energy, Powercor, Simply Energy, SP AusNet, TRUenergy, United Energy Distribution.

<sup>20</sup> The Commission's approach to confidential information is explained in section 4.4 of the Statement of Approach.

competitive markets where price is unregulated or no benchmark or reference price exists;

- retailers charging prices which are lower or higher than they would be in the absence of a benchmark or regulated price; and
- consumers making more or less informed and beneficial price/service decisions than they would have made in the absence of a benchmark or regulated price.

Professor Yarrow's report was published on the Commission's website on 23 January 2008. Stakeholders and interested parties were encouraged to provide any relevant written observations in relation to the report to the Commission.<sup>21</sup>

Professor Yarrow's report has been considered by the Commission in preparing its final recommendations and has been incorporated into the Second Final Report.

## **1.5 Structure of the Report**

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

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

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<sup>21</sup> Submissions from APG, ERAA, Origin and TRUenergy to the Second Draft Report made reference to the contents of the Yarrow report.

## **2 Framework for Advice**

### **2.1 Introduction**

As discussed in Chapter 1, the Commission is required under the AEMA to review the effectiveness of competition in the retail supply of electricity and gas in each jurisdiction that participates in the NEM, and to publicly report the results.<sup>22</sup> Where competition is found to be effective, the jurisdictions have agreed to phase out retail price regulation.<sup>23</sup> This chapter summarises the Commission's conclusions regarding effective competition and the rationale for removing retail price regulation, and sets out a framework for considering the process of phasing out retail price regulation in Victoria and the evaluation of any other complementary regulatory reforms which may be necessary.

### **2.2 Application of advice to residential customers**

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

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

### **2.3 Rationale for removal of retail price regulation**

Where competition is found to be effective, it should ensure that market prices reflect efficient costs, retailers will have the incentive to provide products and prices which attract consumers and resources will be allocated efficiently to reflect changing resource costs and customer preferences. In these circumstances there is no need to maintain price regulation. Indeed, regulated prices will almost always provide an imperfect substitute for those prices determined in a competitive market and are likely to impose costs and distortions not present in a competitive market.<sup>24</sup> Regulators have imperfect information and regulated prices often lack the flexibility of market prices. Regulated prices will generally either be too low, deterring investment and innovation, or too high, to the detriment of consumers. Either way, consumers are harmed in the long run – if prices are too low to provide an adequate return on investment and an incentive for innovation, in the long run it is consumers

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<sup>22</sup> The Economic Regulation Authority (ERA) of Western Australia is required to undertake the review for its jurisdiction at an appropriate time.

<sup>23</sup> AEMA, clause 14.13.

<sup>24</sup> This view is also expressed by the Productivity Commission in one of its recent reports – Productivity Commission 2007, *Review of Australian's Consumer Policy Framework*, Draft Report, Canberra, Chapter 5, p. 97.

who will suffer from insufficient and poor quality supply. Furthermore, retail price regulation imposes administrative and compliance costs on Government, and hence tax payers and consumers, and market participants.

While regulated price caps in monopolised markets should reflect long run average costs, ensuring an adequate return on investment, where markets are competitive, regulated price caps will need to be set at higher levels. This is because competition will tend to drive prices below the regulated caps in conditions of excess supply, while prices capped at long run average cost will prevent investors recouping in periods of excess demand. Hence, if prices are regulated in competitive markets, they will need to be set at levels which are higher than they would be in non-competitive markets, in order to ensure that suppliers receive an adequate return on their investment over the long run. Setting prices at appropriate levels in these circumstances will be even more difficult than setting prices that reflect long run average cost in markets which are not competitive. As Professor Yarrow submitted in his report to the Commission, the costs of price regulation in competitive markets, in terms of both market distortion and administration, will likely be higher, while the benefits will be lower, than in markets which are not competitive.<sup>25</sup> Competition may not be perfect. There may be problems associated with information, search costs, wholesale market design or other factors, but as long as competition is effective, these remaining imperfections are better tackled directly, not by imposing price regulation.

The existence of regulated prices, which will be appropriately set above long run average costs, will create additional problems in an otherwise competitive market. Such prices can provide a focal point for price coordination between suppliers, to the detriment of competition. They can also discourage consumers from engaging in sufficient search activity, even where this would provide net benefits to them, because consumers perceive that these prices, and even more so a discount from them, are a “good deal”, even though they are appropriately set at levels above long run average cost. Furthermore, regulated prices tend to discourage innovation in tariff design, which can be a major source of differentiation in retail energy markets, providing consumers with products that best suit their needs and preferences. Tariff innovation has been a notable feature of overseas countries where retail energy prices have been deregulated, as described in Professor Yarrow’s report.

Professor Yarrow’s review of the evidence from overseas countries where price regulation has been removed, often prior to the emergence of fully effective competition, finds that consumers have not been harmed and markets have worked to allocate resources and to deliver price and non-price benefits to consumers.

It is important to distinguish between competition issues and non-competition issues. Where concerns arise regarding issues going beyond the operation and performance of the competitive energy market, such as the affordability of energy for low income households, these issues need to be addressed through appropriately targeted policies rather than by intervening to distort the efficient operation of the

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<sup>25</sup> See Professor George Yarrow, *Report on the impact of maintaining price regulation*, Oxford, January 2008, prepared for the Australian Energy Market Commission.

market. While energy affordability is a genuine concern, particularly if energy prices rise in the future, for example, due to the introduction of an emissions trading regime, investment shortfalls or scarcity of energy sector inputs, price regulation is not the answer and indeed could exacerbate the underlying causes of increased prices. Price regulation affects all market participants, not just those consumers experiencing hardship. A competitive market ensures that energy prices reflect the real resource costs of energy supply and sends appropriate price signals to firms regarding investment decisions and to consumers regarding their energy use. It would be inappropriate to subvert that process through introducing price regulation and distorting competitive market outcomes.

## 2.4 Findings on the effectiveness of competition

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

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

Retailers are offering customers discounted tariffs together with a range of non-price incentives in an effort to differentiate their energy services from those of their rivals. For example, many retailers are offering accredited GreenPower or renewable energy products which appeal to many customers. However, the standing offer tariffs also constrain the way in which retailers are able to price their products and compete for customers.<sup>26</sup> When wholesale energy prices were rising during 2007, standing offer tariffs did not keep pace and at least one retailer stopped actively promoting market contracts to consumers because it was no longer profitable to offer prices below the standing offer.<sup>27</sup>

The Commission's finding that competition is effective is also supported by evidence of customer behaviour. Customers are demonstrating a clear willingness to participate in the competitive retail market, particularly if approached directly by a

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<sup>26</sup> Ofgem, *Domestic Retail Market Report*, June 2007, Chapter 4, notes that British energy retailers are offering consumers a range of innovative tariffs which are proving popular.

<sup>27</sup> For example, refer to Simply Energy's submission to the *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets - First Draft Report*, October 2007.

retailer. While customers may undertake only limited search activity on their own behalf, they respond well to direct marketing and exhibit a high willingness to switch retailers, particularly in response to lower prices. Neither brand loyalty nor perceived switching costs seem to be significant deterrents. Indeed, the percentage of all domestic and small business customers in Victoria who have entered into a market contract is currently 60 per cent for electricity and 59 per cent for gas. The Commission expects these levels of participation to increase further as competition continues to develop.

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

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

The Commission recognises the potential for problems relating to information disclosure and misleading or deceptive conduct to arise in the context of direct marketing. It notes, however, that there are comprehensive consumer protection laws and codes in place in Victoria and that the ESC and Consumer Affairs Victoria (CAV) have appropriate investigation and enforcement powers to address such conduct. It considers, therefore, that these problems should be addressed through the effective enforcement of consumer protection provisions and not through the ongoing regulation of prices.

On the basis of the evidence and analysis before it, the Commission’s conclusion is that competition in electricity and gas retailing in Victoria is effective. The Commission considers that competition is relatively more effective for electricity than for gas, but that gas retailing is nonetheless effectively competitive as retailers are pursuing opportunities to secure gas customers in conjunction with marketing electricity, the number of gas products available is continuing to grow and access to wholesale gas products is improving. The Commission is aware that recent

amendments to the rules governing the operation of the wholesale gas market may have unintended consequences for the future competitiveness of gas retailing in Victoria. Representatives from the Victorian Government have advised the Commission that the matter is under ongoing review. The Commission notes that this is a matter for the Victorian Government to pursue in order to ensure security of supply and appropriate competition outcomes.

A number of submissions to the *Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, June 2007 (Issues Paper) and the *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets - First Draft Report*, October 2007 (First Draft Report) stated that competition is effective *because* of the existence of a public standing offer tariff, which provides a benchmark for consumers to compare against market offers and a “price to beat” for retailers and, further, that competition would be undermined if the standing offer was removed, as there is no comparison point for savings and consumers will have no confidence that they are receiving the best deal.<sup>28</sup>

The Commission does not agree with this assessment. A regulated price, which is appropriately set at a level above long run average costs in a competitive market, is not a very useful benchmark against which to evaluate alternative offers and is likely to discourage consumers from engaging with the market and undertaking sufficient search activity. Rather than limit consumers’ choice and information, it is better to encourage the provision of tools which assist consumers to make better use of information and to obtain products which best suit their needs.

## **2.5 Principles of good regulatory practice**

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

The term “regulation” is used to describe the laws and other government-endorsed rules with which there is an expectation of compliance.<sup>29</sup> Economic regulation applies to the rules that govern the operation of markets, the rights and obligations of market participants, and the powers and obligations of market regulators. A market becomes subject to regulation where a government or some other authorised body develops and implements rules that govern the way some aspect of a market is to operate. Regulation serves a number of important purposes. Regulation can be used to increase economic efficiency where there would otherwise be market failure, for example, insufficient competition and/or costs and benefits of production or consumption bypass the market (externalities). In these situations, unregulated markets may not allocate resources efficiently or provide the necessary incentives for cost and dynamic efficiency.

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<sup>28</sup> For example, submissions from CALC on the First Draft Report, p. 8, and the Issues Paper, p. 15; CUAC submission to Issues Paper p. 8; St Vincent de Paul submission to Issues Paper, p. 2 and the First Draft Report, p. 2; ATA, submission to First Draft Report, p. 1.

