

FIX IT!

An analysis of the first retail rule change in Australia's energy markets

This report has been prepared for the
Consumer Action Law Centre Ltd (CALC) and
Consumer Utilities Advocacy Centre Ltd (CUAC)

May Mauseth Johnston, February 2015
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Disclaimer

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The Consumer Advocacy Panel ceased operations on 30 January 2015. Its functions have been transferred to Energy Consumers Australia, established on the same date.

The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel, Energy Consumers Australia or the Australian Energy Market Commission.

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APPENDIX A: Background on the energy rule change process

Abbreviations

ACCC	Australian Competition and Consumer Commission
ACL	Australian Consumer Law
ACT	Australian Capital Territory
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CALC	Consumer Action Law Centre
CEO	Chief Executive officer
COAG	Council of Australian Governments
COTA	Council on the Aging
CPSA	Combined Pensioners and Superannuants Association
CUAC	Consumer Utilities Advocacy Centre
DMITRE	Department for Manufacturing, Innovation, Trade, Resources and Energy
ECA	Energy Consumers Australia
ECC	Ethnic Communities Council
ENA	Energy Networks Association
ERC	Energy Retail Code
ESC	Essential Services Commission
ERAA	Energy Retail Association Australia
EWOV	Energy and Water Ombudsman, Victoria
EWOSA	Energy and Water Ombudsman, South Australia
MEU	Major Energy Users
MRC	Market Retail Contract
NCOSS	NSW Council of Social Service
NECF	National Energy Customer Framework
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NER	National Electricity Rules
NERL	National Energy Retail Law
NERO	National Energy Retail Objective
NERR	National Energy Retail Rules
NGR	National Gas Rules
NSW	New South Wales
PIAC	Public Interest Advocacy Centre
PILCH	Public Interest Law Clearing House
SACOSS	South Australian Council of Social Service
TasCOSS	Tasmanian Council of Social Service
ToR	Terms of Reference
Quails	Queensland Association of Independent Legal Services
QCOSS	Queensland Council of Social Service

Executive Summary

The National Energy Retail Rules (**NERR**) impose minimum requirements that apply to terms and conditions of energy retail contracts. For market retail contracts, Rule 46 requires energy retailers to notify customers of changes to price as soon as practicable, and no later than the customer's next bill. By only regulating the way in which variations prices are notified, this provision implies that retailers can unilaterally vary prices under market retail contracts, including prices in fixed-term and fixed benefit contracts.

Unilateral variation terms mean that retailers retain the right to vary the price. As such, retailers are effectively shielded from much of the risk of varying costs incurred for the delivery of energy services. This risk is transferred to their customers. 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 an erosion of confidence in the competitive market.

Unilateral variation clauses also negatively affect competition. For example, a consumer can select an offer that suits their needs at a particular point in time, potentially expending significant search costs, only to find this contract rendered unsuitable and uncompetitive even prior to receiving the first bill if the retailer increases the price. The customer can then be subject to exit fees if they wish to select a new offer, thereby undermining the benefits of shopping around for a better offer or further engaging in the energy market.

The Australian Consumer Law (**ACL**) considers that unilateral variation clauses in consumer contracts are likely to be unfair terms and thus void (section 25(g)). However, where government regulation elsewhere permits such terms, such as the NERR, the ACL does not apply (section 26(1)(c)).

In October 2013 the Consumer Utilities Advocacy Centre (**CUAC**) and the Consumer Action Law Centre (**Consumer Action**) submitted a rule change request to the Australian Energy Market Commission (**AEMC**) seeking to address this consumer problem.

Consumer Action and CUAC sought to limit terms in fixed period retail market contracts that permit retailers to unilaterally vary the tariffs and charges that apply under those contracts.

They proposed to change the NERR by including the following **Rule 46A**:

Fixed period market retail contracts

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

The AEMC issued its final determination in October 2014.

The AEMC's draft determination¹

The Commission considers that the proposed rule and alternatives could have a range of negative effects on the price consumers pay for energy, as well as on the choices available to consumers and the level of competition in retail energy markets. The Commission considers that these negative effects of the proposed rule would outweigh the benefits of the proposed rule from increased transparency of prices for consumers and improved consumer engagement.

In light of these findings, the Commission considers that it is not appropriate to make the rule as proposed or the alternatives proposed because they are not a proportionate or appropriate response to the issues raised by the rule change request.

The AEMC's view was that the proposed Rule could have an effect on energy prices and consumer choice. Specifically the AEMC considered it likely that retailers would build a risk-premium into prices if they were unable to change the price during the contract term. Alternatively, the AEMC considered that retailers might cease to offer fixed term contracts all together. The AEMC felt that consumers could be better informed about contract terms and conditions, and that this was the only issue that required a regulatory response, albeit a proportionate one. The AEMC's solution was thus to improve disclosure, transparency and consumer information.

Following the draft determination, the AEMC proposed new preferred changes to the rules. The rule presented in the Final Determination was largely the same as that set out in the draft determination. The AEMC stated:

"The Commission has considered the range of issues raised in submissions and continues to consider that its draft rule provides an effective and proportionate response to the issues raised by the rule change request in relation to the impact of price variations on consumer engagement. Therefore, the Commission's more preferable final rule is largely unchanged from the draft rule set out in the Commission's draft determination."²

The new rule took effect on 1 May 2015 and applies to all new gas and electricity market contracts.

The AEMC's new rule³

The Commission has amended the retail rules to:

¹ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 53

² AEMC, *Retailer price variations in market retail contracts*, Rule determination, 23 October 2014, 64

³ AEMC, *Retailer price variations in market retail contracts*, Rule determination, 23 October 2014, 14

a) include a new rule 46A of the retail rules that specifically requires retailers to disclose to consumers any term or condition that provides for the variation of tariffs, charges or benefits (that is, prices) as part of the existing requirement to obtain explicit informed consent from consumers to the entry into a market retail contract; and

b) amend rule 64 of the retail rules to put beyond doubt that retailers are required to provide information about when they will notify consumers of variations to prices, charges and benefits (to the extent both are not otherwise part of prices) in market retail contracts. This information would be provided to consumers shortly before or following contract entry as part of existing product disclosure requirements. Under the current retail rules, consumers have a ten business day cooling off period to withdraw from the contract after they receive product disclosure information on contract entry.

Consumer Action and CUAC's reflections on the Final Determination

We were very disappointed by the AEMC's decision. After a long process, some additional information and disclosure requirements seem like a loss.

As this was the first retail rule change review the AEMC has conducted it is difficult to judge what is regarded as a significant response in terms of amending the rules.

The AEMC were concerned that retailers might build a risk premium into prices if unable to change the price during the contract term, or cease offering fixed term contracts altogether. There are a number of responses to these concerns.

Firstly, if the assumption is that all retailers would behave in these ways, this would suggest that there is very little, if any, effective competition between retailers. If that were the case, this would require a response from the AEMC.

If, however, competition is effective, then it is likely that retailers would make a range of offers to customers, particularly if they wish to gain customers from their rivals.

If the "fixed term, fixed price" offer is a choice for energy retail customers, then even if it does include a premium, this may be an offer that some customers would be interested in; for example, if they have a preference for security of price over the term, compared to the lowest price.

Finally, if retailers cease to offer fixed term contracts because they are no longer permitted to offer contracts that call themselves "fixed term" but are not actually "fixed term" in respect of price, then it is difficult to see that customers have lost anything valuable.

Lessons learned: the necessary "evidence" and the theoretical context

“We did seek to push the evidence burden back on to the AEMC but it is now clear that the AEMC needs new and better powers to properly investigate concerns raised by proponents as well as claims made by industry.

*If the AEMC expect future proponents to produce the level of evidence that they expected from us, we are unlikely to see any successful rule changes proposed by consumer groups.”
(see box 23)*

The analysis presented in this report raises several issues regarding evidence. With whom the evidence burden lays, what is considered solid evidence, how evidence is interpreted and the AEMC’s powers when it comes to gathering evidence from industry, all emerged during the review process. Consumer Action and CUAC wanted to push some of the evidence burden back on to the AEMC, believing the AEMC was better resourced and placed to investigate retailers’ claims. The AEMC kept asking for more evidence and rejected requests from Consumer Action and CUAC to investigate, claiming it did not having the necessary information gathering powers.⁴ This does, however, raise the question about who

should gather the necessary information, and are they appropriately resourced to do so. In the case of consumer advocacy groups, it is arguable that, at the current level of resourcing and without co-operation of relevant parties, this is not possible.

The AEMC, consumer groups and retailers all argued there was insufficient evidence for positions to be taken. Both the AEMC’s draft decision and final determination cite “insufficient evidence” as a reason for the AEMC not to accept the proposed changes. Citation of insufficient evidence may, however, place an unreasonable burden of proof on non-government proponents. There is a reasonableness test that would suggest the use of the word “fixed” to carry with it the factors expected by a reasonable person, in that it is fixed in both duration and price.

It can be both difficult and expensive to obtain information about retail practices and consumer experience in the energy market. Consumer Action and CUAC could have collected contract price information over time to ascertain frequency of price changes to new customers (although this would have delayed the project by several years) but as only retailers and consumers themselves know what happens to prices for existing customers, this evidence would in all likelihood have been dismissed. Another option would have been to survey a large number of consumers, however in reality consumer organisations do not have the resources to undertake large-scale surveys.

It is therefore crucial that an agency such as the AEMC has sufficient information gathering powers in order to investigate specific market issues, as well as having a thorough understanding of the various retail markets, to avoid rule change proponents without significant resources being disenfranchised.

In the absence of “evidence”, the theoretical context underpinning arguments play an important role. The analysis undertaken by the AEMC during this rule change suggests that it believes that outcomes such as ‘maximum choice’ and ‘lowest price’ are more

⁴ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 29

important to effective competition than transparency, simplicity and consumer confidence. This is perhaps based in ‘traditional’ economic theory, with a strong preference for market-based solutions: establish the necessary conditions for suppliers to compete, and efficiency that satisfies consumer preferences will result. At least in the context of this rule change, the AEMC appeared to be less convinced by consumers’ experience or theoretical frameworks stemming from behavioural economics, which acknowledge consumer biases and imperfect decision-making.

New Market Review Mechanism

Consumer Action and CUAC’s experience of the rule change process was that it was extremely resource intensive, and too lengthy and cumbersome for it to be a viable avenue for consumer advocates seeking to improve the workings of energy retail markets. This is a cause for concern.

Energy retail markets are rapidly changing but there is no easy mechanism to ensure that the rules are aligned to the market they actually seek to govern. This causes just as much of a challenge for rule makers and regulators as it does for consumer groups. Without the ability to implement responsive and efficient rules to address consumer issues and market inefficiencies, there is a real risk that consumers lose confidence, and interest, in energy retail markets to the detriment of effective competition.

*“The retail rule change process is slow, ungainly and unresponsive to market developments in fast changing retail markets”
(see box 27)*

*“After spending more than a year on a resource intensive rule change project that delivered little more than a requirement for retailers to disclose how prices or benefits may change during the length of the contract, as well as when they will notify consumers of changes, we are disappointed at the lack of impact we have been able to achieve to benefit consumers. It is our assessment that the process gives more weight to claims made by industry than the concerns of consumer advocates. The apparent lack of market study powers by the rule maker to properly investigate and verify those claims and concerns is a significant barrier to robust rule review and improvement”
(see box 17)*

Current arrangements, such as the AEMC’s effectiveness of competition reviews, are too narrow in scope to be regarded as a thorough market review. A revised and alternate mechanism would go beyond the current competition review process and initiate regulatory responses to address consumer issues and market failure.

Consideration should also be given to the most appropriate body or agency to undertake such a review.

Improvements to the rule change process

It took approximately 66 weeks from when Consumer Action and CUAC commenced the rule change project to the final determination. For 52 of those weeks, the application was subject to the AEMC's review.

The AEMC published its draft decision on 31 July and its final decision on 23 October 2014. During those three months they received a total of 20 submissions to their draft decision, none of which raised new or compelling matters that could change the AEMC's position adopted in the draft decision.

Consumer Action and CUAC believe there is a case for considering the introduction of a much more flexible multi-layered rule change process where certain issues can be fast-tracked.

The public forum organised by the AEMC as part of this review's consultation process did not enhance the debate beyond what had already been stated in written submissions. All speakers, except one, had already submitted written responses to the consultation paper and reiterated the same information and views. There needs to be genuine and open engagement by all parties to advance the debate. Alternatively, while it can be difficult to identify potentially interesting speakers without having received submissions from them, it is possible to take a more lateral approach by inviting representatives from similar, but different industries, or academics with relevant expertise.

"The public forum did not result in a rational, evidence-driven policy discussion. Rather it was an assertion driven discussion by the different parties that even resulted in the use of scare-tactics. It certainly did not facilitate a useful discussion"
(see box 10)

Recommendations by the proponents

Recommendation to replace the rule change process

1. That the COAG Energy Council consult on alternative mechanisms to the Retail Rule change process that can ensure the national framework for retail markets is responsive and keeps pace with market developments.
2. That the COAG Energy Council's Review of Governance Arrangements for Australian Energy Markets consider the benefit of one national energy regulator being responsible for energy market reviews.

Recommendations to improve the rule change process

3. That the AEMC reviews the rule change process and examines options for a much more flexible multi-layered rule change process where particular issues can be fast-tracked.
4. That the COAG Energy Council initiates a review of the AEMC's information gathering powers with the aim to ensure that the AEMC has the powers necessary to thoroughly investigate market issues and industry practices.

5. That the AEMC clearly articulates its expectations regarding the level of evidence to be provided by rule change proponents and evidence that will be collected by the AEMC during a rule change review.
6. That the AEMC develops a guideline for its public fora, organised as part of review processes, that can enhance debates and include views from expert non-stakeholders.
7. That the AEMC consult on and develop a framework for how explanations of consumer behaviour informed by behavioural science informs its decision-making.

About this report

As part of their funding agreement with the Consumer Advocacy Panel to undertake the rule change project, Consumer Action and CUAC received funding to contract an external consultant to:

- Monitor and record Consumer Action and CUAC's progress and experience throughout the process; and
- Produce a report that summarises the process, identifies any obstacles the project partners experienced, and provides a critical analysis of the process as recorded.

As this was the first retail rule change request submitted to the AEMC, as well as being the first undertaken by a consumer group, Consumer Action and CUAC believed it would be useful to document their experience and share them with future Rule change proponents. Furthermore, the proponents considered it important to identify barriers and potential improvements to the rule making process itself.

Methodology

The consultant, Alviss Consulting, has closely monitored Consumer Action and CUAC's tasks and activities throughout the project. Furthermore, the consultant has met with them at various stages of the process to discuss progress, stakeholder feedback and outcomes.

The views and feedback expressed by Consumer Action and CUAC at various stages of the process are presented in a number of 'comment boxes' throughout this report.

This report has also examined the material submitted to the AEMC's consultation process by stakeholders, and considered the AEMC's assessment of the evidence and views presented.

The report was peer reviewed by Dr Gill Owen prior to publication.

Structure

This report is structured into 8 sections.

Section 1 looks at the pre-project phase and discusses the problems identified by Consumer Action and CUAC that prompted the initial rule change proposal, as well as the rule's possible impact on consumers, competition and the energy market more broadly.

Section 2 covers the preparation of the proposal. This section outlines how partnerships were formed, how project funding was secured, as well as the work undertaken in order to develop the proposal.

Section 3 focuses on the AEMC's Consultation Paper stage and discusses the AEMC's paper, as well as information provided and positions taken in submissions prepared by Consumer Action, CUAC and other stakeholders.

Section 4 discusses the Public Forum organised by the AEMC as part of the consultation process.

Section 5 focuses on the AEMC's Draft Determination stage and discusses the AEMC's position and the consumer research commissioned to inform the Commission and stakeholders. It also considers information provided and positions taken in submissions prepared by Consumer Action and CUAC and other stakeholders.

Section 6 outlines the AEMC's Final Determination, the reaction of Consumer Action and CUAC to the decision, and the legal framework for reviews of AEMC decisions.

Section 7 discusses lessons learned, and observations that can be made, from Consumer Action and CUAC's rule change project. Issues discussed pertain to resources used, stakeholder relations and engagement, the proposed Rule, evidence gathering and interpretation, and the use of rule change requests to improve consumer outcomes.

Section 8 summarises key findings and recommends a new market review mechanism to be implemented as well as five recommendations addressing improvements to the rule change process.

Appendix A contains background information about the rule change process.

1. Pre-project stage

This section discusses the problems identified by the Consumer Action Law Centre (**Consumer Action**) and the Consumer Utilities Advocacy Centre (**CUAC**) that prompted the initial rule change proposal, as well as the Rule's potential impact on consumers, competition and the energy market more broadly.

1.1 The problem with Rule 46

The National Energy Retail Rules (**NERR**) impose minimum requirements that apply to terms and conditions of energy retail contracts. Rule 46 requires, for market retail contracts, that energy retailers notify customers of changes to tariffs as soon as practicable, and no later than the customer's next bill. By only regulating the way in which variation to tariffs are notified, this provision implies that retailers can unilaterally vary tariffs under market retail contracts, including tariffs included in fixed-term and fixed benefit contracts.

This issue had been acknowledged and debated for some time in Victoria when Consumer Action and CUAC decided to undertake a rule change request. In 2011, for example, the Victorian Essential Services Commission (**ESC**) conducted a consultation on the issue, as there were strong views about the unfairness of unilateral variations. However, as the introduction of the National Energy Customer Framework (NECF) was pending the consultation did not progress any further.

Both Consumer Action and CUAC conducted research, on separate occasions, into general contract terms and conditions as well as specifically fixed term energy contracts. In 2012, CUAC conducted a survey of 507 consumers, asking for their experience with, and opinions on, fixed term contracts in energy. The results of this research indicated that 86% of the consumers surveyed thought that current arrangements are unfair and 94% of the respondents believed that a change in the regulations is warranted to prevent retailers changing prices during fixed term contracts.

It is unclear what weight the AEMC gives such surveys in its consideration of, and requirement for, evidence to support a rule change proposal.

1.2 The consumer problem

Unilateral variation terms in energy contracts mean that retailers retain the right to vary the price or tariffs. Retailers are effectively shielded from much of the risk of varying costs incurred for the delivery of energy services. This risk is transferred to their customers.

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 an erosion of confidence in the competitive market.

Unilateral variation clauses negatively affect effective competition. For example, a consumer can select an offer that suits their needs at a particular point in time, potentially expending significant search costs, only to find this contract rendered unsuitable and uncompetitive prior to receiving the first bill if the retailer unilaterally increases the price. The customer can then be subject to exit fees if they wish to select a new offer, thereby undermining the benefits of shopping around for a better offer or further engaging in the energy market.

Furthermore, the Australian Consumer Law (**ACL**) considers that unilateral variation clauses in consumer contracts are likely to be unfair terms and thus void (section 25(g)). However, where government regulation elsewhere permits such terms, such as the NERR, the ACL does not apply (section 26(1)(c)).

This exclusion may well have been thought appropriate when energy businesses were government owned. Now that many are privatised it is potentially less so. It could be argued that even government owned businesses should not now be exempt from being required to comply with consumer law in the delivery of goods and services.

1.3 Jurisdictional coverage of the Rule

Consumer Action and CUAC decided to submit a rule change request despite Victoria not being part of the NECF. In 2013 the Victorian Government proposed to adopt the NECF as its baseline consumer protections and replace the protections currently provided in the Energy Retail Code (**ERC**). On this basis, Victorian consumers would have been subject to the same consumer protections as the jurisdictions that have adopted the NECF, and similarly be subjected to the unfair contract terms of unilateral price variation. Consumer Action and CUAC thus saw this rule change proposal as a means to solve this issue for both Victorian consumers, and all other consumers within the National Energy Market (**NEM**).

Both organisations had previously pursued direct advocacy with the ESC and various energy ministers, but with the adoption of the NECF imminent, the strategy changed to jointly pursue a rule change request.⁵

⁵ Since November 2014, the position of the Labor Government in Victoria is not to move to the NECF in the near future.

2. Preparing the Rule change

This section outlines how partnerships were formed, how project funding was secured, as well as the work undertaken in order to develop the proposal.

2.1 Project initiation and funding

In order to leverage each other's resources and expertise, Consumer Action and CUAC wanted to undertake this project in partnership. The two organisations have collaborated on several large projects in the past, most notably in their attempt to intervene in the Victorian network businesses' merit review proceedings. They flagged their intention to pursue a rule change with the Consumer Advocacy Panel, the Department of Industry and the AEMC from early May 2013.

Consumer Action and CUAC decided to work collaboratively on the rule change proposal and throughout the process, until completed.

Prior to making the decision to pursue a rule change request, consumer organisations will typically have to secure external funding to undertake such a project. Consumer Action and CUAC applied for a grant of \$50,000 from the Consumer Advocacy Panel and their application was successful.

The funding received from the Consumer Advocacy Panel allowed for analysis of relevant economic and legal issues, consumer effects and analysis of fixed term contracts (in the NEM and overseas). They also received funding to record the process itself and to produce a report on their experience as proponents and lessons from the process itself (this report).

2.2 Preparing and lodging the rule change proposal

Box 1 Consumer Action and CUAC's reflections on preparing the proposal

Preparation of the rule change application was a significant undertaking, particularly undertaking the economic and legal analysis designed to demonstrate that our proposed Rule would better achieve the market objectives. In initial discussions with the AEMC, we were led to believe that this analysis should be substantial and robust.

Shortly before we submitted the rule change application the responsible team at the AEMC changed and we did register a difference in expectations between the two teams. The new team, for example, was of the view that the initial application was too extensive.

Consumer Action and CUAC regularly met with AEMC staff during the preparation stage, including early meetings regarding the legal architecture of the ACL and the NERR.

In order to strengthen their application, they decided to include both legal and economic analyses of the effect of unilateral variation clauses on consumers and the market more broadly.

Dr. Rhonda Smith, a respected economist, academic and past ACCC Commissioner, was contracted to undertake the economic analysis. The legal firm Maddocks accepted a brief from the Public Interest Law Clearing House (PILCH)⁶ to produce a memorandum of legal advice regarding the current Rule and provide assistance in drafting a proposed new Rule. Simultaneously, in-house research into fixed term contracts and consumer impact was undertaken. Consumer Action and CUAC staff also spent considerable time on managing the project and developing their case.

After reviewing the research, the economic and legal advice, and with the benefit of several discussions with AEMC staff and one meeting with the Commissioners, Consumer Action and CUAC decided to pursue a rule which would limit the terms in fixed period retail market contracts that permit retailers to unilaterally vary the tariffs and charges that apply under those contracts.

In early July 2013, Consumer Action and CUAC briefed consumer advocates across the NEM about the project by teleconference. This teleconference also discussed how the consumer sector could support the project. Consumer Action and CUAC made it clear that they hoped to partner with all interested consumer organisations to strengthen advocacy for the proposed Rule, including undertaking joint advocacy directed at state departments and officials across the NEM.

On 23 October 2013 the rule change request was formally submitted to the AEMC.

Box 2 The rule change proposal – the proposed new Rule

Consumer Action and CUAC sought to limit terms in fixed period retail market contracts that permit retailers to unilaterally vary the tariffs and charges that apply under those contracts.

They proposed to change the NERR by including the following **Rule 46A**:

Fixed period market retail contracts

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

After submitting the rule change proposal, Consumer Action and CUAC briefed state and federal ministers about the request as well as government departments and other stakeholders.

⁶ Now Justice Connect

On 29 January 2014 Consumer Action launched its online “Fix-It” campaign and issued the media release: *End energy retailers’ free ride*. The aim of this campaign was to alert consumers to the issue, gather more information about consumers’ experiences, as well as building public support for the proposal.

Box 3 Media release: Fix it campaign

New proposal to fix energy prices for length of contract

Energy retailers would be banned from increasing a customer’s tariff mid contract under a proposal to be considered by the Australian Energy Market Commission (AEMC). Current rules allow retailers to increase prices at any time during a fixed term contract, meaning a family can sign a multiyear deal only to have the price increase before receiving the first bill.

Consumer Action Law Centre and Consumer Utilities Advocacy Centre (CUAC) have made a rule change application to the AEMC, to help maximise consumers’ long term economic welfare, and to promote competition within the energy market.’

Australians think a contract actually stands for something – that the price you sign up for is the price you should pay. But energy companies are given a free ride and can increase prices at will. It’s blatantly unfair and needs fixing,’ said Gerard Brody of Consumer Action Law Centre.

‘94 per cent of respondents to a recent survey believe retailers shouldn’t be allowed to increase prices during a contract, so our proposal is in line with community expectations. Australians can learn more about the issue and add their voice to the call for change at www.fixit.org.au’ said Mr Brody.

Consumer Action and CUAC’s rule change proposal is a common sense step towards fixing a broken and unfair energy market. Fixing prices for the term of a contract would:

Make shopping around worthwhile; in the face of high prices, consumers are urged to shop around for the best deal. But what’s the point of shopping around when the retailer can increase the price after they’ve signed you up to a long term contract?

End unfair sales tactics; a retailer can deliberately set prices below market level to attract customers, then increase its price once a consumer has signed a contract.

Give families certainty; Utility costs are the leading cause of consumer anxiety among Australians. The proposed rule change would give families certainty and help them budget for their energy bills.

Stop retailers playing by their own rules; your phone company can’t increase the cost of your plan mid contract, and insurers can’t increase premiums mid contract. It’s time energy retailers played by the same rules as everyone else.

Mr Brody said the AEMC will soon be consulting on the proposed rule change and encourages Australians to have their say. ‘If you want to put a stop to ever increasing energy bills, jump onto www.fixit.org.au and help us put fairness back into the energy market.’

