



RULE

Australian Energy Market Commission

DRAFT RULE DETERMINATION

NATIONAL ENERGY RETAIL AMENDMENT (REGULATING CONDITIONAL DISCOUNTING) RULE

PROPONENT

The Hon Angus Taylor, Commonwealth Minister for Energy & Emissions
Reduction, on behalf of the Australian Government

21 NOVEMBER 2019

INQUIRIES

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ABOUT THE AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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SUMMARY

1 The Australian Energy Market Commission (Commission) has made a draft rule that amends the National Energy Retail Rules (NERR) to limit the level of conditional discounts in energy retail contracts. The draft rule, which is a more preferable rule, restricts conditional discounts and conditional fees to the "reasonable costs" the retailer is likely to incur when payment conditions are not met.

Background

2 The draft rule was made in relation to a rule change request submitted by the Commonwealth Government. The proposed rule aimed to improve offer comparability and protect customers from excessive penalties in some retail contracts with conditional discounts. Conditional discounts are pricing structures whereby customers receive a financial incentive (typically lower energy rates) when a certain payment condition is met. The Commonwealth's rule change request noted that missing a payment condition in a contract with large conditional discounts could result in a considerable financial burden to certain small customers.

3 The rule change request was based on a recommendation from the Australian Competition and Consumer Commission (ACCC) in its Retail electricity pricing inquiry (REPI) report (July 2018). The ACCC identified the magnitude of conditional discounts offered and relatively low realisation rates as issues driving inefficient outcomes in the retail market.

Draft rule

4 The draft rule restricts the level of conditional discounts and conditional fees (e.g. late payment fees) retailers can offer to the reasonable costs likely to be incurred by the retailer when a customer fails to comply with the payment condition.

5 The draft rule protects customers by stopping retailers from recovering excessive costs from customers who fail to comply with certain payment conditions.

Rationale for rule change and key design decisions

6 Conditional discounts continue to be a material part of the energy retail market. Approximately 20 per cent of offers feature conditional discounts. Since July 2019, the magnitude of conditional discounts, while reduced, remains above likely reasonable costs.

7 Energy retailers have the freedom to set different types of pricing plans and structures that balance risk between them and customers. However, in the case of conditional discounts, this flexibility has led to detrimental outcomes for many customers, with 27 per cent of residential customers and 58 per cent of hardship customers failing to meet discount conditions according to the ACCC. These findings demonstrate that many customers have not been well-placed to meet contract conditions resulting in an imbalance in risk allocation between the parties.

8 Where risk allocation between parties is no longer balanced or efficient, targeted restrictions on the level of conditional contract terms may be appropriate. Where such a restriction is set at reasonable costs, this approach would not unduly limit retailers' pricing freedom, while

also providing a degree of protection for customers.

- 9 The draft rule approach is consistent with common law restrictions on contract terms that include penalties. However, to date, common law has not adequately protected energy customers due to the onerous nature of a court challenge.
- 10 Coverage of the draft rule must be adequate to deal with the issues at hand while supporting competition in order to meet the national energy retail objective (NERO). Key coverage decisions include:
- Limiting the draft rule to conditional contract terms that are related to payment timing or method. Only terms that are triggered as a consequence of a failure to comply with a payment condition are captured by the draft rule.
 - Extending reasonable costs restrictions to certain conditional fees (e.g. late payment fees).
 - Capturing new and existing retail contracts. Under the draft rule, an existing contract is captured when its benefit is reset or the term of the contract is extended or renewed.
 - Capping, to reasonable costs, the aggregate value of a conditional discount and a conditional fee triggered by the failure to comply with the same payment condition.
 - Applying conditional discount and fee restrictions to gas and electricity contracts and to retail contracts in all relevant jurisdictions, including those with price regulation such as Tasmania, regional Queensland and the Australian Capital Territory (ACT).
- 11 The Commission does not consider that a definition of reasonable costs is required in the draft rule because this is a widely understood legal concept and has been utilised in a range of different industries, including energy. The restriction to reasonable costs is instead made using a principles-based approach.
- 12 The Commission has not required the Australian Energy Regulator (AER) to develop a guideline to determine reasonable costs as it considers that it would be more practical for the AER to enforce the rule on a case-by-case basis.
- 13 The Commission considers the draft rule in this format to be in the long-term interests of consumers in relation to the quality of energy services and customer protections and as a result, it will, or is likely to, contribute to the achievement of the NERO.
- 14 The Commission invites submissions on this draft determination including the draft rule by **16 January 2020**.