<sup>29</sup> Australian Government, *Best Practice Regulation Handbook*, Canberra, August 2007, p. 1.

Regulation can also be used to address broader social objectives, and there continues to be support for regulation that protects consumers, public health and safety, the environment and other significant interests.<sup>30</sup> In some cases these different objectives can overlap and regulation may address both objectives, for example environmental concerns may be addressed by internalising the external costs which production and consumption activities impose on the environment and providing consumer protection (for instance in relation to information disclosure or prohibiting misleading or coercive conduct) can facilitate competition. In other cases, however, different objectives will require different regulations and promoting one objective may conflict with another objective. It is therefore critical that the objectives of regulation are clearly established.

Regulation is not costless. The costs are measured in terms of both administration and compliance costs, and possible distortions to competitive market processes or undermining of other policy objectives. These costs are shared by governments, regulated businesses and consumers, and can impact upon national productivity.<sup>31</sup> The costs of regulation are likely to be exacerbated where the market failure that is sought to be addressed by regulation is poorly specified and targeted or the regulatory solution operates with unforeseen and unintended consequences. Regulation has an additional cost in the potential risks to consumers as a market becomes more competitive. Professor Yarrow's research highlights a number of potential risks to consumers that may arise out the setting of a price cap by regulatory bodies as competition develops:

- Consumers may be misled into thinking the price cap defines what the regulator thinks to be fair and reasonable price, when in fact it is a price in excess of the competitive level.
- Similarly, consumers may be misled into thinking that offers of significant discounts on the regulated price must necessarily be good deals, when in fact they may not be.
- For the above reasons, consumers may curtail their search for alternative, better offers and end up paying higher prices than would otherwise be the case. In the longer run, a less active demand side of the market can be expected to lead to a less well functioning market.
- The existence of transparent, regulated prices, set at levels that would yield super-normal returns to suppliers and which would, with high likelihood, become focal points in the market, increases the risk of tacit co-ordination amongst suppliers, which would be to the detriment of consumers.

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<sup>30</sup> Hilmer Committee, *National Competition Policy: Report by the Independent Committee of Inquiry*, August 1993, p. 189.

<sup>31</sup> See, for example, the Hilmer Committee, *National Competition Policy: Report by the Independent Committee of Inquiry*, August 1993, p. 189, which noted that "regulatory restrictions on competition impose substantial costs on consumers and society, through either cross-subsidies or reduced incentives for firms to innovate and improve their efficiency." Also, Regulation Taskforce, *Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006.

- The standardisation of focal points coupled with reduced consumer search activity creates a risk to the achievement of diversity and innovation in the types of tariffs offered to consumers.<sup>32</sup>

In recognition of the positive impact that appropriate, targeted regulation can have – and the costs incurred as a result of unnecessary, imprecise or ill-defined regulation – considerable resources have been expended in recent years on developing principles and processes to ensure the development and implementation of effective, balanced regulation, both in Australia and overseas. In 2005, the Organisation for Economic Development (OECD) released its updated principles to help countries face the challenges posed by regulatory reform in the 21<sup>st</sup> century, which include eight factors that guide “good regulation” (see Box 2.1 below).<sup>33</sup>

### **Box 2.1 OECD Principles of Good Regulation**

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

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

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

Considerable work has also been undertaken in Australia to ensure regulation is proportionate, effective and not unduly burdensome. In October 2006, the Taskforce on Reducing Regulatory Burdens on Business was appointed to identify practical options for alleviating the compliance burden on business arising out of Commonwealth Government regulation. One of the Taskforce’s recommendations was that the Government endorse six principles of good regulatory process (see Box

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<sup>32</sup> Yarrow Report, pp.71-72.

<sup>33</sup> Organisation for Economic Co-operation and Development, *Guiding Principles for Regulatory Quality and Performance*, Paris, 2005.

2.2 below). These principles are now embodied in the *Best Practice Regulation Handbook* published by the Office of Best Practice Regulation.<sup>34</sup>

**Box 2.2 Taskforce recommendations on good regulatory process**

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

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

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

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

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<sup>34</sup> A copy of the Best Practice Regulation Handbook is available from the Office of Best Practice Regulation’s website at [www.obpr.gov.au](http://www.obpr.gov.au).

To the extent it is permitted to do so by the terms of the AEMA and the MCE's Request for Advice, the Commission has been guided in providing its advice by the principles of good regulatory practice and process propounded by the OECD and the Regulation Taskforce. In considering the options for phasing out price regulation, the requirements for other energy market regulation going forwards, such as the obligation to supply and consumer protection provisions and any price monitoring regime, the Commission has considered the objectives of each regulatory instrument, options for achieving that objective and the costs and benefits of regulation.

## 3 Advice on ways to phase out retail price regulation

### 3.1 Introduction

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

Chapters 3 and 4 are largely focused on policy advice. Accordingly, it will be necessary for the ESC to review current energy regulatory instruments, such as the *Energy Retail Code* (Energy Retail Code), for any detailed consequential changes that are necessary to implement these policy recommendations and to ensure the maintenance of current customer protection standards.<sup>34</sup> There is one exception to this policy advice in that Chapter 3 contains a suggested basis for Retailer of Last Resort (RoLR) prices.

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

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

The Commission acknowledges the concerns raised in submissions that retailer-determined standing offer prices, which will apply to customers who have chosen not to engage with the competitive market or enter into a market contract, will likely be higher than market prices generally. However, the answer to this potential problem is not to regulate prices and thereby distort the entire market, but to

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<sup>34</sup> The Commission notes that at the time of writing the ESC had called for submissions as part of a review of its existing regulatory instruments.

encourage and facilitate greater market engagement. Over time, as more and more consumers switch away from standing offer prices, they are likely to converge towards a competitive level. A similar process has been observed in the UK, where retailers initially maintained higher prices in their “home” territories but were eventually forced by competition to reduce them.<sup>35</sup>

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

Under section 13 of the *Electricity Industry Act 2000* (Vic) (EIA) and section 21 of the *Gas Industry Act 2001* (GIA) the Government of Victoria has the reserve power to determine retail prices.<sup>36</sup> This power has not been exercised since 2002.

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

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

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

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<sup>35</sup> It has been observed that energy retailers in the UK have tended to charge higher prices in their “home” territories than elsewhere, finding it more profitable to make higher margins on a smaller base of sticky home consumers than to make a lower margin on a larger number of consumers. (See Davies, Waddams Price & Whittaker (2007) "Competition Policy and UK Energy Markets" *Consumer Policy Review* Vol; 17 No.1) However, we note that the most recent Ofgem report found that these price differences have reduced as competition continues to develop and retailers face a shrinking home consumer base (Ofgem, Domestic Retail Market Report, June 2007).

<sup>36</sup> Section 13 of the EIA and Section 21 of the GIA provide for the Governor in Council may regulate tariffs for the sale and supply of energy to prescribed customers or a class of prescribed customers. This is known as the ‘reserve power’ but has not been exercised by the Government since 2002. The provisions are due to expire on 31 December 2008.

### **3.3 Recommendations regarding how retail price regulation can be phased out**

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

The Commission recommends that the regulation of standing offer retail prices cease from 1 January 2009 and that there be no extension of the existing reserve powers, in their current form in the EIA and GIA, beyond the current expiry date of 31 December 2008.<sup>37</sup> However, the Commission also recommends that a conditional reserve power for the Victorian Government to reinstate retail price regulation under specific conditions be provided for in the EIA and GIA. The conditions to be met are that the AEMC:

- has reviewed retail competition at the request of the Government;
- concluded that competition is no longer effective; and
- recommended that reinstating price regulation is an appropriate policy response.

These arrangements would be consistent with the requirements of clause 14.14(c) of the AEMA, while enabling the Victorian Government to respond relatively quickly to a deterioration in the effectiveness of competition and in pricing outcomes for energy consumers. These conditional arrangements for reinstating retail price regulation are described in further detail below in relation to the price monitoring regime the Commission recommends should accompany the removal of price regulation.

The Commission notes the following issues related to this recommendation:

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

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<sup>37</sup> Price regulation could be reintroduced in the circumstances set out in clause 14.4(c) of the AEMA following a subsequent finding by the Commission that competition has ceased to be effective and resumption of price regulation is an appropriate response.

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

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

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

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

Retailer-determined standing offer prices will provide a more relevant benchmark than regulated prices which have been appropriately set above long run average cost in a competitive market. By contrast, retailer-determined prices should converge towards competitive levels over time as more consumers become fully engaged with the competitive market and exercise their right to choose. However, while price transparency can assist consumer choice, under certain market conditions it also has the potential to facilitate coordinated pricing and to deter customer poaching through price discounting and “specials”.<sup>38</sup> The UK energy regulator requires all tariff schedules to be published with a view to reducing consumers’ search costs, but some commentators have been critical of this approach because it also provides information to firms about the behaviour of competitors, ensuring that competition is not too vigorous.<sup>39</sup> These potentially negative effects of price transparency are more likely to occur where all prices are posted and universally available and where other conditions are conducive to coordinated conduct in a market. In the context of energy retailing in Victoria, there is currently active competition between a range of host and new retailers and it is likely that there would be some publication of rates in any case. For these reasons, the Commission is not recommending that retailers be required to publish all market contract prices on offer, or requiring all prices to be

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<sup>38</sup> See, for example, David Genesove and Wallace P Mullin, “Rules, Communication and Collusion: Narrative Evidence from the Sugar Institute Case”, *The American Economic Review* Vol 91 No 3, June 2001, 379; Svend Albaek, Peter Mollgaard and Per B Overgaard, “Government Assisted Oligopoly Coordination? A Concrete Case”, *The Journal of Industrial Economics*, Vol. XLV, No.4, December 1997, 429; Jill Walker and Luke Woodward, “The Ampol/Caltex Australia Merger: Trade Practices Issues”, *Trade Practices Law Journal*, Vol.4, No.1, March 1996, 21.