3. AEMC Consultation paper

The AEMC's Consultation Paper was released on 13 February 2014. The paper outlined the rule change request, the assessment framework and the relevant tests, and also discussed the issues identified by the AEMC as being relevant for this rule change proposal.

This section covers the AEMC's Consultation Paper and responses submitted by the Consumer Action and CUAC and other stakeholders. It also analyses information provided and positions taken in regards to four key issues for this rule change process. The four issues, all of which were raised by the AEMC in its initial consultation paper, were:

1. Allocation of costs and risks
2. Consumer participation and engagement
3. Competition between retailers
4. Alternative approaches

3.1 The National Energy Retail Objective (NERO) and the consumer protection tests

The National Energy Retail Law (NERL) requires the AEMC to consider whether a change to the retail rules will, or is likely to, promote the National Energy Retail Objective (NERO), also known as the 'NERO test'.⁷ Furthermore, the AEMC is required to ensure that the Rule is *"compatible with the development and application of consumer protections for small customers, including (but not limited to) protections relating to hardship customers"*⁸ (the 'consumer protections test'). A proposal must pass both tests in order for the AEMC to make changes to the retail rules. However, it is not required to make the proposed rule just because it passes these two tests.

In regards to assessment criteria for the NERO test, the consultation paper stated:

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

- efficient allocation of costs and risks;
- effective consumer engagement and participation;
- provision of a range of products and services consumers value; and
- independent rivalry and competition between retailers."⁹

⁷ The NERO states: "The objective of this Law is to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy."

⁸ NERL, section 236(2)(b)

⁹ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 21

For the consumer protection test, the AEMC's approach was to assess whether the proposed Rule would be compatible with current consumer protections, as well as whether the Rule was likely to be compatible with future legislative developments and regulations (national or jurisdictional). In terms of scope, the AEMC proposed to assess whether the new Rule is "compatible with the development and application of:

- relevant consumer protections provided within the NECF;
- relevant consumer protections under the general law (for example, the Australian Consumer Law);
- relevant consumer protections provided under retail energy laws and regulations of jurisdictions participating in the NECF (which currently includes Tasmania, the Australian Capital Territory, South Australia and New South Wales); and
- to the extent relevant and to be given appropriate weight, relevant consumer protections under the retail energy laws and regulations of jurisdictions not yet participating in the NECF (which currently relevantly includes Queensland and Victoria)."¹⁰

Box 4 AEMC's questions to stakeholders¹¹

- Are there any other matters that the AEMC should consider in its assessment of the NERO test?
- Is the scope of the consumer protections that the Commission intends to consider appropriate for this rule change request?
- Should the Commission consider any other factors in assessing the rule change request against the consumer protections test under the Retail Law?

3.2 Key issues raised for consultation

3.2.1 The AEMC's discussion of allocation of costs and risks

The AEMC outlined the main input costs that make up a retail bill and discussed them in terms of retailers' ability to manage risks. Government charges, through direct regulation and network costs, were characterised as input costs that retailers had limited capacity to manage, while market based government policies (e.g. the carbon price) were considered more manageable, wholesale costs even more so and retailer costs most manageable.

The report referred to the NSW electricity market and noted that of the 53 contracts identified:

¹⁰ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 25

¹¹ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 24 and 26

44% had a fixed term and/or benefit period;
4% had a fixed price;
21% had no fixed term or benefit period; and
21% were standing offer contracts.¹²

Furthermore, the AEMC noted that the only two retailers that offered a fixed price contract are major retailers that operate across jurisdictions and are vertically integrated. The AEMC stated:

“It is evident from the terms of the available range of market offers that retailers generally manage some risks (e.g. risks associated with wholesale market costs) and may not manage others (e.g. regulated network costs and government policy costs). However, it is also evident that there are a small number of market offers that manage more, if not all, risks for consumers.”¹³

The AEMC also considered it likely that retailers would build a risk premium into prices if they were unable to change the price during the contract term. Furthermore, the AEMC predicted that retailers may cease to offer fixed term contracts altogether. The AEMC stated:

“An alternative option for retailers if the proposed rule is adopted may be for them to cease to offer contracts with a fixed period, or to only offer contracts with a shorter fixed period, so that they are not required to take on the additional risks under the proposed rule. Such an outcome would reduce consumer choice.”¹⁴

Box 5 AEMC’s questions to stakeholders¹⁵

- Do the current rules result in an inefficient allocation of risks between retailers and consumers in retail energy markets?
- If the proposed rule is made, would risk premiums be built into fixed period contracts?
- How significant would these risk premiums be and would these risk premiums create a permanent increase in the price of fixed period contracts?

3.2.2 The AEMC’s discussion of consumer participation and engagement

This section of the consultation paper discussed whether retailers’ behaviour under the current rules had a negative effect on consumer participation and engagement with the market, and whether the proposed rule was likely to promote such engagement.

¹² We note that this adds up to 90% but we assume there is a typo in the 44% and that it should have stated 54%. If so, this would be based on 29 fixed term offers, 2 fixed price, 11 no fixed term and 11 standing offers. See figure 5.4 in AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014

¹³ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 36

¹⁴ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 37

¹⁵ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 36 and 38

Firstly, the AEMC set out to consider whether consumers:

- believe that prices cannot vary when entering a fixed term contract;
- know that the prices can vary but are unaware of fixed price products available; or
- know that the prices can vary and are aware of fixed price products available.

The AEMC noted that it was difficult to assess these scenarios due to the limited information available. The consumer research that the AEMC had commissioned would therefore be an important source of information for the assessment of these issues.

Secondly, the AEMC set out to investigate whether search costs and exit fees acted as a barrier to consumer participation and switching. The AEMC stated:

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

- the existence of exit fees may restrict consumers from seeking a more competitively priced contract; and
- the experience of the price rise and the existence of price variation clauses in most other market retail contracts may stop some consumers from switching. This may occur due to the perception that similar price rises will occur again with the new retailer, wasting any potential further search costs.”¹⁶

Third, and finally, the AEMC set out to analyse the potential benefits of the proposed Rule and weigh them up against potential costs. The potential benefits were identified as:

- increased competitive pressures on prices because prices are more comparable;
- increased certainty in regards to the benefits of switching; and
- clearer communication of consumer preferences to retailers because consumers have a better understanding of the products they are purchasing.

The potential cost identified was higher prices due to risk premiums required by retailers.

Box 6 AEMC’s questions to stakeholders¹⁷

¹⁶ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 44

¹⁷ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 42 and 45

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

3.2.3 The AEMC's discussion of competition between retailers

The AEMC stated that a high number of retailers and a variety of product offerings are crucial to effective competition. Concerns relevant to the rule change proposal included the different effect it could have on different retailers (e.g. incumbents versus 2nd tier), effect on new entrants, market innovation and the number and/or variety of products that would be available to consumers.

Firstly, the AEMC discussed how the proposed Rule may affect retailers differently. The AEMC stated that larger (incumbent) retailers could potentially find it easier to manage increased risk than smaller (2nd tier) retailers and the proposed Rule could thus give large retailers a competitive advantage. For example, large retailers could more easily manage the following, compared to small retailers:

- greater capacity to analyse risk and predict future price changes;
- greater capacity to spread the costs associated with managing risks across a larger number of customers on fixed period contracts;
- greater capacity to spread risk across customers that are on different kinds of retail energy contracts; and
- easier access to financial markets.

Secondly, the AEMC raised concerns about the effect the proposed Rule may have on new market entrants. The AEMC stated that potential new entrants may perceive fixed price contracts as too risky and therefore not enter all together:

“If this lower risk pathway to entering energy markets as a retailer is no longer available, fewer new entrants may enter the market.”¹⁸

¹⁸ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 49

However, as the proposed Rule would not prevent retailers from offering variable price if the contract term is not fixed, the AEMC did acknowledge that new entrants may still decide to enter the market, but not offer fixed period contracts.

The AEMC noted that the two retailers that currently offered fixed price contracts were large retailers (Origin and Energy Australia) and that this could indicate that newer retailers had less capacity to offer fixed price contracts or that they do not believe their customers would be interested in such contracts.

Finally, the AEMC stated that the proposed Rule would clearly affect the kinds of offers available in the retail market and consumers would not be able to choose between market offers where they bear different levels of risk, if they chose to be on a fixed contract in the first place. Furthermore, consumers choosing to be on a fixed contract would, under the proposed Rule, not receive any price reductions in the event that prices should fall.

Another possibility raised by the AEMC was that retailers would reduce the length of the contract term as it is easier to predict costs in the short term than in the longer term. The AEMC noted that the longest-term market contract currently available was 36 months compared to 24 months for fixed price contracts. The effect of a reduced range of market offers could, according to the AEMC, be significant, including:

- Consumers making inefficient product decisions
- Consumers consuming more or less than what would be efficient because they choose a contract that does not meet their preference
- Consumers may engage less with the retail market

Box 7 AEMC's questions to stakeholders¹⁹

- How would the proposed rule affect larger retailers compared to smaller retailers?
- Would the proposed rule make it more difficult for new entrants to enter retail energy markets?
- If the proposed rule is made, are retailers likely to withdraw or offer shorter fixed period offers from the market?
- 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?

3.2.4 The AEMC's discussion of alternative approaches

The AEMC discussed the two alternative approaches raised by Consumer Action and CUAC and sought comments from stakeholders on the limited pass-through approach as well as the possibility of applying the unfair contract terms provisions in the ACL.

In order to foster ideas for alternative approaches from stakeholders, the AEMC listed several possibilities as discussion starters. The three suggestions were:²⁰

1. "Creating a prescriptive list of costs that can and cannot be passed through to consumers by retailers during fixed periods in market retail contracts. Such an approach could set out the costs that are more efficiently managed by retailers and those that cannot be efficiently managed by retailers and so may be passed on to consumers. This approach is similar to that proposed by CALC and CUAC, but could potentially allow retailers to pass through a broader range of costs to consumers rather than only changes in government charges."
2. "Allowing consumers a limited amount of time to switch retailers or contracts without paying exit fees following a price variation. We note that Queensland currently allows customers to exit contracts without paying exit fees for 20 days if prices are increased above the regulated tariff rate. This approach could increase competitive pressures on retailers to limit price variations during fixed periods."
3. "Requiring retailers to provide more information to consumers about how prices could vary under market retail contracts. This approach could improve the transparency of information available to consumers when they are deciding which contract to switch to, and thus promote greater consumer engagement and participation in retail energy markets. This in turn could

¹⁹ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 49 and 50

²⁰ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 64

improve retail competition, as consumers are able to make decisions on a more informed basis."

Box 8 AEMC's questions to stakeholders²¹

- 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?
- 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?
- Should the misleading and deceptive conduct provisions of the ACL be relied on to effectively address the issues raised by CALC and CUAC?
- Are there any other consumer protections under the ACL that are relevant to this rule change request?
- 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?
- Considering the issues identified by CALC and CUAC, is the proposed rule a proportionate and appropriate response to address these issues?
- 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?
- If so, which types of costs should retailers be allowed to pass-through to consumers and why?
- 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?
- If so, what could these alternative approaches include and what would be the potential costs, benefits and effects of these alternatives?

²¹ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 56, 57, 61, 62 and 65

3.3 Consumer Action and CUAC's response to the consultation paper

Box 9 Consumer Action and CUAC's reflections on the Consultation Paper

We were cautiously optimistic when the consultation paper came out. The AEMC demonstrated a willingness to explore the issues we had raised in our proposal and it recognised that it could improve consumer confidence and trust in energy contracts, pricing and the industry.

That said, we were concerned that there was a lack of understanding about how consumers actually make choices, and that the basis for decision making still rested on the assumption that consumers will always make decisions in their own best interests. We know that's not true, and why, but it was clear we had a lot of work ahead of us to convince the Commission otherwise.

Consumer Action and CUAC questioned why the AEMC thought of the NERO and the consumer protection test as separate concepts. Consumer Action and CUAC stated: "[O]n 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."²²

Their submission also explained:

"The AEMC has already stated in the consultation paper that consumer protections are relevant to this rule change. 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."

²² Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, AEMC Consultation Paper, March 2014, 2

3.3.1 Consumer Action and CUAC's views on allocation of costs and risks

In their submission, Consumer Action and CUAC stated that they agreed with the AEMC's observation that the various contracts available in the market allocate different degrees of risk to consumers. However, Consumer Action and CUAC did not accept the notion that this is a good outcome for consumers. They stated: "we reject any suggestion that, therefore, the market is functioning well by enabling consumers to select products that reflect their desired level of risk."²³ The submission referred to research undertaken by CUAC and Wallis Consulting, showing limited consumer awareness of energy retail markets and contract terms and conditions, as well as low support for unilateral price variations in retail contracts.

Consumer Action and CUAC agreed with the AEMC that the proposed rule would require retailers to bear more risk and that retailers are likely to pass some of these costs on to consumers. Consumer Action and CUAC argued:

"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." ²⁴

3.3.2 Consumer Action and CUAC's views on consumer participation and engagement

Consumer Action and CUAC referred to issues raised in the rule change proposal and encouraged the AEMC "to explore how a consumer may easily gain access to transparent contract information more fully".²⁵

In response to the AEMC's question about whether consumers perceive that they would waste search costs if they 'shopped around' because retailers can change the price anyway, Consumer Action and CUAC stated that it is very difficult to measure consumers' perception but that they believe "there *are* consumers that would think there's little point changing retailers due to the wasted search costs if a retailer simply changes prices."²⁶ They explained:

²³ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, AEMC Consultation Paper, March 2014, 6

²⁴ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, AEMC Consultation Paper, March 2014, 7

²⁵ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, AEMC Consultation Paper, March 2014, 11

²⁶ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, AEMC Consultation Paper, March 2014, 12

“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. 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.”²⁷

3.3.3 Consumer Action and CUAC’s views on competition between retailers

Consumer Action and CUAC acknowledged that larger retailers might be better equipped to take on additional risks compared to second tier retailers and new entrants. However, their submission also highlighted that not all of the second tier retailers currently offer fixed term contracts and that one retailer in Victoria, Red Energy, offers fixed term, fixed price contracts. In regards to new entrants, the submission stated:

“[T]he 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.”²⁸

In relation to whether retailers are likely to withdraw or offer shorter fixed period offers from the market and the potential effect this may have on retail competition and prices in the long term, Consumer Action and CUAC argued that effective competition should not be measured in terms of number of offers available. The submission stated:

“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.”²⁹

²⁷ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, AEMC Consultation Paper, March 2014, 12

²⁸ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, AEMC Consultation Paper, March 2014, 16

²⁹ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, AEMC Consultation Paper, March 2014, 17

They also argued that a potential price difference may be less of an actual difference and more a difference between an explicit price (that consumers are aware of) compared to the implicit price consumers now pay (but are not aware of before or after the fact). The submission stated:

“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.”³⁰

3.3.4 Consumer Action and CUAC’s views on alternative approaches

Consumer Action and CUAC did not support the alternative approaches raised by the AEMC. They reiterated the evidence and arguments presented in the initial proposal and dismissed an alternative approach that would allow limited pass-through of some costs, including network charges and costs associated with Government policies. The submission stated:

“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”.³¹

³⁰ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, AEMC Consultation Paper, March 2014, 17

³¹ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, AEMC Consultation Paper, March 2014, 31

3.3.5 Advocacy undertaken by Consumer Action and CUAC's

In relation to stakeholder engagement and advocacy, Consumer Action and CUAC circulated a brief to all interested consumer advocates that addressed each of the AEMC's questions for stakeholders.

Consumer organisations in other jurisdictions provided advocacy on this issue to state departments and ministers either directly, or as part of discussions at existing forums.

3.4 Stakeholders' submissions to consultation paper

Stakeholders had six weeks to submit their responses to the Consultation Paper and the AEMC received 38 submissions in total. Of these, industry submitted 12 and 16 were by consumer groups.

3.4.1 Stakeholders' views on allocation of costs and risks

Submissions presenting consumer views typically stated that shifting risk away from consumers and on to retailers would deliver better outcomes for consumers.

Queensland Council of Social Service (**QCOSS**) and Tasmanian Council of Social Service (**TasCOSS**), National Seniors Australia, the Public Interest Advocacy Centre (**PIAC**), Queensland Association of Independent Legal Services (**QAILS**), Council on the Aging (**COTA**) Queensland and Uniting Care Australia, stated that retailers have a greater capacity to manage risk compared to consumers.

United Care Wesley Bowden, Ethnic Communities' Council of NSW, QCOSS, COTA Queensland, the NSW Council of Social Service (**NCOSS**) and Major Energy Users also stressed that the unfair risk allocation between retailers and customers was exacerbated by retailers' ability to apply exit fees:

"The current rules allocate risk more heavily on consumers as the retailers can change the price if the wholesale price rises. If the retailer loses a customer due to the price rise then the costs of losing the customer are carried by the customer in the exit fee."³²

Similarly to Consumer Action and CUAC, PIAC indicated that they accepted that the proposed rule may result in retailers charging customers a risk premium but did not regard this as a reason for not implementing it. PIAC stated:

"PIAC accepts that if the proposed rule change were implemented, retailers may respond by changing the structure of their offers in order to manage the risk of increasing costs that they could not immediately pass on to consumers.

³² Ethnic Communities' Council of NSW, Submission to AEMC's Rule Change Request, 7 February 2014, 2

PIAC takes the view that this would more accurately reflect the true cost of an energy contract.”³³

In addition, PIAC encouraged the AEMC to undertake a study into the risk premiums in fixed term contracts:

“To help stakeholders better understand the impact of the proposed rule, PIAC recommends that the AEMC analyse risk premiums in current fixed term contracts and compare these with the small number of fixed-price contracts available in the market. In doing so, any comparison should be between fixed price contracts and variable contracts *after* the first price increase. This is because PIAC is aware of a number of customers who have signed up to a contract with a low initial price and seen the cost go up soon after, only to find that the lower price to which they were originally attracted is still available to new customers of that retailer.”³⁴

South Australian Council of Social Service (**SACOSS**) stressed that the important issue to assess is whether the proposed rule would exacerbate the net cost of risk:

“Firstly, it is important to reiterate that risk premiums are in effect in all contracts. A critical question then is the extent existing risk premiums are recovered through the practices described in the rule change proposal and whether this proposed rule change exacerbates the net cost of risk or simply makes it more explicit.”³⁵

Furthermore, SACOSS referred to research of South Australian market offers that showed that the annual bill for customers on Energy Australia and Origin’s “Rate Freeze” products was actually lower than the retailers’ standard (variable price) contracts.

Submissions presenting retailers’ interests highlighted that greater risk for retailers would result in higher prices for consumers.

The Energy Retail Association of Australia’s (**ERAA**) submission stressed that retailers take on the role of risk managers for customers. The submission stated: “As customer preferences vary, and bearing in mind the risk that retailers absorb, retailers provide a broad range of market offers.”³⁶ The ERAA argued that the proposed rule would

³³ PIAC, Let’s be clear: PIAC submission to the AEMC’s Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 2

³⁴ PIAC, Let’s be clear: PIAC submission to the AEMC’s Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 4

³⁵ SACOSS, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014 – Consultation Paper, 21 March 2014, 9

³⁶ ERAA, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014 – Consultation Paper, 27 March 2014, 2

either result in a limited number of offers available to consumers or higher prices (due to an increase in the risk faced by retailers).

This sentiment was echoed in submissions made by individual retailers. AGL stated:

“Should price variation for such components, such as network and Government policy changes, be prohibited for any market contracts of a fixed period, retailers will then need to re-allocate the costs of managing these risks. Should this apply for all customers on fixed period contracts, this would result in significant cost re-allocation as risk premiums are priced into these products.”³⁷

Energy Australia stated:

“Restricting retailers’ ability to vary prices during the contract term, will subject them to further risk which cannot be adequately managed without imposing a premium on consumers’ prices to allow for uncontrollable changes to input costs. If this risk premium is calculated incorrectly, consumers will face inefficient prices (ie, will pay too much) or retailers will face serious financial difficulty and may be unable to meet their obligations and cease trading. Neither of these outcomes is attractive from a consumer point of view.”³⁸

Origin Energy focused on the drafting of the proposed rule and argued that it placed too much risk on retailers and that prices would increase as a result:

“Origin agrees with the proponents that it is a retailer’s task to manage such fluctuations. However, there are some costs that are beyond the control of retailers such as changes in transmission and distribution network charges, market charges (participation fees), government imposed policy changes (taxes, environmental programs) and so on. The proposed rule goes beyond a retailer’s ability to pass through changes in wholesale and retail costs, extending to these other categories of exogenous costs. The proposed rule if implemented as drafted will require retailers to factor in additional risks, inevitably creating an increase in risk premiums incorporated into end-use prices.”³⁹

Red Energy, Simply Energy, Ergon Energy, Lumo and Momentum also submitted responses outlining similar arguments.

Retailers’ submissions mostly focused on network costs and government policies as examples of changing input costs that would make the proposed rule unworkable.

³⁷ AGL, Retailer price variations in market retail contracts, Consultation Paper, 1 April 2014, 4

³⁸ Energy Australia, Response to Consultation Paper on Retailer price variations in market retail contracts, 27 March 2014, 9

³⁹ Origin, Submission to Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 4

The ERAA submission stated that retailers typically vary the price of fixed term contracts in response to increases to input prices. Energy Australia stated:

“Retailers do not vary prices without due cause, and generally, will only do so once a year, at the same time as the network businesses, a retailer’s biggest input cost.”⁴⁰

However, some retailers identified other reasons for why price variations are necessary. AGL’s submission raised that retailers’ ability to vary prices for fixed term contracts is also important in order to pass on price decreases and used the potential repeal of the carbon price as an example of a situation where an inability to vary prices would be to the detriment of consumers:

“It should also be made clear that this proposal, if implemented would not only apply to price rises, but also limit the ability of retailers to pass through reductions in price to consumers. Governments have rightly placed a high value in these reductions being passed through to customers, in particular we refer to the current discussions in relation in the repeal of the carbon price and associated pass-through. Should the Rule Change Proposal be in place today, retailers would potentially soon be faced with conflicting legislative requirements, namely an obligation to pass on price reductions stemming from the carbon price repeal, in conflict with a NERL prohibition on varying prices for any fixed period contract.”⁴¹

Simply Energy stated that consumers would be more likely to experience bill shocks as customers on longer-term contracts “could experience significant change in the retail price as the price re-aligns with industry costs.”⁴² Furthermore, Simply Energy referred to scenarios where customers are mandatorily reassigned to time varying prices and that a restriction on retailers’ ability to pass through these price signals would run “counter to the Standing Committee on Energy and Resources’ objective of end customers receiving better pricing signals about the cost of their use of the network.”⁴³

The Energy Networks Association (**ENA**) argued that the network businesses could ultimately end up facing significant risk if the proposed rule was adopted, ENA did not believe the current cost recovery rules would be able to ensure that the networks can obtain their costs from retailers if retailers were hindered by the rules to recover these

⁴⁰ Energy Australia, Response to Consultation Paper on Retailer price variations in market retail contracts, 27 March 2014, 9

⁴¹ AGL, Retailer price variations in market retail contracts, Consultation Paper, 1 April 2014, 4

⁴² Simply, Submission to National Energy retail Amendment Rule 2014, 27 March 2014, 3

⁴³ Simply, Submission to National Energy retail Amendment Rule 2014, 27 March 2014, 6

costs from customers.⁴⁴ United Energy and Multinet echoed the ENA's concern in their submission.

The Australian Energy Regulator (**AER**) agreed with the AEMC that retailers were likely to build a risk premium onto its prices if the proposed rule was adopted. Another potential outcome envisaged by the AER was that retailers would not be willing to take on this additional risk and "therefore cease to offer fixed term or fixed benefit period contracts, or only offer contracts with a shorter fixed period."⁴⁵ In the AER's view, this would result in less choice for consumers and could stifle innovation and retail competition.

The then Victorian Department of State Development, Business and Innovation also expressed concern about potential price increases and less choice for consumers. Their submission stated:

"The Department believes that some consumers may take up fixed term, variable price contracts, because they have lower tariffs or higher discounts compared to fixed term, fixed price contracts. The Department is therefore cautious in supporting a blanket prohibition on fixed term contracts that allow for price increases, as it will remove offers that some customers may be happy with."⁴⁶

The South Australian Department for Manufacturing, Innovation, Trade, Resources and Energy also argued against a rule change that could limit consumer choice in the retail market. Similar to SACOSS, the department had compared fixed rate offers to standard (variable) contracts. However, rather than comparing the fixed rate products offered by Energy Australia and Origin to standard (variable) contracts offered by the same retailers, the Department compared these offers to the best offers available by any retailer in South Australia. The submission stated:

"Two fully fixed offers are also available in South Australia, being the Origin Energy Rate freeze contract and the Energy Australia Rate Fix Contract. Currently, these contracts are more expensive than other market offers. However, the Division is aware that some customers in South Australia would prefer price certainty over a lowest priced offer that carries the risk of a price change."⁴⁷

3.4.2 Stakeholders' views on consumer participation and engagement

⁴⁴ ENA, AEMC Rule change - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Consultation Paper, ENA Submission, 27 March 2014

⁴⁵ AER, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 26 March 2014, 3

⁴⁶ Victorian Government Department of State Development, Business and Innovation, Submission to Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 9 April 2014, 2

⁴⁷ South Australian Government Department for Manufacturing, Innovation, Trade, Resources and Energy, Submission to AEMC Consultation Paper, 27 March 2014, 2

Submissions presenting consumer views typically stated that less uncertainty and fairer contract terms and conditions would lead to increased consumer confidence and market participation.

