Submission to

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

Consumer Action Law Centre
Consumer Utilities Advocacy Centre

March 2014

The Consumer Action Law Centre (**Consumer Action**) and the Consumer Utility Advocacy Centre (CUAC) welcome the opportunity to comment on the Australian Energy Market Commission's (**AEMC**) *National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014 Consultation Paper* (**Consultation Paper**) which is as a result of a rule change proposed jointly by our two organisations.

We have provided a response to each of the questions in the Consultation Paper below and we look forward to the ongoing discussions in relation to unilateral variations under fixed term contracts and a focus on how to ensure a fairer market for consumers.

Assessment Framework

Question 1 - NERO test
Are there any other matters that the AEMC should consider in its assessment of the NERO test?

Question 2 - Consumer protections test
a) Is the scope of the consumer protections that the Commission intends to consider appropriate for this rule change request?
b) Should the Commission consider any other factors in assessing the rule change request against the consumer protections test under the Retail Law?

In the consultation paper, the AEMC seems to consider the 'NERO test'[1] and the 'consumer protections test'[2] to be two separate concepts. However, on a plain reading, the rule change test is a **singular** test that requires the AEMC to satisfy itself that the proposed rule is likely to contribute to, or achieve, the NERO. In assessing the likely contribution to, or achievement of, the NERO, the AEMC:

- may give weight to any aspect of the NERO it considers necessary;
- where relevant, must satisfy itself that the proposed rule is compatible with the development and application of consumer protections; and
- must have regard to any relevant MCE statement of policy principles

The NERO is to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy. The AEMC must consider the NERO and in doing so it may give the necessary weight to its different components, it may satisfy itself that the proposed rule is compatible with the development and application of consumer protections if it considers them relevant, and it must have regard to any relevant MCE statement of policy principles. The AEMC's discretion is limited to the weight it gives to components of the NERO (eg. Price) and whether it considers the development and application of consumer protections to be a relevant consideration.

[1] Consultation Paper, p 21
[2] Consultation Paper, p 24

The AEMC has already stated in the consultation paper that consumer protections are relevant to this rule change.[3] We strongly support that finding, but note that the proposed rule change is not only about improved consumer protection but also aimed at improving competition in retail energy markets. Indeed, it is our view that the improved protection being sought is a necessary precursor to effective competition and that it is effective competition that drives efficiency in the operation of energy services (a key aspect of the NERO). This is because the protection is designed to support consumer participation in a way that enables consumers to "activate" competition.

In her 2006 lecture, 'The interface between consumer policy and competition policy', Louise Sylvan discussed 'the category of consumer protection that might be best described as consumer empowerment'. She stated:

> *It is the analysis that addresses not the question of 'what does competition do for consumers?' but the equally crucial question of 'what do consumers do for competition?' I call this area of inquiry 'economics for the demand side'. Competition policy is concerned with the supply side structure of markets and the behaviours of firms. Consumer policy starts from the position that the structural soundness of markets should be being properly attended to, and focuses on a well-informed understanding of what's happening on the demand side.*
>
> *We have all observed markets where consumers seem entirely capable of driving competition, while in other markets, consumers appear to have serious difficulty or some consumers appear to have difficulty. I take it as a given that without consumers activating competition, you don't have competition. As Ron Bannerman has put it so concisely 'Consumers not only benefit from competition, they activate it, and one of the purposes of consumer protection law is to ensure they are in position to do so.'*[4]

In the second reading speech enacting the retail rule-making test, the relevant Minister made a similar point:

> *The long-term interests of consumers of energy require the economic welfare of consumers, over the long term, to be maximised. The long term interests of consumers in competitive energy markets are promoted through the application and development of consumer protections to enable customers to participate in the market with confidence, support effective consumer choice and ensure ongoing access to energy on reasonable terms as an essential service.*

It is from this demand-side perspective that we submit that the NERO test should be applied.

Other than the limited guidance in the second reading speech, the phrase 'development and application of consumer protections' is not defined in the NERL. Given this, the AEMC proposed the following scope in its consultation paper:

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[3] Consultation Paper, p 25

[4] Louise Sylvan, Deputy Chair, Australian Competition and Consumer Commission, Consumer Affairs Victoria Lecture, 2006, available at: https://www.accc.gov.au/system/files/The%20interface%20between%20consumer%20policy%20and%20competition%20policy.pdf

- relevant consumer protections provided within the National Energy Customer Framework (NECF);
- relevant consumer protections under the general law (for example, the ACL);
- relevant consumer protections provided under retail energy laws and regulations of jurisdictions participating in the NECF (which currently includes Tasmania, the Australian Capital Territory, South Australia and New South Wales); and
- to the extent relevant and to be given appropriate weight, relevant consumer protections under the retail energy laws and regulations of jurisdictions not yet participating in the NECF (which currently relevantly includes Queensland and Victoria).[5]

We submit that it is open to the AEMC to consider and rely upon other evidence in considering 'the application and development of consumer protections', such as evidence from international jurisdictions or relevant consumer protections operating in Victoria (including under the previous *Fair Trading Act* 1991 (Vic)). In this regard, we note that the Productivity Commission, prior to the amendments of the *Trade Practices Act 1974* (Cth), looked to European jurisdictions when it prepared its Review of Australia's Consumer Policy Framework.[6] In this submission, we will refer to consumer protections, including case law, that have arisen from a broader set of jurisdictions.

[5] Consultation Paper, p 25-26

[6] Productivity Commission, Productivity Commission Inquiry Report (Review of Australia's Consumer Policy Framework) Volume 2, No. 45, 30 April 2008 (**Productivity Commission Report**), p 141

Allocation of Costs and Risks

Question 3 - Risk allocation in market retail contracts
Do the current rules result in an inefficient allocation of risks between retailers and consumers in retail energy markets?

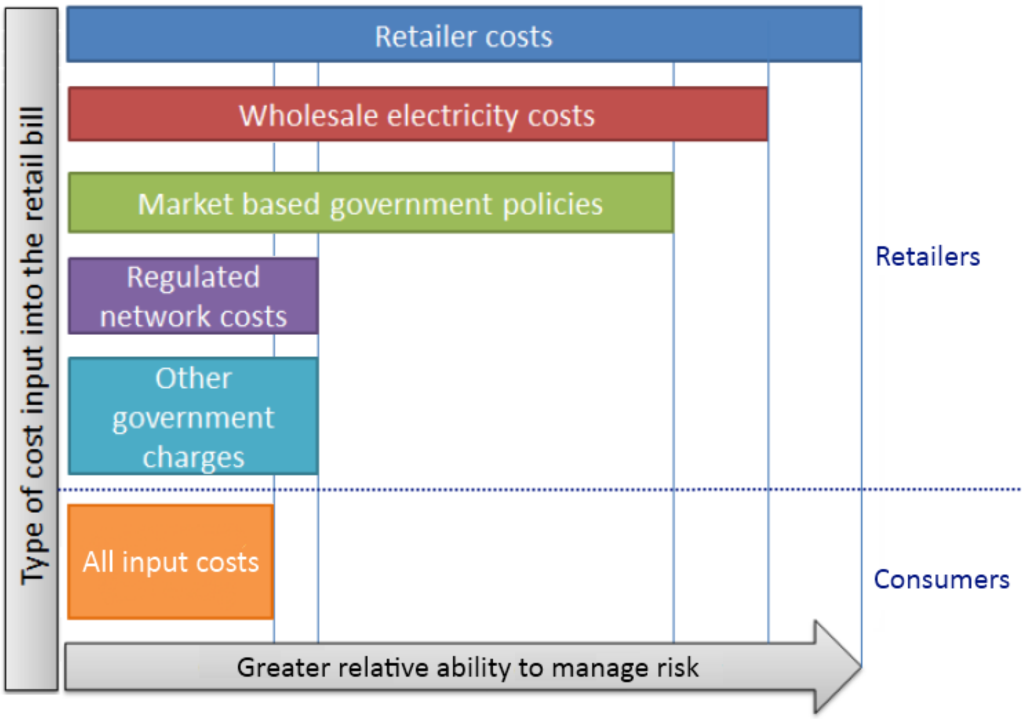
Yes, the current rules result in an inefficient allocation of risks between retailers and consumers in retail energy markets. Retailers would more efficiently manage risks that consumers currently bear.