<sup>39</sup> Prof Stephen Davies, Prof Catherine Waddams Price and Cheryl Whittaker, “Competition Policy and the UK Energy Markets”, *Consumer Policy Review* Jan/Feb 2007, Vol 17, 1 at page 5.

universally available, as this could run the risk of deterring discounting, discouraging competition and facilitating price coordination.<sup>40</sup>

The Commission has considered the views put in submissions to the Second Draft Report from consumer groups that the requirement to publish standing offer prices should be extended to encompass all prices offered by retailers<sup>41</sup>, but does not agree with this approach. While the Commission feels that publication of some prices, in this case standing offer prices, is beneficial in underpinning consumer confidence, particularly in the early stages following removal of price regulation, requiring the publication of all prices would encourage the creation of obvious focal points, and potentially work to promote “supra-competitive prices”<sup>42</sup>. An obligation to publish every price deal or offer made to a customer, particularly when made to win a sale, and make it generally, or conditionally, available to all customers, would act as a disincentive for retailers to make such offers and compete as vigorously for customers.

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

### **3.3.2 Guideline regarding format for publication of standing offer prices**

The energy regulatory framework specifies how energy market offers are presented, including detailed requirements setting out how prices, fees and other charges are presented to consumers. There are no such requirements regarding how standing offer prices are presented to residential customers. This is probably due to the fact that standing offer prices are currently the product of an agreement between host retailers and the Victorian Government, with the Government endorsing the prices that are ultimately published. This will not be the case on the removal of retail price regulation and all retailers will be required to determine and publish their own standing offer prices.

The Commission recommends that the ESC develop and implement a guideline regarding how the retailers’ own standing offer prices should be published to enable residential customers to make informed judgements about the standing offer, particularly as tariff innovation in the future may make comparisons and judgements more complex. The Commission would envisage, however, that in developing any new guideline resulting from the recommendations contained in the Second Final

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<sup>40</sup> The UK regulator has been criticised for requiring comprehensive price transparency for these reasons. See Davies, Waddams Price & Whittaker (2007) "Competition Policy and UK Energy Markets" *Consumer Policy Review* Vol; 17 No.1 and Harker & Waddams Price (2006) "Introducing Competition & Deregulating the British Domestic Energy Markets" CCP Working Paper 06-20.

<sup>41</sup> See submissions to the Second Draft report from CUAC p. 3, CALC p. 4, ATA p. 2.

<sup>42</sup> See Yarrow report, p. 16 and section 2.4.2 and 2.4.3.

Report, the ESC would have regard to the current Product Disclosure Guideline and the developing national framework for regulation and make every effort to avoid duplication or repetition, particularly where it would impose additional, avoidable, costs upon retailers.

The Commission has noted comments made in submissions to the Second Draft Report regarding the apparent inconsistency of recommending that the ESC take on this role given the present implementation target of September 2009 for a national framework for retail regulation.<sup>43</sup> While the Commission considers it would be appropriate for the AER to perform this function once a national framework for retail regulation has been established and transferred to the AER, the current uncertainty regarding the contents of the national framework and the current responsibilities of the ESC for other guidelines and reporting functions provide support for the recommendation that the ESC undertake this role.

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

- how each relevant tariff and its various elements should be described;
- for each relevant tariff type the annual expenditure based on predetermined consumption levels (such as 3 MWh per year, 8 MWh per year and 11 MWh per year);<sup>44</sup> and
- any discounts or other benefits for payment by certain methods.

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

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

### **3.3.3 Additional publication requirements**

Currently, standing offer prices are published in the Government Gazette, on retailers' websites and are made available to customers in hard copy upon request. While publication of standing offer prices on retailers' websites and making hard copies available on request are considered appropriate disclosure methods, the Commission took the view in the Second Draft Report that publication in the Government Gazette would not necessarily fulfil transparency and wide circulation requirements as few consumers will be aware of this publication or have access to it.

The requirements for retailers to publish standing offer prices on their websites and to make available their standing offer prices in hard copy on request should continue

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<sup>43</sup> AGL submission to Second Draft Report, p. 2, TRUenergy, Submission to Second Draft report, p. 3

<sup>44</sup> The Commission is aware of the ESC's decision not to adopt this particular requirement in its existing information guidelines; however the Commission has taken the view that in the context of the removal of price regulation, this is a beneficial piece of information to provide to consumers.

to apply. However, rather than continuing to require publication of standing offer prices in the Government Gazette, the Commission sought specific comment from stakeholders on the merits of an obligation to be imposed on retailers to require them to publish their standing offer prices in newspapers circulating in the areas to which their standing offer prices apply.<sup>45</sup>

It saw the potential benefits as including the greater accessibility of newspapers compared to the Government Gazette and the wider notification of changes in standing offer prices in newspapers than would be achieved by publication in the Government Gazette, particularly with respect to customers without internet access. This practice would be consistent with that adopted in other jurisdictions, such as New South Wales, for amending standing offer prices. In an environment of no retail price regulation retailers may be able to amend their prices more frequently than annually (depending on the other terms and conditions of the standing offer contract). Having to publish notification of those prices on each occasion in a newspaper would make any changes more transparent and encourage retailers to focus on the need for, and timing of, such changes. It is arguable that in an environment of no retail price regulation consumers may take an increased interest in standing offer prices and any amendments to them.

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

In its submission, EWOV expressed strong support for the publication of standing offers in newspapers, noting that publication in the Government Gazette implied Government approval for the price, which would not be appropriate in the absence of direct price regulation.<sup>46</sup>

However, retailers' submissions to the Second Draft Report<sup>47</sup> expressed concerns regarding the potential cost of publication in newspapers. Submissions also expressed uncertainty over which prices would be required to be published in the newspaper and in which areas, as well as the potential for customers to be confused or misled by the publication of standing offer prices, particularly if they are on a market contract. The Commission has considered comments made in submissions on this issue, and has modified its draft recommendation.

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<sup>45</sup> The requirement to publish standing offer prices on the retailers' websites and to make them available to customers in hard copy upon request would remain.

<sup>46</sup> EWOV submission to Second Draft report, p. 2

<sup>47</sup> See for AGL submission to Second Draft Report p. 2 and Origin, submission to Second Draft Report, p. 3.

The Commission recommends that:

- Retailers be required to publish a summary notice advising consumers that standing offer prices are to change. This notice is to be published prominently in a relevant local newspaper and should advise that details of the new standing offer prices are available on the retailer's website or upon request in hard copy from the retailer. The Commission also recommends that a guideline be developed by the ESC governing the publication format for this summary notice and stipulating that the notice be published in a prominent location within the newspaper.
- The ESC should maintain a database of all current standing offer prices and changes from the previous standing offer. The ESC should publish this information on its website.

These two recommendations represent an effective balance between ensuring information transparency and accessibility for customers with regard to notification of changes in standing offer prices, whilst not imposing excessive additional costs upon retailers.

### **3.4 Price monitoring**

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

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

The objective of price monitoring is to identify and publish trends in standing offer prices with a view to providing a timely indication of any possible future deterioration in the effectiveness of retail competition and in the competitiveness of observed prices. If concerns about the effectiveness of retail competition are identified through the monitoring of retailers' standing offer prices and other available information sources this could provide the trigger for an urgent inquiry by the AEMC into the effectiveness of retail competition in accordance with the requirements of the AEMA. The Commission's findings and recommendations would provide the basis for policy decisions on appropriate responses to any significant deterioration in the effectiveness of competition which could include reintroduction of retail price regulation in appropriate circumstances.<sup>48</sup>

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<sup>48</sup> Price regulation could be reintroduced in the circumstances set out in clause 14.4(c) of the AEMA following a subsequent finding by the AEMC that competition has ceased to be effective and resumption of price regulation is an appropriate response.

The proposed price monitoring regime is described in further detail below in the light of comments in stakeholders' submissions related to this issue.

### **3.4.1 Rationale for price monitoring of standing offer prices**

As noted above, the objective of price monitoring in the Victorian gas and electricity retail markets is to monitor and publish the trend in prices paid for energy by those customers who are not party to a market contract, being those customers on standing offer contracts and deemed supply arrangements. These customers are generally those who have not actively engaged with the market by switching to a market contract for retail energy supply and may be more exposed to the risk of inappropriate pricing.<sup>49</sup> Although in an effectively competitive market such behaviour is not expected, this group of customers is the most exposed to the potential exercise of localised market power. Accordingly, the prices charged to these customers should be monitored, at least for a transition period, to provide transparency for consumers and policy makers; to identify any potentially inappropriate pricing and exercise of transient market power, if it occurs, and to inform the need for a further competition review.

The Commission notes that the ESC already monitors market contract developments through its annual energy retail business comparative performance report. In the Commission's view additional price monitoring of the market contract prices and offers for electricity and gas is not warranted and would very likely be detrimental to retail competition in the long run.

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

### **3.4.2 Submissions from stakeholders**

In its submission to the First Draft Report, CALC commented that, should price regulation be removed, consumers with the least opportunity actively to engage in the market (for example due to their low income and vulnerable status) will be disadvantaged and will no longer be assured of price protection in the purchase of an essential service. CALC suggested an alternative form of regulation involving implementation of pricing principles to protect those consumers who will no longer be ensured price protection.<sup>50</sup>

While not supporting price monitoring, in its submission in response to the First Draft Report EWOV stated that it would be useful to have a point of reference on

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<sup>49</sup> Similarly, it has been observed that energy retailers in the UK have tended to charge higher prices in their "home" territories than elsewhere, finding it more profitable to make higher margins on a smaller base of sticky home consumers than to make a lower margin on a larger number of consumers. (See Davies, Waddams Price & Whittaker (2007) "Competition Policy and UK Energy Markets" *Consumer Policy Review* Vol; 17 No.1) However, we note that the most recent Ofgem report found that these price differences have reduced as competition continues to develop and retailers face a shrinking home consumer base (Ofgem, *Domestic Retail Market Report*, June 2007).