Uniting Care Australia was adamant that consumers would expect prices to be fixed when agreeing to a fixed contract. Their submission stated:

“We expect that most customers enter into a fixed period energy contract expecting fixed prices. This is what contracts have traditionally been about: an agreement to purchase an agreed good or service at an agreed price. Fixed prices in fixed term contracts are a completely reasonable and rational consumer expectation.”⁴⁸

That said, some consumer groups acknowledged that it was difficult to ascertain whether, and what proportion, of consumers would expect the price to be fixed when agreeing to a fixed contract or being unaware of fixed price products available in the market. As stated in SACOSS’ submission:

“SACOSS can only defer to the survey results contained in the Rule Change Proposal and anecdotal feedback from our membership that this is widely regarded as an unfair practice.”⁴⁹

Others, such as the Ethnic Communities’ Council (ECC) NSW gathered some information in relation to AEMC’s questions. ECC stated:

“The staff of organisations who work with refugees and newly arrived migrants are not aware that during a fixed period contract the price can change. For example the staff and team leaders at Settlement Services International (approximately 60) had no idea that the price could change. They work with 20 – 30 clients each over 6 months and each client represents an energy consumer. It needs to be remembered that these members of the community do not have access to energy rebates so cost is paramount.

Similarly in another organisation that works with refugees and newly arrived migrants the staff of over 30 did not know that the price could change during the fixed period contract and they were responsible for educating the clients about living in the Australian community. Their training was provided to over 250 energy consumers this year.”⁵⁰

⁴⁸ Uniting Care Australia, Submission, In response to AEMC Consultation Paper, Retailer price variations in market retail contracts: Rule Change Proposed by CUAC and CALC, March 2014, 7

⁴⁹ SACOSS, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014 – Consultation Paper, 21 March 2014, 12

⁵⁰ Ethnic Communities’ Council of NSW, Submission to AEMC’s Rule Change Request, 7 February 2014, 2

The Energy and Water Ombudsman Victoria (**EWOV**) submitted information in relation to its case data. EWOV explained that:

“Cases about price increases during fixed-term contracts fall into EWOV’s transfer-related contract variation in price/terms issue category. Cases about this issue and about termination fees do not always include a concern about companies increasing prices during fixed-term contracts. However, anecdotally, EWOV finds that most cases in these categories involve customers who are concerned that the tariff and/or discount had changed or was not the same as they believed when they entered the contract.”⁵¹

In terms of customer numbers, 3,381 customers raised variation in price/contract terms as their primary issue from 2009 to 2013, and an additional 1,450 customers raised it as a secondary issue in relation their case. Moreover, the increase in cases raised in relation to this issue has been significant, from 339 cases in 2009 to 2,171 in 2013 (primary issues only).⁵²

The Energy and Water Ombudsman South Australia (**EWOSA**) submitted that in 2012-13, 916 cases out of a total of 21,029 were contract related and over half of these were in relation to fairness/condition of contract.

In PIAC’s view, there were three specific ways the proposed rule could improve competition and place a downward pressure on prices through increased consumer participation and awareness. Firstly, PIAC stated that the better informed consumers are, the more competitive pressures they are able to place on retailers, and:

“Where competitive pressure increases, retailers should, in theory, be more likely to develop products that are attractive to consumers. Where true prices are opaque and prone to unpredictable and significant change, retailers may create offers that initially appear attractive but quickly become less beneficial when prices rise.”⁵³

Secondly, PIAC highlighted the benefits of consumers having a better understanding of future prices. The submission stated:

“Where clarity exists around current and future prices, consumers are better able to weight price and other contract terms, such as exit fees, against their existing contract (or other offers) to decide which is the best option for them. Further, where consumers are better able to choose an offer that is right for

⁵¹ EWOV, Submission to AEMC, Retailer price variations in market retail contracts, Consultation Paper, 25 March 2014, 2

⁵² EWOV, Submission to AEMC, Retailer price variations in market retail contracts, Consultation Paper, 25 March 2014, 2

⁵³ PIAC, Let’s be clear: PIAC submission to the AEMC’s Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 3

them, search costs will be reduced or deliver better results. If consumers spend time seeking out an offer that is not what it appears to be (because the price increases soon after they sign up), they may choose to invest more time seeking an alternative.”⁵⁴

Thirdly, PIAC raised that better informed consumers can communicate their preferences more clearly. The submission referred to an AEMC survey of NSW energy consumers that: “suggests that retailers are currently only mildly effective at meeting consumers’ expectations. Of surveyed consumers who had switched retailers, little more than half (57%) were satisfied with their new provider.”⁵⁵

Submissions presenting retailers’ interests commonly argued that there was no evidence to support that price variations resulted in consumers disengaging with the market. Like most of the consumer group submissions, most of the retail submissions were unable to provide data in relation to how wide-spread consumer misunderstanding of fixed term contracts is, or whether this aspect deters consumers from participating in the market.

The ERAA made some general statements in relation to consumer preferences and otherwise stressed that Consumer Action and CUAC had failed to demonstrate that price variations on fixed contracts cause consumer detriment or acted as a barrier to effective competition. The ERAA highlighted the potential increase in search cost for consumers:

- “customers will require a greater knowledge of the industry to ensure they select a new offer at the best possible time for them
- the proposed rule could result in higher search and transactions costs for customers as customers will have to re-contract their energy supply on a more frequent basis.
- if customers wish to reduce their search and transactions costs by taking advantage of longer term contracts, they could be subject to increased risk of bill shock as prices may change significantly between contracts”⁵⁶

AGL did not put forward any evidence in relation to consumer participation and engagement in its submission. It did, however, offer to provide information to the AEMC directly. The submission stated:

“AGL is collating some information to provide to the AEMC which will assist the AEMC in this analysis. This information will make clear that there is a high risk

⁵⁴ PIAC, Let’s be clear: PIAC submission to the AEMC’s Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 3

⁵⁵ PIAC, Let’s be clear: PIAC submission to the AEMC’s Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 3

⁵⁶ ERAA, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014 – Consultation Paper, 27 March 2014, 5

that the Rule Change Proposal risks limiting the breadth and affordability of energy offers available to customer, and thereby risks exacerbating any affordability issues.”⁵⁷

The AEMC did not make this information provided by AGL public, so it could not be independently tested.

Origin stated it was unaware of any evidence that suggests customers see little gain from switching retailers and referred to the high switching rates experienced in Australian retail markets as evidence of the contrary. Furthermore, Origin did not believe “search costs are prohibitive; access to comparison tools (including Energy Made Easy and the My Power Planner website in Victoria) reduce transaction costs and have the purpose of minimising challenges for customers to identify offers that best suit their needs”.⁵⁸ Origin also highlighted the various information channels consumers have access to:

“Customers seeking information on available products, including specific information on market offers with fixed prices, are able to source this from individual retailers, respond to marketing campaigns and examine a range of price comparison services, including the Australian Energy Regulator’s Energy Made Easy website. In addition, retailers’ energy price fact sheets must clearly set out whether or not prices will change – so clear and relevant information is easily accessible to all customers.”⁵⁹

Energy Australia was one of the retailers that engaged with the issues in regards to consumer participation and awareness discussed in the AEMC’s consultation paper. In relation to consumer awareness about price variations applying to fixed term contracts, Energy Australia stated:

“EnergyAustralia has no reason to doubt the proponents’ assertions that some consumers may be under the impression that prices are fixed for the duration of a contract however, in our experience this understanding does not appear to be common among consumers and we seek to minimise such misunderstandings as far as possible. EnergyAustralia endeavours to ensure that consumers are properly informed with regard to their contractual rights and obligations, and have taken a number of steps to this end. These steps include ensuring that scripting reflects that prices may change and avoiding the potentially confusing terminology such as “fixed term” in favour of the phrase “benefit term” which generally denotes the period of time for which a consumer is eligible to receive a discount.

⁵⁷ AGL, Retailer price variations in market retail contracts, Consultation Paper, 1 April 2014, 5

⁵⁸ Origin, Submission to Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 6

⁵⁹ Origin, Submission to Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 5

We consider that it is reasonably unlikely that large numbers of consumers are under the impression that prices are fixed within contract terms due to the maturity of the contestable retail market; the proponents' discussion of the problem does not lead us to conclude otherwise or that this will be a persistent issue. "⁶⁰

Energy Australia is one of the retailers that does offer fixed price contracts and in relation to consumer awareness of those, the submission stated:

"With regard to the issue of fixed period contracts with fully fixed prices, we believe that it is possible that a significant number of consumers are unaware of the existence of these products as they have only been introduced to the market relatively recently and are not offered by all retailers. We believe that these contracts will be offered by a greater number of retailers if the potential for mid-term price increases is a genuine concern amongst consumers."

Furthermore, Energy Australia argued that the proposed rule could result in customers taking a "set and forget" approach to their retail contracts and hence lessen engagement with the market. The submission stated:

"We agree that greater consumer engagement will put downward pressure on prices but as outlined above, do not believe that this rule will facilitate this outcome. Engagement will lead to greater understanding of the reasons for price increases, the relationship between retailers, distributors and consumers and will create a more cooperative relationship between customers and their retailer, resulting in lower customer management costs, decreased bad debt costs as consumers are proactive about payment difficulties and lower complaint handling costs as customer better understand what issues are the responsibility of their retailer and what issues are handled by the distributor."⁶¹

Second tier retailers, such as Alinta, Red Energy and Simply Energy, highlighted that the information provided to consumers about contract terms and conditions was plentiful and detailed, and that customers already provided explicit informed consent.

Simply Energy, however, also argued that energy is a low engagement product by nature and that more consumer information only leads to less customer engagement. Their submission stated:

"[E]nergy is a low engagement product and no amount of information is going to increase customers' excitement levels with respect to shopping around for a

⁶⁰ Energy Australia, Response to Consultation Paper on Retailer price variations in market retail contracts, 27 March 2014, 10

⁶¹ Energy Australia, Response to Consultation Paper on Retailer price variations in market retail contracts, 27 March 2014, 12

better energy deal. Energy is not a product that customers want to spend a great deal of time on to understand and compare various offers.

To date, regulations have focussed on requiring retailers to provide ever increasing amounts of information to customers in the hope that the next piece of information will be the one that gets customers excited about their energy supply and actively engaged in the market.

In our view, retailers are now required to provide so much information that it is overwhelming customers and detracting from their willingness to engage with the industry. Much more information is provided than that needed to make an effective purchasing choice, and the amount of information is discouraging customers from engaging (given that their interest in the product is low to begin with)."⁶²

The AER highlighted information requirements but welcomed further research into the effectiveness of these requirements in practise. The AER stated:

"Notwithstanding that both energy contracts and energy price fact sheets must include terms setting out that the retailer may vary prices (as applicable), there may be some customers who do not read and/or understand either document prior to entering into an energy contract. It is not clear how significant a group of customers this might be or whether some customers do enter into a fixed term contract incorrectly assuming the price is also fixed. A better understanding and examination of customers' beliefs (and preferences) on these issues and price variations terms in energy contracts will assist the AEMC to understand the scale of these concerns and any likely consumer detriment."⁶³

3.4.3 Stakeholders' views on competition between retailers

Most of the submissions presenting consumer views did not address this issue in detail. The ones that did, however, commonly raised that a reduction of offers available would be welcome if it meant that unfair or misleading offers disappeared

⁶² Simply, Submission to National Energy retail Amendment Rule 2014, 27 March 2014, 9

⁶³ AER, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 26 March 2014, 4

from the market.⁶⁴ Many also highlighted the positive effect the proposed rule could have on competition (due to better informed consumers and/or innovation).⁶⁵

In regards to second tier retailers and new entrants, SACOSS stressed that material barriers to market entry were created by the market structures rather than the retail rules. SACOSS stated:

“An important consideration here is the availability of hedge contracts for small, non-vertically-integrated retailers. As outlined in the ACCC rejection of AGL’s proposed acquisition of Macquarie Generation on March 4th, 2014, extensive vertical integration can impair the ability of small retailers to secure hedge cover over the timeframes considered. Given the extent of vertical integration in South Australia (around 99% of small customers are contracted to one of five vertically integrated businesses), it is likely that the non-integrated retailers will be exposed to a different scale of risk than the majority.

However, this is more a result of market concentration and the consequential exercise of market power than the proposed rule change... [I]t is the market structure that presents the material barriers to entry in the South Australian market. In the SACOSS view, the proposed rule change would be unlikely to impact on this.”⁶⁶

In relation to innovation and the number of offers available to consumers, SACOSS stated that a reduction in misleading offers would be a good outcome.

Uniting Care Australia offered a similar view, as it did not regard the number of offers available in the market to be a good yardstick for measuring competition. The submission stated:

“Increasing the range of market offers, beyond an optimum threshold, is most likely to reduce competition in practice, due to rising search and transactions costs.

⁶⁴ See SACOSS, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014 – Consultation Paper, 21 March 2014, TasCOSS, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Consultation Paper, March 2014 and Uniting Care Australia, Submission, In response to AEMC Consultation Paper, Retailer price variations in market retail contracts: Rule Change Proposed by CUAC and CALC, March 2014

⁶⁵ See, for example, Queensland Association of Independent Legal Services (QUAILS), Submission to Retailer price variations in market retail contracts, 25 March 2014, Uniting Care Australia, Submission, In response to AEMC Consultation Paper, Retailer price variations in market retail contracts: Rule Change Proposed by CUAC and CALC, March 2014, Consumers SA, Submission to the Australian energy market Commission, March 2014 and QCOSS, Submission to Retailer price variations in market retail contracts, 20 March 2014

⁶⁶ SACOSS, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014 – Consultation Paper, 21 March 2014, 14

We do not believe that any reduction in the range of market offers, from current levels, as a result of the proposed rule change would have a significant effect on retail competition and prices. Indeed, the rule change may well enhance competition.”⁶⁷

Consumers SA regarded it as unlikely that retailers would withdraw fixed period contracts from the market and that the effect on innovation would be positive:

“The rule change will also improve innovation and investment in mechanisms to more efficiently manage energy market risks. This will have a long term positive impact on pricing available to consumers.”⁶⁸

Submissions presenting retailers’ interests highlighted that the proposed rule would have a negative effect on competition, reduce retail market innovation and make it more challenging for new entrants/second tier retailers to survive.

The ERAA as peak body, supported the AEMC to “consider how the proposed rule will impact on the effectiveness of competition in the market.”⁶⁹ Otherwise they referred the AEMC to the retailers’ individual submissions for assessments of this issue.

In relation to new entrants, both Origin Energy and Energy Australia expressed concern that the proposed rule would create additional challenges for new entrants.⁷⁰ Energy Australia stressed that the smaller retailers would be disproportionately affected as many of them “are not vertically integrated and rely on hedging contracts to manage their wholesale market risk.”⁷¹ In addition to hedging issues, Energy Australia raised issues about the resources and expertise required by retailers in order to analyse network price paths. It warned that many of the smaller players do not easily have the resources to undertake such analysis and could thus “simply choose to be ultra-conservative in setting prices in order to avoid taking on the additional resources required”.⁷²

Origin also provided stark warnings for the effect that the proposed rule could have on market retail contracts (**MRCs**), including the reduction (or elimination) of discounts or increases to prices:

⁶⁷ Uniting Care Australia, Submission, In response to AEMC Consultation Paper, Retailer price variations in market retail contracts: Rule Change Proposed by CUAC and CALC, March 2014, 11

⁶⁸ Consumers SA, Submission to the Australian energy market Commission, March 2014, 4

⁶⁹ ERAA, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014 – Consultation Paper, 27 March 2014, 4

⁷⁰ Origin, Submission to Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014 and Energy Australia, Response to Consultation Paper on Retailer price variations in market retail contracts, 27 March 2014

⁷¹ Energy Australia, Response to Consultation Paper on Retailer price variations in market retail contracts, 27 March 2014, 12

⁷² Energy Australia, Response to Consultation Paper on Retailer price variations in market retail contracts, 27 March 2014, 13

“Origin considers that it is probable that if the proposed rule is made, MRCs featuring benefit periods will be withdrawn from the market or will include much shorter periods. Such offers will be less attractive to consumers and will diminish consumer choice. While Consumer Action and CUAC have surveyed consumer attitudes to unilateral price change clauses in MRCs (though we note this analysis was limited to Victoria), it might be instructive to see how these views might change if customers were aware that the proposed rule may have the following consequences:

- Eliminate or reduce the availability of products featuring discounts for defined periods, or;
- Would result in an increase in energy prices to support the management of additional risks.

The proposed rule will have a negative impact on competition and thus pricing outcomes over the long term. There will be an impact on dynamic efficiency as further innovation on the part of retailers may face the risk of regulatory sanction in the future. This will discourage the development of products that a large number of customers may actually seek and the cost of this negative long term impact may be substantial.”⁷³

Energy Australia argued that retailers may respond in a number of ways if the proposed rule took effect, including withdrawing fixed term contracts and retailers ceasing operations in jurisdictions covered by the National Energy Customer Framework (**NECF**). Energy Australia warned:

“Whatever the predominate approach taken by retailers, the overall outcome is a contraction in the choice available to consumers. It is worth noting retailers withdrawing or shortening fixed term contracts could lead to consumers being subject to more frequent price increases (as generally speaking retailers currently only vary prices one a year). This would be a perverse outcome indeed.”⁷⁴

AGL did not address potential effects on competition in their submission while some of the 2nd tier retailers did. Simply Energy likened the rule change proposal to retail price regulation:

“As this Rule change proposal is nothing more than an attempt to introduce price regulation, the impact on competition is likely to be as deadening as explicit price regulation is to competition.”⁷⁵

⁷³ Origin, Submission to Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 7

⁷⁴ Energy Australia, Submission to National Energy retail Amendment Rule 2014, 27 March 2014, 13

⁷⁵ Simply, Submission to National Energy retail Amendment Rule 2014, 27 March 2014, 12

Simply Energy also believed that 2nd tier retailers would be affected more than incumbent retailers, albeit for different reasons than hedging issues and limited resources as pointed out by Energy Australia. Simply Energy believed it would be easier for incumbent retailers as they have more “sticky-customers” compared to the second tiers. Simply Energy argued:

“First tier retailers have groups of customers that do not participate actively in the market and are content to remain on legacy contracts. As a result, first tiers may have a greater capacity to absorb some of the cost risks that this Rule change would impose than second tier retailers whose contracts are typically fixed term contracts.”⁷⁶

Momentum argued that: “competition would be further limited by reducing retailers’ incentive to innovate.”⁷⁷ Similarly, Alinta stated “that adoption of the proposed rule will only serve to decrease the level of competition and number of product offerings in retail energy markets.”⁷⁸ Ergon Energy also raised concerns about the proposed rule’s effect on competition, as retailers would be limited in their ability to innovate and less products would be offered to consumers. Ergon Energy also expressed a strong belief in markets being able to deliver efficient outcomes without interference:

“After a MRC price increase, customers will either consume less energy, pay more to consume the same amount of energy, or perhaps a combination of the two. The CUAC and CALC consider that these responses are less than ideal for the retail market overall because:

- Where the customer reduces their consumption, less energy is being consumed that is efficient for the market; and
- Where the customer pays more, there is a transfer of wealth from the customer to the retailer, which would not occur if the market price was efficient.

Whilst these examples are valid, Ergon Energy is not convinced that, with the operation of an efficient retail market being the underpinning objective, the market will not eventually demonstrate an efficient price without market interference.”⁷⁹

The AER expressed concern about the proposed rule resulting in retailers offering fewer fixed term contracts as in AER’s view “a more efficient market outcome could

⁷⁶ Simply, Submission to National Energy retail Amendment Rule 2014, 27 March 2014, 13

⁷⁷ Momentum Energy, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 1

⁷⁸ Alinta Energy, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Consultation Paper, 27 March 2014, 5

⁷⁹ Ergon Energy, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Consultation Paper, 27 March 2014, 4

see retailers offering a greater selection of fixed price contracts in response to demand from those customers who are willing to pay more for price certainty”.⁸⁰ The AER did note, however, that such developments should be supported by consumer information in order to ensure that customers understand the difference between the contract types and the implications of their choices.

The AER also agreed with the AEMC’s observation that second tier retailers may be more disadvantaged by the proposed rule compared to incumbent retailers.

3.4.4 Stakeholders’ views on alternative approaches

Most consumer groups did not support a limited pass-through and/or proposed alternative approaches.⁸¹

PIAC and Consumers SA both expressed strong support for the proposed rule change but provided alternatives should the AEMC not accept the rule as proposed by Consumer Action and CUAC. PIAC’s proposal included that:

- Consumers are notified about price increases 21 days in advance
- Retailers are required to clearly and consistently inform consumers about how prices may vary during the contract period
- Consumers should be allowed to terminate a contract without having to pay Early Termination Fees upon receiving notification about price increases⁸²

Consumers SA stated that other alternatives might be:

- Removing the ability to include both variable pricing and exit fees in the same contract
- A requirement for retailers to offer both a variable price and fixed price market contract (with appropriate adjustments to terminology to make this clear)⁸³

None of the retail submissions were supportive of the alternative approaches raised by the AEMC. The ERAA, while it didn’t consider Consumer Action and CUAC’s proposal, briefly assessed three of its own alternative rules:

1. Creating a prescriptive list of costs that can and cannot be passed through to consumers by retailers during fixed periods.

⁸⁰ AER, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 26 March 2014, 5

⁸¹ See submissions by Uniting Care Australia, TasCOSS, Uniting Care Wesley Bowden, SACOSS, QCOSS, Queensland Association of Independent Legal Services, NCOSS, National Seniors, Major Energy Users, Ethnic Communities’ Council of NSW and COTA Queensland.

⁸² PIAC, Let’s be clear: PIAC submission to the AEMC’s Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 5

⁸³ Consumers SA, Submission to the Australian energy market Commission, March 2014, 5

2. Allowing customers a limited amount of time to switch retailers or contracts without paying an exit fee following a price variation.
3. Requiring retailers to provide more information to consumers about how prices could vary under market retail contracts.⁸⁴

It concluded that none of them would deliver outcomes that were in the interest of consumers.

In regards to a limited pass-through, Energy Australia argued that it was impractical and, if limited to network charges only, very similar to the current arrangements:

“A limited pass-through of costs will inevitably be beset by definitional issues regarding allowable, and non-allowable costs. While some such as network increases, are easily defined and impact all retailers relatively evenly, others are more troublesome...

With regard to network costs, once determined by the AER the impact on retail prices is generally quite easy to quantify and consequently these would make a suitable candidate for a limited pass through component. However, current practice is for retailers to increase prices on an annual basis in line with network increases, so it is difficult to see how restricting passthrough to network increases is materially different to the status quo.”

In relation to alternative approaches, Energy Australia stated that they were not convinced that the current arrangements caused a problem and “placing a regulatory prohibition on what is considered by most to be a valid contract option will disempower and disengage consumers in a climate where it is important that they are informed and aware.”⁸⁵

Origin opposed the limited pass-through alternative and called for further evidence of the costs and benefits associated with the issues raised prior to discussing alternative approaches:

“There may be alternative means of managing the issues identified by the proponents that will not require a change to the NERR with such significant and disproportionate negative impact on energy retailing.”⁸⁶

⁸⁴ ERAA, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014 – Consultation Paper, 27 March 2014, 6

⁸⁵ Energy Australia, Response to Consultation Paper on Retailer price variations in market retail contracts, 27 March 2014, 15

⁸⁶ Origin, Submission to Consultation Paper - National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 27 March 2014, 9

AGL indicated that there might be alternative approaches that could address the consumers' understanding of contract terms:

"AGL would be happy to work with the AEMC and customer advocacy groups to consider means of improving engagement with customers to ensure there is comprehension of terms and conditions of contracts. AGL further notes that PIAC has suggested some alternative regulatory amendments for consideration to the AEMC. While AGL is not endorsing these suggested amendments per se, AGL does agree that there may be merit in consulting further on such measures."⁸⁷

Other retailers, including Alinta, Ergon, Momentum, Red Energy and Simply Energy did not believe that the rule change proposal had demonstrated a problem with the current arrangements and action was therefore not required.

The AER referred to its Retail Pricing Information Guideline that prescribes the type of information retailers must include in their fact sheets and expressed a willingness to amend these guidelines to address some of the concerns highlighted by the rule change proposal:

"For example, requiring retailers to present information more clearly and prominently about the applicability of price variations for energy contracts on their energy price fact sheets; being more prescriptive (as well as promoting better practice across retailers) about how they describe fixed price and fixed term contracts on energy price fact sheets. We could also work in partnership with energy retailers and consumer organisations to improve energy customers' understanding and awareness of these different contracts."⁸⁸

The Victorian Department of State Development, Business and Innovation also highlighted increased consumer awareness of the different contract types as a solution to the problem raised. The Department therefore suggested the AEMC to consider amendments to the relevant Marketing Rules in order to ensure that retailers expressly advise consumers that their contract may be subject to change.

3.4.5 Summary of stakeholders' views

In regards to risk and cost allocation the submissions presented two sets of beliefs or arguments. On the one hand, there were those who argued that the most important aspect for retail markets, competition and consumers is that consumers pay the

⁸⁷ AGL, Retailer price variations in market retail contracts, Consultation Paper, 1 April 2014, 5

⁸⁸ AER, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 26 March 2014, 7

lowest price possible and have maximum choice.⁸⁹ On the other hand were those who argued that markets and competition do not benefit consumers if consumers do not have confidence in the market. Clear contract obligations would promote consumer confidence and market transparency. However, neither side submitted much evidence in support of their arguments.

Similarly, there was very little evidence presented on whether variable prices had a negative effect on consumer participation. Again, it was one argument versus another.