As CUAC and Consumer Action argued in our rule change proposal, and as the AEMC has recognised in its Consultation Paper, it is economically efficient that the party most willing and able to manage risks does so. As the AEMC puts it, risks should be allocated "to the party in the best position to minimise the costs associated with that particular risk." (p.28)

To explicate the concept underlying the phrases "most willing and able" and "best position", the key consideration for efficient risk allocation is parties' ability to manage risk *relative to each other.*

The AEMC rightly recognises that retailers have different relative abilities to manage different types of risks; these are described in Section 5 of the Consultation Paper, and illustrated in Figure 5.2 (p.31). However, we consider this analysis is incomplete, as it should properly include the relative ability of consumers to manage each risk. We extend the AEMC's analysis in Figure 1, below.

Figure 1: Relative ability of retailers and consumers to manage different cost components in a retail electricity bill



The clear conclusion of the analysis illustrated in **Figure 1** is that retailers have greater ability, relative to consumers, to manage all input cost risks, and it would therefore be economically efficient for retailers to bear them.

We agree with the AEMC that the range of energy market offers currently available allocate different degrees of risk to consumers (p.35). However, we reject any suggestion that, therefore, the market is functioning well by enabling consumers to select products that reflect their desired level of risk.

Firstly, most consumers have a limited understanding of the risks affecting inputs to retail bills. The ABS in 2011-12 found that approximately 44% of Australians aged 15 to 74 years have literacy skills at levels that mean understanding the most basic level of information presented in the form of energy prices and contracts would be inaccessible to the majority of them.[7] And in a 2012 survey commissioned by CUAC, only 53% of Victorian consumers knew of retailers' powers regarding unilateral price variation.[8] Further, a recent survey of electricity consumers in Victoria showed that many consumers are unaware even of the identity of alternative retailers.[9] The likelihood that consumers generally are aware of the risk profiles of different market offers is very low.

Secondly, to the extent that consumers are aware of contracts' different risk profiles, they reject the current allocation of risks to consumers: CUAC's 2012 survey found 86% considered unilateral price variation clauses unfair, and 94% supported removing them; 94% of survey respondents, in effect, supported change contracts' risk profiles so that retailers – and not consumers – bear the risks. This does not support the thesis that the market is currently well-structured or allocating risk efficiently.

[7] ABS 4228.0 - Programme for the International Assessment of Adult Competencies, Australia, 2011-12
[8] CUAC (2012) Fixing Up Fixed Term Contracts for Energy Customers
[9] Wallis (2013) Victorians' Experience of the Electricity Market, p.8

Question 4 - Risk premiums

a) If the proposed rule is made, would risk premiums be built into fixed period contracts?

b) How significant would these risk premiums be and would these risk premiums create a permanent increase in the price of fixed period contracts?

CUAC and Consumer Action agree with the AEMC that our proposed rule would require retailers to bear additional risks (versus their current situation), and face some costs in managing those risks. We consider it likely that retailers would seek to pass a portion of those costs on to consumers, depending on the competitive pressure they face.

The precise costs to retailers of managing pricing risks are best known to the retailers. However, the Essential Services Commission of Victoria (ESC) in 2006 conducted a review of Early Termination Fees (ETFs), which included assessing hedge book imbalance costs—a form of wholesale price risk management.[10] The ESC found that a reasonable allowance for administration and hedge book imbalance costs together was no more than $20.[11] Earlier work by Intelligent Energy Systems put the cost of hedge mismatch risk for electricity at approximately $1/MWh,[12] an insignificant proportion of total electricity supply costs.

In a supplementary 2009 report on ETFs, the ESC engaged a consultant to provide independent economic analysis and advice on retailer hedge book imbalance costs. The consultant advised that these hedging costs should not be material.[13]

Other types of risk, such as regulated network costs or government charges, may be more costly for retailers to manage, and give rise to a material risk premium. We do not expect these risk premiums to be of a much greater magnitude than hedge book imbalance costs.

In all cases, an eventual risk premium charged by retailers should not automatically be considered an increase in costs for consumers, as consumers currently bear the costs of managing the risks themselves. The *net* change in consumers' costs should be considered: the difference between the retailer risk premium and the costs consumers currently bear. Given retailers' ability to more efficiently manage risk, the net cost to consumers should be negative, i.e. a saving. The risk premium would be analogous to an insurance payment, for the purchase of insurance against price changes.

Initially, risk premiums would increase the price of fixed period contracts. However, as retailers improve their processes for managing the new (to them) risks, they can be expected to do so more efficiently and reduce their risk premiums. Vigorous and effective competition

[10] Essential Services Commission (2006) Final Decision: Early Termination Fees
When a customer enters an energy contract with a retailer, retailers do not expose themselves to the risk of purchasing all the energy for that customer on the spot market. Instead, retailers will hedge against the energy they expect the customer to consume during the contract. The costs of the hedging form the hedge book. Should a customer leave the retailer before the end of the contract, there will be an imbalance between the amount of energy the customer has consumed (and paid for) and the amount of energy the retailers have paid to hedge. The difference in these amounts lead to hedge book imbalance costs.

[11] Ibid, p. 5-6. The ESC considered three-year contracts.

[12] Ibid, p. 13

[13] ESC (2009) Early termination fees compliance review supplementary report, p. 13

between retailers should also see risk premiums driven downward. Additionally, exposure to e.g. network pricing risk might encourage retailers to engage with the process of network price regulation, and put downward pressure on network prices. Shifting risks to retailers may not just lead to lower costs for *managing* risks, but also to *lower* (magnitudes of) risk.

Consumer Participation and Engagement

Question 5 - Transparency and market retail contracts
a) When entering fixed period contracts, do some consumers believe that the prices will be fully fixed when in fact they are not? If so, what proportion of consumers are likely to fall into this category?
b) Are there some consumers that are not aware that fixed period contracts with fully fixed prices are available on the market? If so, what proportion of consumers are likely to fall into this category?

The manner in which products are marketed is fundamental to consumer understanding of a product. Simple omission (without a reasonable expectation to inform) or poor (purposeful or otherwise) communication of terms and conditions is unlikely to amount to misleading or unconscionable conduct. We refer to the relevance of these provisions in response to question 11 below.

The ways in which consumers interact with the market fall into few categories. Broadly, consumers are approached directly by retailers (largely via door to door sales or other direct sales mechanisms), consumers actively seek out offers they have seen advertised (potentially via a search function), or consumers engage as they move residences.

Until recently, door to door sales have been the most significant driver of switching across the NEM in an area—energy—that is otherwise defined as a low engagement product. Door to door sales, unless provided by a brokering service (and even these have considerable limitations), means consumers are likely to be marketed a single contract. In addition, the high pressure nature of door to door sales and the documented history and legal action in relation to misleading and unconscionable conduct,[14] would suggest that many consumers who are sold fixed term contracts are unlikely to be aware of the terms and conditions of the contract they are signing, particularly as it is often not until *after* the point of sale that consumers actually receive the detailed terms and conditions. As a consequence, there is a high probability that the majority of consumers are *not aware* there are fixed period contracts with fixed prices available on the market. Indeed, the 2013 Wallis survey of electricity consumers in Victoria showed that many consumers are unaware even of the *identity* of alternative retailers, let alone their product offerings.