<sup>50</sup> CALC submission to First Draft Report, p.3.

what happens to market contract prices if regulated price control is to be phased out.<sup>51</sup>

AGL supported a price monitoring regime that is non-interventionist and does not become a *de facto* retail price review.<sup>52</sup> TRUenergy considered that a price monitoring regime must provide restrictions on the use of reserve powers to regulate prices and should not be used to threaten reintroduction of a price setting arrangement. TRUenergy proposed conducting an independent review to identify the exercise of market power prior to the reinstatement of market price regulation.<sup>53</sup> Origin Energy commented that regulation of retail energy prices was unnecessary where there is effective competition and that competition and non-competition issues must be distinguished in order to clarify what policy goals particular regulations were targeting.<sup>54</sup> In its submission to the Issues Paper, GridX supported price monitoring as a transitional measure.<sup>55</sup>

In submissions to the Second Draft Report, almost all retailers expressed concerns about the imposition of a price monitoring regime, predominantly on the grounds that this would introduce an inappropriate degree of regulatory oversight or potential intervention.<sup>56</sup> This was of particular concern in an environment of effective competition. For example, ESAA stated that the monitoring of prices in these circumstances was “superfluous, adds an unnecessary cost and potentially inhibits market and product development.”<sup>57</sup> Victoria Electricity did not support price monitoring, but recommended ongoing monitoring of competitiveness.<sup>58</sup> Origin and ERAA sought further clarification of the scope and objectives of any proposed price monitoring regime.<sup>59</sup> Retailers also questioned the appropriateness of the ESC being nominated as the monitoring body, given the development of a national framework.<sup>60</sup>

Consumer groups, on the other hand, supported the proposal to monitor standing offer prices on the grounds of transparency and ensuring consumer confidence. However, the efficacy of a price monitoring regime limited to factual reporting was questioned by the ATA, CUAC and CALC, as was the ability of the Government to respond to perceived problems in retail competition.

The Commission remains of the view that the introduction of a price monitoring regime is the most appropriate measure in an environment where there is effective

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<sup>51</sup> EWOV submission to the First Draft Report, pp.4-5.

<sup>52</sup> AGL submission to the First Draft Report, p.4.

<sup>53</sup> TRUenergy, submission to the First Draft Report, p.3.

<sup>54</sup> Origin submission to the First Draft Report, p.12.

<sup>55</sup> GridX submission to the Issues Paper, p 4.

<sup>56</sup> See, for example, AGL p. 3, APG p. 2, ERAA p. 2 and TRU p. 4.

<sup>57</sup> ESAA, submission to Second Draft Report, p. 3.

<sup>58</sup> VEL, submission to Second Draft Report, p. 6.

<sup>59</sup> Origin submission to Second Draft Report, p. 4, ERAA submission to Second Draft Report p. 2.

<sup>60</sup> See AGL submission to Second Draft Report, p. 3, APG submission to Second Draft Report, p. 2 and ERAA submission to Second Draft Report, p. 2.

competition and does not support alternatives such as pricing principles. In the Commission's opinion, pricing principles and any related compliance obligations would become another form of price regulation, which could become unnecessarily intrusive in an effectively competitive retail energy sector.

Retailer concerns about the proposed regime appear to stem from a misapprehension of the intention and extent of the price monitoring model recommended in the Second Draft Report, as suggested by TRUenergy's comment that the term "reporting" should be used instead of "monitoring" to mitigate any supposed regulatory threat.<sup>61</sup> The proposed price monitoring regime is not intended to function as *de facto* price regulation. The monitoring function is to be restricted to factual monitoring, reporting to the Victorian Government and publication of retailers' standing offer prices and trends in those prices over time. The Commission notes that retailers would be required to publish their standing offer prices under the Commission's recommendations. These published prices would be inputs into the factual reporting under the proposed price monitoring scheme, avoiding the need for retailers to comply with additional reporting requirements.

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

The Commission recommends an incentive based approach to price monitoring that draws on the current arrangements in Victoria. It assumes the publishing and posting by all retailers of standing offer prices and other terms and conditions. Having considered comments in submissions, the Commission has made a number of refinements to the monitoring regime proposed in its draft report. The price monitoring approach recommended consists of:

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

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<sup>61</sup> TRUenergy, Submission to Second Draft report, p. 4.

These elements are explained in more detail below.

#### **3.4.3.1 Monitoring and public reporting**

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

#### **3.4.3.2 Factual reporting**

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

The pricing issues to be monitored and reported on include:

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

The Commission does not recommend that the monitoring role be extended to movements in wholesale electricity and gas prices. As discussed in the First Final Report, one of the principal roles of energy retailers is to manage wholesale price risk on behalf of their customers and managing that risk is a critical dimension on which retailers can compete. Retailers employ a wide variety of hedging strategies and there is no simple or necessary correlation between wholesale and retail prices in an effectively competitive market. Monitoring retailers' wholesale costs would involve high compliance and administration costs with little obvious benefit, particularly in the absence of credible public contract price data.<sup>62</sup> Energy contract portfolios are traded and varied daily and their component parts and value cannot be represented in simple averages. Furthermore, energy contract portfolios provide for supply to all of a retailer's customers and are not targeted to different customer classes such as small customers. This suggests that estimating wholesale prices for the obligation to offer to supply and sell energy to small customers (and deemed supply arrangements) is necessarily an arbitrary and uncertain exercise.

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<sup>62</sup> In the Commission's view, the publicly available AFMA data is not representative for these purposes.

### **3.4.3.3 Monitoring role**

The role of monitoring and reporting on standing offer prices should be conducted by the ESC. The ESC prepares and publishes an annual retail performance monitoring report, and the reporting of published standing offer prices could be incorporated within this existing report.<sup>63</sup>

The Commission considers it would be appropriate for the AER to perform this function once a national framework for retail regulation has been established and transferred to the AER, should the Victorian Government wish to receive continued monitoring reports on the standing offer prices. As noted previously, while the Commission acknowledges concerns raised in submissions, the Commission considers it prudent for this function to remain with the ESC given the current uncertainty regarding the contents of the national framework for retail regulation. Furthermore, the ESC already undertakes a degree of monitoring activity in the preparation of its annual energy retail business performance report and as such is well placed to expand these activities to fulfil a price monitoring role within the jurisdiction with little duplication or additional cost until the national framework is finalised and transition of roles to the AER is settled. The proposed reporting by the ESC (and, ultimately, the AER) provides appropriate separation of roles between reporting on the market and reviewing the effectiveness of competition, which would be a function of the AEMC.

### **3.4.3.4 Further competition reviews**

As already noted, the Victorian Government can request a further competition review by the Commission if the standing offer price monitoring report suggests there may have been a deterioration in the effectiveness of competition. In this regard any trends in the standing offer prices that could not be explained by observable market conditions could trigger a request by the Victorian Government for information from the retailers concerned. If the Victorian Government is not satisfied with the response, it could request the AEMC to undertake a further review to ascertain whether competition is no longer effective and if so to recommend appropriate policy responses (consistent with the process set out in the AEMA). The ESC's performance reports will also provide systematic information on relevant aspects of the performance of the market.

The Commission recognises that the capacity may be needed for a rapid response to an identified possible deterioration in the effectiveness of competition. It recommends, therefore, that the Victorian Government should have the ability to request a review by the AEMC at either short notice, or according to an accelerated timeframe. In circumstances of potential public detriment arising out of rapid deterioration in retail competition, this ability would assure consumers that the Victorian Government is able to respond in a timely fashion and take any appropriate policy action. At the same time, the presence of a credible threat of a swift policy response should there be an actual deterioration in competition and

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<sup>63</sup> Essential Services Commission Energy Retail Business Comparative Performance Report for the 2005-06 Financial Year, November 2006

pricing discipline will provide a strong incentive for retailers to avoid market behaviours that are likely to trigger such a response.

### **3.4.3.5 Reserve power**

As stated above in section 3.2, under the current legislative arrangements, the Victorian Government has reserve powers to regulate prices. The Commission notes that the provisions establishing these reserve powers are due to expire on 31 December 2008. In accordance with the requirements of the AEMA (clause 14.14(c)), the Commission recommends that legislative powers to regulate prices in their current form should be allowed to expire on 31 December 2008. In their place, the Commission recommends the introduction of powers to regulate prices if, following a competition review by the AEMC:

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

The maintenance of this conditional reserve power to regulate retail prices will enable the Victorian Government to respond quickly to reintroduce price regulation where the specific conditions are satisfied. At the same time, it constrains the Government's capacity to regulate retail prices in circumstances other than those specified in the AEMA.

The publication of standing offer prices by retailers together with public monitoring and reporting of these prices, in the context of an effectively competitive market, together with the capacity for an accelerated competition review by the AEMC and an appropriate and timely policy response by the Government, provide appropriate incentives for retailers to continue to charge cost reflective prices. The approach is not overly intrusive as information is obtained by the regulator from public sources.

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

## **3.5 Retailer of Last Resort Prices**

Electricity and gas retailers in Victoria may be subject to an obligation that requires them, in certain circumstances, to supply and sell energy or gas to certain customers of another retailer on tariffs, terms and conditions approved by the ESC.<sup>64</sup> The tariffs, terms and conditions of that supply are to be approved by the ESC and published in

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<sup>64</sup> Under section 49D, EIA and 51D, GIA, electricity and gas retail licences may include a requirement to supply or sell electricity to relevant customers (i.e. small retail customers) to whom electricity is supplied or sold under another licence.

the Government Gazette. This is the retailer of last resort (RoLR) obligation – it is triggered when an existing retailer’s licence is revoked or a retailer loses its right to operate in the relevant wholesale market. The RoLR and the relevant customer are deemed to have entered into a contract on the terms and conditions approved by the ESC and published in the Government Gazette. The term of the contract is for a limited period.

The gas and electricity legislation in Victoria confers on the ESC a broad discretion to develop and implement electricity and gas RoLR schemes.<sup>65</sup> In February 2006, and after substantial review, the ESC published its final decision regarding an energy RoLR scheme for Victoria.<sup>66</sup> A summary of the decision is included in the First Final Report. The decision contained outcomes on a number of issues including the assignment of RoLR responsibility and terms and conditions and pricing for a RoLR event. The following outcomes are relevant to this advice:

- The RoLR responsibility lies with the host retailers only.
- The standing offer terms and conditions that apply under the EIA and GIA, including the provisions of the Energy Retail Code, will form the basis of the terms and conditions for the provision of RoLR services to relevant customers (being small retail customers). Any departure from these terms and conditions will require the ESC’s approval.
- The RoLR tariff for relevant customers will comprise:
  - the standing offer tariff under the safety net provisions of the EIA and GIA; and
  - a one off, up front RoLR supply fee of \$44 for electricity RoLR customers and \$30 for gas RoLR customers (escalated by the Consumer Price Index) for the recovery of incremental energy and retail operating costs above those incorporated in the standing offer tariff.