Stakeholders' views on competition were also polarised. From one side, the view was that the more offers and contract types that are available to consumers the more consumers benefit from competition. The other side argued that the total number of offers is of less importance to consumers, especially when many of the offers available are misleading and/or unfair.

These polarised views were also evident in relation to what delivered the most efficient outcomes: free market versus regulation of contract terms.

Interestingly, incumbent retailers, regulators, and even consumer groups, were more concerned about how the rule could disproportionately disadvantage 2nd tier retailers (or new entrants) than the 2nd tier retailers themselves.

Finally, neither consumer groups nor retailers were very interested in alternative approaches. Consumer groups argued for the proposed rule while retailers argued for the status quo. Regulators and government departments, on the other hand, supported an option that would improve consumer understanding of contract terms through the provision of clearer information.

4. Public forum

On 19 May, the AEMC held a public forum on the rule change proposal in Melbourne. In addition to the AEMC Commissioners and staff, the forum was well attended by industry, regulators, policy makers, consumer groups from various NEM jurisdictions, as well as other interested stakeholders.

In organising the forum the AEMC consulted with Consumer Action and CUAC, at which time they suggested speakers for the forum. They found however, that the AEMC was unwilling to accommodate their suggestions. Consumer Action and CUAC, for example, believed that the discussion would benefit from a presentation by an

⁸⁹ We note that AGL's submission stated that "AGL is collating some information to provide to the AEMC which will assist the AEMC in this analysis. This information will make clear that there is a high risk that the Rule Change Proposal risks limiting the breadth and affordability of energy offers available to customer, and thereby risks exacerbating any affordability issue" (as discussed above). However the AEMC has confirmed that "AGL did not subsequently provide us with information that we considered achieved this aim" (email correspondence between Consumer Action and the AEMC).

expert on behavioural economics but the AEMC would not allow additional time for this. The result was that CUAC gave up some of its allotted time to address the forum in order to make time for a presentation on consumer behaviour.

The forum commenced with the AEMC presenting on its assessment framework and providing an overview of submissions received to the consultation paper.

The first session focused on whether there is a problem that requires a regulatory response. Presentations by Gerard Brody from Consumer Action, Keith Robertson from Origin Energy, Vince Duffy from the South Australian Department for Manufacturing, Innovation, Trade, Resources and Energy (**DMITRE**) and Dr Paul Harrison, Senior Lecturer and Chair of Consumer Behaviour, Deakin University were followed by questions and open discussion.

The second session focused on what the appropriate regulatory response to the consumer problem should be. Presentations by Jo Benvenuti from CUAC, Ramy Soussou from the ERAA, Andrew Reeves from the AER were followed by general discussion.

Despite significant interest in the issue, evident from the turnout, most of the arguments and views presented echoed those presented in the submissions to the AEMC's consultation paper. The exception was Dr Paul Harrison from Deakin University who was able to deliver "new" perspectives on the issues.

Box 10 Consumer Action and CUAC's reflections on the public forum

The public forum did not result in a rational, evidence-driven policy discussion. Rather it was an assertion-driven discussion by the different parties that even resulted in the use of scare tactics. It certainly did not facilitate a useful discussion.

There was no real engagement and it is difficult to see what value the forum provided the Commissioners – being the primary audience for all that speaking.

In June 2014, Consumer Action and CUAC wrote to the AEMC to express their concerns about a number of assertions made at the public forum. In particular, they were concerned about the comments made in relation to:

- customer preferences for variable rate contracts; and
- the effect on customers of adopting the proposed rule.⁹⁰

Origin Energy's forum presentation included claims such as:

- Repeated customer selection of energy plans where the price may vary indicate that consumers understand and prefer this option; and

⁹⁰ Consumer Action and CUAC, Letter to the AEMC, 26 June 2014

- The likely outcome [of the proposed rule] is shorter contracts—increasing search/transaction costs for consumers.⁹¹

Furthermore, it was argued that customers understand price variation and do not see this as problematic. The evidence presented in support of this claim was an AEMC survey of NSW consumers in December 2012 (when NSW prices were still regulated), which found that only 2% of electricity customers (and no gas customers) were dissatisfied due to price rises.⁹²

Consumer Action and CUAC's letter outlined why these claims were fraught and unsubstantiated. In addition, they referred to the AER's alternative characterisation of the consumer problem, which was that:

"[C]onsumers may not understand that a fixed term contract (or one with a fixed benefit period) does not mean that the price they are charged for energy is also fixed for the period of that term."⁹³

With this in mind, Consumer Action and CUAC proposed a joint meeting of the AER, AEMC, ERAA and themselves to discuss "other rules that are designed to improve consumer understanding of the types of contract that they enter into, and particularly the ability of the retailer to vary the price."⁹⁴

5. AEMC Draft Determination

On 31 July 2014, the AEMC released its draft determination. At the same time, the AEMC released a report it had commissioned on Consumer Research on Retailer Price Variations in Market Retail Contracts.⁹⁵

The draft determination assessed issues raised during the rule change request, including the views of Consumer Action and CUAC, stakeholder submissions, and the AEMC's views on whether these issues required a regulatory response. The report also presented the AEMC's preferred draft rule and other relevant observations.

5.1 Consumer research

⁹¹ Origin, Retailer price variations in market retail contracts, Presentation to Public Forum 19 May 2014

⁹² Origin, Retailer price variations in market retail contracts, Presentation to Public Forum 19 May 2014 and Consumer Action and CUAC, Letter to the AEMC, 26 June 2014

⁹³ Consumer Action and CUAC, Letter to the AEMC, 26 June 2014, 3

⁹⁴ Consumer Action and CUAC, Letter to the AEMC, 26 June 2014, 3. This meeting did occur, and it precipitated the AER's review of its Retail Price Information Guideline which was initiated in early 2015.

⁹⁵ Newgate Research, Consumer Research on Retailer Price Variations in Market Retail Contracts for the Australian Energy Market commission (AEMC), Final Qualitative and Quantitative Research Report, June 2014

The Newgate report presented the findings of research conducted between February and April 2014 on behalf of the AEMC. The objective of this research was to explore community reactions to issues relating to retailer price variations in market retail contracts.⁹⁶

More specifically, the study was designed to explore:

- How consumers interpret different terminology around market contracts;
- Consumers' awareness of price changes during market contracts and how they react to this;
- Consumers' preferences in relation to contracts with a higher fixed price per unit of energy consumed versus a lower variable price per unit of energy consumed; and
- Consumers' preferences for addressing this issue going forward.⁹⁷

Qualitative and quantitative research was conducted in southeast Queensland, Victoria, South Australia, New South Wales and the ACT. The qualitative research involved 162 participants attending forums lasting for three and a half hours. The quantitative component surveyed 2,213 participants using telephone and online questionnaires.

Newgate Research stated that consumers in most jurisdictions knew about retail choice and that different types of plans were available. Consumers' knowledge and understanding of these plans, however, were relatively low. The report also noted that in forum discussions outside Victoria, only a few consumers mentioned that retailers offer contracts of various lengths.

Box 11 Newgate research – key findings⁹⁸

The qualitative research suggests retailer price variations in market retail contracts is not an issue that many people have thought much about before and it is not the issue of greatest importance to most – rather, it is seen as another example of the complexity of energy offers that could be addressed through clearer marketing.

There was confusion about what is actually fixed in an energy contract – the rate per unit of energy used, discounts off the price paid, both or neither, with one in five (21%) unsure. In the qualitative research many said they hoped the rate per unit was fixed but did not expect it was.

⁹⁶ Newgate Research, Consumer Research on Retailer Price Variations in Market Retail Contracts for the Australian Energy Market commission (AEMC), Final Qualitative and Quantitative Research Report, June 2014

⁹⁷ Newgate Research, Consumer Research on Retailer Price Variations in Market Retail Contracts for the Australian Energy Market commission (AEMC), Final Qualitative and Quantitative Research Report, June 2014, 4

⁹⁸ Newgate Research, Consumer Research on Retailer Price Variations in Market Retail Contracts for the Australian Energy Market commission (AEMC), Final Qualitative and Quantitative Research Report, June 2014, 3

Both the qualitative and quantitative research suggests many consumers were not aware whether or not they were actually on a contract. Across the NEM, just over half of the residential and small business consumers surveyed (53% and 52% respectively) said they had previously signed up for a contract for a specific period of time, such as one, two or three years.

Among those who had previously signed up for a contract for a specified period of time, there was mixed awareness of whether the rate per unit of energy used had changed during that contract with half (49%) of residential consumers and around three in five (59%) small business consumers reporting that the rate had changed.

Amongst those who had noticed a change in the rate per unit of energy used once signed up to a contract for a specified period of time, the most common response was to do nothing. Around 37% of residential customers and 25% of business customers said they did nothing and just paid their account with others saying they just accepted that prices were rising, felt they were locked into a contract or were aware that price rises were within the terms of the contract. The second most common response was to contact their energy company and query the amount (20% residential, 24% business). Around 6% of residential consumers and 1% of business consumers said they had looked at switching to other energy companies, with around 8% of residential and 7% of business consumers actually changing. Around 4% of residential consumers and 5% of business consumers expressed negative emotion over this issue, saying they were angry, disgruntled or shocked.

There were mixed responses when respondents were presented with the option of a contract with a *fixed rate per unit consumed with an estimated 1% saving from the regulated price* or a contract with a *variable rate per unit of energy consumed with an estimated 9% saving*. Participants expressed preference for the option that met the needs of their specific household situation, with the majority of low-income households expressing a preference for the fixed rate. Most participants felt a range of different contract options with both fixed and variable rates per unit of energy should be available for consumers to choose from.

5.2 AEMC's analysis and position

The AEMC took the view that the issues requiring a regulatory response are narrower than that argued by Consumer Action and CUAC. The AEMC's position was that some consumers could be better informed about contract terms and conditions and that this was the only issue that required a regulatory response, albeit a proportionate one. The AEMC stated:

"The Commission considers that its response to this issue should be proportionate and consistent with the promotion of consumer engagement and competitive retail energy markets. The Commission considers that a proportionate approach would be to promote transparency and better

information for consumers in relation to the ability for prices to vary during fixed periods in *market retail contracts*.”⁹⁹

The AEMC’s draft decision involved the inclusion of one new rule (46A) and an amendment to rule 64.

Box 12 Proposed changes based on the AEMC’s preferred draft rule¹⁰⁰

To include a new rule 46A of the retail rules that specifically requires retailers to disclose to consumers any term or condition that provides for the variation of tariffs, charges and benefits (that is, prices) as part of the existing requirement to obtain explicit informed consent from consumers to the entry into a market retail contract.

To amend rule 64 of the retail rules to put beyond doubt that retailers are required to provide information about when they will notify consumers of variations to prices, charges and benefits (to the extent both are not otherwise part of prices) in market retail contracts. This information would be provided to consumers shortly before or following contract entry as part of existing product disclosure requirements. Under the current retail rules, consumers have a ten business day cooling off period to withdraw from the contract after they receive product disclosure information on contract entry.

In relation to the NERO test and the consumer protection test, the AEMC stated that the preferred rule is likely to enhance consumer engagement by better informing consumers and thus contribute to the NERO. Furthermore, the AEMC believed the preferred rule was compatible with consumer protections as it will work alongside and enhance current requirements on retailers in regards to obtaining explicit informed consent and product disclosure.

The draft determination discussed four key issues raised by Consumer Action and CUAC’s rule change proposal and assessed stakeholders’ views (as presented in submissions to the initial consultation paper) in regards to the issues. The four issues were:

1. Allocation of costs and risks in market contracts
2. Inefficient consumption decisions due to price variations
3. Consumer participation in retail energy markets
4. Uncertainty in the application of ACL

5.2.1 The AEMC’s views on allocation of costs and risks

⁹⁹ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 13

¹⁰⁰ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 13

The AEMC's starting point for this analysis was that competition would allocate risks efficiently. As long as a market is competitive, there would be no reason to interfere with a market to allocate risks. Such interference will always result in less efficient risk allocation than what a competitive market will produce:

"In a competitive market there should be few incentives for retailers to pass risks on to consumers where retailers are themselves better able to manage these risks. Not managing these risks (and therefore passing on inefficient costs) would expose the retailers to the competitive threat that other retailers would have lower costs and those other retailers would therefore secure greater market share and profits. In other words, the competitive process should discipline the behaviour of all retailers in the market to reflect efficient costs by efficiently managing or passing on risks in their market offers."¹⁰¹

The AEMC acknowledged "it is generally more efficient for the party with the greatest ability to manage risks to do so."¹⁰² However, they rejected Consumer Action and CUAC's argument that retailers should therefore bear all risks in energy retail markets. The reason given was that the risk in the energy retail market is too far outside the retailers' control. If retailers were required to manage such risks it would result in a risk premium being charged to consumers.

The AEMC also noted the arguments presented by retailers stating that they generally only pass on costs outside their control when they vary prices and argued that this would be because of the competitive pressures in the market:

"The Commission notes that, even though retailers are able to pass on increased costs in the form of price rises in fixed period market retail contracts, retailers still have a competitive incentive to manage risks where it is efficient to do so and only pass on efficient costs. This reflects the views provided by retailers who submitted that generally only costs outside of their control are passed on in the form of price variations."¹⁰³

One key indicator that the AEMC used to assess whether price variations are negatively affecting competition and efficiency was to ascertain to what extent current risk and cost allocations are different to consumer preferences.

This is based on a reference to the AEMC's research of 53 offers (of which 22% were standing offers) available to customers in Sydney in July 2014¹⁰⁴ that found:

¹⁰¹ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 19

¹⁰² AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 20

¹⁰³ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 20

¹⁰⁴ We note that the AEMC's Consultation Paper referred to this research being undertaken in January 2014 (prior to price deregulation taking effect in NSW). See AEMC, *Retailer price variations in market retail contracts*, Consultation Paper, 13 February 2014, FN 84, 35

“Almost half of the electricity contracts available in Sydney in July 2014 were fixed period contracts in which the price could vary during the fixed period. Over 95 per cent of the available fixed period contracts did not have a fixed price. In these contracts, risks associated with increases in the cost of supplying energy, to the extent that they are not tempered by competition, are borne by consumers. Two of the available fixed period contracts fixed the price of electricity for a defined period of time. In these contracts, all risks associated with increases in the cost of supplying energy are borne by retailers. Similar fully fixed price contracts are available in Victoria, South Australia, and most of New South Wales.”¹⁰⁵

The AEMC used this evidence to reach the following conclusion:

“It is evident from the terms of the available range of market offers that retailers generally manage some risks (e.g. risks associated with changes in wholesale market costs) and manage others to a lesser degree or not at all (e.g. risks associated with changes in regulated network costs and government policy costs). However, it is also evident that there are a small number of market offers that manage more, if not all, risks for consumers for a fixed period. This can be seen in the fully fixed price market offers currently being offered by some retailers in some jurisdictions.”¹⁰⁶

In order to assess consumer preferences, the AEMC referred to its Newgate consumer research report. Respondents were asked whether they would prefer a contract that had a variable price that would give them an estimated 9% saving or a fixed price contract that would give them a saving of 1%. Forty-five per cent of respondents preferred the variable offer with the greatest saving, 31% preferred the fixed price with the lower saving and 20% wanted “something else”.¹⁰⁷

The AEMC stated:

“The Newgate consumer research clearly indicates that surveyed residential and small business consumers have varying appetites for bearing risks.”¹⁰⁸

Furthermore, they noted that the research also demonstrated that a significant number of consumers value price certainty. In relation to this the AEMC stated:

“Given this, it may be that the competitive market is not currently delivering the level of fixed price contracts that one would expect to meet those consumers' preferences.”¹⁰⁹

¹⁰⁵ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 21

¹⁰⁶ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 21

¹⁰⁷ Based on 1,833 residential consumers across the NEM. The remaining 4% stated something else or they did not know.

¹⁰⁸ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 22

¹⁰⁹ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 22

In regards to whether this issue required a regulatory response, however, the AEMC concluded:

“The Commission considers that there is not sufficient evidence to show that the ability of retailers to vary prices is of itself allowing retailers to pass through inefficient costs to consumers. The Commission also notes there is a range of contracts available which appear to largely reflect the varying preferences of consumers with respect to the level of risk they are willing to bear in market retail contracts. Given this, the Commission considers that there is not sufficient evidence to support the view that there is a market failure in the allocation of risks between retailers and consumers in market retail contracts.”¹¹⁰

In addition, the AEMC recommended more transparency and clearer information about contract terms. The AEMC argued that improved transparency could result in more competitive retail markets as well as allowing consumers to more clearly communicate their preferences.

5.2.2 The AEMC’s views on inefficient consumption decisions due to price variations

The AEMC noted that inefficient consumption decisions are likely to occur if retailers engage in “price baiting” practices (i.e. offering low prices and then increasing the price shortly after the consumer has entered a contract). However, the AEMC also argued that such practices, if involving significant price increases, could only occur in markets where competition is ineffective.

The AEMC had consulted with consumer groups and jurisdictional ombudsmen schemes and awareness of price baiting cases was low. While submissions from EWOV and EWOSA stated that consumer complaints regarding price rises occurred, the AEMC argued that there was no evidence that these complaints were linked to price baiting practices. In their submissions, PIAC and SACOSS argued that price baiting occurs but the AEMC noted that neither organisation provided evidence to support the view that price baiting is widespread. In regards to retailers’ submissions, the AEMC noted that submissions stated “that they do not engage in price baiting practices”.¹¹¹

The AEMC formed the view that there is insufficient evidence to conclude that widespread price baiting practices occur. In addition, the AEMC noted that when such practices do occur, the ACL already provides the necessary protections and that the ACCC had taken action against energy retailers for deceptive and misleading conduct.

¹¹⁰ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 23

¹¹¹ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 27

5.2.3 The AEMC's views on consumer participation in retail energy markets

Firstly, the AEMC assessed whether price variations cause consumer disengagement and they concluded that there was insufficient evidence that this was a significant issue. The AEMC noted the following findings by the Newgate Consumer Research:

- Consumers are generally satisfied with their current retailers.
- A low number of consumers responded to price variations with negative emotions (i.e. anger or shock).
- Most consumers regard price variations of less importance compared to other retail market issues (such as improved information, comparability and availability of comparison websites).

In addition, submissions from consumer groups largely focused on difficulties experienced by consumers attempting to engage with the retail market due to market complexity and inadequate information.

Secondly, the AEMC assessed whether poor information about price variations could contribute to consumer disengagement. The AEMC's view was that:

“[E]ven though it does not appear that price variation clauses are causing significant consumer disengagement from retail energy markets, the level of consumer understanding of retail energy contracts with respect to price variations is low. Poor information and low levels of transparency with respect to the terms and conditions in retail energy contracts have the potential to hinder competition in retail energy markets.”¹¹²

The AEMC referred to the Consumer Research that showed that only 11–16% (depending on jurisdiction) of respondents said that “neither (rate or discount) are fixed” when it comes to residential energy contracts. In relation to the qualitative research component however, the AEMC noted that the majority of participants “clarified that they had actually hoped the price would be fixed because it would shield them from rising energy prices, but they assumed that, realistically, the price would probably not be fixed.”¹¹³

In conclusion, the AEMC did not consider there to be sufficient evidence to support the view that consumers disengage from the market because retailers can vary prices for fixed term contracts. However, the AEMC also concluded that some consumers are not well informed about terms and conditions of contracts, and that this finding does require regulatory response.

5.2.4 The AEMC's views on uncertainty in the application of ACL

¹¹² AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 35

¹¹³ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 36

The AEMC agreed that there “is a degree of uncertainty in the application of the unfair contract terms provisions in the ACL. This is because rule 46 of the retail rules appears to imply rather than “expressly permit” retailers to include terms that allow for price variations during fixed periods in *market retail contracts*.”¹¹⁴

However, as the evidence for retailers engaging in price baiting practices was insufficient, the AEMC considered it unnecessary to clarify this uncertainty.

5.2.5 The AEMC’s consideration of the proposed rule

The AEMC concluded that it was inappropriate to make the rule as proposed, or the alternative proposed rules, because they are not a proportionate response to the issues identified in the request. In its assessment of the effect of the proposed rule, it highlighted negative effects pertaining to consumer choice, prices and competition.

Firstly, the AEMC took the view that the proposed rule would limit consumer choice and restrict retail innovation. Less product choice would also hinder the competitive process of consumer choices informing retailers of consumer preferences. This could further lead to retailers not responding to consumer preferences by adapting their products. The AEMC also noted the “risk that consumer engagement in the market could be affected if consumers find that the market is not meeting their preferences.”¹¹⁵

Secondly, the AEMC believed it was likely that the proposed rule would result in higher prices for fixed term contracts. The AEMC stated:

“The proposed rule would require retailers to manage more risks on behalf of consumers. In particular it would require retailers to manage risks that they have a limited ability to predict or manage, such as the risks that network prices and government policy costs may rise over the duration of fixed period contracts. These are significant costs, making up more than 60 per cent of the average retail energy bill. While retailers may have a better ability to manage changes in network prices and government policy costs than consumers, the Commission notes that retailers still have a limited ability to predict or control these changes in costs.”¹¹⁶

The AEMC had investigated the price difference between fixed price contracts (offered by Origin and Energy Australia) and variable contracts, and that while the “premium” paid for fixed price contracts varied significantly between jurisdictions they were material (from approximately 9–20%). So while the proposed rule could result in greater market transparency, the AEMC considered the consumer benefits from

¹¹⁴ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 36

¹¹⁴ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 40

¹¹⁵ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 50

¹¹⁶ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 50

increased transparency to be marginal compared to the negative effects the proposed rule would have on price, consumer choice and competition.

Thirdly, the AEMC believed that the proposed rule would affect small (2nd tier) retailers more than the large, vertically integrated retailers due to their more limited ability to manage risk. This could result in smaller retailers, and particularly new entrants, being unable to offer fixed term contracts or only offer short term, fixed term contracts. The effect of this, the AEMC argued:

“This in turn could impact the level of competition in retail energy markets as smaller retailers are not able to effectively compete with larger and more established retailers in providing fixed period contracts. Over time, lower levels of competition and a reduced threat of new entrants are likely to reduce competitive pressure on existing retailers to offer efficiently priced contracts that reflect consumers’ preferences.”¹¹⁷

The AEMC also considered the effect of the alternative rules proposed by Consumer Action and CUAC. In relation to a rule that allowed for a limited pass through (of government policy costs) the AEMC took the view that this rule would have the same negative effects as the preferred proposed rule, as well as causing:

- greater regulatory uncertainty for retailers regarding which costs can and cannot be passed through to consumers as a result of the need to create a prescriptive list of costs, or to define categories of costs, that may be passed through to consumers;
- greater administrative burden for retailers in managing the pass-through of costs to consumers;
- greater difficulty in administering and enforcing compliance for the AER in overseeing compliance with the rule; and
- the potential for consumer confusion as to how prices may vary.¹¹⁸

In relation to the proposed alternative to remove rule 46 of the retail rules to ensure that the ACL’s unfair contract terms can be applied to energy retail contracts, the AEMC noted that “there would be no appreciable benefit to be gained from clarifying the application of the unfair contract terms provisions in the ACL”¹¹⁹ and that no regulatory response to this issue was required.

Box 13 The AEMC’s determination¹²⁰

The Commission considers that the proposed rule and alternatives could have a range of negative effects on the price consumers pay for energy, as well as on the choices available to consumers and the level of competition in retail energy markets. The

¹¹⁷ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 52

¹¹⁸ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 52

¹¹⁹ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 53

¹²⁰ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 53

Commission considers that these negative effects of the proposed rule would outweigh the benefits of the proposed rule from increased transparency of prices for consumers and improved consumer engagement.

In light of these findings, the Commission considers that it is not appropriate to make the rule as proposed or the alternatives proposed because they are not a proportionate or appropriate response to the issues raised by the rule change request.

5.3 Consumer Action and CUAC's response to the Draft Decision

Box 14 Consumer Action and CUAC's reflections on the Draft Decision

CUAC and Consumer Action were naturally very disappointed, and surprised, by the AEMC's Draft Determination. We were somewhat bewildered as to how the AEMC had reached these views and question the quality of the evidence behind the AEMC's conclusions. We were particularly frustrated by the consumer research commissioned by the AEMC. The question as to whether consumers would prefer a fixed price contract with a 1% saving off the regulated price or a variable contract with a 9% saving off the regulated price, seemed flawed and the interpretation of survey results selective.

In their submissions to the draft decision, Consumer Action and CUAC rejected the AEMC's conclusions and identified 10 specific problems they had in regards to the decision and associated material.

1) A lack of response to the economic analysis and advice provided as part of the evidence base for the Rule Change Application. While the economic analysis undertaken by Dr Rhonda Smith was presented as evidence to support the rule change request, the AEMC's draft decision failed to provide any substantive analysis or critique of Dr Smith's work.

2) That the AEMC has applied a selective analysis of the consumer research findings. The AEMC has, for example, not acknowledged that the consumer research shows that a plurality of residential consumers across the NEM (43 per cent) believes that the rate paid per unit of energy consumed on an energy contract is fixed.