CONTENTS

1	Australian Government's rule change request	1
1.1	The rule change request	1
1.2	Background	1
1.3	Rationale for the rule change request	2
1.4	Current regulatory arrangements	3
1.5	Consultation on draft rule determination	7
2	Draft rule determination	8
2.1	Rule making test	8
2.2	Assessment framework	9
2.3	Features of the draft rule	9
2.4	Summary of reasons	10
3	Analysis of issues raised and appropriate response	13
3.1	Issues raised by the proponent	13
3.2	Stakeholder views	13
3.3	Analysis of conditional discount materiality	14
3.4	Risk allocation and the need for the draft rule	19
3.5	Conclusion: the need for a rule change	22
4	Coverage of the draft rule	23
4.1	Issues raised by the proponent	23
4.2	Stakeholder views	24
4.3	Commission's approach to coverage	25
4.4	Conclusion: proposed rule coverage	28
5	Approach to reasonable costs restriction and implementation	29
5.1	Issues raised by the proponent	29
5.2	Stakeholder views	29
5.3	Principles-based restriction to reasonable costs	30
5.4	Estimates of reasonable costs	31
5.5	Transitional and implementation issues	32
	Abbreviations	34
	APPENDICES	
A	Summary of issues raised in submissions	35
B	Legal requirements under the NERL	42
B.1	Draft rule determination	42
B.2	Power to make the rule	42
B.3	Commission's considerations	42
B.4	Civil penalties	42
B.5	Conduct provisions	43
	TABLES	
Table 1.1:	Jurisdiction arrangements regarding late payment fees	6
Table 4.1:	Commission's approach on coverage issues under draft rule	28
Table A.1:	Summary of other issues raised in submissions	35

FIGURES

Figure 3.1:	Proportion of offers with conditional discounts across different distribution areas	15
Figure 3.2:	Average magnitude of conditional discounts March 2018-September 2019	16
Figure 3.3:	Estimates of reasonable costs comparison with actual conditional discount rates	18
Figure 3.4:	Historical proportion and magnitude of conditional discounts	19
Figure 3.5:	Conditional discount realisation rates across different customer cohorts, 2016-7	20

1 AUSTRALIAN GOVERNMENT'S RULE CHANGE REQUEST

1.1 The rule change request

On 18 February 2019, the Honourable Angus Taylor, Minister for Energy and Emissions Reduction, on behalf of the Australian Government, submitted a rule change request to the Australian Energy Market Commission (AEMC or the Commission) to regulate conditional discounting practices by energy retailers.

The rule change request proposes that the level of conditional discounts for gas and electricity retail offers be restricted to the reasonable cost savings that a retailer expects to make if a customer satisfies the conditions attached to the discount. The proponent noted that the request is based on recommendation 33 of the ACCC REPI.¹

The rule change request outlines two key policy objectives:

- remove excessive penalties for customers on conditional discounts who fail to meet a contract condition²
- improve the comparability of market offers by simplifying and reducing conditional discounts³

The rule change request includes a proposed rule. If made, the request would amend Rule 45A of the National Energy Retail Rules (NERR), and new rules would be made (Rule 46C and Rule 46D).⁴

Copies of the rule change request may be found on the AEMC website, www.aemc.gov.au.

1.2 Background

Conditional discounts have been a common feature of energy retail pricing practices. The proportion of conditional discounts peaked at 78 per cent of market offers in 2017⁵, decreasing to 47 per cent of market offers in early 2019.⁶ The level of conditional discounts have also increased significantly, from an average of five to 10 per cent rates in 2014 to 30 to 40 per cent rates in 2018.⁷ Some stakeholders have noted that the popularity of these discounting practices have been driven by its "marketing value", i.e. the ability of large discounts to attract customers to sign up.

1 Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, p. 2.

2 Ibid p. 2.

3 Ibid.

4 Please note that the National Energy Customer Framework (NECF) does not apply in Victoria, and as a consequence, retail rule changes, including this rule change will not apply in Victoria.

5 Figures refer to offers in New South Wales, South Australia and south east Queensland for responding retailers: AEMC, 2017 *Retail Energy Competition Review*, 25 July 2017, pp. 228, 242, 290.

6 AEMC, 2019 *Retail Energy Competition Review*, 28 June 2019, p. 82. Figures refer to offers available on Energy Made Easy and Victorian Energy Compare websites.

7 ACCC, *Retail energy pricing inquiry - Final Report*, July 2018, p. 257.

Major inquiries into the energy retail sector by the ACCC in REPI, and an independent panel commissioned by the Victorian Government (the Independent and Bipartisan Review of the Electricity and Gas Retail Markets in Victoria — also known as the Thwaites Review) have identified energy retailer practices that may have been driving customer dissatisfaction. In outlining the motivating factors for its investigation, the ACCC found that retailers have made pricing structures confusing and have developed a practice of discounting which is opaque.⁸ These inquiries recommended that Commonwealth and Victorian governments propose changes to retail market rules and practices, including this rule change request.