The ESC’s decision contemplates the removal of retail price regulation and recognises that in those circumstances the RoLR prices for relevant customers would need to be reviewed.<sup>67</sup> The ESC will need to decide on RoLR prices to apply once retail price regulation is removed.<sup>68</sup>

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

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<sup>65</sup> Part 2, Division 8 (sections 49A-49K), EIA. Part 6, Division 6 (sections 51A-51K), GIA.

<sup>66</sup> Energy Retailer of Last Resort – Final Decision of the Essential Services Commission of Victoria, June 2006.

<sup>67</sup> Energy Retailer of Last Resort – Final Decision of the Essential Services Commission of Victoria, June 2006, pages 34-35.

<sup>68</sup> The submission from the St Vincent de Paul Society to the First Draft report referred to the importance of standing offer prices in the RoLR context, page 2.

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

In the Commission's view, these criteria provide a good basis for the ESC to decide on RoLR prices in a competitive environment and where there is no retail price regulation. Measured against these criteria, the retailers' own published standing offer prices may be appropriate RoLR prices, the use of which would not only meet the ESC's criteria, but would also reduce the risk that determination by the ESC of different RoLR prices may introduce a regulated benchmark price, even though its application is intended to be limited. Further, using the retailers' own standing offer prices would meet the requirements of good regulation principles, including being clear, simple and practical, minimising costs, being consistent with other regulations and practices and being compatible with competition. Submissions to the Second Draft Report questioned the Commission's view regarding the appropriateness of the standing offer price as a RoLR price, given that "the costs and risk of supplying customers of a failed retailer"<sup>69</sup> would not be factored into the standing offer price. The Commission notes, however, that the use of retailers' own standing offer price as a RoLR price does not preclude the addition of a RoLR supply fee in order to accommodate the inherent risks of a RoLR incident.

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<sup>69</sup> See Origin p.5, TRUenergy p.3, Ergon p.1.

## **4 Advice on consumer protection issues**

### **4.1 Introduction**

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

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

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

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

#### **4.2.1 Obligation to offer to supply and sell energy**

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

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

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

The Commission recognises that there are legitimate concerns about those residential customers who, by virtue of their personal circumstances or the perception that they are unprofitable to serve, may not currently be able to access the full benefits of

competition. This point was also made in some of the submissions in response to the First Draft Report and the Second Draft Report.<sup>69</sup> Recognising the essential nature of electricity and, to a lesser extent, gas supply the Commission considers that the regulatory arrangements should continue to ensure that residential customers have access to the supply and sale of energy on reasonable terms and conditions. The Victorian Government and the ESC, in consultation with retailers and consumer groups, has developed and implemented a regulatory framework designed to safeguard the interests of these consumers.

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

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

It should be noted that under clause 14.4(a) of the AEMA the parties agree that the phase out of retail price regulation need not include the removal of 'obligation to supply' arrangements. The most recent consultation paper on the proposed national framework for non-economic distribution and retail regulation for the Retail Policy Working Group (RPWG) prepared by Allens Arthur Robinson in June 2007 (National Framework Consultation Paper) includes recommendations that contemplate a national retail energy regulatory framework that includes an obligation on certain nominated retailers to offer to supply and sell energy to small customers.<sup>70</sup>

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

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

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<sup>69</sup> For example, in its submission to the First Draft Report on page 11, CALC requested that the advice deal with the situations where competition is not effective. In its submission to the First Draft report on p. 4, SVDP nominated certain groups that might not benefit from competition and suggested a separate protection regime for each - regional, rural, rental, credit risk and financially vulnerable customers.

<sup>70</sup> National Framework for Non-Economic Distribution and Retail Regulation- Consultation Paper for the Retail Policy Working Group June 2007 - prepared by Allens Arthur Robinson - Chapter 2, pp. 5-18.

jurisdictions. Submissions made in response to the Commission's First Draft Report and Second Draft Report also considered this issue.<sup>71</sup>

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

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

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

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

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

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<sup>71</sup> Submissions from AGL (p.3), TRUenergy (p.2) and Origin Energy (pp. 12-15) to the First Draft Report. Stakeholders were asked to directly consider it in the context of the Second Draft Report, and as such all submissions considered it to some degree.

retailers because of the increased wholesale risk and administrative costs that would be incurred with such a broad obligation.

In contrast to the other models, the FRMP model also sits comfortably with the existing deemed supply arrangement obligations provided for in the EIA and GIA. Under the deemed supply arrangements the existing retailer or FRMP has the obligation to supply energy to the premises for which it is financially responsible (this is discussed further below in section 4.2.2). It follows that the FRMP should also have the obligation to offer to supply and sell energy to the premises for which it is financially responsible.<sup>72</sup>

For these reasons, the Commission's draft recommendation was that the obligation to offer to supply and sell energy to a residential customer's premises be with the existing FRMP, and it has maintained this view in its final recommendation. The FRMP model is consistent with the work of the RPWG on the national framework for retail and distribution regulation. It is the model that was adopted for the introduction of full retail competition in Queensland. It is also consistent with the principles of good regulation. It is a clear and simple approach to the obligation, it imposes costs that are unlikely to be higher than under the alternative options and which are more likely to be fairly distributed, it is consistent with other regulations and policies and it is compatible with competition. Submissions to the Second Draft Report were divided in their support for the FRMP model and the maintenance of the status quo.<sup>73</sup> Support for the FRMP model by and large reflected agreement with the Commission's position that the concept of the host retailer was becoming increasingly less relevant as the market develops, whereas Simply Energy and APG expressed concerns about the FRMP model acting as a potential barrier to entry, particularly given the current effectiveness of the host model.<sup>74</sup> CALC, while acknowledging that the FRMP model may have possible benefits, questioned whether it had been thoroughly tested in practice and stated that it would require material changes to current customer protection measures.<sup>75</sup>

#### **4.2.1.3 Designated retailer for new connections**

Having recommended the adoption of the FRMP model, it is also necessary to make a recommendation regarding the obligation to supply and sell energy to residential customers at new connections (New Connection Obligation). Under the FRMP

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<sup>72</sup> As noted in the National Framework Consultation Paper at p. 8, the FRMP model simplifies the application of deemed supply arrangements for new retailers in that it will be required to have standing offer terms and conditions and these can be used as the basis for deemed supply arrangements. In addition it may address concerns about what should happen at the end of the term of a deemed supply arrangement in that the deemed supplier will also be the retailer required to supply on standing offer terms.

<sup>73</sup> AGL, ESAA and EWOV were supportive of the FRMP model, while Origin was in favour of the defined area model but conceded that the FRMP model was an improvement on the status quo. APG, CUAC, CALC and Simply Energy were in favour of the status quo or host model.

<sup>74</sup> Simply Energy, submission to Second Draft Report, p. 1, and APG, submission to Second Draft Report, p. 2.

<sup>75</sup> CALC, submission to Second Draft Report, p. 3.

model, there is a designated retailer or designated retailers with the New Connection Obligation.

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

The four models for the New Connection Obligation are similar to those for the Existing Connection Obligation and are set out as follows:

- Host retailer - the New Connection Obligation is assigned to each host retailer for all relevant premises/supply points in the retailer's former franchise area (currently applies in Victoria);
- Universal - the New Connection Obligation is assigned to all retailers participating in a jurisdiction for all relevant premises/supply points in the jurisdiction;
- Defined Area - the New Connection Obligation is assigned to all retailers participating in a defined area (for example, a distribution network area) for all relevant premises/supply points in that defined area; and
- Distributor Tender - the relevant distributor tenders out to interested retailers the right to provide the New Connection Obligation in that distribution area.<sup>76</sup> Any revenue obtained by distributors from this tender process could be taken into account during the distributor pricing determination process.

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

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

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<sup>76</sup> In Victoria there would appear to be no regulatory prohibition on a new retailer supplying and selling energy to new connections so long as the retailer meets the market and regulatory requirements to enable the new retailer to supply and sell energy in these circumstances.

During the course of the first two stages<sup>77</sup> of the Victorian Review, stakeholders did not directly comment on the New Connection Obligation. Those retailers who recommended that the Existing Connection Obligation should be more evenly allocated did not specifically state that the New Connection Obligation should be extended to new retailers. Similarly, new retailers are not seeking to take on the New Connection Obligation. The Commission understands that few new retailers choose to offer to supply and sell energy to residential customers at new connections under a market contract. In this regard the continuation of the host retailer model may be appropriate for a certain period.

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

The universal model and, to a lesser extent, the defined area model would create obligations that may be disproportionate to some retailers' shares of the market. In addition, these two models have the potential to be a barrier to entry for new retailers because of the increased wholesale risk and administrative costs that would be incurred with such a broad obligation, particularly in the case of gas.

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

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

The disadvantages with the defined area model relate to the difficulties associated with determining the threshold for participation by retailers. Setting the threshold for the defined area model would need to consider that retailers must have sufficient customer numbers or consumption load in a defined area in order to accommodate customers acquired in the context of new connections. If a retailer's load is relatively small, the retailer may not have adequate wholesale and risk management arrangements in place to support supply obligations that the retailer cannot control or predict with any degree of certainty. This consideration is particularly pertinent for gas where retailers are exposed to a number of different wholesale charges. In

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<sup>77</sup> Specifically, the First Draft report and the First Final Report.

addition there may be implementation issues and practical difficulties in deciding when a retailer actually meets the threshold. This would involve continual scrutiny and analysis by a regulator or other appropriate authority. These issues and difficulties may outweigh the benefits of this model.

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

From the discussion above, the two models that the Commission considered likely to be appropriate for the New Connection Obligation going forward are the host retailer model (the status quo) or the distributor tender model. To inform its consideration of this issue, the Commission sought comments from stakeholders on the advantages and disadvantages of the host retailer and distributor tender models from both the consumer and market competition perspectives as part of the consultation on the Second Draft Report.