Furthermore, the draft decision, with reference to Newgate's consumer research, considers that consumers do not find the problem of non-fixed prices to be particularly important. Consumer Action and CUAC argued:

"Given that Newgate's research found consumers were generally frustrated with and distrustful of energy retailers, this is unsurprising: when the overall attitude toward retailers is this bad, it's rare for single issues to stand out. Simply because fixed pricing did not rank highly on the list of consumers' concerns does not mean it is an issue consumers are not concerned about. A change in one aspect of the

relationship between consumers and their retailer could have a significantly positive impact across the board.”¹²¹

They also argued that the AEMC appears to rely heavily on the consumer research finding that “almost half of residential and small business customers say they prefer the type of contract this request would have stopped retailers from offering.”¹²² Consumer Action and CUAC stressed that there are a number of problems with the question behind this finding, as well as the AEMC’s reliance on it:

“The relevant question from the research asked whether consumers would prefer a fixed period contract with a relatively large discount from the regulated tariff, or whether they’d prefer a fixed period contract with small or no discounts from the regulated tariff that had a variable price... In Victoria, and indeed a number of the NECF jurisdictions, there is no longer a regulated tariff. It is therefore hard to see how a respondent is to make sense of this question; at the very least, it doesn’t tell a policy maker much about the impact of the proposed rule change. The Newgate research report also noted that the qualitative sample found this question “somewhat difficult to absorb”. As such, caution should be taken placing too much reliance on the quantitative sample’s response to the question. Around 25 per cent of respondents answered ‘something else’ or ‘don’t know’, which indicates that there may well have been confusion.”¹²³

3) No acknowledgement of the insights of behavioural economics into consumer behaviour or any analysis of the issues raised:

“It is disappointing that the Commission has, at least in its published Draft Determination, given no consideration to this relevant field and its ability to inform robust analysis and decision making. We again refer to statements from other regulators, such as the Chairman of the Australian Securities & Investments Commission, who states that regulators should be considering behavioural science ‘to better understand how consumers really behave’. We also reiterate that the Office of Best Practice Regulation has provided guidance to policy makers and regulators about influencing consumer behaviour through regulatory design.”¹²⁴

¹²¹ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, September 2014, 4

¹²² See AEMC, Letter to the Editor – Retailer Price Variations, <http://www.aemc.gov.au/News-Center/What-s-New/Announcements/Letter-to-the-editor-%E2%80%93-Retailer-Price-Variations-i>

¹²³ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, September 2014, 5

¹²⁴ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, September 2014, 6. With references to Greg Medcraf, ‘Speech—Regulating for Real Consumers’, ASIC Annual Forum, March 2014, available at:

[https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-Forum-2014--Opening-address--24March2014.pdf/\\$file/ASIC-Forum-2014--Opening-address--24March2014.pdf](https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-Forum-2014--Opening-address--24March2014.pdf/$file/ASIC-Forum-2014--Opening-address--24March2014.pdf)

Office of Best Practice Regulation, ‘Influencing Consumer Behaviour: Improving Regulatory Design’, December 2012, available at: <http://ris.dpmc.gov.au/2012/12/18/obpr-research-paper-influencing-consumer-behaviour-improving-regulatory-design/>

4) That the AEMC fails to demonstrate why consumers are better at managing risks compared to energy retailers. While the draft decision acknowledges that Consumer Action and CUAC's proposed rule would require retailers to manage more risk on behalf of consumers and that retailers have a better ability to manage price changes than consumers, it does not explain why consumers should bear these risks. Consumer Action and CUAC added:

"We feel that the Commission may have overlooked the fact that the proposed rule does not inhibit a retailer from offering variable price market contracts. It does, however, prevent such contracts operating for a fixed term. Retailers would be free to offer a variable price market contract on an 'evergreen' arrangement, free from fixed terms or exit penalties. Given this flexibility, there should be no cause for concern about retailers being unable to manage risks."¹²⁵

5) That the decision lacks modelling of the alleged "premium" that retailers would charge if the proposed rule was made. The AEMC had compared current fully fixed-price market contracts to other market contracts and found that the "price premiums" for fully fixed contracts ranged from 9.7% and 20.4%. Consumer Action and CUAC argued:

"While the Commission acknowledges that these percentages may not actually reflect the risk involved for retailers in offering these contracts due to the low level of competition in the provision of these contracts, these percentages in fact cannot represent any risk premium. This is because the comparison point is not the entry price for a fully-fixed offer versus a variable price offer. Rather, the comparison should be the total amount paid by a consumer on a fully-fixed offer and a consumer on a variable offer over the term of the contract. This would therefore include price increases imposed by the retailer on the variable offer. In the absence of the necessary analysis, the Commission's stated variations cannot be relied on."¹²⁶

6) That the AEMC has not properly considered alternative scenarios or solutions raised in consultation (i.e. stakeholder submissions), such as the banning of exit fees and requiring prices in a fixed-period market contract to be fixed for a period of time.

7) That the AEMC has not adequately sought to establish the presence or absence of price-baiting as a market practice:

"The Draft Determination states that there is insufficient evidence to conclude that retailers are engaging in widespread price baiting practices. The Commission

¹²⁵ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, September 2014, 7

¹²⁶ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, September 2014, 7

has not, to our knowledge, asked retailers for the history of price increases and their timing for market contracts offered to consumers. Without this information, it is impossible to say there is no evidence of price baiting.”¹²⁷

8) That the AEMC appears unwilling to consider international experiences and evidence to inform the draft decision. Consumer Action and CUAC noted that while there is no requirement on the AEMC to consider international consumer protections, it does have “a significant policy making role, and it would be expected to seek out and consider international examples of good and bad practice in the matter under consideration.”¹²⁸

9) That the AEMC fails to reduce uncertainty with the application of unfair contract term laws for energy consumers. While the AEMC acknowledges that this uncertainty creates costs, and for consumers in particular, it will not take any responsibility for fixing the problem. The draft decision merely suggests that the unfair term provisions should be first tested by the courts. Consumer Action and CUAC argued:

“The Commission had the opportunity to reduce uncertainty and these costs by making the proposed rule and effectively clarifying that unilateral price variation clauses are unfair. While it may not have regulatory power in relation the ACL or the Retail Law, the Commission could have also expressed a view about the application of unfair contract term laws to energy market contracts. It could do this jointly with the ACCC. This sort of regulatory guidance can be very influential on consumer contracts, and we note that it is this sort of regulatory guidance that has had practical impacts on other areas of consumer contracts. We urge the Commission to reconsider and offer regulatory guidance to reduce uncertainty and consumer costs.”¹²⁹

10) That the AEMC appears willing to accept retailers’ assertions about limiting contracts despite there being no clear supporting evidence base:

“[T]he proposed rule would not limit retailers in areas other than fixed-term contracts. Retailers would still be free to offer variable price market contracts on an ‘evergreen’ arrangement, free from fixed terms or exit penalties. Claims of undue limitation in contract structure or innovation appear to have little basis in evidence.”¹³⁰

In their concluding remarks, Consumer Action and CUAC stated their intentions:

¹²⁷ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, September 2014, 8

¹²⁸ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, September 2014, 9

¹²⁹ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, September 2014, 10

¹³⁰ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, September 2014, 11

“While the content of this submission is indeed critical, we encourage the Commission to consider our response to the Draft Determination in the spirit in which it is intended. That is, we intend it to be a constructive critique with a view to improving the level of analysis before any final decision is made. We also intend it to underscore that we think there are significant problems with consumer engagement with energy contracts, particularly fixed-period market contracts, and that narrow constructions of the issue will not address the problems. Consumer advocates will continue to highlight problems with energy marketing, contractual terms, product design and distribution, to enable consumers to make informed choices and participate effectively in the market.”¹³¹

Consumer Action and CUAC also made a supplementary submission in which they recommended the AEMC seek information directly from retailers to ensure that their final decision reflects the realities of the market.

Consumer Action and CUAC's reason for this recommendation was:

“No definitive information is available to consumers or consumer advocates about how frequently retailers increase or otherwise change the prices or other terms and conditions in the course of a fixed term contract...

The frequency and magnitude of price changes are relevant in determining whether, as claimed by retailers, a fixed term contract offers consumers savings over other contracts (including fixed price contracts), and to what extent customers' expectations of a contract providing for stable conditions are unfulfilled.”¹³²

5.3.1 Advocacy undertaken by Consumer Action and CUAC

Consumer Action and CUAC convened a teleconference to brief interested consumer advocates on the draft decision and next steps. They also sought feedback and advice on issues and/or evidence that could be submitted to the consultation.

Consumer Action and CUAC pursued a joint meeting with the AEMC, AER, ERAA and ACCC to explore options beyond a rule change. The outcome of this meeting was that the AER would examine the issues raised by Consumer Action and CUAC as part of a review of the retail pricing information guidelines.¹³³

5.4 Stakeholders' submissions to Draft Determination

¹³¹ Consumer Action and CUAC, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, September 2014, 11

¹³² Consumer Action and CUAC, Retailer price variations in market retail contracts, Supplementary submission, 30 September 2014, 1

¹³³ The AER commenced the review of the retail pricing information guidelines on 12 February 2015

The AEMC received 19 submissions in response to the Draft Determination and almost half of these (9 submissions) were from retailers or industry groups. Apart from Consumer Action and CUAC themselves, only four consumer groups made submissions to this consultation round.

The majority of the submissions opposed the AEMC's draft determination, although the motivations differed between industry and consumer groups.

Consumer groups opposed the AEMC's draft determination on the grounds that the draft rule would not prevent retailers' from varying their prices for fixed term contracts. National Seniors recommended the AEMC review its draft decision and prohibit retailers from varying prices within a contract's term. In addition, they stressed their concern with the inequality of allowing retailers to vary prices but consumers not being able to break a contract without paying an early termination fee. National Seniors expressed surprise by the position taken by the AEMC:

"National Seniors is puzzled by the Australian Energy Market Commission's conclusion that input cost of electricity retailers is so unpredictable that they have to be able to increase the price paid by consumers at any time to manage their business risk."¹³⁴

Similarly, the Combined Pensioners and Superannuants Association (**CPSA**) of NSW expressed concern that the AEMC's draft decision did not prohibit retailers from being able to vary prices for fixed term contracts as well as the issue of exit fees:

"At the very least, a change in price within a contract period should result in customers being able to leave for a better deal without penalty. A change in price within a contract period should negate any requirement to pay an exit fee for switching retailers. Exit fees create a barrier which prevent people, particularly low income people who cannot afford any additional expenses, from being able to shop around."¹³⁵

The Ethnic Communities' Council (**ECC**) of NSW raised concerns about the AEMC's interpretation and reporting of evidence:

"[T]he Draft Determination fails to give sufficient consideration to the economic analysis by Dr Rhonda Smith, a well respected economist, despite it being provided as part of the evidence base underpinning the application. In addition the interpretation and reporting of the AEMC's own consumer research is somewhat selective. For example, it found that 43 percent of residential consumers across the NEM believe that the rate paid per unit of

¹³⁴ National Seniors Australia, Retailer price variations in market retail contracts, 10 September 2014, 1

¹³⁵ Combined Pensioners and Superannuants Association (CPSA) of NSW, Submission to the AEMC on the Draft Ruling on Retailer price variations in market retail contracts, September 2014, 3

energy consumed on an energy contract is fixed. Other responses also indicate that consumers believe – or hope – per unit rates of energy are fixed within contracts.”¹³⁶

ECC NSW also asserted that the AEMC appeared to prefer certain findings to others, and subsequently over-emphasised consumers’ preference for choice and under-emphasised qualitative research findings showing that consumers have difficulties understanding energy retail markets and contracts. ECC NSW also expressed disappointment in the AEMC for ignoring research undertaken in fields such as behavioural economics and psychology:

“Behavioural economics and psychology are more or less ignored in the draft determination, despite attempts to bring this to the attention of the Commission in written submissions and presentations. The preferred response, ie to provide more information to consumers at the point of providing ‘explicit informed consent’, demonstrates a lack of understanding how consumers actually make decisions and has limited prospects of success. Consumers are likely to have made up their mind at the point of ‘explicit informed consent’, and treat the necessary disclosures as a checklist to be completed.”¹³⁷

ECC NSW also argued that the AEMC appears to accept claims by industry that prices would increase if Consumer Action and CUAC's rule were implemented and that they have limited ability to predict or control risks. For example, the submission stated:

“The Draft Determination states that there is insufficient evidence to conclude that retailers are engaging in price baiting practices on a widespread scale, but the Commission has not, to our knowledge, asked retailers for the history of price increases and their timing for market contracts offered to consumers. Without obtaining this information, it is true there no evidence of price baiting, but this is because it has not been sought in specific terms.”¹³⁸

Finally, ECC NSW expressed its disappointment with the AEMC’s failure to consider the alternative solution of banning exit fees in any depth in its draft decision.

PIAC also expressed disappointment with the draft determination and argued that more information to consumers alone will not fix the problem. PIAC reiterated issues raised as alternative approaches in their submission to the initial consultation paper and recommended:

¹³⁶ Ethnic Communities’ Council of NSW, Submission to AEMC National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, 11 September 2014, 1

¹³⁷ Ethnic Communities’ Council of NSW, Submission to AEMC National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, 11 September 2014, 2

¹³⁸ Ethnic Communities’ Council of NSW, Submission to AEMC National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, Draft determination, 11 September 2014, 3

“That the NERR be amended to require retailers to inform consumers of a price rise before it takes effect. This would allow consumers to respond to this price increase and, if able, reduce their consumption in response. PIAC recommends that consumers be given a minimum of 21 days notice before a price increase takes effect.”¹³⁹

The ERAA questioned the need for the proposed rule as well as whether the draft rule was within the scope of the rule change request. The ERAA argued that existing regulation ensured that retailers’ disclosed product information in a clear and transparent manner. They also noted that no assessment of the NERR’s shortcomings in relation to information provision had occurred. In relation to scope, the ERAA was concerned if the draft rule applied to all market retail contracts, as opposed to those with a fixed term or fixed benefit period only. The ERAA stated:

“The ERAA is concerned that should the Draft Rule cover all market retail contracts it will inadvertently capture retail products where price variation disclosures are not required. By way of example, a product with a guaranteed fixed price for the entire contract term. A requirement for disclosure in this instance will be detrimental to consumer benefit as it would serve no purpose but to create further complexity in the market, confuse consumers, and will lead to additional costs for retailers with no corresponding benefit to consumers.”¹⁴⁰

Alinta and Energy Australia also strongly opposed the draft rule. Similarly to the ERAA, Alinta argued that the current obligations for retailers to provide information about contract terms and conditions at the time a contract is entered, or immediately thereafter, are sufficient. Energy Australia stated their belief in competitive markets producing better outcomes than regulation. Energy Australia stated:

“[W]e also assert that competitive retail markets will deliver outcomes to consumers through provision of clear information, products and pricing structures which meet their needs, thus nullifying the need to impose regulation.”¹⁴¹

Furthermore, Energy Australia argued that both Consumer Action and CUAC's and the AEMC's evidence did not show that there is a material issue in regards to consumer confusion about rate variations. They were critical of the AEMC's reliance on the

¹³⁹ PIAC, National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 10 September 2014, 2

¹⁴⁰ ERAA, Submission to Draft Rule Determination National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 11 September 2014, 2

¹⁴¹ Energy Australia, Submission in response to Draft Determination on Retailer price variations in market retail contracts, 11 September 2014, 1

Consumer Research as evidence and strongly disagreed with some of the AEMC's interpretations. Energy Australia stated:

"The AEMC's Draft Decision rejects Consumer Action and CUAC's rule change on the basis that there is no evidence to support their claims of bait pricing, but has proceeded with a more preferable rule to address the issue of customer confusion regarding the nature of fixed term contracts despite the fact that evidence of this issue is equally scarce."¹⁴²

Origin Energy and Lumo echoed that the current obligations are sufficient and that no new rule is required. Their submissions, however, focused on whether the AEMC had redefined the problem raised by the proponents in order to propose a more preferable rule. Origin argued:

"Where a Rule change request has demonstrated that a legitimate problem exists, but consultation with stakeholders has highlighted problems with the proposed solution, the Commission's ability to make a more preferable Rule is a more constructive alternative to rejecting the entire Rule proposal. Rather than exercising its discretion to make a more preferable Rule, if the Commission has identified a legitimate but separate problem to that raised by the Rule proponent, it ought to advise the relevant body or individual that they should consider bringing a new Rule proposal forward that addresses the new issues. A separate Rule change process would provide market participants and other interested parties with the appropriate due process to assess and determine the merits of the identified problem and whether it warrants a Rule change response. In Origin's view, this would have been the best course of action with respect to this Rule change."¹⁴³

Red Energy generally supported the draft determination but did not consider the AEMC's proposed amendments were warranted. In addition, Red Energy argued that some aspects of the draft rule were too prescriptive. Red Energy explained that they use various methods to communicate price changes to customers, and that one approach utilised to communicate information about significant price increases would not be necessary if the customer was receiving price reductions. Finally, Red Energy recommended a requirement for retailers to inform potential customers about how they will be notified about price changes in Product Information Statements, if the AEMC should feel compelled to amend Rule 64. Red Energy argued that this would clearly inform customers about how prices can change, and at the same time, promote retailer flexibility.

¹⁴² Energy Australia, Submission in response to Draft Determination on Retailer price variations in market retail contracts, 11 September 2014, 2

¹⁴³ Origin, Submission to Draft Rule Determination - Retailer price variations in market retail contracts, 11 September 2014, 2

Simply Energy supported the AEMC's decision to reject Consumer Action and CUAC's proposal but expressed disappointment with the AEMC's draft decision to add regulation when research shows that "most retailers already advise customers that the price they pay could vary".¹⁴⁴

AGL was the retailer that was most positive to the draft determination. While they reiterated their view that existing requirements were sufficient, AGL also conceded that:

"[I]mproved customer understanding of the terms and conditions of their contract would be beneficial and agrees that the Draft Rule assists in this regard."¹⁴⁵

EWOV's submission questioned the way the AEMC had categorised EWOV's initial submission in the draft determination paper. The AEMC placed EWOV's initial submission under the category of stakeholders that "generally considered that an approach that improves the information provided to consumers would be a more appropriate and proportionate response to the issues raised than the proposed rule".¹⁴⁶ In response, EWOV stated:

"The inclusion of EWOV's submission in this category is not entirely accurate. Our submission outlined current Victorian law, described trends in EWOV transfer contract terms cases about termination fees and variations in price/terms, and detailed three related case studies. It showed that customer confusion and dissatisfaction around price variations in fixed term contracts were causing complaints to EWOV, but did not take a position on suitable policy options for addressing the issue."¹⁴⁷

EWOV also raised that the rule proposed by the AEMC in the draft determination is very similar to the current requirements in Victoria that have been in place for some time. EWOV thus stated:

"[I]t is noteworthy that EWOV received a substantial and increasing number of complaints about price variation during fixed term contracts while such disclosure requirements have been in place."¹⁴⁸

The AER and the South Australian Department for Manufacturing, Innovation, Trade, Resources and Energy were both very supportive of the AEMC's draft determination.

¹⁴⁴ Simply, Draft Rule Determination National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 11 September 2014, 1

¹⁴⁵ AGL, Retailer price variations in market retail contracts, Draft Rule Determination, 11 September 2014, 3

¹⁴⁶ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 12

¹⁴⁷ EWOV, Draft Rule Determination National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 9 September 2014, 2

¹⁴⁸ EWOV, Draft Rule Determination National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 9 September 2014, 4

In addition, the AER listed a range of issues that they believed would be worth considering during the consultation and development of AER's Retail Pricing Information Guidelines post the rule change process. These issues included:

- To limit the use of the term “fixed” in contracts
- Prioritising the information provided in product information statement (or fact sheets) differently
- Further standardisation of product information statements' format and layout
- Change language in line with recommendations from behavioural economics (i.e. a more direct, immediate and personal style)
- Introduce new filters to the Energy Made Easy website in order to increase awareness of contract types
- New requirements on retailers regarding the clarity and simplicity of the information provided
- Ensuring that customers receive notice about price changes in advance
- Improving compliance monitoring

5.4.1 Summary of stakeholders' views

Most of the submissions expressed disappointment with the AEMC's draft decision for one reason or another. Retailers' submissions focused on the proposed draft rule being unnecessary while consumer groups expressed surprise at the AEMC's conclusions. The AER, the South Australian energy department and the Energy Network Association provided the only three submissions that were strongly supportive of the AEMC's views.

The issue of evidence, and the AEMC's interpretation of it, was raised by consumer groups, retailers and EWOV alike. While their preferred interpretation varied, all questioned whether enough evidence had been gathered, what the findings meant or whether the AEMC had over-emphasised the importance of certain findings compared to others

6. The AEMC's decision

Exactly one year after Consumer Action and CUAC lodged its rule change request, the AEMC issued its Final Rule Determination on 23 October 2014. The Final Determination set out the final rule, discussed issues raised in the rule change request, the AEMC's draft decision, stakeholder submissions and the AEMC's final conclusion.

6.1 AEMC's response to issues raised in submissions

As outlined in section 5 above, the vast majority of the submissions responding to the AEMC's draft determination were critical of the position the AEMC had arrived at and/or the evidence presented in support of their decision.

On the allocation of cost and risks, the AEMC stated that it did not agree with the arguments presented by the various consumer groups. The AEMC therefore reiterated its conclusion from the Draft Determination. In relation to Consumer Action and CUAC's assertion that the AEMC is overly optimistic when believing that only efficient risks are passed on to consumers, the AEMC disagreed and stated:

"If they did so, they would be less competitive and lose customers or profits. In contrast to the views of Dr Smith expressed in the rule change request, the Commission considers that even with the ability to increase prices during a fixed period, retailers still have a competitive incentive to manage risks where it is efficient to do so and only pass on efficient costs. The Commission notes that the incentive for retailers to manage risks and only pass on efficient costs is also influenced by the way other retailers manage costs and risks and the way that consumers respond."¹⁴⁹

Furthermore, the AEMC acknowledged that while consumers' status quo bias (as argued in behavioural economics) may temper competition this does not "necessarily mean that retailers have an incentive not to manage risk".¹⁵⁰

As such, the AEMC concluded that it "does not consider that new or compelling matters have been raised that would merit changing the views it expressed in the draft determination on the allocation of risk in market retail contracts."¹⁵¹

In regards to the issue of inefficient consumption decisions due to price variations, the AEMC responded to criticism for not having sufficiently engaged with the analysis provided by Dr Smith in the rule change request by explaining:

"The Commission acknowledges that in the draft determination it did not refer specifically to the analysis of Dr Smith provided in the rule change request. The

¹⁴⁹ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 25

¹⁵⁰ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 25

¹⁵¹ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 25

Commission agrees that the negative consequences described by Dr Smith arise if the assumptions the analysis are based on are proven to be true. This was noted in the draft determination. It is equally true that if the assumptions are not proven, the negative consequences described by Dr Smith will not necessarily follow.

The key assumption that Dr Smith's analysis is based upon is that due to the oligopolistic nature of energy markets and the ability of retailers to vary prices, retailers are behaving in an anti-competitive manner by setting prices below the competitive level and then later increasing prices above the competitive level. The Commission considers that if this price baiting is not occurring, the resulting consequences described by Dr Smith would not arise and would therefore not need to be further discussed.”¹⁵²

In response to Consumer Action and CUAC’s assertion that the AEMC should have requested information from the retailers about the history of their price increases as well as the timing of increases applied to consumers on market contracts, the AEMC stated that they do not have the information gathering powers to obtain such information.¹⁵³

The AEMC concluded that it “does not consider that new or compelling matters have been raised that would merit changing the views it expressed in the draft determination on this issue.”¹⁵⁴

In regards to the issue of price variations causing consumer disengagement, the AEMC rejected criticism of the consumer research questions and survey interpretation from both consumer groups and industry. The AEMC stated:

“The Commission disagrees with the assertion that it misinterpreted or was selective in its analysis of the results of the Newgate consumer research. The Commission carefully considered all of the results of the consumer research and considered the results in light of stakeholder views as well as its own research and investigations.

The Commission agrees that an important consideration in its reasoning was that the proposed rule would have removed from the market the kind of contract that a large number of consumers prefer. That is, market retail contracts with a fixed period and a variable price. The Commission however does not agree that it relied solely on one question from the Newgate

¹⁵² AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 28

¹⁵³ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 29

¹⁵⁴ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 30

consumer research to form this view, and it also does not agree that the relevant question in the research was flawed.”¹⁵⁵

The AEMC explained that in addition to the consumer research it “relied on submissions of retailers indicating that such contracts are the most popular and its own investigations that showed almost half of the retail electricity offers available to consumers in Sydney in June 2014 were fixed period contracts with flexible prices.”¹⁵⁶

Again the AEMC concluded that there were no new or compelling matters raised in regard to this issue.

On the issue of uncertainty in the application of ACL, the AEMC responded to Consumer Action and CUAC’s submission by stating:

“The Commission has acknowledged that there is some uncertainty in the application of the unfair contract terms provisions in the ACL. The Commission however does not agree that the uncertainty gives rise to significant additional costs for consumers. In order for that to occur the uncertainty in the application of the unfair contract terms provisions would need to result in retailers passing through inefficient costs to consumers. The Commission considers that there is little evidence to support that view because:

- the Commission has found there is insufficient evidence to support the view that retailers are passing through an inefficient allocation of costs to consumers or engaging in price baiting practices on a widespread scale; and
- retailer submissions on the consultation paper indicated that they generally consider that the unfair contract terms provisions in the ACL apply to market retail contracts, and act accordingly.”¹⁵⁷

The AEMC also raised that while it is not their role to issue regulatory guidance on the interpretation of the ACL, it may be appropriate for the ACCC to issue guidance in regard to how it regulates compliance with the ACL.¹⁵⁸

The AEMC concluded that there were no new or compelling matters raised in regard to this issue.