Further, as detailed in our rule change proposal, there are an array of reasons cited by contract terms and conditions which provide the basis for varying a tariff: Some cite the meter type needing to be correct, or if it changes from accumulation to interval; many cite increases to the Consumer Price Index, changes to wholesale costs or distribution pass throughs; and one retailer's contract provides that prices may vary simply because of their operating costs. As such, even if consumers are aware of the right to vary the tariff, the variation in bases for such right is likely to mean that consumers do not understand when or

[14] ACCC "Australian Power and Gas ordered by consent to pay $1.1 million for door to door sales conduct" http://www.accc.gov.au/media-release/australian-power-and-gas-ordered-by-consent-to-pay-11-million-for-door-to-door-sales-conduct - accessed 17 March 2014

how it will be exercised. Moreover, the lack of comparability between offers generally suggests that consumers could be easily forgiven for not having a sensible or accurate understanding of what a reference to ‘fixed’ actually pertains to. Given the low literacy rates among consumers,[15] combined with the complexity of market arrangements and number of potential offers available to consumers, we reiterate the findings of CUAC's research: the most important factor affecting consumer participation is limited capacity; individuals, unlike businesses, cannot bring specialised resources to bear on their decision making in a particular market.[16]

For those consumers who actively seek a retail product, finding the most suitable plan would realistically still require visiting multiple websites to make sure he/she wasn’t getting poor recommendations—hardly an optimal result. We explore this further in our rule change proposal, however, to summarise: consumers, as a result of such a search, would likely find themselves with a range of offers that are inconsistent and difficult to assess for suitability, having to consider a range of factors such as tariffs, discounts, bill estimates and any potential savings. To demonstrate this, the My Power Planner website provided through the Victorian government for the Victorian jurisdiction only, is estimated to have 3,500 offers available to consumers at any one time, and when the search function is enabled, consumers will often find between 120 and 250 offers applicable to their individual circumstances. This reinforces the immense task facing even those consumers who are willing to engage proactively in the market.

Further, there are still significant limitations in commercial energy switching and comparator services. Research undertaken by CUAC suggests that although consumers can find savings using these services, there can be problems with their accuracy, transparency, and consistency.[17] Consumers cannot be confident they are getting the best deal unless they use multiple services, and they can be difficult to compare. Further, it is our understanding that commercial energy switching services rarely specifically bring to the attention of a consumer the right of a retailer to unilaterally vary the price.

It is in the nature of complex offerings that consumers would likely interpret fixed terms to be linked with a fixed tariff, for it is likely to be unclear what other benefit might justify signing on to a contract. Certainly, once the first price rise is applied to their bill, any plan that was appropriate at the time of signing can easily become inappropriate due to retailers’ ability to unilaterally vary prices within a contract even where the customer has signed for a fixed period.

Of particular concern is the extent to which low income and vulnerable consumers are able to benefit from choice, given the complexity of the market and access to appropriate information—and, in the context of significant price increases, their ability to maintain access to supply. Our experience indicates that vulnerable consumers have additional information needs and often lack the means to gain access to that information, as they may have limited access to computers and the internet.

[15] ABS 4228.0 - Programme for the International Assessment of Adult Competencies, Australia, 2011-12
[16] CUAC (2011), Improving Energy Market Competition through Consumer Participation: A research report.
[17] CUAC (2011), Energy Switching Sites: A briefing paper.

We encourage the AEMC to explore how a consumer may easily gain access to transparent contract information more fully.

Question 6 - Barriers to consumer participation and engagement
a) Does the ability for retailers to vary prices lead to a perception for consumers that changing to a new retailer or contract would waste search costs?

The measurement of consumers' perceptions of whether they believe a retailer's unilateral right to vary contract prices would result in them wasting search costs is difficult to establish. However, we believe that there *are* consumers that would think there's little point changing retailers due to the wasted search costs if a retailer simply changes prices.

Behavioural economics suggests that a consumer is not necessarily likely to switch within the market should a fixed contract term period end, "as sometimes the transaction costs and/or the switching costs associated with finding an alternative retailer exceed any benefit available from change, especially as search tends to be a sunk cost".[18] Or alternatively, given the market complexity present in Victoria consumers may view market choice as just too hard. Further, consumers have bounded rationality and one of the responses in such situations is to remain with the status quo.

The classification of 'search costs' is also difficult to define, for it equates to the time a consumer may invest into a process, and the value a consumer places on their time is relative to each individual. We certainly can suggest that the amount of time a consumer may invest in actively searching for an alternative offer would be undermined should a retailer raise its prices once a consumer has decided upon a certain product, at a certain price and as per the efforts of Victoria's Chair of the Essential Services Commission, the time he, as an informed consumer took to find an optimal offer for him.

> *" To begin, Dr. Ben-David spent 5-6 hours digging out several years of past bills and aggregating the data into a useable spreadsheet. Constraining his search to switching sites that neither wanted his contact details nor proved too confusing or difficult to navigate, he soon found himself "overwhelmed by a plethora of electricity plans, discounts, special offers, bill estimates and claimed savings—with none of the sites seeming to agree on which retailer and which offer was best, or*
>
> *After 10-12 hours establishing the top 5-6 recommended offers, Dr. Ben-David then turned to the retailers' websites to answer the question, "What would I be paying if I signed up with you?". In a further 5-6 hours of searching, Dr. Ben-David encountered opaque discount claims, difficult-to-find and unhelpful product disclosure statements, and very little clarity around what his prospective tariffs would actually be."*

Approximately 20 hours later, this informed consumer was clearly still at a loss as to whether he had made the right decision.

Should Dr Ben-David wish to place a value, monetary or otherwise, on the 20 hours he invested in searching for an optimal offer, it may well exceed his reasonable expectations for pursuing another deal and he may think it was a waste of time/money/other, thereby acting as a deterrent to further switching.

[18] Sunk costs are those costs incurred in entering an industry which cannot be recouped on exit.

b) To what extent might the existence of exit fees and other transaction costs affect consumer behaviour after a price variation in a fixed period of a *market retail contract*?

As discussed in our rule change Proposal, many fixed term contracts impose significant exit fees. These exit fees, although limited under the NERR to the reasonable costs incurred or to be incurred by the retailer (and do not include costs based on lost supply or lost profits), can discourage consumers from switching to another provider, thereby discouraging competition. Similar limitations in Victoria mean that exit fees of over $100 can be imposed, depending on the length of the contract and its features. By imposing exit fees, in addition to retaining the right to vary the price or tariff included in the contract, energy retailers can effectively shield themselves from much of the risk of varying costs incurred for the delivery of energy services. Managing risk on behalf of customers is a key role of energy retailers and this shifting of risk to consumers can result in consumer detriment and lead to an erosion of confidence in the competitive market.

In a scenario where unilateral price variations are allowed but exit fees are eliminated (or where exit fees are waived should a retailer exercise its right to unilaterally vary the price), while consumers *may* be more likely to switch retailers, search costs, trust, and perceptions of fairness would not be improved. To the extent that consumers are still unlikely to switch, retailers will continue to offer low (below equilibrium) initial rates followed by unilateral escalations, creating a deadweight loss.

Active customers who switch when price rises are announced may be able to collect consumer surplus from producers over several contracts (depending on switching costs). However, to the extent that consumers are still unlikely to switch, all other outcomes from the scenario are likely to remain.

In considering this issue further, we would encourage the AEMC to engage experts in the area of behavioural economics and consumer psychology when assessing costs affecting consumer behaviour. In implementing regulations that are designed to affect or deal with consumer behaviour in the marketplace, it cannot be assumed that consumers will behave rationally.