Those stakeholders that commented on this issue were almost universally opposed to the adoption of a distributor tender model,<sup>78</sup> primarily on the grounds that there would be insufficient interest from retailers to guarantee participation in the tender process or to justify the administrative burden and expense of conducting a tender process, particularly in the context of a market making the transition away from price regulation and into a national framework.<sup>79</sup>

EWOV expressed concern in its submission that conducting a tender process could result in delays in the provision of new connections or reduce the choices available to consumers.<sup>80</sup> However, this concern seems to rest on a misconception that each new connection would require a new tender process. The same misconception appears to underpin other submissions. However, the proposal envisages a tender process which would determine the obligation to supply for new connections in a defined distributor area for a specified period of time.

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<sup>78</sup> The ESAA was the only stakeholder not opposed to the distributor tender model, on the grounds that it was more reflective of a flexible, market based approach, while noting that there would be an opportunity to examine the issue in more detail as part of the development of the national framework. See p. 4 of ESAA submission to Second Draft Report.

<sup>79</sup> See for example submissions to the Second Draft Report from Citipower, p. 2, Origin p. 6, TRUenergy p. 2, United, p. 2 and SP AusNet pp. 3 - 4.

<sup>80</sup> EWOV, Submission to Second Draft Report, p.3.

While a distributor tender model is, in the Commission's view, more in keeping with a competitive retail energy sector, the practical considerations raised by stakeholders have led the Commission to conclude that it would be appropriate to maintain the current host retailer model for the obligation to supply new connections, at least until sufficient time has passed for the removal of price regulation to be bedded down and the issue can be thoroughly reviewed. Furthermore, there is no regulatory restriction to prevent direct competition for new connections, wherever retailers feel they are in a position to compete.

#### **4.2.2 Deemed supply arrangements**

As stated above, while recommending the removal of retail price regulation, the Commission is of the view that the other elements of the safety net arrangements should remain in place. The Commission recommends that the obligation to supply and sell energy on reasonable terms and conditions should continue to apply following the removal of retail price regulation. Another aspect of the supply obligation is the deemed supply arrangements that apply under the EIA and GIA. Under the EIA and GIA there are circumstances where a contract is deemed to exist between a residential customer and the retailer financially responsible for the supply point at the customer's premises. Briefly the circumstances are:

- where a customer has never entered into a contract with a retailer;
- where a customer commences to take supply of energy at a premises without having entered into a contract for the supply and sale of energy; and
- where a customer cancels a contract during the cooling off period but the customer continues to take supply without entering into a further contract with the existing retailer or another retailer.<sup>81</sup>

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

##### **4.2.2.1 Rationale for retaining deemed supply arrangements**

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

Recognising the essential nature of electricity and, to a lesser extent, gas supply the Commission considers that the regulatory arrangements should continue to ensure that residential customers have access to the supply and sale of energy on reasonable terms and conditions for a certain period of time even though they may not have entered into a contract (whether a market contract or standing offer contract). This

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<sup>81</sup> Sections 37, 39(1) and 39(2) of the EIA. Sections 44, 46(1) and 46(2) of the GIA.

has been part of the regulatory framework that has been designed to safeguard the interests of these customers.

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

#### **4.2.2.2 Terms and conditions applying to deemed supply arrangements**

Currently, the standing offer prices and other terms and conditions apply to the deemed supply arrangements in addition to the obligation to offer to supply and sell energy.<sup>82</sup> While historically only host retailers have published standing offer prices and other terms and conditions, it should be noted that for two of the three circumstances listed above the retailer may be a host retailer or a new retailer. To date new retailers have not published prices and other terms and conditions because they do not have the obligation to offer to supply and sell energy (the obligation to make a standing offer). However, these retailers do have supply obligations in respect of the deemed supply arrangements for move-ins and cooling off period cancellations. As new retailers increase their market shares their deemed supply arrangement obligations will also increase.

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

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

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

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

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<sup>82</sup> Sections 37(1), 39(1) and 39(2) of the EIA. Section 44(1), 46(1) and 46(2) of the GIA.

### 4.3.1 Rationale for a consumer awareness campaign

The removal of retail price regulation in the retail energy market in Victoria as recommended in Chapter 3 and Chapter 4 is a substantial reform of the energy regulatory framework. Communication of the changes to all stakeholders, and in particular residential customers, is necessary to ensure awareness and to maintain confidence in the market. In this regard the Commission notes the customer awareness campaign currently being conducted in the context of the removal of price regulation for small business customers in Victoria. That campaign involves both retailers and Government and encompasses press releases and bill messages from both the ESC and the retailers. The Commission does not, however, wish to suggest that the campaign undertaken for small business customers would be appropriate, or adequate, for communicating with residential customers.

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

One aspect of the marketing misconduct referred to in submissions relates to alleged breaches of information requirements, such as incorrect information being given to customers and customers being told they have to sign a contract before being supplied with requested information. A fundamental feature of a competitive market is that consumers have access to adequate information in order to participate in that market. However, submissions have suggested that some consumers may not be aware of their rights to information and other relevant consumer protections. For example, CUAC pointed out that customers are unaware of their rights to request and receive information in many cases, yet the regulatory regime relies heavily on the customer taking the initiative to find relevant information. In CUAC's view the regulatory regime fails if consumers are unaware of their rights to request and receive information.<sup>83</sup>

In this context, a consumer awareness and education campaign can also serve another purpose. The removal of retail price regulation and the resulting need to communicate information about any changes to consumers presents a timely and appropriate opportunity to ensure that residential customers are aware of their rights under the regulatory framework. The objective of a consumer awareness and education campaign is to inform residential customers and to improve their access to information available to assist them in decision making in a retail sector where search costs may be relatively high. If residential customers are aware of the information they can access this will assist them when responding to energy offers presented via direct marketing approaches. Direct marketing may not achieve its potential as an integral tool of the competitive market if residential customers are unaware of their rights to information or if retailers are ignoring the laws and obligations that apply to the direct marketing sales channels.

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<sup>83</sup> CUAC, Submission to First Draft Report, p. 4.

The Commission agrees that the effectiveness of the regulatory framework relies on residential customers being aware of their rights to request and receive information about energy offers. An effective consumer awareness and education campaign may go some way to addressing the concerns of some consumer representative groups that customers are not well informed and are unaware that they can, for example, obtain market offer information from retailers without first having to enter into a contract with them.<sup>84</sup>

#### **4.3.2 Consumer awareness and education campaign**

Submissions to the Second Draft Report were universally supportive of the Commission's recommendation that an appropriately targeted and timely consumer awareness and education campaign be undertaken to inform residential customers of the changes being made to energy retailing (and what remains the same) as part of the removal of retail price regulation and emphasise their ongoing rights under the consumer protection framework. The consumer awareness and education campaign should inform residential customers about:

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

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

Submissions from AGL and VEL noted that a consumer education campaign was the appropriate vehicle for informing consumers not only of their rights in the competitive retail sector, but also of the role of retailers and customers responsibilities to the retailer.<sup>85</sup> The Commission considers there to be some merit in this suggestion, as it could contribute to the avoidance of disputes between customer and retailers, and as such recommends that any consumer information and education

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<sup>84</sup> CUAC, Submission to First Draft Report, p. 4.

<sup>85</sup> AGL, Submission to Second Draft Report, p. 3 and VEL, Submission to Second Draft Report, p. 6.

campaign incorporate information about the various responsibilities of both retailers and consumers.

## **4.4 Compliance issues**

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

### **4.4.1 Issues raised in submissions**

Direct marketing is a common feature of competitive retail energy markets around the world and Victoria is no exception. As noted in the First Final Report, direct marketing can be an efficient and rational approach by competitive retailers in a market characterised by a low level of consumer engagement and search and/or switching costs that may be perceived to be high relative to the expected benefits. Direct marketing can play an important role in providing consumers with information, reducing their search costs and encouraging them to switch to a better retail offer. However, there is also the potential for inappropriate direct marketing activity to mislead consumers and to pressure them into decisions they would not otherwise make. It is imperative that retailers take seriously their licence obligations in these respects by ensuring that their sales staff do not engage in such conduct and that there is effective monitoring of compliance with, and enforcement of, those obligations by relevant regulatory bodies, a position welcomed in submissions from consumer organisations to the Second Draft Report.<sup>86</sup>

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

A number of submissions also indicated that there is evidence of some significant instances of marketing misconduct in Victoria which may not all be captured by reported statistics.<sup>87</sup> In its submission, EWOV stated that one complaint can be representative of a systemic issue on the basis that it can be indicative of unreported

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<sup>86</sup> See submissions to Second Draft Report from EWOV p. 3, CALC, p. 6, CUAC, p. 4.

<sup>87</sup> For example submissions in response to the First Draft Report from CALC, pp. 6-7 and CUAC, p. 3 and EWOV, p. 2-4.

instances of similar conduct.<sup>88</sup> Some examples of specific behaviour referred to in submissions are:

- transfers without consent;
- incorrect information being given to customers;
- customers requesting information but being told that they have to sign a contract in order to obtain it; and
- door to door marketing practices that involve high pressure selling techniques.

The Fitzroy Legal Centre conducted a small survey of public housing estate residents in western Melbourne, which indicated similar concerns.<sup>89</sup>

CALC stated that the marketing activity of many retailers has involved widespread breaches of the energy specific regulation as well as the FTA and TPA.<sup>90</sup> In its submission to Second Draft Report, CALC supported the Commission's expectation that regulator respond appropriately to breaches of consumer protection provisions and called for more public reporting on enforcement actions by regulators. CALC also proposed the creation of a 'Do Not Contact' register as an extension of the national 'Do Not Call' register.<sup>91</sup>

CUAC pointed out that customers are unaware of their rights to request and receive information in many cases yet the regulatory regime relies heavily on the customer taking the initiative to obtain relevant information and to complain about any misconduct. In CUAC's view the regulatory regime fails if consumers are unaware of their rights to request and receive information.<sup>92</sup>

#### 4.4.2 Consumer protection provisions

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

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

The Product Disclosure Guideline includes the obligation to provide an offer summary in writing to a small customer on request and when providing the

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88 EWOV, p. 2.

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

90 CALC submission to the First Draft Report p. 6.

91 CALC, submission to Second Draft Report, p. 6.

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

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

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

- misleading or deceptive and unconscionable conduct;
- false or misleading representations; and
- harassment and coercion.