¹⁵⁵ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 38

¹⁵⁶ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 39

¹⁵⁷ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 44

¹⁵⁸ Other industry-specific industry regulators have issued guidance about how the ACL applies to their industry. For example, Queensland Legal Services Commissioner, *Regulatory Guide 2-2012: How the Australian Consumer Law applies to lawyers*,

https://www.lsc.qld.gov.au/__data/assets/pdf_file/0009/137808/Regulatory-Guide-2-ACL.pdf

On the AEMC's assessment of the proposed rule (and alternative rules), it responded to criticism of AEMC research into risk premiums comparing the cost of fixed price contracts to the price of variable price contracts:

"In considering the likely risk premium that would occur under the proposed rule, the Commission notes that comparing the cost of fixed price contracts with variable price contracts over the duration of a contract would be difficult in practice and could provide misleading results. This is because only two retailers are currently offering fixed price contracts and these contracts have only been offered for a short period of time. It would also be difficult to accurately assess risk premiums for fixed price contracts because retailers tend to spread their overall costs and risks across their customer base, rather than allocate them to each type of contract. Further, the Commission notes that it does not have the information gathering power to request this type of information from retailers.

...[T]he Commission has sought to provide an indication of possible risk premiums under the proposed rule by comparing the entry price of current fixed price contracts with variable price contracts."¹⁵⁹

The AEMC recognised that it was difficult to determine what the risk premiums would actually be under the arrangements set out by the proposed rule change. However, the AEMC considered that some degree of risk premium would occur as "retailers would never have complete certainty about how all of their costs may change over the duration of contracts."¹⁶⁰

On banning exit fees, as proposed by some consumer group submissions, the AEMC took the view that such a ban has the potential to increase prices for all consumers due to the need for retailers to "recover the cost of obtaining and retaining customers through higher prices."¹⁶¹

In relation to PIAC's recommendation that would require retailers to provide 21 days notice of price increases, the AEMC stated:

"While the Commission considers that advanced notification of price changes should be encouraged as a matter of good customer service by retailers, it considers that a more proportionate response to promote and encourage competition in this practice is to require retailers to be transparent regarding when they will notify consumers of price changes, rather than to mandate advanced notification. The Commission has sought to achieve this through its more preferable final rule. The Commission also notes that requiring retailers

¹⁵⁹ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 55

¹⁶⁰ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 55

¹⁶¹ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 56

provide a set number of days of advanced notice could create additional risks for retailers, where changes in costs occur at short notice.”¹⁶²

Finally, in relation to Consumer Action and CUAC’s alternative that included a requirement to fix prices for fixed contracts for a fixed period, the AEMC considered this option to have similar drawbacks to the proposed rule as well as resulting in greater search costs for consumers:

“[I]t could also increase search costs for consumers where retailers are only able to offer fixed period contracts for a 12 or 18 month period, as it could result in consumers needing to change their contract on a more regular basis.”

6.2 The Final Determination

The preferable rule presented in the Final Determination was largely the same as that the AEMC set out in the draft determination. The AEMC stated:

“The Commission has considered the range of issues raised in submissions and continues to consider that its draft rule provides an effective and proportionate response to the issues raised by the rule change request in relation to the impact of price variations on consumer engagement. Therefore, the Commission’s more preferable final rule is largely unchanged from the draft rule set out in the Commission’s draft determination.”¹⁶³

The new rule will take effect on 1 May 2015 and it will apply to all new gas and electricity market contracts.

Box 15 The AEMC’s new rule¹⁶⁴

The Commission has amended the retail rules to:

- a) include a new rule 46A of the retail rules that specifically requires retailers to disclose to consumers any term or condition that provides for the variation of tariffs, charges or benefits (that is, prices) as part of the existing requirement to obtain explicit informed consent from consumers to the entry into a market retail contract; and
- b) amend rule 64 of the retail rules to put beyond doubt that retailers are required to provide information about when they will notify consumers of variations to prices, charges and benefits (to the extent both are not otherwise part of prices) in market retail contracts. This information would be provided to consumers shortly before or

¹⁶² AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 56

¹⁶³ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 64

¹⁶⁴ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 14

following contract entry as part of existing product disclosure requirements. Under the current retail rules, consumers have a ten business day cooling off period to withdraw from the contract after they receive product disclosure information on contract entry.

6.3 Reception of Final Determination

Box 16 Consumer Action and CUAC's reflections on the Final Determination

We were very disappointed by the AEMC's decision. After a long process, some additional information and disclosure requirements seem like a loss.

It was also frustrating that the AEMC gave us short notice of the release. We had run a very public campaign throughout the process and it was clearly important to publicly comment on the decision. Maybe this was why we received such short notice - but it was still frustrating.

The Canberra Times reported on the AEMC's decision with an article that highlighted the new information and transparency requirements in the amended rule.¹⁶⁵ Consumer Action and CUAC immediately released a media statement criticising the AEMC decision and the following day news.com.au ran an article focusing on Consumer Action and CUAC's response to the AEMC decision.¹⁶⁶

The AEMC's decision to reject the rule change proposal prompted the then Victorian Government to announce that they would only allow retailers to call contracts 'fixed term' if they had a fixed price.¹⁶⁷ The Victorian Labor Party (now in Government) had previously pledged to abolish exit fees for energy contracts that did not offer a genuine fixed term contract¹⁶⁸ and this was reiterated on 7 February 2015¹⁶⁹. Most recently, it has been reported that the Victorian Government will make changes that would substantially implement the proposed rule change in Victoria.¹⁷⁰

On 27 November 2014, the AEMC received a rule change request from an individual consumer who proposed a rule that would prohibit retailers from increasing prices for

¹⁶⁵ Kelly, Emma, Retailers forced to be upfront about rising electricity prices, The Canberra Times, 23 October 2014

¹⁶⁶ Chung, Frank, Power companies given 'green light' to bait and switch, consumer advocates say, news.com.au, 24 October 2014

¹⁶⁷ See Victorian Government, Media release, *Naphthine Government commits to easing pressure of household energy bills*, 3 November 2014. This Government lost the election on 29 November 2014.

¹⁶⁸ D'Ambrosio, State Member for Mill Park, Media release, *Labor to abolish utility exit fees for Victorian families*, 16 October 2012

¹⁶⁹ ABC News 'Fixed costs for gas and electricity in Victoria up over 50pc' <http://mobile.abc.net.au/news/2015-02-07/gas-electricity-fixed-costs-up-50pc-in-victoria/6077396>

¹⁷⁰ Marc Moncrief, 'Victorian State Government to reform electricity pricing', *The Age*, 22 April 2015: <http://www.theage.com.au/victoria/victoria-state-government-to-reform-electricity-pricing-20150422-1mqwmg.html>

exit fee contracts.¹⁷¹ The AEMC decided not to initiate this rule change request because the subject matter had already been dealt with in the review following Consumer Action and CUAC's rule change proposal.¹⁷²

6.4 The proponent's options after the determination

Once the AEMC has handed down a final determination, this decision can only be challenged through a judicial review.¹⁷³ However, it is not entirely clear whether the Administrative Decisions (Judicial Review) Act applies to an AEMC determination. While that Act does state that the NERL is considered an enactment for the purposes of this act,¹⁷⁴ it will depend upon whether a rule change decision can be considered 'an administrative decision'.

As AEMC decisions are not subject to parliamentary scrutiny, it appears that AEMC has executive control regarding whether to make a NERL rule change or not. As such, it might be argued that the rule change is an administrative decision. However, it is also arguable that such a decision could be interpreted as a decision of a legislative character on the basis that:

- a decision to make a rule-change would effectively result in the creation of a new rule;
- the NERL has a general rather than specific application;
- final AEMC rules require that a notice be published in the South Australian Government Gazette.

Whether an AEMC determination can be reviewed under the Administrative Decisions (Judicial Review) Act may be significant. While common law judicial review would still be available, the Act removes technical requirements applying to common law review such as issuing prerogative writs, makes review for error of law simpler, and expands remedies available.

If judicial review under the Administrative Decisions (Judicial Review) Act was available, the following requirements must be met:

- the individual seeking to challenge the decision (which includes a corporation, entity or community group) must have standing to challenge the decision – in other words, the individual must be able to show that they have an interest in the decision and that they suffered grievance beyond that suffered by ordinary members of the public;¹⁷⁵

¹⁷¹ Consumer Action and CUAC, Energy retailers given green light to increase prices at will, Media release, 23 October 2014 and Lloyd, Donald, *Retailer Price Variations in Market Retail Contracts, Rule Change Request for AEMC*, November, 2014

¹⁷² AEMC, Letter to Donald Lloyd, 10 December 2014

¹⁷³ See section 302 of the National Energy Retail Law

¹⁷⁴ Administrative Decisions (Judicial Review) Act 1977 Schedule 3, clauses 2 (db) and 2 (dc)

¹⁷⁵ See *Toohy Ltd v Minister for Business & Consumer Affairs* [1981] FCA 121 per Ellicott J at [79]

- the decision must be of an administrative character and must be a final decision - not a proposed or interim decision;
- there must be a grounds for review as set out in sections 5, 6 or 7 of the Administrative Decisions (Judicial Review) Act; and
- the application for judicial review must be made within the statutory timeframe – unless an extension of time is granted, an application must be made within 28 days of receipt of a copy of the written terms of the decision.

To inform themselves appropriately, Consumer Action and CUAC requested legal advice from Maddocks (the legal firm offering pro-bono services for the Rule Change proposal) on Consumer Action’s ability to pursue a judicial review.¹⁷⁶

On whether Consumer Action would be sufficiently regarded as “aggrieved” by the AEMC’s decision to have standing in a judicial review, Maddocks advised that Consumer Action would need a specific (not just a general) interest in the subject matter of the decision. The decision must either affect or have a real likelihood of affecting Consumer Action, beyond the effect the decision would have on an ordinary member of the public.¹⁷⁷

Maddocks noted that from their review of case law relating to judicial review applications by community groups, it is clear that the question of standing is determined on a case by case basis depending on the subject matter. Maddocks’ advice was that Consumer Action was likely to have standing in regards to this Rule Determination. This is also likely to be the case should the organisations be limited to common law judicial review alone

Once an organisation has established that they have standing, they can apply to the Federal Court or the Federal Circuit Court for a review of the relevant decision. When making such an application, the organisation will need to make out the grounds for the application.

The grounds for seeking a review under the Administrative Decisions (Judicial Review) Act are:

- the procedures that were required by law to be observed in connection with the making of the decision were not observed;
- the making of the decision was an improper exercise of the power conferred by the enactment in pursuance of which it was purported to be made;

¹⁷⁶ Consumer Action and CUAC believed this advice could be important information for future Rule Change proponents.

¹⁷⁷ See *Toohy Ltd v Minister for Business & Consumer Affairs* [1981] FCA 121 per Ellicott J at [79]

- the decision involved an error of law, whether or not the error appears on the record of the decision;
- there was no evidence or other material to justify the making of the decision;
- a breach of the rules of natural justice has occurred, is occurring, or is likely to occur, in connection with the conduct;
- the procedures that are required by law to be observed in respect of the conduct have not been, are not being, or are likely not to be, observed;
- the failure to make the decision without reasonable delay; and
- the failure to make the decision notwithstanding the expiration of the period required by law.¹⁷⁸

As noted above, the grounds for seeking judicial review under common law are narrower. However the ground of 'jurisdictional error' is available, that is, there was an error of law in the decision making process such that the decision cannot be regarded to have been made according to law (eg, the decision-maker misunderstood their functions). Further, review can be sought of 'conduct ... proposed to be engaged in, by the AEMC for the purpose of making a decision or determination...'.¹⁷⁸

Maddocks considered the AEMC's decision-making powers in relation to making, or changing, rules as well as the processes that the AEMC is required to follow under the NERL, and found that the NERL affords the AEMC significant discretion in their decision-making. In Maddocks' view the Administrative Decisions (Judicial Review) Act would most likely be used to potentially challenge AEMC rule change decisions in situations where:

- AEMC has not published (on their website) a written statement of reasons for their decision;
- AEMC has breached the rules of natural justice in making the decision (eg: this may arise in situations where a conflict of interest exists in relation to an AEMC member(s) who is involved in the making of the rule change decision or where the relevant statutory processes have not been followed);
- AEMC has failed to take a relevant consideration into account when making its final rule change decision;
- there was an error of law involved in the making of the decision; or

¹⁷⁸ From the Administrative Decisions (Judicial Review) Act 1977 Schedules 5, 6 and 7

- the decision is contrary to the National Energy Retail Rules, which includes the National Energy Retail Objective.¹⁷⁹

The orders that a Court can make under the Administrative Decisions (Judicial Review) Act include:

- an order quashing or setting aside the decision, or a part of the decision, with effect from the date of the order or from such earlier or later date as the court specifies;
- an order referring the matter to which the decision relates to the person who made the decision for further consideration, subject to such directions as the court thinks fit;
- an order declaring the rights of the parties in respect of any matter to which the decision relates; and
- an order directing any of the parties to do, or to refrain from doing, any act or thing the doing, or the refraining from the doing, of which the court considers necessary to do justice between the parties.

Maddocks noted that that whilst there is flexibility in the types of orders a Court can make, the Court cannot, in a judicial review hearing, step into the shoes of the decision-maker and remake their decision as the court sees fit¹⁸⁰ because judicial review is only concerned with the lawfulness of the decision making process.¹⁸¹

In summary, Maddocks' view was that in the absence of any explicit failure by AEMC to follow the relevant statutory process or to take into account submissions received (as opposed to simply not giving them adequate weight), AEMC's rule change decisions are unlikely to be reviewable under the Administrative Decisions (Judicial Review) Act or at common law due to the broad powers conferred upon AEMC which include making a more preferable rule or no rule at all if it considers that doing so would better serve the long-term interests of consumers.

Another issue, particularly important to community organisations, is the potential costs associated with a judicial review. The costs of pursuing a judicial review include court related costs (such as filing and hearing fees) and legal costs, which may be significant depending on the nature of the review sought.

¹⁷⁹ Maddocks, Advice to Consumer Action Law Center, 23 January 2015

¹⁸⁰ Fitzroy Legal Service 'The Law Handbook' available at:
<http://www.lawhandbook.org.au/handbook/ch21s02s05.php>

¹⁸¹ Maddocks, Advice to Consumer Action Law Center, 23 January 2015

The risk of facing legal costs would be a major concern for most community organisations. Funders of community organisations, often governments, may not view the payment of legal costs for an unsuccessful judicial review as consistent with the general funding purpose. Project specific funding sources are also unlikely to offer contracts that allow for legal costs to be a potential project expense.¹⁸²

¹⁸² This issue was also discussed in relation to community organisations risking having cost orders imposed on them if intervening (as a third party) in merits reviews of the AER's electricity distribution price determinations. See Consumer Action and CUAC, *Barriers to Fair Network Prices*, August 2011.

7. Deliberations and lessons learned

This section discusses key observations from the rule change project. It looks at the cost of the project, stakeholder engagement and relations, the significance of the proposed rule, evidence gathering and interpretations, as well as the viability of consumer advocates using the rule change mechanism to improve consumer outcomes. It also offers recommendations for future rule change projects as well as alternative mechanisms.

7.1 Cost versus benefits

Box 17 Consumer Action and CUAC's reflections on costs and benefits

After spending more than a year on a resource intensive rule change project that delivered little more than a requirement for retailers to disclose how prices or benefits may change during the length of the contract, as well as when they will notify consumers of changes, we are disappointed at the lack of impact we have been able to achieve to benefit consumers. It is our assessment that the process gives more weight to claims made by industry than the concerns of consumer advocates. The apparent lack of market study powers by the rule maker to properly investigate and verify those claims and concerns is a significant barrier to robust rule review and improvement.

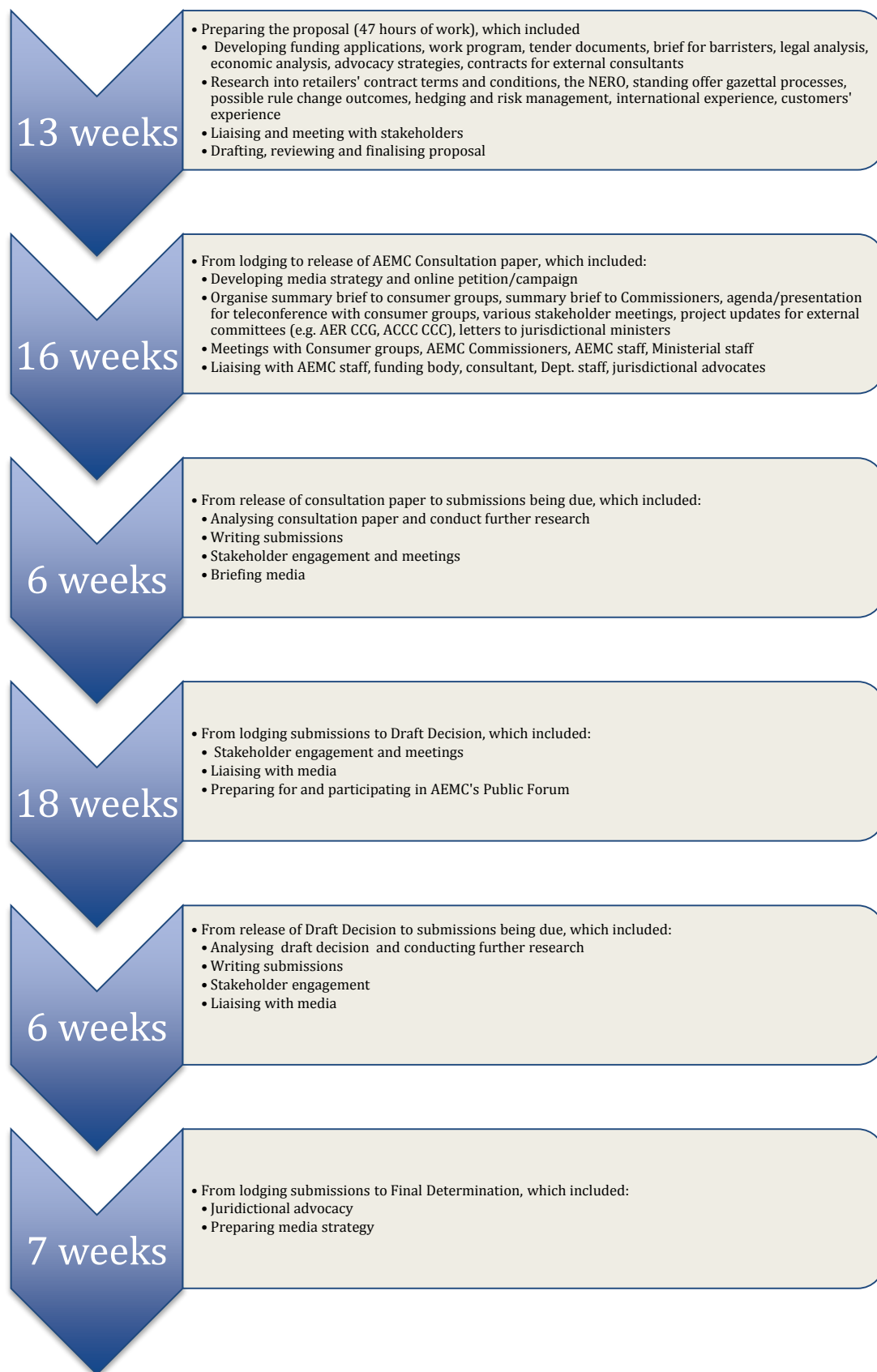
7.1.1 Resources used

For over 18 months the rule change project was a key activity for Consumer Action and CUAC. This is clearly a significant impost on the resources of two advocacy organisations. While the Consumer Advocacy Panel funded the majority of the research and engagement expenses, the use of internal resources and staff also meant that both Consumer Action and CUAC had to prioritise and disengage from other important activities and issues. However, Consumer Action and CUAC had anticipated that a rule change request would be a time demanding exercise and were committed to allocate the resources required to maximise the chance of a positive outcome for consumers.

Figure 1 below, shows the numerous and various tasks undertaken at different stages of the process, and it is clear that a consumer organisation would not be able to utilise the rule change mechanism to address retail market issues on a regular basis. Furthermore, Consumer Action and CUAC were fortunate to secure funding from the Consumer Advocacy Panel. There is, however, no guarantee that its successor, Energy Consumers Australia, will be willing, or able, to fund future efforts. Lack of financial resources may thus be a barrier for many consumer organisations considering a rule change request.

The AEMC advises that the costs it incurred undertaking this rule change project consisted primarily of the use of the time of its existing staff. While this can be difficult to quantify precisely, they have indicated that a reasonable estimate for this staff time is between \$200,000 and \$220,000. The AEMC incurred additional direct costs for customer research, travel, venue hire and miscellaneous costs of approximately \$20,000. They advise that the costs incurred in undertaking rule changes varies greatly depending on the issues involved and the level of stakeholder engagement required. Given the issues raised by this rule change and the range of stakeholders affected, substantial additional consultation beyond that required by the National Energy Retail Law was undertaken by the AEMC. This included a public forum in Melbourne on 19 May 2014.

Figure 1 Timelines and the tasks of the proponents



7.1.2 Quality of process versus resource intensiveness

It is important that the AEMC has adequate time to consider the issues raised and seek stakeholder input. There is nonetheless a case for considering the introduction of a multi-layered rule change process. The ACCC currently offers different processes for merger reviews process. If there are no substantive competition concerns, the ACCC typically finalises a review within eight weeks:

“Most merger reviews in which substantive competition concerns do not arise will be completed within eight weeks. However, the complexity and competition concerns involved in a matter are not always clear from the outset of a review. For example, it will rarely be clear from the beginning of a review whether a given merger will raise competition issues which may require a Statement of Issues and therefore whether the initial indicative review period will need to be extended.”¹⁸³

The AEMC published its draft decision on 31 July and its final decision on 23 October 2014. During those three months they received a total of 20 submissions to their draft decision, none of which raised new or compelling matters that could change the AEMC’s position adopted in the draft decision. While it is difficult to balance sufficient timelines to allow for stakeholder input with quick and efficient processes, there may be a case for the AEMC to introduce limited, or simplified, review of draft decisions in cases where they believe the likelihood of new or compelling matters being raised are minimal.

7.2 Stakeholder engagement and relations

There were several stakeholders that Consumer Action and CUAC needed to engage and liaise with throughout the project. In addition to the people with direct involvement in the project (i.e. the funding body and contractors or external expertise), consumer groups, energy consumers, the media, retailers, regulators and policy makers were all important stakeholders.

7.2.1 Engaging consumer groups

Throughout the process, Consumer Action and CUAC placed a high importance on informing other consumer advocates and creating the opportunity for advocacy around this project. The proponents encouraged and supported (when necessary) various consumer groups to participate in the review. While NEMchat (an email group for energy consumer advocates across the NEM) and meetings of the National Energy Roundtable for Consumer Advocates on energy issues were the primary information channels, meetings with lead advocates in the affected jurisdictions were also organised. As soon as the proposal was lodged, Consumer Action and CUAC briefed

¹⁸³ ACCC, Informal merger review process guidelines, September 2013, 15

consumer advocates by telephone conference on the project and Consumer Action and CUAC's proposal more specifically.

In December 2014, Consumer Action and CUAC sought feedback from other consumer groups (members of the National Energy Consumer Roundtable) on the rule change project as well as the AEMC's process. The comments listed below represent the various views expressed.

Box 18 Feedback from consumer advocates

Questions	Feedback
Do you think the rule change process is a viable and effective avenue for consumer advocates to improve energy retail market arrangements for consumers?	<p>"Yes it could be, but not if the process is based solely on a contest of opinions from stakeholders and not substantive independent analysis."</p> <p>"Should be, but doesn't seem to work. Hugely resource and time intensive."</p>
Knowing more about the rule change process do you feel encouraged to use the process as a means of reform?	<p>"Not really, but if it's the only process then it's the one we have to use."</p> <p>"It seemed like an incredible investment of time and resources – I'm not sure we would make the investment with such a low likelihood of getting an outcome."</p> <p>"Maybe the process needs to be changed to be more effective and less complicated."</p>
What, if anything, could the AEMC do to make the process more accessible for consumer groups?	<p>"Set up a Customer Council, like the AER has done, or at very least commit to twice yearly customer forums attended by the Commissioners and CEO, to build their own knowledge of the way real consumers behave/make decisions. Employ a behavioural economist."</p> <p>"I'm not aware of aspects of the process that limited accessibility. My understanding of the deficiencies of the process is about the way the decision was made."</p> <p>"The problem is really the AEMC's mindset. They just don't get that people need help from regulation to prevent bad behaviour. Consumers' can't just be given MORE information and be expected to fend for themselves."</p>
Do you have any other comments about CALC/CUAC's proposal?	<p>"I think that CALC/CUAC could have had more success if they had worded their rule change differently. Rather than completely ban price changes in fixed term contracts, there may have</p>

	<p>been another option more palatable to the AEMC and retailers to ban the use of the word fixed if the price is variable.”</p> <p>“I think it was a good proposal and congratulate CALC and CUAC for pursuing it.”</p> <p>“A bold and admirable step. Those who go first make it easier for those who would come next.”</p>
Do you have any other comments about the rule change process?	“The rule change process is far too slow to be useful in the rapidly changing market. It needs to be reformed.”
Do you have any other comments about the AEMC's final decision?	<p>“Again, frustrating but not unexpected.”</p> <p>“Disappointing but entirely expected.”</p>

Box 19 Consumer Action and CUAC's reflections on sector engagement

While several consumer organisations got involved in the rule change process and many provided substantial submissions to the review, we acknowledge the difficulty in developing critical mass in a mostly under-resourced sector. In order to spread their resources, consumer groups also tend to prioritise issues that others are not involved in. We therefore believe that many organisations decided to prioritise other issues as Consumer Action and CUAC were already “doing this one.”

Consumer groups are generally more effective if they are involved as equal partners from the outset. While it would have made the preparation stage longer, more complex and resource intensive, the case could have been more powerful if the proponents had partnered with consumer groups across the NEM from the beginning of the project.