This has been recognised by other regulators, most recently the Chairman of the Australian Securities & Investments Committee in his speech to the 2014 ASIC Annual Forum. He states:

... regulators around the world are considering behavioural science, and insights from it, to better understand how investors [consumers] really behave. For example, over and over behavioural research shows that consumers:

- *have a bias towards the default option*
- *prefer a small reward today over a larger one later*
- *tend to disengage when faced with complexity and too many options, and*

- *are influenced by nudges, framing and, most importantly, their relationship with the person delivering the message.*[19]

We submit that in this rule change, and in its work on retail markets more broadly, the AEMC needs to give consideration to this significant body of work on actual consumer behaviour. Without such research and understanding, rules that are designed to empower consumers, thereby improving competition and efficiency (in line with the NERO) risk having limited or no effect. Reliance on disclosure in a number of markets to the problems caused by asymmetrical information is a case in point.

[19] Greg Medcraft, 'Regulating for Real People', Address to ASIC Annual Forum 2014, http://asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-Forum-2014--Opening-address--24March2014.pdf/$file/ASIC-Forum-2014--Opening-address--24March2014.pdf.

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

a) Would the proposed rule improve the level of consumer participation and engagement in retail energy markets?

The proposed rule would improve the level of consumer participation and engagement in retail energy markets—indeed, we submit that this would be the primary outcome should the rule change proceed.

The rule will facilitate more transparent market contract offers and a clearer understanding amongst consumers of exactly the product and price they are signing up for. This will foster more informed decision making amongst consumers (increasing market efficiency) but also greater trust amongst consumers in the product they are signing up for (and by extension, the energy company).

We note that consumer trust and confidence in energy retailers is very low. For example, we understand that consumer complaints to the Energy and Water Ombudsman Victoria are set to reach 100,000 this year, up from 77,149 in 2012/13, the vast majority relating to retail energy businesses. This amounts to one complaint per twenty-five households in Victoria. There have also been increases in complaint levels in other states—in NSW, the Energy and Water Ombudsman NSW recorded a 45per cent increase in cases in 2012/13;[20] in South Australia, the Energy Industry Ombudsman SA recorded a 47 per cent increase in cases in the same year.[21]

Independent research has substantiated this, finding that the industry least trusted to act in the public interest being the power industry (18 per cent), less than media (30 per cent), mining (32 per cent) and banking (33 per cent).[22]

The proposed rule would ensure that energy retailers commit to only charging the price that it quotes over a period of a fixed period contract. We submit that this would contribute to improving consumer trust and confidence from these very low levels.

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

As outlined above, the proposed rule would simplify the information available to consumers in relation to the price they would pay for energy. By removing the ability to unilaterally vary prices within a fixed period contract, the prices offered within market contracts will be more reflective of the true cost of energy supply (recognising that some companies may build in a risk premium). This would thereby introduce more standard contract offerings that will help consumer understanding, and promote their engagement and participation in the market.

Together with the increased transparency of the offer, and going some way to correcting the power imbalance between consumers and retailers, the removal of the right to vary prices within a fixed period contract will lead to increased competition for informed consumers which, all other things being equal, will put downward pressure on energy prices.

[20] EWON, Annual Report 2012/13, available at: http://www.ewon.com.au/ewon/assets/File/Media%20release_AR2012-2013.pdf

[21] EIOSA, Annual Report 2012/13, available at: http://www.eiosa.com.au/images/publications/EWOSA_REPORT_2013.pdf.

[22] Essential Report available at: http://essentialvision.com.au/trust-in-industries.

Competition Between Retailers

Question 8 - Competition between retailers
a) How would the proposed rule affect larger retailers compared to smaller retailers?
b) Would the proposed rule make it more difficult for new entrants to enter retail energy markets?

CUAC and CALC agree with the AEMC that effective competition in retail energy markets requires a range of retailers to participate. We are keen for all jurisdictions that have retail contestability to have sufficiently strong competition to satisfy consumer preferences and drive costs and prices to the optimal level.

Our proposed rule may lead to retailers bearing risks that larger retailers are in a better position to manage than smaller retailers, should each be offering fixed period contracts. However, there is no obligation for retailers to offer fixed period products. In Victoria, the retailers Alinta, Dodo, and Powershop do not offer plans with fixed period contracts[23]—indeed, Powershop offers no 'plans' in the traditional sense at all. As a counterpoint, at least one smaller (non-incumbent) retailer, Red Energy, is able to offer fixed period, fixed price contracts.

With examples of small retailers offering fixed period fixed price contracts, or forgoing fixed period contracts entirely, we do not believe our proposed rule would make it significantly more difficult for new entrants to enter retail energy markets.

Finally, the purpose of energy retailers is to manage energy risks on behalf of consumers. If a potential new entrant is discouraged by that requirement, then it is perhaps appropriate that they do not enter the market – the benefits to consumers of a new entrant who makes consumers bear price risks (in fixed period contracts) may be less than the benefits of fair, equitable, and efficient contracts with existing retailers. In some senses, the requirement to fix prices during fixed period contracts is analogous to requirements that retailers offer legislated customer protections: the protections may be an impost on retailers and be more easily managed by larger than smaller retailers (e.g. hardship programs), but it is in the long-term interest of consumers that they be in place.

[23] For postcode 3000, as at 13/03/2014

Question 9 - Innovation in retail market offers

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

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

If the proposed rule is made, retailers will face higher costs than currently for fixed period contracts, as they bear the costs of managing price risk. However, as discussed in the answer to Question 4, it is likely that retailers will pass on these risk management costs via a risk premium, and as such will not face significantly higher net costs. Given that retailers will not face higher net costs in providing fixed period contracts, there is no reason they should be likely to withdraw fixed period offers.

We recognise that the costs of managing risks will rise the further into the future one seeks to fix prices. It is possible that retailers could regard the premium for managing fixed period risk of e.g. three-years as higher than consumers are willing to pay, and will therefore cease to offer three-year fixed period contracts. However, this outcome is no worse than the current situation: if consumers would be unwilling to bear three-year risks when the management costs are explicit, it would not be an improvement for them to (continue to) implicitly bear those risks.

It is also possible that some retailers may withdraw or offer shorter fixed period contracts from the market if their risk management costs are not competitive with other retailers. We have addressed such concerns in our answer to the previous question, but emphasise that a market is not improved by setting its parameters to accommodate the lowest-performing participants.

In general, however, a reduction in the range of market offers is not a reliable indication that competition has decreased. Effective competition requires a range of offers to meet different consumers' needs, but too large or complex a range will hamper, rather than aid consumers in selecting the best offer for them. From the Victorian Government's My Power Planner website, we are aware that there are 3,500 offers available on the market, of which 120-250 will be relevant to any given consumer. It is unlikely that all of these offers are necessary for effective consumer choice.

Any reduction in offers due to our proposed rule is likely to reflect more effective competition, rather than less competition, as sub-optimal offers are withdrawn from the market and those that best meet consumer needs remain. There should thus be no significant upward effect on prices in retail energy markets over the long term from our proposed rule.

Consumer Protection Issues

Question 10 - Application of the unfair contract terms provisions in the ACL
a) If the unfair contract terms provisions in the ACL generally apply to price variation clauses in *market retail contracts*, should these provisions be relied on to address the issues raised by CALC and CUAC?
b) Should changes be made to the retail rules to clarify whether the unfair contract terms provisions in the ACL apply to price variation clauses in *market retail contracts*?

The provisions relating to unfair contract terms are set out in Part 2-3 of the ACL. The key provision is subsection 23(1):

> *A term of a consumer contract is void if:*
> *(a) the term is unfair; and*
> *(b) the contract is a standard form contract.*

Unlike the NERL, which extends the definition of a small customer to either a residential customer or a business customer, the unfair contract terms provisions of the ACL only apply to consumer contracts for the supply of goods and services to an 'individual whose acquisition of the good or services is wholly or predominately for personal, domestic or household use or consumption'.[24]

We note, however, it is current Federal Government policy to extend the unfair contract term provisions in the ACL to small business.[25] To be amended, this position will have to be agreed to by the Consumer Affairs Forum, which is the Ministerial Council for consumer affairs.