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

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

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

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

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

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

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

#### **4.4.3 Commission's response to submissions**

##### **4.4.3.1 Relationship to retail price regulation**

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

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

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

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

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

To the extent that such conduct continues on a scale greater than that being reported by the complaint handling and enforcement bodies, the appropriate response would be more effective incentives for retailer compliance with current requirements, more effective monitoring of compliance with relevant codes and laws by regulatory bodies and targeted enforcement action where serious contraventions occur. Submissions received in response to the Second Draft Report from consumer organisations have emphasised the need for more effective monitoring and enforcement.

The Commission has recommended the implementation of a consumer awareness and education campaign that reinforces consumer awareness of their rights. While improving consumer awareness of their rights is critical to ensuring more effective participation in the market by consumers, it is also important to improve the effectiveness of retailers' participation in the market by minimising instances of misconduct. Retailers must face effective incentives not to engage in misleading marketing or to pressure consumers into a particular choice. These incentives will depend on the risk of detection and the likely penalty for such conduct. Furthermore, publicity about breaches of the consumer protection regulations can have an adverse effect on a retailer's reputation and demand for its services. Ensuring that consumers are aware of their rights will help with detection but, as EWOV has pointed out, it is likely that many consumers do not complain about misconduct. This makes it all the more important that when breaches of the law and relevant codes are detected enforcement action is taken and sufficient penalties are imposed, a view supported by EWOV in its submission to the Second Draft Report.<sup>93</sup>

Where marketing misconduct is reported, the Commission expects that regulators do respond appropriately and in a timely manner. Regarding the issues raised in submissions, regulators may wish to consider whether their existing approaches to compliance and enforcement should be reviewed to identify possible areas of improvement having regard to a future market environment where there is no retail price regulation. In the Commission's view there is an adequate consumer protection framework including remedies available for non-compliance. This framework should be enforced where instances of non-compliance are notified, investigated and supported by the evidence.

#### **4.5 Enhancements to regulatory instruments**

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

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<sup>93</sup> EWOV, submission to Second Draft report, p. 3.

The Commission also notes that changes to tariff structures or innovation in the kinds of products developed by retailers following the removal of price regulation may necessitate a reassessment of the content of information provision guidelines in the future in order to ensure that they adequately encompass the kind of information that needs to be available to consumers in an effective but evolving market. Submissions from retailers have supported the proposition that innovation in the market will be encouraged by the removal of price regulation. Bundled utility products, such as those already being offered by Dodo Power and Gas which combine telecommunications and energy services, are recent examples of market innovation, and it can be assumed that more innovation will follow the removal of price regulation.<sup>94</sup>

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<sup>94</sup> Ofgem's latest retail market report indicates that British energy retailers are increasingly providing a range of new and innovative tariffs, such as fixed and capped rates, tracker tariffs and cheaper online deals. (See Ofgem *Domestic Retail Market Report*, June 2007). The Commission has also observed the ESC's recent call for submissions as part of a review of its existing regulatory instruments.

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## **5 Possible enhancements to product information for consideration**

### **5.1 Introduction**

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

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

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

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

### **5.2 Existing energy comparative tools**

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

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

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

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

### **5.3 Potential shortcomings of existing models**

Online comparators have been criticised in some quarters for being unable to incorporate or value non-price factors, such as non-price goods and services or plan-specific terms and conditions, into an estimate of payable charges or comparison of two or more products.<sup>95</sup> There are also concerns about the level of access to internet-only tools amongst consumers without ready access to a computer or without the requisite degree of computer literacy; this is particularly an issue for disadvantaged consumers or the elderly.<sup>96</sup>

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

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

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<sup>95</sup> See, for example, Origin's submission to First Draft Report, p. 3 and TRUenergy's submission to the Second Draft Report, p. 4.

<sup>96</sup> See CALC submission to First Draft Report, p. 8.

switch.”<sup>97</sup> The ESC has confirmed that it has had contact with a number of third parties seeking to develop commercial energy information services in the second half of 2007.<sup>98</sup> In its submission to the Second Draft Report, TRU has stated that whilst comparative services may come onto the market as a reflection of consumer demand, it would be inappropriate for regulators to perform such a role due to concerns about regulatory intervention.<sup>99</sup>

The ESCOSA and QCA model is less complicated and time consuming for the consumer, in part because it relies on the provision of a smaller amount of information, but consequently does provide a less comprehensive price comparison report with less scope for customisation by the user. By not requiring the user to have an offer upon which to base the comparison, the ESCOSA model is potentially more relevant to a wider range of consumers and of more value during initial information gathering on the part of consumers. However, as pointed out in a submission from CALC, the ESCOSA model does not easily “enable users to understand important non-price terms and conditions”<sup>100</sup>

#### **5.4 Areas for further consideration**

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

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

Online tools in the financial services and telecommunications sectors encompass both product comparison and calculation functions. Similar to the process for energy comparators/estimators, product comparison tools provide recommendations based

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<sup>97</sup> CALC submission to First Draft Report, p. 8.

<sup>98</sup> At the time writing none of these services had commenced operation.

<sup>99</sup> TRUenergy, Submission to Second Draft report, p. 4.

<sup>100</sup> CALC p. 8.

on desired variables as entered by the user (e.g. usage, monthly cost in the case of telecommunications, loan amount, term for financial services). A list of the best fit products are then displayed. The amount of detail available varies between services, though most allow the user to click through to more detailed information. In the telecommunications area, simple browsing (without the input of specific variables) of available plans is also an option available to users of some services. Generic calculation tools are more prevalent in the financial services sector, reflecting the nature of the products involved.

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

## A Energy Regulatory Framework

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

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

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

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

### Minimum terms and conditions

Terms and conditions in standing offer contracts concerning disconnections, the provision of information about customer rights and entitlements, access to premises for meter reading, and confidentiality of customer information must comply with those specified by the ESC (which are contained in the Energy Retail Code). Any term or condition that is inconsistent with a term or condition specified by the ESC is void to the extent of the inconsistency, and is deemed to be replaced by the term or condition contained in the Energy Retail Code.<sup>101</sup>

The Energy Retail Code also contains a number of other terms and conditions that are not specified as matters for approval by the ESC under the energy legislation. However, it is a condition of the licences issued to host retailers that the terms and conditions of a standing offer must not be inconsistent with these terms and conditions.<sup>102</sup> These relate to matters such as billing, credit management, contract

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<sup>101</sup>Sections 36(1) and (2) of the EIA and sections 43(1) and (2) of the GIA.

<sup>102</sup>The retail licences issued to AGL, Origin Energy and TRUenergy provide that each term or condition of the Energy Retail Code is a term or condition with which a contract for the sale of gas or electricity must not be inconsistent.

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

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

The Energy Retail Code specifies that no variations may occur between the Energy Retail Code and energy market contracts, aside from certain clauses which may be altered with the explicit informed consent of the customer. These specific clauses are described in the Energy Retail Code.<sup>103</sup> Any other variation to the clauses contained in the Energy Retail Code will result in those clauses becoming void and replaced by the relevant clause from the Energy Retail Code.

The FTA<sup>104</sup> contains restrictions that apply to contracts in terms of liability limitation. The Energy Retail Code specifies that energy contracts may not be altered in any way that limits the liability of the retailer to the customer for any breach by the retailer of the energy contract or for any negligence by the retailer in relation to the energy contract. Energy contracts may not be altered to require the customer to take precautions to minimise the risk of loss or damage to any equipment, premises or business of the customer which may result from poor quality or reliability of energy supply.<sup>105</sup>

Retailers must not include an indemnity or other term or condition in an energy contract which allows the retailer to collect greater amounts than allowed under common law or statute for any breach by the customer of their energy contract or any negligence by the customer in relation to their energy contract.<sup>106</sup>

## **Disconnection**

The process a retailer must follow before it is permitted to disconnect a customer is set out in the Energy Retail Code.<sup>107</sup> This process is summarised in the figure below.

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<sup>103</sup>Energy Retail Code, clause 19.1.

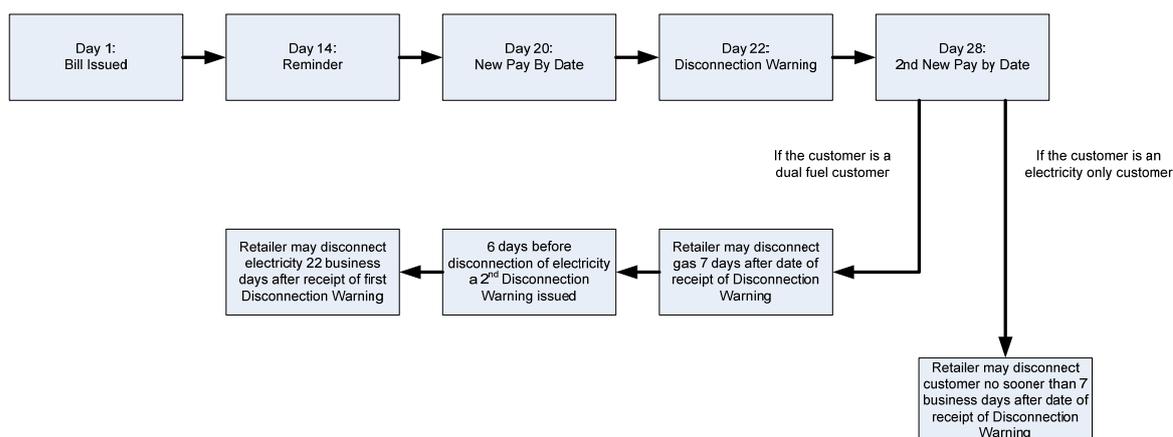
<sup>104</sup>Section 32X, FTA.

<sup>105</sup>Energy Retail Code, clause 16(a).

<sup>106</sup>*Ibid*, clause 17.

<sup>107</sup>*Ibid*, clause 13.1.