7.2.2 Engaging the public

Consumer organisations often rely on public campaigns in order to build support and interest in their work. Another important mechanism to engage the public is to have a strong media strategy in place.

Consumer Action ran the online “Fix It!” campaign that resulted in 1500 people signing a petition to the AEMC. Everyone that signed the petition received the following email from the AEMC's CEO, Paul Smith:

Hello

The Australian Energy Market Commission (AEMC) has recently received a petition you responded to on the Consumer Action Law Centre website. It is in response to their “Fix-it” campaign to fix prices for retail energy contracts that have a fixed period, such as a two year contract.

Thank you for your interest in this matter and for taking the time to respond to the petition.

We have received the petition responses because the Consumer Action Law Centre and the Consumer Utilities Advocacy Centre have requested that the AEMC change the rules that govern how retailers can vary prices in energy market retail contracts in some states and territories.

More information about the proposed change and the rule change process generally can be found on the [AEMC project page](#).

The AEMC will take these petition responses into account as part of our consultation process on this proposed change. If you wish you can also make a written submission to the AEMC by visiting the [AEMC submissions page](#). Please note that written submissions will be published on the AEMC’s website, except where they contain confidential information.

The petition responses we receive will not be published on our website as they may include personal information that you would like to keep confidential. The responses and any other material that may contain your personal information will be dealt with in accordance with our [privacy policy](#) and any other applicable obligations.

Upon the release of the draft determination, the AEMC informed petitioners of developments with the following email:

Hello

*As you may recall, the Australian Energy Market Commission (AEMC) received a petition you responded to on the Consumer Action Law Centre website. It **was** in response to their “Fix-it” campaign to fix prices for retail energy contracts that have a fixed period, such as a two year contract.*

We received the petition responses because the Consumer Action Law Centre and the Consumer Utilities Advocacy Centre have requested that the AEMC change the rules that govern how retailers can vary prices in energy contracts in some states and territories.

The AEMC has made a draft rule in response to the Consumer Action Law Centre and the Consumer Utilities Advocacy Centre’s request. The AEMC’s draft rule improves the

information given to consumers about price changes when they enter energy contracts. The Commission conducted extensive stakeholder engagement and consumer research in considering the rule change request and concluded that the key issue raised by the request is that some consumers may be entering contracts unaware that prices may change during the period of the contract. The Commission's draft rule provides a proportionate response to address this issue.

This draft rule would apply to electricity and gas market retail contracts in South Australia, New South Wales, the Australian Capital Territory, and Tasmania.

The consumer research undertaken by the Commission also indicated that consumers want to be able to choose between energy contracts which have a higher fixed price and contracts with a lower variable price. This choice of contracts will be preserved under the Commission's draft rule.

More information about the Commission's draft rule, consumer research undertaken, and the rule change process can be found on the [AEMC project page](#). If you wish you can also make a written submission to the AEMC by visiting the [AEMC submissions page](#). Submissions on the AEMC's draft rule will close on 11 September 2014. Please note that written submissions will be published on the AEMC's website, except where they contain confidential information.

The final email from the AEMC to petitioners was sent upon the release of the final determination:

Hello

As you may recall, the Australian Energy Market Commission (AEMC) received a petition you responded to on the Consumer Action Law Centre website. It was in response to their "Fix-it" campaign to fix prices for retail energy contracts that have a fixed period, such as a two year contract.

We received the petition responses because the Consumer Action Law Centre and the Consumer Utilities Advocacy Centre requested that the AEMC change the rules that govern how retailers can vary prices in energy contracts in some states and territories.

The AEMC has made a final rule in response to the Consumer Action Law Centre and the Consumer Utilities Advocacy Centre's request. Your petition response was taken into account by the Commission in developing the final rule.

We conducted extensive research on consumer behaviour and experiences regarding price changes in their energy contracts. From this research and our extensive stakeholder engagement we considered the key issue to be that some consumers may be entering contracts unaware that prices may change during the period of the contract. The Commission's final rule addresses this issue by requiring retailers to better inform consumers about any terms and conditions relating to price changes.

Retailers will continue to be required to comply with the terms and conditions of their contracts in relation to price changes under the Commission's final rule. Contracts are enforceable by law and consumers can take action against companies that breach their contracts.

This final rule will apply to electricity and gas market retail contracts in South Australia, New South Wales, the Australian Capital Territory, and Tasmania.

More information about the Commission's final rule, consumer research undertaken, and the rule change process can be found on the [AEMC project page](#).

Thank you again for your interest in this matter.

Box 20 Consumer Action and CUAC's reflections on public engagement

As this was the first retail rule change proposal, we formed the view that energy retail customers should have a direct say in what is an otherwise remote and complex process. We advised AEMC staff that we would do this, and why, and agreed to forward petition signatures to them on a batch basis. It was therefore disappointing that AEMC took the view that the petition and its signatories would have no effect on their decision making, on the basis that the views expressed provided no additional evidence relevant to assessment of the proposed rule. We think the fact that 1500 people were motivated enough to sign the petition, and 12 of them went on to write individual submissions to the rule change process itself, was an indication of two things:

- AEMC processes are remote and little known outside energy industry and consumer advocacy sectors
- That so many did in fact choose to engage indicates a level of concern about the fairness of energy contracts and the need for regulatory action to address this

Following the rule change, the AEMC informed us that the petition had no effect and that it does not amount to the type of "evidence" it can consider. We were troubled by this, as an effective consultation process should consider all the views put before it.

In addition to liaising with the media directly, the proponents issued four media releases during the project:

- 29 January 2014, CALC Media release: End energy retailers' free ride
- 13 February 2014, CALC/CUAC Media release: Australian households to get their say on rising energy bills
- 24 October 2014, CALC/CUAC Media release: Energy retailers given green light to increase prices at will
- 3 November 2014, CALC/CUAC Media release: Ensuring 'fixed' means 'fixed' when it comes to energy contracts

Their media strategy resulted in extensive print, television and radio coverage, including:

- 3AW Radio news bulletin, 30 January 2014
- ABC Statewide Drive, 30 January 2014
- Daryl Passmore, Power to the people in prices push, Courier Mail, 14 February 2014.
- 3SER Radio Sydney, 13 February 2014.
- ABC Radio Adelaide with Chris Komorek, 14 February 2014.
- ABC Radio Sydney with Linda Mortum, 14 February 2014.
- ABC Central West with Angela Owens, 18 February 2014.
- A Current Affair, 4 March 2014.
- Gerard Brody, Current energy retailing system not working, Opinion piece, Newcastle Herald, 16 March 2014
- National Seniors weekly newsletter, 14 April 2014.
- Brian Robbins, Over the odds when power is bestowed on select few, Sydney Morning Herald, 8 April 2014
- ABC's The Checkout, Electrickery Contracts, 26 June 2014
- Brian Robins, All power to energy companies when it comes to adjusting prices, The Age, 31 July 2014
- ABC Murray Goulburn with Bronwyn O'Shea, 5 August 2014.
- Frank Chung, Power companies given the green light to bait and switch consumer advocates say, www.news.com.au, 24 October 2014.
- Emma Kelly, Retailers forced to be upfront about rising electricity prices, 24 October 2014.
- Daniel Simpson, Letter to the editor, Herald Sun, 23 November 2014

7.2.3 Engaging with other stakeholders

Consumer Action and CUAC engaged with the offices of state energy ministers as they were likely to be sensitive to community concern about rising energy bills but their views are also important in terms of public opinion. They also sought to engage with departmental staff at an early stage of the process. The ACCC was also briefed about the project.

For industry engagement, the proponents largely directed their focus at the ERAA as the retail sector peak body.

Box 21 Consumer Action and CUAC's reflections on stakeholder engagement

One potential oversight was that we did not brief the AER in the early stages of the project. We had formed a view that as the regulator, the AER would be unlikely to engage publicly. In fact, they were strongly engaged throughout the process and it became clear early on that they would not be in favour of our proposal:

"We are, however, concerned that the proposed regulatory intervention to ban price variations in fixed term market contracts may result in reduced choice and higher prices for customers, and therefore may not be in the long term interests of consumers. We consider the central issue of this rule change request is that some customers may not understand that a fixed term contract, or one that has a fixed benefit period, does not mean that the price they are charged for energy is also fixed for the period of that term."¹⁸⁴

In hindsight, we probably should have briefed individual retailers at an earlier stage than we did. We have well established and good working relationships with some of the retailers and while they all opposed our proposal, their arguments (as well as the level of criticism) did vary. While it also seemed more efficient to focus on the ERAA, the interests and concerns of their members do not always align.

7.2.4 The proponent – rule maker relationship

Consumer Action and CUAC focused on having a good working relationship with the AEMC throughout the process. They engaged with staff as well as the CEO and the Commissioners directly. The AEMC was helpful in ensuring that the proponents had the information required and showed a great willingness to meet and provide advice on process as well as engaging on the issues emerging from the proposal.

The very public advocacy component of Consumer Action and CUAC's work compared to a fairly "non-public" rule maker did cause some tensions. However, in the proponents view this was a project that directly affected consumers (as the rule change would affect the retail-end user relationship) and the project therefore needed to have a public profile.

7.3 Consumer Action and CUAC's rule proposal

The AEMC appeared to believe that the proposed rule was not a proportionate response to the problem. While Consumer Action and CUAC did propose some alternatives they also argued strongly for the proposed rule throughout the process.

¹⁸⁴ AER Submission on National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule, March 2014 (p2)

While the proposed rule would require retailers to offer a fixed price for fixed term contract, there were no limitations on retailers offering variable price products apart from not being able to lock customers into a contract for a set period. The ERAA argued that a range of products would be captured by the rule change proposal. However if one looks at it as two broad categories of contract types – fixed price and variable price – and the only requirement was that variable price contracts cannot have a fixed term, a significant proportion of current market offers would fall into this category.¹⁸⁵ A quick analysis of retailers' most flexible contract offers (as of October and November 2014) shows that the following retailers/retail offers do not include a fixed term:

- AGL - Select 3% in South Australia
- Alinta - Fair Go in Victoria and South Australia
- Click - all offers in Victoria, Queensland and NSW
- Dodo - 15% pay on time discount in NSW, 5% pay on time discount in Queensland, 20% pay on time discount in Victoria and South Australia
- Energy Australia - Flexi Saver in NSW, Victoria, the ACT, Queensland and South Australia
- Lumo - Basic in NSW and South Australia
- Origin - Daily Saver Plus and/or Extra in the ACT, Queensland, NSW, Victoria and South Australia
- People Energy - No risk saver in Victoria
- Powerdirect - 3% discount in South Australia
- QEnergy - Home your way in NSW
- Red Energy - Easy Saver in NSW and Victoria and No Exit Easy Saver in South Australia
- Simply - Save no term fee in South Australia

AGL and Powerdirect are the only retailers that operate across several jurisdictions and do not generally offer market offers without fixed term (except in South Australia). While the rates and/or additional discounts are in many cases better for contracts with a fixed term (although these discounts are typically conditional upon customers paying their bills on time), there is a question whether the magnitude of the proposed rule was somewhat overestimated in terms of the number of contracts that would be affected and the extent to which it would affect consumer choice.

Furthermore, as the high number of no-fixed-term contracts in the market presumably reflects consumer preferences, the usefulness of comparing fixed term, fixed price contracts to fixed term, variable price contracts in order to ascertain potential risk premiums and consumer preferences is questionable. The argument that consumers prefer fixed term contracts has not been tested independently of receiving a better price.

¹⁸⁵ ERAA, National Energy Retail Amendment, Presentation at Public Forum 19 May 2014

The AEMC expressed the concern that retailers might build a risk premium into prices if unable to change the price during the contract term, or cease offering fixed term contracts altogether. There are a number of responses to these concerns.

Firstly, if the assumption is that all retailers would behave in these ways, this would suggest that there is very little, if any, effective competition between retailers. If that were the case, this would require a response from the AEMC.

If, however, competition is effective, then it is likely that retailers would make a range of offers to customers, particularly if they wish to gain customers from their rivals.

If the “fixed term, fixed price” offer is a choice for energy retail customers, then even if it does include a premium, this may be an offer that some customers would be interested in; for example, if they have a preference for security of price over the term, compared to the lowest price.

Finally, if retailers cease to offer fixed term contracts because they are no longer permitted to offer contracts that call themselves “fixed term” but are not actually “fixed term” in respect of price, then it is difficult to see that customers have lost anything valuable.

As this was the first retail rule change review the AEMC has conducted it is difficult to judge what the AEMC regard as a significant response in terms of amending the rules. It could mean that future proponents are unlikely to succeed unless they are seeking minor changes, or it could indicate that no rule change is likely to succeed if it seeks to place obligations on retailers beyond providing more information. Alternatively, it could mean that Consumer Action and CUAC’s proposal could have damaged retail competition and increased prices for consumers.

However, if we assume that the latter would have occurred, it is reasonable to ask why retailers are “managing” these costs in the first place. The AEMC took the view that “requiring retailers to manage the risks of changes in network and pipeline costs could impose significant risks on retailers. The size of this risk for retailers is compounded because network and pipeline costs represent a significant proportion of energy retail bills.”¹⁸⁶

Under the current arrangements, retailers have the opportunity to “hide” behind significant costs that they do not control (and therefore pass the risk on to consumers) while consumers are asked to make decisions about contracts (of significant cost to households) where a relatively small proportion of the total cost is subject to competition in the first place.¹⁸⁷

¹⁸⁶ AEMC, Retailer price variations in market retail contracts, Consultation Paper, 13 February 2014, 62

¹⁸⁷ This issue was discussed in detail in Gavin Dufty and May Mauseth Johnston, *The NEM: Wrong way, Go back? Observations from the Vinnies’ Tariff-Tracking Project*, September 2014

Based on the submissions to this review, retailers clearly do not want to manage uncontrollable risks, so why do we make them responsible for passing these costs on in the first place?

Box 22 Consumer Action and CUAC's reflections on their proposal

When consumer advocacy organisations decide to get involved in something as resource intensive as a rule change request, it is difficult to justify the project if only aiming for minor or incremental improvements.

It is possible that the Rule change proposal would have been adopted if we only asked for the competitive costs of the contract to be fixed (e.g. allow for pass through of government policy charges as well as changes to network costs) and while that would have made some improvements for consumers, we remain firmly of the view that a fair fixed term contract should mean the price is fixed for the duration of that contract.

7.4 Evidence

The AEMC, consumer groups and retailers all argued there was insufficient evidence for positions to be taken. Both the AEMC's draft decision and final determination cite "insufficient evidence" as a reason for the AEMC not to accept the proposed changes. Citation of insufficient evidence may, however, place an unreasonable burden of proof on non-government proponents. There is a reasonableness test that would suggest the use of the word "fixed" to carry with it the factors expected by a reasonable person, in that it is fixed in both duration and price.

Stakeholders also raised issues about the evidence the AEMC did rely on and how it was interpreted, as well as the weight placed upon it. Another issue raised, mostly by industry, was that the proponents had not offered enough evidence in order to substantiate their claims. This section discusses some of the various evidence related issues that arose during the review.

7.4.1 The evidence burden

Several retailers argued that Consumer Action and CUAC's rule change request contained insufficient evidence to support their arguments.¹⁸⁸ However, the AEMC's rule change guidelines for proponents do not require the presentation of evidence for their claims. The guideline states:

"For the proponent to best support its views, the AEMC requests that statements of fact be supported with evidence where possible and include

¹⁸⁸ See, for example, submissions to the AEMC's Consultation Paper by Alinta Energy, Simply Energy, Momentum and ERAA.

quantitative and/or qualitative analysis to support statements regarding the effect of a proposed Rule.”¹⁸⁹

This does, however, raise the question about who should gather the necessary information, and are they appropriately resourced to do so. In the case of consumer advocacy groups, it is arguable that at the current level of resourcing and without the co-operation of relevant parties, this is not possible

It can be both difficult and expensive to obtain information about retail practices and consumer experience in the energy market. Consumer Action and CUAC could have collected contract and tariff data over time to ascertain frequency of price changes to new customers (although this would have delayed the project by several years) but as only retailers and consumers themselves know what happens to prices for existing customers, this evidence would in all likelihood have been dismissed. Another option would have been to survey a large number of consumers. In reality consumer organisations do not have the resources to undertake large-scale surveys.

Box 23 Consumer Action and CUAC's reflections on the evidence burden

We did seek to push the evidence burden back on to the AEMC but it is now clear that the AEMC needs new and better powers to properly investigate concerns raised by proponents as well as claims made by industry.

If the AEMC expect future proponents to produce the level of evidence that they expected from us, we are unlikely to see any successful rule changes proposed by consumer groups.

7.4.2 The quality of the evidence

The AEMC undertook some internal research in order to determine the penetration of fixed price contracts in the market and to estimate the size of the risk-premium that retailers would have to charge when offering fixed price contracts.

Both these pieces of evidence were used to inform the AEMC's position. Importantly, the risk premium estimate was also used to inform a key question in the consumer research (commissioned by the AEMC and undertaken by Newgate) and as such, the rigor of the AEMC's analysis becomes particularly important.¹⁹⁰ The AEMC compared

¹⁸⁹ AEMC, Guidelines for proponents, 3 at www.aemc.gov.au/Energy-Rules/National-gas-rules/Rule-making-process/Guidelines-for-proponents-preparing-a-rule-change.aspx

¹⁹⁰ The AEMC estimated the risk premium to be between 10 – 20% and appears to have used the lower end of this estimate to inform the options for survey question number 45 that asked respondents about what contract types they prefer.

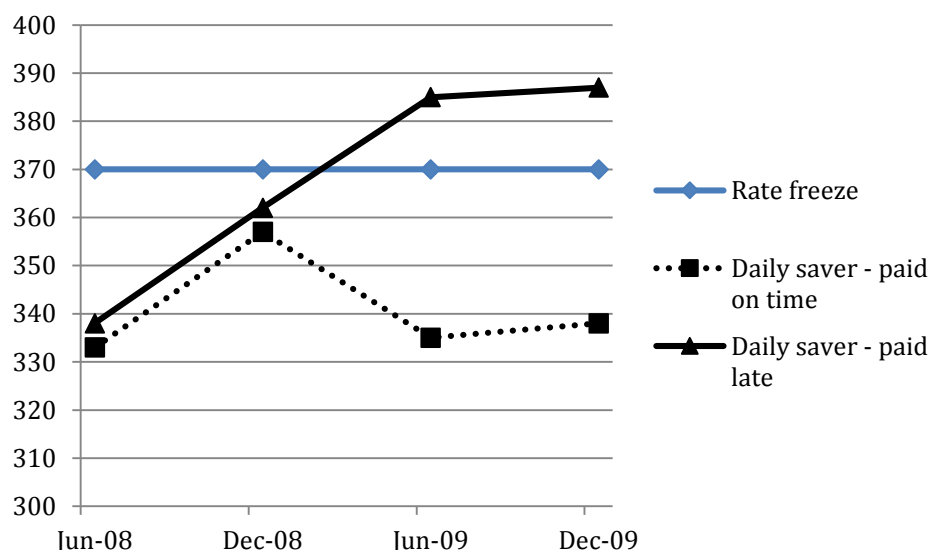
the cost of the fixed term contracts “against the cheapest market offers from the same retailers”¹⁹¹ as of July 2014.

‘This comparison would have been more thorough had the AEMC compared costs over the whole fixed price period.¹⁹² A quick analysis of Origin’s rate freeze product in Victoria from July 2012 to January 2014 shows that a customer entering a rate freeze contract in July 2012 would pay more than an Origin customer on the Daily Saver over the first year, but in the second year the Daily Saver customer (assuming she/he enters a new 12 month contract) would only pay less than the ‘rate freeze customer’ if she/he pays on time and receives a pay on time discount. Table 1 and chart 1 below compares quarterly bills from July 2012 to 2014 for the two contract types.¹⁹³

Table 1 Origin’s fixed price versus variable price products, quarterly bills

	July 2012	January 2013	July 2013	January 2014
Rate freeze (fixed)	\$370	\$370	\$370	\$370
Daily saver (variable)	On time \$333	On time \$356	On time \$335	On time \$338
	Late \$339	Late \$362	Late \$385	Late \$387

Chart 1 Quarterly bills for customers on Origin Energy’s Rate Freeze and Daily Saver products (July 2012-January 2014)¹⁹⁴



¹⁹¹ Final Determination, 48 Note: we do not know what Energy Australia and Origin Energy offers the AEMC deemed as being the offers with the cheapest rate.

¹⁹² This issue was raised by Consumer Action and CUAC in their submission to the Draft Decision.

¹⁹³ Based on a quarterly consumption of 1,200kWh (single rate) in the Citipower network. Note: the Daily Saver only has a 12 month benefit term and we have assumed that the customer signed up to a new Daily Saver contract in July 2013 and at this point Origin did not offer a guaranteed discount but the pay on time discount had increased.

¹⁹⁴ Chart based on data collected by the St Vincent de Paul Society’s Tariff-Tracking Project

This comparison shows that the 'fixed rate customer' paid \$2,960 for electricity over a two-year period compared to \$2,724 for the 'daily saver customer' that always paid bills on time. This would equate to a risk premium of 8.7%.¹⁹⁵ A late paying 'daily saver customer', however, would pay \$2,946 over the two-year period. So compared to this customer, the risk-premium for the rate freeze product is only 0.5%. If one accepts the assumption that comparing prices is a good indicator for potential risk premiums this also shows that good cash flow (secured through customers that pay their bills on time) is a more important issue for retailers to manage than changing input costs for customers on a fixed price product.¹⁹⁶

In light of the above, the outcome of the consumer research could have been significantly altered had the options to question 45 been:¹⁹⁷

1. Estimated 3% saving, price per unit can vary;¹⁹⁸ and
2. Estimated 1% saving, price per unit remains fixed

The AEMC, however, believed that comparing the risk-premium over the length of the contract period would be difficult and could provide misleading results.

"This is because only two retailers are currently offering fixed price contracts and these contracts have only been offered for a short period of time. It would also be difficult to accurately assess risk premiums for fixed price contracts because retailers tend to spread their overall costs and risks across their customer base, rather than allocate them to each type of contract. Further, the Commission notes that it does not have the information gathering power to request this type of information from retailers."¹⁹⁹

While it is unclear why this could result in misleading results for a comparison of contracts over time but not for a comparison of contracts at a single point in time, the importance of thorough investigation, especially when the results influence multiple aspects of the review process, becomes critical. The absence of the necessary information gathering powers by the AEMC is clearly in need of attention.

¹⁹⁵ If we based the comparison on contracts as of July 2012 and July 2013 only, the difference would have been 11 and 10% respectively.

¹⁹⁶ Although other issues pertaining to consumer preferences for products with high discounts, consumers over-estimating their ability to pay on time etc. are examples of potential issues that impact on the price retailers' offer.

¹⁹⁷ Question 45: "In principle, which of the following options would you prefer for a fixed term contract of say, two years?" In the survey, option one read "Estimated 9% saving, price per unit can vary".

¹⁹⁸ 3% is based on the halfway mark between customers that pay on time (8.7%) and pay late (0.5%) as well as the assumption (presented by the AEMC) that competition would reduce the risk-premium somewhat.

¹⁹⁹ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 55

7.4.3 Information gathering powers

We note that the AEMC may not have the specific information gathering powers granted to the AER under the NERL and we are concerned about any restrictions on the AEMC that may hinder thorough investigation of important market issues.

As a rule maker, the AEMC plays a key role in the efficient workings of energy retail markets and it is crucial that the AEMC has the powers required to make well-informed decisions.

7.4.4 Evidence gathering and interpretation

When the availability of clear evidence is limited, the interpretation of, and emphasis placed on, any piece of evidence is of great importance. This rule change process lacked robust evidence from all sides and this resulted in small pieces of evidence being supported by theory. For the AEMC, the theory of choice is “traditional” economic theory, with a strong preference for market-based solutions over regulation, if the evidence is insufficient. For Consumer Action and CUAC, on the other hand, the preferred theoretical framework combines traditional theory with behavioural economics, which recognises consumer biases and imperfect decision-making. This framework supports their view that regulation is required to promote consumer confidence and competitive outcomes.

Section 4 of this report outlined the structure of the public consultation forum that the AEMC organised as part of this review. All but one of the speakers that addressed the forum represented stakeholders that had already expressed their opinions through written submissions. Future rule change processes may benefit from the involvement of people with relevant expertise but without a direct interest in the review outcome. By inviting non-stakeholders to address issues, the AEMC could ensure that the forums produce new and different ideas for all stakeholders to consider.

The consumer research undertaken by Newgate became the key information source about consumer preferences and understanding of the market. However, many stakeholders (including the proponents) lacked confidence in the methodology (the way questions were formulated and type of questions asked), which led to concerns about the AEMC’s interpretation and emphasis placed on the findings.

Future reviews could therefore involve stakeholders in the development of research projects. The rule change process is already lengthy and resource intensive, but more trust and confidence in evidence collected may outweigh this concern, particularly if the significant resources all parties currently invest to argue theoretical views and beliefs could potentially be redirected to developing thorough and trusted evidence.

Box 24 Consumer Action and CUAC's reflections on interpretation of evidence

The AEMC appears to have a strong preference for modelling and theoretical frameworks. Proposals based on consumers' experience seem to have less persuasive power than economic theory. We understand that this could be expected due to the type of expertise typically required by an organisation such as the AEMC, but we are concerned about the potential long-term effect on energy retail markets and consumers, particularly as the energy reform agenda will continue to move the decision making processes from a jurisdictional to a national level.