A term is only considered unfair where it satisfies three tests being that the term must:

- cause a significant imbalance in the parties' rights and obligations under the contract;
- not be reasonably necessary to protect the legitimate interests of the party advantaged by the term; and
- cause financial or other detriment to a consumer if it were relied upon.[26]

In determining whether a term of a consumer contract is unfair, a court may take into account such matters as it thinks relevant, but it must take into account:

- the extent to which the term is transparent; and
- the contract as a whole.[27]

[24] s 23(3)(b), ACL
[25] See 'Our Plan—Real Solutions for Australia. The directions, values and policy priorities of the next Coalition Government', January 2013, page 27.
[26] s 24(1), ACL
[27] s 24(2) ACL

Further, subsection 25(1)(d) of the ACL states that an example of an unfair term is one that permits one party (but not another) to vary the terms of the contract. In addition, s 25(1)(f) states that a term that permits one party to vary the upfront price payable under the contract without the right of another party to terminate the contract is an example of an unfair contract term.

Section 26 of the ACL

The effect of section 23 is, however, displaced and does not apply to a term of a consumer contract to the extent, but only to the extent, that the term is a term required, or expressly permitted, by a law of the Commonwealth, a State or a Territory.[28]

The meaning and effect of section 26(1)(c), and in particular, the meaning of 'expressly permitted' has not been judicially considered.

The ACL's explanatory memorandum[29] at 2.55 states that there is no presumption in the ACL that unilateral variation terms are prohibited, despite such a term being an example of an unfair term in subsection 25(1)(d). Further, the explanatory memorandum refers to other legislation where unilateral variation is expressly contemplated in a specific context. The *Uniform Consumer Credit Code*[30] was given as an example of where unilateral price variation was permitted.

Relevantly, Division 1 in Part 4 of the *National Credit Code* is entitled 'Unilateral changes by credit provider'. This Division stipulates how a credit provider may unilaterally make various changes, including interest rate changes, repayment changes and credit fees and charges changes. Taking interest rate changes as an example, under section 64 of the *National Credit Code*, a credit provider may notify a debtor of a change to the annual percentage rate or rates payable under a credit contract by giving written notice no later than the day on which the change takes effect. The notice must set out the new rates and any other information required by the regulations.

We submit that there is a distinction between this example in the *National Credit Code* and the NERR is that the National Credit Code specifies when interest rates may be unilaterally varied. Whereas the NERR only specifies what needs to occur if the electricity prices are varied. Therefore, there is no rule in the NERR which expressly permits retailers to vary prices. Rather, it is the case that the NERR simply expressly requires notice to a customer for a variation that is implicitly (rather than expressly) permitted by the NERR.

As such, if it was intended for the unfair contract term prohibition in the ACL to apply to energy market contracts, we submit that amendments to the NER would be required to clarify this effect.

However, even if such a change was made, there would remain some uncertainty about what this required in terms of price variation terms in fixed period market retail contracts. The limited case law on subsections 25(1)(d) and (f) demonstrate this point.

[28] ACL, s 26(1)(c)
[29] Explanatory memorandum to the Trade Practices Amendment (Australian Consumer Law) Bill 2009 (Cth)
[30] Previous title, now called 'National Credit Code' in Schedule 1 of the *National Consumer Credit Protection Act 2009* (Cth).

The only decided case in respect of the unfair contract terms provisions in the ACL is *ACCC v Bytecard Pty Ltd*.[31] In that case, Jessup J by consent ordered that some terms in Bytecard Pty Limited's contracts were unfair terms. Relevantly, Jessup J held that clause 1.7 of the terms and conditions of a standard form consumer contract for the supply of internet access services was unfair because it entitled Bytecard Pty Limited to unilaterally vary the amount payable under an existing contract without providing:

- prior notice;
- an opportunity to negotiate carried terms; or
- for consumers whose contract period had not yet expired, a right to terminate to avoid the obligation to pay the varied amount.[32]

Clause 1.7 of Bytecard Pty Limited's terms and conditions read:

> *NetSpeed reserves the right to change prices or services at any time without prior notice to customers or the public, except when the service is an Australian Broadband Guarantee Service. Price changes will not be retroactive for existing prepaid customers. It Is the User's responsibility to check this online.*

While Jessup J did not go so far as to say that unilateral variation in itself is an unfair contract term, the case showed that something beyond notice to the customer (namely an ability to negotiate) is required for a term to be fair.

It is clear that the NERR lacks these minimum requirements and thus they create a significant imbalance in the rights and obligations between the consumer and the energy retailer. However, retailers may seek to still impose price variation terms by complying with these requirements.

If this is the response, then consumers may still not be empowered. This is because that they will still face decision paralysis which can result in consumers either not exercising choice or staying with the default option. The paralysis will be caused by the fact that the consumer is aware that prices can be varied so that there is little point choosing a contract. If they choose a contract, and the price is varied, then they will be required to choose again, only to be faced with the same quandary. Joshua Gans of Melbourne University coined this problem under the term "confusopoly".[33] It is due to such confusopoly that we submit that the proposed rule change to disallow price variation clauses in fixed period contracts is a far preferable course of action compared to relying on the ACL.

We reiterate our comments in relation to behavioural economics in our response to question 6, and in particular the recommendation for the AEMC to develop a deeper understanding of body of research that exists on actual consumer behaviour.

[31] *ACCC v Bytecard Pty Limited* 301 FCA 2013
[32] *ACCC v Bytecard Pty Limited* 301 FCA 2013 at [1].
[33] For further discussion, see Ian McAuley, You can see a lot by just looking, Understanding human judgement in financial decision-making, Centre for Policy development, October 2008, available at: http://cpd.org.au/wp-content/uploads/2008/10/CPD_OP5_Ian_McAuley_Behavioural_Economics_Web2.pdf.

Question 11 - Misleading and deceptive conduct and other ACL provisions
a) Should the misleading and deceptive conduct provisions of the ACL be relied on to effectively address the issues raised by CALC and CUAC?

The AEMC queries in the Consultation Paper whether the misleading and deceptive provisions in the ACL apply to the conduct of retailers in varying prices during fixed periods of market retail contracts.[34]

Subsection 18(1) of the ACL states that:

> A person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

The provision is broad and establishes a norm of conduct applicable to all consumers, unlike the unfair contract terms which are limited to individual consumers acquiring wholly or predominantly for personal, domestic or household use or consumption.

The test is applied objectively by the court. However, the provisions are not designed for the benefit of those who fail to take reasonable care of their own interests.[35]

If an energy retailer has, however, labelled a contract 'fixed <u>price</u> market contract' made representations to there being no variability of the price or simply stayed silent when a costumer queried whether the price is fixed, then these activities may amount to misleading or deceptive conduct.

Conversely, a contract titled 'fixed <u>term</u> market contract' without any additional misrepresentations or omissions made by the retailer regarding pricing, is unlikely to invoke the operation of the misleading and deceptive provisions.

This type of conduct would have to induce the consumer to labour under some sort of error.[36] Irrespective of whether conduct is likely to cause confusion in the consumer, it cannot be categorised as misleading unless the consumer is actively lead into error.[37]

If a consumer simply signed the contract holding an erroneous assumption that the price was fixed without any conduct or representation by the energy retailer to induce it, then the misleading and deceptive provisions of the ACL are unlikely to apply.

Due to this, we submit that the misleading and deceptive conduct provisions do not sufficiently protect consumers who are 'confused'. Moreover, this prohibition is insufficient to empower consumers to activate competition, in a way described under question one.