**Figure A.1**



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

- the amount payable is less than any amount approved by the Commission (this amount is not publicly available);
- the customer has made a complaint directly related to the non-payment of the bill to EWOV or another external dispute resolution body and the complaint remains unresolved;
- the customer has formally applied for a Utility Relief Grant and a decision on the application has not been made; or
- the only charge the customer has not paid is a charge not for the supply or sale of energy.<sup>108</sup>

A retailer must not disconnect a customer:

- who cannot pay due to financial hardship unless the retailer has assessed the customer's position and offered assistance (i.e. a payment plan);
- if the customer's supply address is registered by the relevant distributor as a life support machine supply address; or
- unless requested by the customer, after 2pm on a weekday, or any time on a Friday, a public holiday or the day before a public holiday.<sup>109</sup>

A retailer must pay compensation to any customer that it wrongfully disconnects in the amount of \$250 per day for each whole day the customer was disconnected.<sup>110</sup>

<sup>108</sup> *Ibid*, clause 14.

<sup>109</sup> *Ibid*, clauses 13.2 and 14.

<sup>110</sup> Section 40B of the EIA and section 48A of the GIA.

Claims for compensation are decided using the retailer's internal dispute resolution processes.<sup>111</sup> Aggrieved customers may appeal to EWOV to mediate a solution, who may refer cases it cannot resolve to the ESC.

### **Financial hardship policies**

The EIA and GIA require energy retailers to develop, publish and implement financial hardship policies and to submit them to the ESC for approval.<sup>112</sup> The legislation requires a financial hardship policy to include:

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

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

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

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

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<sup>111</sup> Marketing Code, clause 10.1 and *Operating Procedure Compensation for Wrongful Disconnection*, clause 5.1.

<sup>112</sup> Section 43 of the EIA and section 48G of the GIA.

## Information Requirements

Energy retailers are required to make information about their market offers available to customers in accordance with both the Product Disclosure Guideline and the Marketing Code. All retailers are required to produce and publish a product information statement for each of their market offers on their websites.<sup>113</sup>

A product information statement must be updated within five business days of any change to the information presented in the statement. On request, such statements must be provided in writing, and specified retailers must maintain adequate records to substantiate compliance with this requirement.<sup>114</sup>

The product information published on retailers' websites must be easy for customers to access. Where a retailer determines that there is no tariff available for the customer based on the information provided, it must communicate this to the customer. Where more than one tariff may apply, a retailer must either provide a product information statement for one of the potentially applicable tariffs or for each potentially applicable tariff or indicate that it is not clear on the basis of the information provided which product information statement applies.<sup>115</sup>

In addition to product information statements retailers must also provide an offer summary in writing to a small customer on request and when providing the customer the terms, or information about the terms, of a new retail contract. Such offer summaries must be a separate document to the full contractual terms and conditions and must include certain information, excluding the eligibility criteria and disclaimers.<sup>116</sup> Retailers may include more than the minimum information requirements in the offer summaries, although such information should be appropriate and not excessive.

The Marketing Code requires retailers to provide customers with certain information before they enter into a contract including information on billing, tariffs, rights to cancel the contract, period of the contract and a commission or fee for the market representative.<sup>117</sup>

Retailers are required to provide the customer with a reasonable opportunity to consider this information before entering into the contract. After a customer has entered into a contract, retailers are required to send the following information to the customer within two business days, unless already provided:<sup>118</sup>

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

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<sup>113</sup> Product Disclosure Guideline, clause 2.4.

<sup>114</sup> *Ibid*, clause 2.6.

<sup>115</sup> *Ibid*, clause 2.3.

<sup>116</sup> In relation to any fixed fees or charges relating to the supply of energy, the offer summary must also include the number of days in the period to which the charge relates.

<sup>117</sup> Marketing Code, clause 6.3.

<sup>118</sup> *Ibid*, clause 6.3.

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

In addition to the obligations around marketing activity, retailers must also obtain explicit informed consent before transferring a customer to a market contract.<sup>119</sup> The ESC considers consent to be explicit and informed where it is given in writing, electronically or verbally, and where the retailer has fully and adequately disclosed, in plain English, all matters relevant to the consent such that the customer was likely to be aware of what the consent applied to.<sup>120</sup> Retailers are required to keep a record of any explicit informed consent given by a customer for at least as long as the retailer has any related contract with the customer.<sup>121</sup>

In addition to the above, retailers must also include at least the following information in a customer's bill:<sup>122</sup>

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

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<sup>119</sup> Marketing Code, clause 7.1.

<sup>120</sup> Essential Services Commission, *Guideline No. 10 Confidentiality and Informed Consent Electricity and Gas*, May 2002, clause 5, pp. 8-9. A customer will not be considered capable of giving consent if he or she is not capable of understanding issues, forming views based on reasoned judgement and/or communicating his or her decision. Minors are assumed not to be competent to provide consent unless the retailer can establish that the preconditions to the validity of such a contract are satisfied.

<sup>121</sup> *Ibid*, clause 6, pp. 9-10.

<sup>122</sup> Energy Retail Code, clause 4.2

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

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

The Energy Retail Code requires retailers to provide a copy of their charter upon a customer’s request and at the time of commencement of a new energy contract or transfers to the retailer from another retailer.<sup>123</sup> The charter must contain all details of the rights, entitlements and obligations of retailers and customers. Further to this, retailers must provide copies of the Energy Retail Code upon request and also provide non-English or large print versions upon request.

A retailer must provide information to a customer on tariffs the retailer may offer to the customer as well as any variation to tariffs that may affect the customer.<sup>124</sup>

The FTA contains reference to contract cancellation periods.<sup>125</sup> Pursuant to the FRA, the Energy Retail Code details the specifics of a “cooling off” period as they apply to energy customers.

The Energy Retail Code states that following signing of a contract, a customer has between 5 to 10 business days to cancel a new energy contract.<sup>126</sup> The shorter time frame applies to an energisation contract (for electricity) or a supply point unplugging/installation for gas. The 10 business day period applies to all other contracts.<sup>127</sup>

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<sup>123</sup> Energy Retail Code, clause 26.2.

<sup>124</sup> *Ibid*, clause 26.4.

<sup>125</sup> Section 63, FTA.

<sup>126</sup> Energy Retail Code, clause 23.1.

<sup>127</sup> *Ibid*, clause 23.1(b).

## Marketing Conduct

The Marketing Code reproduces key provisions of the TPA and FTA, specifically those provisions covering misleading and deceptive behaviour and unconscionable conduct. Further, it supplements these legislative requirements by addressing such matters as training and auditing.<sup>128</sup>

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

- Refrain from engaging in misleading or deceptive conduct, unconscionable conduct or making false or misleading representations;
- Ensure that all relevant facts are provided and are not exaggerated, use words and images that promote customer comprehension and use best endeavours to ensure that information provided to customers is truthful and when supplied directly to individual customers, relevant to that customer's circumstances;
- Ensure that any comparisons made are clear, factually correct and easily understood by customers and that they do not omit important information that should be disclosed;
- Ensure that the inclusion of rebates and/or concessions is made clear to customers and any prices that exclude rebates and concessions be disclosed;
- Provide specific information to a customer before they enter into a contract and provide the customer with a reasonable opportunity to consider this information;
- Comply with the restrictions placed upon off premises marketing as laid down in the Fair Trading Act, with certain further defined provisions,;
- Comply with the restrictions placed upon telephone marketing as laid down in the Fair Trading Act, with certain further defined provisions;
- Maintain "no contact" lists of customer who do not wish to be contacted by marketing representatives; and
- Maintain records of all off-premises marketing visits and all phone marketing calls.<sup>129</sup>

The requirement for electricity retailers to abide by the Marketing Code is a component of standard electricity retail licences<sup>130</sup> and standard gas retail licences.<sup>131</sup> The administration and implementation of the Marketing Code is the

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<sup>128</sup> Marketing Code, Introduction 1.1.

<sup>129</sup> *Ibid*, clause 5.

<sup>130</sup> See for example the electricity retail licences, available at [www.esc.vic.gov.au](http://www.esc.vic.gov.au), for TRUenergy (clause 14.1(d)), Origin Energy (clause 14.1(d)) and Dodo Energy (clause 15.1(b)(viii)).

<sup>131</sup> See for example the gas retail licences, available at [www.esc.vic.gov.au](http://www.esc.vic.gov.au), for AGL (clause 15.1(f)), Dodo Energy (clause 17.1(g)) and Origin Energy 15.1(f).

responsibility of the ESC.<sup>132</sup> Customer redress is provided through retailers' internal dispute resolution mechanisms and, if not resolved internally, by EWOV.

### *Marketing representative training*

The Marketing Code requires retailers to take all reasonable steps to ensure that their marketing representatives have adequate training in and understanding of the Marketing Code as well as an understanding of:<sup>133</sup>

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

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

### *Consent audit*

The Marketing Code requires retailers to conduct an annual consent audit of customers who have entered into a contract with the retailer.<sup>134</sup> The audit requires retailers to contact randomly selected customers who have entered into a contract with the retailer within the past 14 days and ask them if:

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

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<sup>132</sup>Marketing Code, clause 1.1.

<sup>133</sup>*Ibid*, clause 4.1.

<sup>134</sup>*Ibid*, clause 7.3

The audit must be conducted during periods of marketing activity.

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

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

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

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

### **Complaint Procedures**

Retailers are required to have an internal process for handling customer complaints arising from the retailer's marketing activities. This process is to comply with the Australian Standard of Complaints Handling and must be provided to customers at no cost.<sup>135</sup>

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

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

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

EWOV has power to handle complaints made against gas and electricity companies. Energy legislation<sup>136</sup> in conjunction with retail licences<sup>137</sup> requires licensees to enter

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<sup>135</sup> *Ibid*, clause 1.1.

<sup>136</sup> Section 28 EIA, section 36 GIA.

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

On receipt of a customer complaint, EWOV must confirm that the retailer has had the opportunity to consider the complaint. EWOV may make a binding determination (for example, that a retailer pay compensation, provide the relevant energy services or amend a charge in relation to a service).<sup>138</sup>

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<sup>137</sup> For example, clause 16 of Origin Energy's electricity retail licence ("Dispute resolution").

<sup>138</sup> EWOV does not have jurisdiction to handle complaints about certain matters (such as the setting of prices or tariffs, any matters specifically required by legislation to be considered by the ESC or events beyond the reasonable control of a retailer).

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