It would be helpful for the AEMC to explore broader bases for its decision-making that recognise the way in which consumers experience the energy market. For example, principles of behavioural economics include some relevant considerations:

- The way products and services are framed will influence consumer take up as well as the effectiveness of competition. The proliferation of energy plans promoting discounts and savings off energy use and/or supply charges under those plans is an example. Consumers tend to focus on the amount of the discount, even though the base rate of plans offered by different retailers vary significantly, meaning the discount is not a useful comparison point. The way in which fixed term market contracts are 'framed' to provide certainty was also core to the concern raised in the rule change proposal.
- Complexity, for example the number of offers available and the inconsistent and incomparable way in which offers are presented, mean that consumers are often overloaded with unhelpful information and subsequently unable to make a decision ('status quo bias').

Consumer Action and CUAC noted in their submission to the AEMC consultation paper that other regulators have welcomed the analytical power of behavioural findings. For example, the Chairman of the Australian Securities & Investments Committee has stated:

... 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.*²⁰⁰

While the AEMC did acknowledge in its final determination that consumers may exhibit status quo bias and that this may temper competition, it did not believe this

²⁰⁰ Greg Medcraft, 'Regulating for Real People', Address to ASIC Annual Forum 2014, [http://asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ASIC-Forum-2014--Opening-address--24March2014.pdf/\\$file/ASIC-Forum-2014--Opening-address--24March2014.pdf](http://asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ASIC-Forum-2014--Opening-address--24March2014.pdf/$file/ASIC-Forum-2014--Opening-address--24March2014.pdf).

was significant. The AEMC stated this does not “necessarily mean that retailers have an incentive not to manage risk”.²⁰¹ So as to inform the weight it puts on different forms of evidence and analysis, the AEMC could develop a framework and approach to analysing consumer behaviour, drawing from insights from behavioural economics. It could consider the work of other regulators in this regard, including UK’s Ofgem.²⁰²

7.5 Utilising the rule change process to improve retail market arrangements for consumers

This section explores whether the rule change process is a viable mechanism to address consumer issues in energy retail markets, the role of the AEMC, and a potential alternative.

7.5.1 The role of the AEMC

The AEMC has significant influence on the working of the energy retail market while other organisations, predominantly the AER, are tasked with implementing the rules, monitoring compliance and reporting. The AER is a key stakeholder in the consultation process but practical realities such as adequate resourcing to undertake these tasks are not something the AEMC needs to consider.

The AEMC relies heavily on the AER to solve issues the AEMC has in the retail markets through light-handed regulation. However, light-handed regulation is often an expensive undertaking for the regulatory agency and there is no additional funding available to the AER every time the AEMC makes such decisions.

In relation to the AEMC’s review of effectiveness of competition in NSW, for example, the AER’s submission to the draft decision highlighted the potential effects on the AER:

“The AER considers that the AEMC’s analysis appears to raise some issues with existing retail markets in NSW. Therefore, if the AEMC concludes in its final report that energy retail competition is effective in NSW and that prices should be deregulated, we consider that the market monitoring measures proposed by the AEMC would be an important feature of this deregulation”²⁰³

The AER submission also raised the resourcing issue:

“However, the AER does not underestimate the task of assessing retailer revenue/margins on a regular basis. While we believe that we could undertake

²⁰¹ AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 25

²⁰² See, eg, Ofgem, 2011, What can behavioural economics say about GB energy consumers?, available <https://www.ofgem.gov.uk/publications-and-updates/what-can-behavioural-economics-say-about-gb-energy-consumers-1>

²⁰³ AER, Submission to Draft report: Review of Competition in the Retail Electricity and Natural Gas Markets in NSW, 3

this role, the AER's funding arrangements would need to be adjusted to reflect this new responsibility. We would also require additional information gathering powers to collect pricing information."²⁰⁴

Consumer Action has previously questioned the structural separation of the rule maker and the regulator. In its submission to the Senate Inquiry into Electricity network companies, Consumer Action stated:

"We consider there may be merit in considering whether it is necessary to have structural separation between the energy market rule-maker and regulator. It seems to us that the public and political pressure to deliver consumer outcomes is placed on the AER as regulator, rather than the AEMC as rule-maker. Should there be one institution that makes and administers the rules, the accountability would be with that body rather than be diluted between two different organisations."²⁰⁵

Box 25 Consumer Action and CUAC's reflections on the role of the AEMC

As previously raised (i.e. in response to the Senate Inquiry into Electricity network companies), the public and political pressure to deliver consumer outcomes is placed on the AER as regulator rather than the AEMC as rule maker.

There certainly appears to be a lot more scrutiny about the quality of AER's work compared to the quality of AEMC's.

Rather than solely focus on the AER, the structure of the AEMC and whether the arrangement with a separate rule maker promotes the long-term interests of consumers should be considered.

7.5.2 Monopoly on competition assessments

It is arguably problematic that the same agency that undertakes effectiveness of competition reviews also assesses retail market rule change proposals. When the AEMC finds that a retail market is first displaying effective competition it becomes difficult for the AEMC to later take the view that competition in the market can be ineffective.

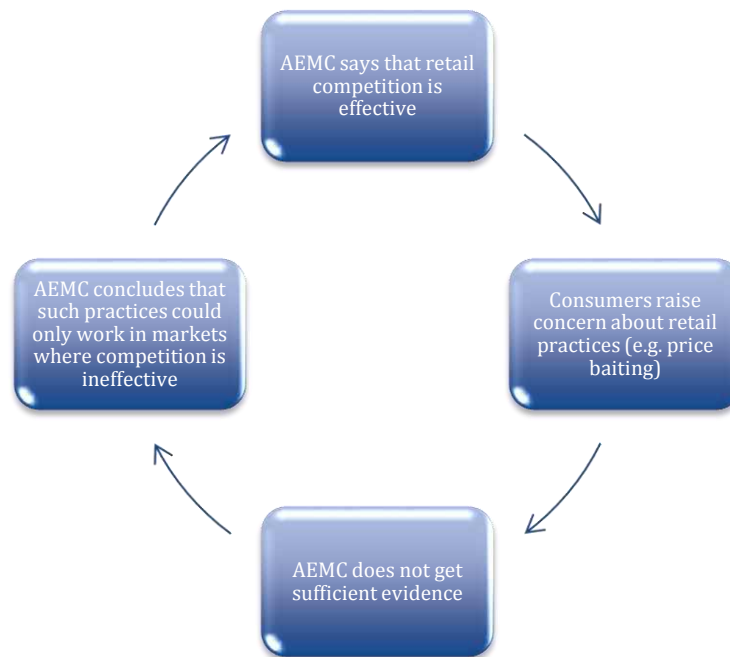
For example, on the issue of potential price-baiting practices raised in the rule change process, the AEMC argued that price-baiting could not be a problem because price-

²⁰⁴ AER, Submission to Draft report: Review of Competition in the Retail Electricity and Natural Gas Markets in NSW, 2

²⁰⁵ Consumer Action, Submission to the Senate Inquiry into performance and management of electricity network companies, 18 December 2014, 7

baiting can only occur in markets where competition is ineffective, and the AEMC's review into effectiveness of competition in 2014 found that competition was effective.

Figure 2 When competition is effective



7.5.3 Regulatory processes and advocacy

Box 26 Consumer Action and CUAC's reflections on regulatory processes and advocacy

It is the role of consumer advocates to challenge assumptions of competitive effectiveness and that competition alone will deliver the best outcomes for consumers, if we identify an issue that can cause consumer detriment. We do this with the greatest respect for regulatory processes and while we accept the outcome of these processes, even where it may not be the outcome we were seeking, we will also engage in advocacy activities and public commentary to express our views and inform consumers and stakeholders.²⁰⁶

Consumer advocacy on energy issues is often more effective at a jurisdictional level. The various NEM retail markets differ in terms of market maturity, prices, jurisdictional regulation and consumer issues. It can thus be easier to find support for issues that cause consumer detriment within a single market rather than at a national level when problems may be non-existent in some markets and prevalent in others. The Queensland Government's initiative "Power Q", which is a long-term, state based

²⁰⁶ Note that industry tend to do the same when they do not agree with regulatory decisions. See, for example, ActewAGL's reaction to the AER's recent draft determination in the Canberra Times: <http://www.canberratimes.com.au/act-news/actewagl-says-power-supply-in-canberra-at-risk-20141127-11uyv7.html>

energy reform model, is a clear example of a state government believing that each jurisdiction faces its own issues and thus being reluctant to leave the reform agenda with national agencies.²⁰⁷

In Victoria, the then Opposition Labor Party had already pledged to abolish exit fees for energy contracts that did not offer a genuine fixed term contract if elected.²⁰⁸ The AEMC's decision to reject the rule change proposal also prompted the then Victorian Government to announce that the Government would only allow retailers to call contracts 'fixed term' if they had a fixed price.²⁰⁹

If the AEMC is perceived to be out of step with consumers' actual experiences in the various energy retail markets, there is a risk that the national reform agenda will be eroded as more jurisdictional derogations are adopted.

7.5.4 Alternatives to the rule change process

Box 27 Consumer Action and CUAC's reflections on the process

The retail rule change process is slow, ungainly and unresponsive to market developments in fast changing retail markets.

After having been through one retail rule change process, Consumer Action and CUAC strongly believe that an alternative approach to address emerging retail market issues is required. The increase in jurisdictional derogations as well as the incomplete uptake of the NECF across the NEM, indicates that the rules are not aligned with community expectations. Alvis Consulting and the St Vincent de Paul Society have also previously noted that the rules are out of date and that the framework needs to be more responsive:

"As markets develop, it is crucial that regulators can respond to emerging issues and address customer protection issues."²¹⁰

Consumer organisations have recently proposed that the separation of rule-maker and regulator in energy market institutions is not serving the long-term interests of consumers.²¹¹ The COAG Energy Council is currently reviewing the governance arrangements in the national energy market. In this context, consideration should be given to folding the responsibilities of the AEMC into that of the AER, so that there is

²⁰⁷ See <https://www.dews.qld.gov.au/policies-initiatives/electricity-sector-reform>

²⁰⁸ D'Ambrosio, State Member for Mill Park, Media release, *Labor to abolish utility exit fees for Victorian families*, 16 October 2012

²⁰⁹ See Victorian Government, Media release, *Naphthine Government commits to easing pressure of household energy bills*, 3 November 2014. This Government lost the election on 29 November 2014.

²¹⁰ Gavin Duffy and May Mauseth Johnston, *The National Energy Market – Is there a devil in the retail? Observations from the Vinnies' Tariff-Tracking Project*, December 2013, 21

²¹¹ Energy Users Association of Australia, Submission to Senate Inquiry into the Performance of Electricity Network Providers, p 23; Consumer Action Law Centre, Submission to Senate Inquiry into the Performance of Electricity Network Providers, p 7.

one body responsible for regulating retail energy markets and promoting the long-term interests of energy consumers.

One potential option is to schedule a fixed retail market review process (e.g. commencing in March every three years) where the Terms of Reference are consulted upon to ensure that stakeholder issues are considered. Current arrangements, such as the AEMC's effectiveness of competition reviews, are too narrow in scope to be regarded as a thorough market review.

8. Summary and proponent recommendations

In Consumer Action and CUAC's experience, the rule change process is extremely resource intensive, and too lengthy and cumbersome for it to be a viable avenue for consumer advocates seeking to improve the workings of energy retail markets. As a rule change request is the only option available to consumer groups wishing to address poor consumer outcomes, this is cause for concern.

There is, however, a more fundamental issue with Australia's energy market, in that it is not primarily designed to protect the interests of consumers. A comparison of the overall objectives of the AER, the AEMC and their UK counterpart, OFGEM, reveals a key difference that drives their operations.

AEMC describes its mission as "To deliver high quality and impartial energy market rules and advice to policy makers." The AER articulates its role as to regulate "energy markets and networks under national energy market legislation and rules."

Both AER and AEMC lack any overt statement that they exist to serve a consumer objective. By contrast, OFGEM states its principal objective is "to protect the interests of existing and future electricity and gas consumers."

The energy retail markets are rapidly changing but there is no easy mechanism to ensure that the rules are aligned to the market they actually seek to govern, nor to protect the interests of the end users, energy consumers. This causes just as much of a challenge for rule makers and regulators as it does for consumer groups. Without the ability to implement responsive and efficient rules to address consumer issues and market inefficiencies, or driving principles that puts consumers at the heart of all decisions, there is a real risk that consumers lose confidence, and interest, in energy retail markets to the detriment of effective competition.

This section recommends the establishment of a new review mechanism, as well as improvements to the current rule change process.

8.1 New review mechanism

In order to ensure that the legal and regulatory framework for energy retail markets deliver outcomes as intended in a rapidly changing market, a new mechanism that allows stakeholders to alert the AEMC to emerging issues is required.

Such a review should:

- Evaluate the consumer experience to understand the current market issues;
- Assesses the impact of changes to the market, including the impact of technology and new types of energy services;
- Involve a consultative process that incorporates input from a range of consumer stakeholders, energy industry and government;
- Involve consultation on its terms of reference to ensure stakeholder issues are considered;
- Obtain relevant data and information from energy suppliers, using robust information gathering powers;
- Draw upon complaint data and expertise from ombudsman schemes;
- Utilise insights from behavioural science that explains consumer behaviour;
- Produce a report that recommends changes to regulatory instruments so that consumers are empowered and confident to exercise choice;
- Implement changes to regulatory instruments following a final report.

A revised and alternate mechanism would go beyond the current competition review process and initiate regulatory responses to address consumer issues and market failure.

Consideration should also be given to the most appropriate body or agency to undertake such a review. Consumer organisations have previously suggested that there should be one national energy regulator to replace the AEMC and AER, given existing limitations. The COAG Energy Council is currently reviewing the governance arrangements in the national energy market. In this context, consideration should be given to folding the responsibilities of the AEMC into that of the AER, so that there is one body responsible for regulating retail energy markets and promoting the long-term interests of energy consumers.

Recommendation 1:

That the COAG Energy Council consult on alternative mechanisms to the Retail Rule change process that can ensure the national framework for retail markets is responsive and keeps pace with market developments.

Recommendation 2:

That the COAG Energy Council's Review of Governance Arrangements for Australian Energy Markets consider the benefit of one national energy regulator being responsible for energy market reviews.

8.2 Improving the rule change process

The remaining recommendations are in relation to improving the current rule change process. These recommendations assess ways to fast-track rule change proposals, improvements to evidence gathering, and how the AEMC can enhance and broaden the debate about issues raised in rule change proposals.

8.2.1 Fast-tracking certain rule change applications

It took approximately 66 weeks from when Consumer Action and CUAC commenced the rule change project to the final determination. For 52 of those weeks, the application was subject to the AEMC's formal process. As discussed in section 7.1.2, the ACCC currently offers different processes for merger reviews. If there are no substantive competition concerns, the ACCC typically finalises a review within eight weeks. The impetus for this flexibility shown by the ACCC is of course that significant business transactions (or other business decisions) is at stake, but if we extend that logic, energy market rules that may cause consumer harm should arguably be allowed a fast-tracked review as well.

It is important that the AEMC has adequate time to consider the issues raised and seek stakeholder input. There is, nonetheless, a case for considering the introduction of a much more flexible multi-layered rule change process where certain issues can be fast-tracked.

Recommendation 3:

That the AEMC reviews the rule change process and examines options for a much more flexible multi-layered rule change process where particular issues can be fast-tracked.

8.2.2 Evidence burden and evidence gathering

The analysis presented in this report raises several issues in regards to evidence. With whom the evidence burden lays, what is considered solid evidence, how evidence is interpreted and the AEMC's powers when it comes to gathering evidence from industry, all emerged as issues during the process. Consumer Action and CUAC wanted to push some of the evidence burden back on to the AEMC (as they believed the AEMC was better resourced and placed to investigate retailers' claims), while the AEMC kept asking for more evidence and rejected requests from the proponents to investigate, claiming they did not have the information gathering powers to do so.²¹²

Both the AEMC's draft decision and final determination cite "insufficient evidence" as a reason for the AEMC not to accept the proposed changes.

²¹² AEMC, Retailer price variations in market retail contracts, Rule determination, 23 October 2014, 29

It is crucial that an agency such as the AEMC has sufficient information gathering powers in order to investigate specific market issues, as well as having a thorough understanding of the various retail markets.

On the issue of price baiting, for example, some consumer groups argued that this does occur but the AEMC responded that they needed evidence in support of the claim. At the same time, the AEMC noted that the retailers had stated in their submissions that price baiting does not occur.²¹³ The AEMC was faced with a stand-off situation that arguably should have triggered an investigation. The AEMC, however, dismissed the issue based on insufficient evidence. While the AEMC may not have the capacity to investigate all claims that may arise during a rule change review, an investigation into the price-baiting issue could at least have occurred had the AEMC had the powers to do so.

In its submission to the consultation paper the AER highlighted that an examination and better understanding of customers' preferences and price variation terms in energy contracts would assist the AEMC to understand the scale of these concerns and any likely consumer detriment.²¹⁴ If the AEMC does not have the powers to request information about price variations from retailers, however, the ability of the AEMC to better understand the issues is limited.

The above analysis also found that the potential effect of the proposed rule was somewhat exaggerated by the assumption that consumers prefer fixed term contracts. If consumers generally prefer no term contracts, however, the effect of this rule proposal on retail competition and prices paid would have been minimal. Again, this demonstrates the importance of ensuring that the AEMC has sufficient information, as well as access, to be adequately informed about consumer preferences and retail market developments.

Recommendation 4:

That the COAG Energy Council initiates a review of the AEMC's information gathering powers with the aim to ensure that the AEMC has the powers necessary to thoroughly investigate market issues and industry practices.

Recommendation 5:

That the AEMC clearly articulates its expectations regarding the level of evidence to be provided by rule change proponents and evidence that will be collected by the AEMC during a rule change review.

²¹³ AEMC, *Retailer price variations in market retail contracts*, Draft Rule determination, 31 July 2014, 27

²¹⁴ AER, Submission to National Energy Retail Amendment (Retailer price variations in market retail contracts) Rule 2014, 26 March 2014, 4

8.2.2 Improved and broadened debate

As discussed in section 4 of this report, the public forum organised by the AEMC as part of this review's consultation process did not enhance the debate beyond statements in written submissions. All speakers, except one, had already submitted written responses to the consultation paper and, naturally, reiterated the same information and views. While it can be difficult to identify potentially interesting speakers without having received submissions from them, it is possible to take a more lateral approach by inviting representatives from similar, but different industries, or academics with relevant expertise.

Consumer Action and CUAC managed to convince the AEMC to invite Dr Paul Harrison, Senior Lecturer and Chair of Consumer Behaviour at Deakin University, to address the forum and there was thus one speaker that could offer new views and information on the day. However, as the proponents referred to behavioural economics several times in their application and subsequent submissions, the AEMC could easily have initiated an invitation to an expert in this field. Similarly, invitations could have been extended to other experts to speak to different issues raised on other stakeholder submissions.

The AEMC has in the past invited external expertise to address public fora taking place during a rule change review. On the review of economic regulation of network service providers, for example, two professors were invited.²¹⁵

To ensure that public forums can enhance the debate and provide the AEMC with new and different information, the AEMC should ensure that invited speakers include non-stakeholders with expertise, information or views on issues relevant to the review.

As discussed in section 7, the rule change involved debate about the types of evidence and the use of modern economic theories, including insights from behavioural economics. To bring some clarity to the types of evidence relevant to AEMC's decision-making, it should make explicit how it considers insights from behavioural economics and how these can help understand consumer behaviour in the Australian energy retail markets.

Recommendation 6:

That the AEMC develops a guideline for its public fora, organised as part of review processes, that can enhance debates and include views from expert non-stakeholders.

Recommendation 7:

That the AEMC consult on and develop a framework for how explanations of consumer behaviour informed by behavioural science informs its decision-making.

²¹⁵ Professor George Yarrow and Professor Stephen Littlechild presented at the AEMC's public forum on 9 May 2012.

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APPENDIX A: Background on the energy rule change process

1. The process

The Australian Energy Market Commission (**AEMC**) has been tasked to consider rule change requests made in relation to the National Energy Retail Rules (**NERR**).²¹⁶

Under the National Energy Retail Law (**NERL**) any person can propose a rule change to the AEMC.²¹⁷ However, in order to be considered by the AEMC, a rule change proposal must contain the information prescribed in the Regulations.²¹⁸ That is:

- the name and address of the person making the request;
- a description of the rule that the person proposes be made;
- a statement of the nature and scope of the issue that is proposed to be addressed and an explanation of how the proposed rule would address the issue;
- an explanation of how the proposed rule will, or is likely to, contribute to the achievement of the National Energy Retail Objective (**NERO**); and
- an explanation of the expected benefits and costs of the proposed change and the potential impacts of the change on those likely to be affected.²¹⁹

If the request is deemed to contain this information, the AEMC commences the Rule change process by considering whether the request:

- is misconceived or lacking in substance;
- is for a Rule that is within the AEMC's power to make; and
- relates to the subject matter of:
 - a Rule made by the AEMC in the 12 months immediately before the date of receipt of the requested Rule;
 - a request for the making of a Rule not proceeded with in the 12 months immediately before the date of the active request; or
 - a request for the making of a Rule in respect of which the AEMC is already taking action under the rule amendment procedure.²²⁰

After this stage the AEMC determines whether to proceed with the rule change request or not.

²¹⁶ The AEMC also considers Rule change requests in relation to the National Electricity Rules (NER) and the National Gas Rules (NGR).

²¹⁷ Section 243 NERL

²¹⁸ Section 246 NERL and Regulations

²¹⁹ See AEMC, Guidelines for proponents: Preparing a rule change request – Retail, May 2012, p 3

²²⁰ <http://www.aemc.gov.au/Energy-Rules/Retail-energy-rules/Rule-making-process/Stage-1>

If the request proceeds, the second stage involves public consultations before the AEMC can reach its draft decision (stage 3). This draft decision contains the AEMC's reasoning, including:

- in the case where the proposed Rule is not a proposed more preferable Rule, its reasons as to whether it is satisfied the proposed Rule will or is likely to contribute to the achievement of the national energy retail objective;
- in the case of a proposed more preferable Rule, its reasons as to whether it is satisfied the proposed more preferable Rule will or is likely to better contribute to the achievement of the national energy retail objective than the proponent's request;
- if relevant, the reasons of the AEMC having regard to any relevant Ministerial Council on Energy statement of policy principles; and
- if the AEMC determines to make a rule in the determination, a draft of the Rule to be made.²²¹

The AEMC then consults on the draft decision before reaching its Final Determination (stage 4).

2. Timelines

The standard timeframe for a rule change is approximately 6 months.²²² However, the AEMC has the ability to either extend or shorten this timeline. If the AEMC deems a rule change request to be complex, it may extend the timelines in order to conduct initial analysis and/or longer consultation periods. The AEMC is, however, required to issue a determination within 12 months of a rule change request being initiated.

The AEMC may expedite the rule change process if the rule is unlikely to have a significant effect on a market, or the regulation of customer connection services, and therefore deemed 'non-controversial'. A determination for 'non-controversial' rules, as well as 'urgent' rules (as defined in the NERL), will take place within 6 weeks of initiation. Furthermore, the AEMC has the ability to fast track the process if the issue has already been subject to an adequate consultation process by a regulatory body. These processes take approximately 4 months from initiation.

3. Requests for rule changes

As of early November 2014, there were 15 rule change requests under review and 168 requests that had been completed since July 2005.²²³ However, as the retail rules only

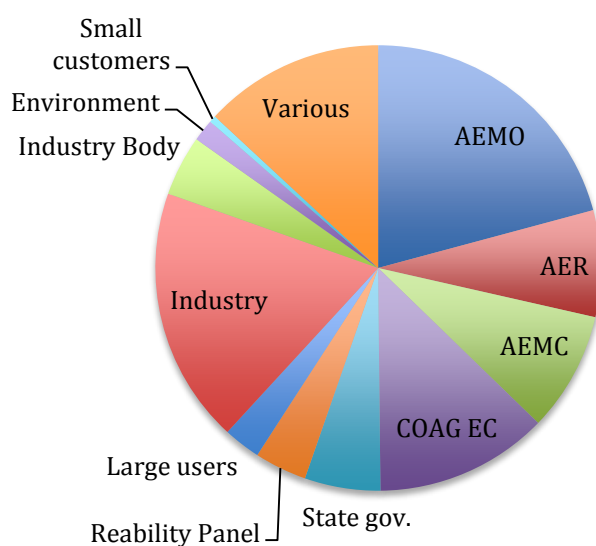
²²¹ Section 256 NERL. See: <http://www.aemc.gov.au/Energy-Rules/Retail-energy-rules/Rule-making-process/Stage-3>

²²² See <http://www.aemc.gov.au/About-Us/Engaging-with-us/Decision-making-process>

²²³ List of rule change requests as of 6 November 2014 at <http://www.aemc.gov.au/Rule-Changes>

commenced on 1 July 2012, only three of these 183 requests have been in relation to retail rules. The Australian Energy Market Operator (AEMO), and its predecessor, NEMMCO, have made a fifth of the applications. Rule change requests by industry, defined as companies involved in the supply chain, accounts for 20% of applications. Other frequent proponents include the Council of Australian Governments' (COAG) Energy Council (and its predecessors), the Australian Energy Regulator (AER) and the AEMC itself.²²⁴ Advocates for large energy users, environmental issues and small customers are the groups with the fewest rule change requests.

Chart 1 Rule change proponents (proportion of total rule changes completed or underway)



²²⁴ The AEMC can only initiate a Rule change if it considers the Rule corrects a minor error in the Rules; it considers the Rule involves a non-material change; or the Rule involves any matter that the regulations provide that the AEMC may make a Rule on its own initiative.