Despite this, we do refer the AEMC to the relevance of the matter *ACCC v AGL South Australia Pty Ltd* (Federal Court Proceeding No. SAD355/2013). The ACCC instituted

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[34] Consultation Paper, p 51
[35] *Elders Trustee and Executor Co Ltd v E G Reeves Pty Ltd* (1987) 78 ALR 193 at 241, A*CCC v Dukemaster Pty Ltd* [2009] FCA 682.
[36] *Taco Co of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177
[37] *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191

proceedings against AGL South Australia Pty Ltd (**AGL**) on 4 December 2013, alleging AGL contravened sections 18(1) or 29(1)(g) and 29(1)(i) of the ACL. The alleged contraventions were in connection with AGL's supply, or possible supply, of electricity to residential consumers of electricity in South Australia under market contract energy plans (**Energy Plans**) which featured a discount in respect of energy usage charges.

In the ACCC's pleadings, it alleges that AGL contravened the ACL in two key ways.

First, the ACCC alleges that AGL represented to residential consumers that if they agreed to enter into an Energy Plan, they would receive a specified discount off the energy usage charges they would otherwise pay for energy supplied by AGL. Further, the ACCC alleges that at the time of increases in the rates for energy usage charges in mid-2012 and mid-2013, AGL made false or misleading representations to consumers who had entered into an Energy Plan that they would continue to receive their discount or that there had been no change to the discount, when this in fact was not the case.

Secondly, the ACCC alleges that at the time of the increases in energy usage charges in mid-2012 and mid-2013, AGL failed to disclose certain relevant information to consumers and thereby engaged in misleading and deceptive conduct. For example, AGL failed to disclose that, after the mid-2012 rate increase, the energy usage charges applicable to the Energy Plans would not be calculated by reference to AGL's standard retail contract rates.

Thus, the ACCC alleges that the relevant discount letters were false or misleading because energy usage charges were actually calculated with reference to rates that were higher than the standard retail contract rates, and their discount would be calculated by reference to these higher rates. The increases were not communicated transparently.

This case suggests that the prohibition against misleading and deceptive conduct may be relevant in relation to any representations made at the time a price is varied during a fixed period contract. It is important to note that this matter is being contested and the outcome remains unknown. Moreover, if the communication at the time the price variation was made was not misleading, for example, if the retailer did not represent that the discount remained the same or was more transparent about the nature of the change,, then there would be no unlawful behaviour. Given this, we submit that even if the ACCC is successful, this matter will have limited impact on the availability of fixed price, fixed period contracts. As noted above, without the availability of these products in the market, consumers will continue to suffer decision paralysis, and the market will not operate in a way that promotes competition and efficiency.

b) Are there any other consumer protections under the ACL that are relevant to this rule change request?

We submit that there is a range of other consumer protections that are relevant to this rule change, including:

- Victorian unfair contract terms legislation and cases determined under that law;
- The Unfair Terms in Consumer Contracts Regulations 1999 (UK); and
- Industry specific protections established by UK's Ofgem.

<u>Victorian unfair contract terms legislation</u>
Unfair contract terms have been the subject of specific regulation in Victoria since 2003.

Part 2B of the repealed *Fair Trading Act 1991* (Vic) (FT Act) was entitled 'Unfair Terms in Consumer Contracts' and set out provisions which were similar to the current provisions in the ACL. Under section 32W, a term in a consumer contract was regarded as unfair if:

> *… contrary to the requirements of good faith and in all the circumstances, it causes significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer.*

Under subsection 32X(d) of the FT Act, one of the considerations to which the court could have regard was whether the term had the object or effect of permitting the supplier but not the consumer to vary the terms of the contract.

The unfair terms provisions in the FT Act have been judicially considered on several occasions, however there does not appear to be judicial consideration of unilateral fee increases in circumstances analogous to the proposed rule change. Nevertheless, we set out the findings in some FT Act cases that could be relevant to the rule change.

Paciocco v Australia and New Zealand Banking Group Limited [2014] FCA 35
On February 2014, Gordon J handed down a judgment in Paciocco v Australia and New Zealand Banking Group Limited [2014] FCA 35 which briefly touched on unfair contract terms in the context of exception fee clauses which gave the respondent, the ANZ, the right to unilaterally vary terms of its customer contracts, which the bank admitted, occurred relatively frequently.

The Applicants consisting of Mr Paciocco and his company Speedy Development Group Pty Ltd, as representative applicants in a class action, contended that exception fees in his / its consumer deposit account and consumer credit card account were unfair contract terms under section 32W of the FTA and/or section 12BG of the Australian Securities and Investments Commission Act 2001 (ASIC Act). Proceedings were brought under these Acts as they were in place at the time the contracts were entered into and accounts established in Victoria.

In reviewing whether the ASIC Act and FTA provisions applied to the various contracts the Applicants had entered into with ANZ, Gordon J discussed the effect of legislative amendments and transitional arrangements which precluded several contracts from the provisions. However, Gordon J found that only some the exception fees in question were terms to which the FTA unfair contract terms regime could apply and that the ASIC Act regime was wholly inapplicable.

Ultimately, Her Honour rejected the Applicants' submissions alleging unconscionable conduct and unfair contract terms. In finding that the exception fees were not unfair contract terms, her Honour referred back to her reasoning for dismissing the unconscionable conduct claim:

- there was no allegation of dishonesty, oppression or abuse of a commercially powerful position and none existed;
- the ANZ disclosed the exception fees and there was no allegation that it failed to disclosed the Exception Fees when they were altered;
- there was no allegation that the Applicants were unable to understand the exception fee provisions;
- the Applicants were not compelled to enter into contracts with the ANZ and the ANZ placed no pressure on them to do so;
- the Applicants were under no compulsion to engage in the overdraw transactions and held sufficient credit under facilities in either the ANZ or other financial institution, to cover the amount by which the transaction overdrew the relevant account. It was thus wholly a matter of choice for the Applicants whether used the overdraw facility;
- further the ANZ provided a facility to “switch off” the ability to overdraw their account and thereby avoid incurring the exception fees associated with overdraw transactions;
- ANZ offered various alternative loan products to the contracts with fees structured differently to exception fees thereby offering choice to customers whilst other banks also offered similar products with different fee structures; and
- the contracts were terminable at will by the Applicants, which they could have done if dissatisfied with the exception fees and sought alternative services.

Gordon J's reasoning in relation to unconscionable conduct / unfair contract terms in respect of banking contract in Paciocco can, however, be distinguished from the situation with energy contracts. For example, while the exception fees were not unfair terms because there was no compulsion for the applicants to overdrawn their accounts, consumers of electricity programs do not have the possibility to negotiate in a unilateral price variation and further cannot terminate the contract at will without incurring fees, as was the case in Paciocco.

Director for Consumer Affairs Victoria v AAPT Ltd [2006] VCAT 1493 (AAPT)

In AAPT, VCAT noted that any imbalance between parties should be significant. However, its broader discussion on good faith focuses on the importance of 'open and fair dealing'. Arguably, the requirement under NERR to inform a customer of a unilateral price variation up to the day before the change is implemented is contrary to 'open and fair dealing' as a consumer is left with little – indeed, negligible – opportunities to avoid the variation. Indeed, in AAPT the clause enabling AAPT to unilaterally change the contract with notification of the variation was held to be unfair as it permitted AAPT but not the consumer to avoid or limit the performance of the contract. VCAT dismissed AAPT's argument that it was commercially necessary, as it re-sold services supplied by other providers, because the term was expressed broadly – it allowed AAPT to vary any term of the agreement at any time for any cause.

The Unfair Terms in Consumer Contracts Regulations 1999 (UK)

Under subregulation 5(1) of The Unfair Terms in Consumer Contracts Regulations 1999 (UK) (UK Regulations), a contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.

Schedule 2 of the UK Regulations set out terms which may be regarded as unfair. This 'indicative and non-exhaustive list' includes, under subsection 1(j), a term which has the object or effect of enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract.

Crucially, these protections apply to all contracts (except mandatory statutory or regulatory provisions) – that is, there is no exception for terms which are "expressly permitted" by other laws, that would otherwise be unfair under the UK Regulations. A contractual term must be mandatory to be exempt from this regulatory regime.

Industry specific protections: UK

In October 2013, Ofgem (the UK Office of Gas and Electricity Markets) modified gas and electricity supply licences by amending Standard Licence Condition 22C to provide that suppliers are banned from increasing prices, unless one of the prescribed exceptions in clause 22C applies. This change was made following an extensive consultation process.

The aim of the new rules and the consultation process was to enable customers to secure a better deal, and in doing so, increase the competitive pressure on energy suppliers to deliver good customer service at efficient cost.

The following industry specific consumer protections in the UK are relevant to this rule change:

- Ofgem's Standard Licence Condition 22C.9 (SLC 22C.9) containing the (partial) prohibition on increasing charges during fixed term, including relevant information from the consultation process; and
- the prescribed exceptions to SLC 22C.9.

March 2013 Review

The consultation process included the release of a publication in March 2013 titled, "The Retail Market Review – Final Domestic Proposals" (March 2013 Review). The March 2013 Review described Ofgem's views regarding current market practices, and explored why tariffs should be fixed and unilateral variations should be banned.

According to the March 2013 Review, fixed term tariffs provide predictability for the consumer in the product, which in turn improves consumer trust and understanding of the fixed term market. In Ofgem's view, the existing research suggested that consumers often felt helpless in response to price increases and other adverse unilateral variations, and may not have fully understood the extent to which a fixed term product could help mitigate such variations.

The March 2013 Review also provided analysis as to how unilateral price variations could give rise to consumer lethargy, having a negative impact on competition. It was suggested that the complexity and unknown risks of taking on a fixed term product can mean that only engaged consumers are likely to utilise these products. When combined with a complex tariff system, it was considered that many consumers were being put off from searching for better tariffs, which was leading to a lack of effective engagement with the market and an inclination by consumers to remain with their current supplier. Thus distorting the market and having a negative impact on competition.

The March 2013 Review suggested that protecting consumers from unilateral contract variations creates less risk for consumers. The proposals were designed to ensure that suppliers could not vary the terms of the contract during a fixed term without the customer's consent. This extended to protecting consumers from having fixed term contracts unilaterally extended by the supplier or being automatically rolled over and locked into a new fixed term contract upon expiration.

August 2013 Decision
As part of the consultation process, Ofgem then released "The Retail Market Review – Implementation of Simpler Tariff Choices and Clearer Information" dated 27 August 2013 (RMR August 2013 Decision). Following feedback from stakeholders in response to the March 2013 Review, this document aimed to clarify certain areas of Ofgem's proposals so as to provide suppliers certainty on the effect of the rules on their businesses. Relevant issues raised with respect to the ban on unilateral variations on fixed term supply contracts are described commencing on page 15 of the RMR August 2013 Decision and are as follows:

- One supplier argued that the ban on unilateral variations on fixed term contracts would constrain its ability to pass through costs it does not control, namely VAT and costs associated with environmental programs. Ofgem accepted the supplier's arguments in relation to VAT and an exception to SLC 22C.9 in relation to VAT was incorporated into SLC 22C.11A. However, Ofgem's view was that suppliers should be fully aware of their obligations in respect of environmental costs and estimate their costs accordingly, as they do with other costs—indeed, Ofgem's view was that suppliers should be able to price these costs into the fixed term contract to mitigate the need to vary the contract at a later date.

- As a result of the review and consultation described above, SLC 22C.9 was inserted as part of the standard licences conditions applying to UK energy retailers in October 2013. Under SLC 22C.9:
  …in relation to any Fixed Term Supply Contract, the licensee must not:
    - *increase the Charges for the Supply of Electricity (including, but not limited to, by making any reduction in the amount of a Discount that is directly applied to a Unit Rate or Standing Charge); or*

- *unilaterally vary any other terms and conditions in any way which is to the disadvantage of a Domestic Customer.*

A number of exceptions were included – we outline these in response to Question 13.

Alternative Approaches to the Issues Identified in the Rule Change Request

Question 12 - Impacts of proposed rule
a) Taking into consideration the potential benefits and costs of the proposed rule, on balance how would the proposed rule affect competition in retail energy markets?

We believe that the proposed rule would enhance competition in retail energy markets through more efficient market operation and contracting, more efficient and equitable allocation of risk, and increased long term consumer welfare.

It would improve the efficiency of market operation by discouraging retailers from setting prices below competitive levels to attract customers and charging prices above competitive levels to customers who have signed on for a fixed term. Discouraging these practices would reduce the associated deadweight losses, as consumers would be less likely to consume above or below the socially optimal levels. More transparency in contract costs should also move to rebalance the complexity of the 'contractual bargain'. This may in turn affect profits, but also place pressure on the competitive nature of the industry. Where there is effective competition in the market this should be manageable, with prices more appropriately reflecting the value of the contract and thereby driving consumer behaviour. Where businesses are unable to provide this service, their viability in the market will be exposed.

We acknowledge that energy retailers might still set prices higher than the competitive equilibrium, but this would be apparent in advance and would (ideally) be counteracted by competition between retailers.

This is particularly the case as the more certainty around the prices that consumers would face in a contract, would enhance their ability to participate with confidence in the market and would potentially overcome some of the existing barriers to switching (e.g. search costs of comparing clauses) would decrease. The effectiveness of consumer choices would be improved: without the risk of unilateral price changes, consumers' ex-ante decisions are more likely to be optimal ex-post. Consumers would perceive greater fairness in the market.

Consumers who lack the ability to adjust their usage during the term of a contract (due to e.g. lack of upfront capital or already low usage) would very likely see welfare gains versus the current situation.

Elements of price risk would be more efficiently, equitably, and properly reallocated from the consumer to retailers, i.e. from a party with limited ability and declared unwillingness to deal with risk to a party with much greater ability and high incentives to deal with risk. The reallocation would better recognise the asymmetry of information and opportunities between the various parties.

In line with this reallocation, energy retailers are likely to take greater steps to manage the risks of cost rises. This could include energy retail contracts becoming shorter. However, we note that some companies currently offer fixed-term fixed-price contracts with terms of 24 months or over (e.g. Origin RateFreeze), similar in length to many fixed term contracts *with* unilateral price variation clauses. Fewer than a quarter of residential Victorian consumers recently surveyed indicated their contracts were for longer than 24 months.[38] This suggests consumers are unlikely to experience more limited choice in energy contracts as a result of this rule change.

Indeed, material consumer choice is likely to be increased, as consumers will be able to explicitly select between fixed and variable rates. This choice is not currently clear nor widespread in the energy sector, but is something consumers are familiar with from other industries such as banking (fixed vs. variable mortgages; terms deposits vs. variable rate investments), mobile telephony ("capped" plans, while not strictly fixing prices, are functionally similar), and even gambling (betting on fixed odds vs. the totalisator "tote" system).

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

We believe that the proposed rule is indeed proportionate and appropriate as a response to address the issue. There are strong economic benefits that may arise from prohibiting energy retailers from including terms in their contracts that permit unilateral variation of price and while we believe retailers may bear some initial impact, we think that they are best placed to manage this.

We have assessed other approaches, as discussed in the rule change and have reiterated this in our response to question 14. Since our rule change proposal we also note that the Victorian energy Minister has sought to proffer another solution to improve the situation for consumers who sign up to fixed term market contract that allows for price increases during the life of the contract.

The Minister's approach however was to address the nomenclature of the contract—which we believe is only a partial, and in our view insufficient, solution. Fixed period contracts should reflect customer expectations and come at a price that cannot be increased for the life of the contract. CUAC's research (noted previously) points to the fact that consumers have a very low understanding about the way in which prices can be increased in a fixed-period contract.

This research also suggests that consumers' expectations do not rely alone on a contract being called "fixed": they rely also on the existence of a specified period in the contract for which they agree to certain terms and conditions. This includes both contracts of a fixed term and contracts with a specified benefit period (where the duration of the benefit period may differ for the duration of the contract, e.g. the former may be for two years, the latter month-to-month).[39] While these contracts are often referred to in the energy industry and by policy-makers as "fixed term" contracts, their problems rest not with their name, but their nature.

[38] Wallis (2013) Victorians' Experience of the Electricity Market, in Essential Services Commission (2013) Victorian Residential Electricity Retail Market Research Discussion Paper www.esc.vic.gov.au/getattachment/a662edf7-8852-4618-a4e9-28dfffc9d4f0/Victorian-residential-electricity-retail-market-re.pdf

[39] We note that the creation of 'fixed benefit period contracts' appears to be solely designed to avoid the protections in the Victorian Energy Retail Code relating to informing consumers when a fixed period contract is about to expire (clause 24.3). This protection is designed to inform consumers about the expiration of benefits associated with a contract, and

Further, making a distinction between a fixed term contract that does not allow tariff changes with a fixed term contract that does allow tariff changes will do little to improve consumer understanding and market efficiency. Even if the term 'fixed' is not used, in the event of a tariff change, consumers may still be confused as to why their contact allows for price changes as it is unlikely they will remember that they gave their explicit informed consent to the term and condition allowing this upfront. Further, such a change is unlikely to result in increasing the availability of fixed-price fixed term contracts, thereby limiting the ability of consumers to play their role in 'activating' competition (described elsewhere in this submission).

We firmly believe that prohibiting price changes for all fixed term contracts is the best way to fully address this issue and enhance consumer protections (and benefit the market overall).

encourage them to shop around and consider energy offers from their existing or a new retailer. By creating a fixed benefit period contract, a retailer does not have to comply with clause 24.3 and, as such, the consumer is less likely to exercise their competitive pressure. This is a very poor outcome for effective competition.

Question 13 - Limited pass-through of costs

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

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

We stand by our proposed rule which does not allow the pass through of costs to consumers and we do not believe that allowing pass-throughs would better meet the NERO. Retailers are better placed than consumers to manage all upstream energy risks, as explained in our response to question 3.

For the reasons outlined in our rule change application, we do not believe that there should be pass throughs for changes in distribution prices or government policies. As noted above, in response to similar suggestions in the UK, Ofgem's view was that suppliers should be fully aware of their obligations in respect of government policies and estimate their costs accordingly, as they do with other costs—indeed, Ofgem's view was that suppliers should be able to price these costs into the fixed term contract to mitigate the need to vary the contract at a later date.

Also noted in answer to question 10, Ofgem did allow a number of exceptions to its rule that fixed-term contracts should not allow for unilateral price variation. The following are the key exceptions to SLC 22C.9, together with our assessment as to their applicability in the Australian context.

Exception 1 – Fluctuations in stock exchange quotations or in a financial market rate
Pursuant to SLC 22C.11(a), the licensee is not required to comply with SLC 22C.9 if all the following requirements are satisfied:

i. the domestic supply contract provides that variations to the charges for supply of electricity will occur automatically only in a manner which is fully linked to fluctuations in a published and transparent stock exchange quotation or index or a financial market rate that the licensee does not control;
ii. licensee has complied with SLC 23.1 – that is, the licensee has taken all reasonable steps to communicate the principal terms of the contract which includes the principal terms that would apply in the case of a mutual variation and the principal terms are communicated in plain language; and
iii. the method by which the charge fluctuates automatically is set out in the contract in a prominent position in plain language.

We are not aware of any energy market contract in the Australian context that uses such financial market rates as a basis for changes (although some use CPI). Given there does not appear to be such offers in the market place, it does not appear to us that such an exception is warranted in the Australian context.

Exception 2 – Precise variations set out in advance
Pursuant to SLC 22C.11(b), the licensee is not required to comply with SLC 22C.9 if all the following requirements are satisfied:

i. the domestic supply contract expressly sets out in advance the precise variation or variations to the charges for supply of electricity which are scheduled to occur automatically by a precise amount and on a precise date which is not subject to the licensee's discretion;
ii. the licensee has complied with SLC 23.1, see above; and
iii. the precise variations to the charges for the supply of electricity are set out in the contract in a prominent position and in plain language.

We do not support an exception based on precise variation set out in advance. If the precise price variation is set out in advance, then the parties know the full price of the contract in advance—this does not involve any management of risk. Detailed precise price variations would only contribute to consumer confusion in understanding the full price of the contract at the outset.

Exception 3 – VAT
Pursuant to SLC 22C.11A, the licensee is not required to comply with SLC 22C.9 if all the following requirements are satisfied:
i. the relevant charge is subject to VAT;
ii. there has been a charge in the rate of VAT chargeable in respect of the relevant charge; and
iii. the variation is only in order to fully reflect the rate of VAT that is chargeable in respect of the relevant charge.

As the application of GST in Australia is unlikely to change, we do not expect this exception to be relevant. Moreover, it is practice in Australia for retailers do quote both GST-exclusive and GST-inclusive rates. We submit that this causes consumer confusion, and further rules about add-on taxes will exacerbate this confusion.

Exception 4 – Domestic customer's failure to comply with terms and conditions relating to a payment method
Pursuant to SLC 22C.11B, the licensee is not required to comply with SLC 22C.9 if all the following requirements are satisfied:
i. the licensee is only increasing the charges for the supply of electricity and/or unilaterally varying other terms and conditions in any way which is to the disadvantage of a domestic customer in order to move a domestic customer from one payment method to another;
ii. the power to change payment methods is only exercised on the grounds that the domestic customer has outstanding charges and/or has failed to comply with terms and conditions relating to a payment method;
iii. the power to change payment methods and the precise circumstances when that power will be exercised are set out in the domestic supply contract in a prominent position and in plain language; and
iv. the licensee has complied with SLC 23.1, see above at [5.2].

Under the NERL, where a consumer is experiencing financial hardship they are eligible for a retailer’s financial hardship policy. A financial hardship policy should include processes to review the appropriateness of the customer’s contract, which should include the tariff being applied (s 44(f) NERR). We submit that this should be done with the customer's informed consent, and thus any change in the tariff for those in hardship should only occur with that informed consent. As such, any change in the price would not be unilateral, and thus the exception is unnecessary.

Exception 5 – Treatment of fixed term supply contracts with changes to terms precisely set out in advance
Pursuant to SLC 22C.15, the licensee is not required to comply with SLC 22C.9 if the following requirement is met:

i. The fixed term contract expressly sets out in advance the precise variation or variations to the charges for the supply of electricity which are scheduled to occur automatically by a precise amount and on a precise date which is not subject to the licensee's discretion.

We reiterate our comments above in relation to exception 3.

Question 14 - Other alternative rules

a) Are there any alternative approaches that could better address the issues raised by CALC and CUAC and minimise the potential costs of the proposed rule?

b) If so, what could these alternative approaches include and what would be the potential costs, benefits and impacts of these alternatives?

As noted, Consumer Action and CUAC presented a number of alternatives in our rule change proposal. We also provided information that suggested why these approaches would not sufficiently address the issues raised as a result of existing regulations and the ability for retailers to unilaterally vary prices under fixed term/period/benefit contracts.

As such we do not believe that there are any alternative approach to better address this issue for consumers.