1.3 Rationale for the rule change request

The proponent identified two key policy issues that motivated its rule change request:

- improving the comparability of market offers by simplifying and reducing conditional discounts, thereby reducing barriers to effective customer engagement and enhancing competition.⁹
- removal of excessive penalties on customers (particularly vulnerable customers) who pay after the due date, which are effectively resulting in those customers paying the highest prices in the market.¹⁰

1.3.1 Improving offer comparability

The rule change request identified two problems faced by customers comparing offers with large conditional discounts.¹¹

Firstly, customers are often drawn to higher discounts, even when these offers don't necessarily correspond to a best offer for a customer. The ACCC found that the increase in discounts has in many cases not coincided with similarly deep savings in retail electricity bills.¹² Uneven base rates from which offers are discounted off have made it harder for customers to assess suitable offers to meet their circumstances.

Secondly, competition between retailers on a conditional discount offer basis means that customers and energy retailers may focus on headline discount figures rather than the conditions necessary to achieve these (such as a pay-on-time condition). This exposes customers who are unable to accurately anticipate their ability to pay to higher energy prices. The proponent indicates that low conditional discount realisation rates indicate that a significant number of discount customers do not accurately anticipate their ability to fulfil contract conditions.¹³

8 ACCC, *Retail energy pricing inquiry - Final Report*, July 2018, p. iv.

9 Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting, rule change request*, 18 February 2019, p. 2.

10 *Ibid* p. 3.

11 *Ibid*.

12 *Ibid*.

13 *Ibid*, p. 2.

1.3.2 **Removal of excessive penalties**

The proponent considers that when customers do not meet the conditions of conditional discounts they are required to pay significantly higher rates and that these effectively constitute customers paying "penalty" energy rates. Significant portions of different residential customer groups fail to realise conditional discounts. The proponent noted the ACCC's data, which indicated that 27 per cent of all residential customers failed to realise conditional discounts, while this number is 58 per cent for hardship program customers on conditional discounts.¹⁴

The realisation rates noted above gave rise to the proponent's concerns over excessive penalties, especially because of the increase in the magnitude of conditional discounts experienced since 2014.¹⁵ The proponent's analysis indicates that the costs to an average customer of not meeting a pay-on-time discount could lead to an increase of up to 50 per cent of that customer's annual bill.¹⁶ The proponent considers this increase in the annual bill is not representative of additional costs to retailers from holding debt for customers. In effect, customers who miss payment conditions while they are on high conditional discount offers may be paying some of the highest rates in the market.¹⁷

Vulnerable customers are exposed to these practices, leading to the entrenchment of inequitable outcomes in the market. These types of customers often live in volatile employment, health and social circumstances, which might impede them from prioritising energy plan payments.¹⁸

1.4 **Current regulatory arrangements**

1.4.1 **Inflated discounts rule**

In April 2018, the Commission introduced a rule in the NERR which prohibited retailers from including discounts in market retail contracts where customers would be worse off under the undiscounted market offer than under the retailer's standing offer.¹⁹

The Commission also identified in its final determination that contemporary discounting practices utilised inflated discounting rates to increase their attractiveness. However, larger discounts did not necessarily correlate with lower bills or the best deals for customers. Those practices made it difficult for customers to compare market offers.²⁰

1.4.2 **Electricity Retail Code of Conduct**

On 1 July 2019, the Default Market Offer (DMO) came into effect through the Electricity Retail Code (the Code). The Code was made under the *Competition and Consumer Act 2010*

14 Ibid, p. 6.

15 Ibid p. 3.

16 Ibid, p. 3.

17 Ibid.

18 Ibid, p. 2.

19 AEMC, Preventing discounts on inflated energy rates, final rule determination, 15 May 2018.

20 Ibid.

(Cth) (CCA). The DMO was a recommendation²¹ of the ACCC to the Commonwealth government in REPI.

The introduction of the DMO through the Code restricts the way retailers advertise energy offers that use conditional discounts. Under the Code, the two relevant changes in place from 1 July 2019 are:

- electricity retailers must not advertise a conditional discount as the most conspicuous price-related matter in the advertisement²²
- each conditional discount mentioned in an offer must state the difference between the unconditional price and the conditional price; this must be expressed as a percentage of the reference price.²³

The Code does not apply to jurisdictions with retail price regulation, and therefore does not apply in Tasmania, ACT or regional Queensland. Additionally, the Code only covers electricity offers.

The Commission notes that any changes to the NERR within this rule change should be consistent with the Code. The Commission expects that to the extent of any inconsistency, the Code provisions may override NERR provisions.

At the same time, the Commission considers the drafting of this rule should enable it to stand regardless of developments with the Code.²⁴ This is important because the authority to modify or remove the Code rests with the Commonwealth Minister and would not require parliamentary approval.

1.4.3

Common law and the ACL

Common law

A contract term that imposes a penalty on a party is not enforceable under common law in Australia. Courts have historically taken the view that where a party is obliged to pay an amount of money to the other party (due to breaching a term of the contract), and that amount is out of all proportion to the damage or loss suffered by that other party, then that amount may be regarded as a penalty. Box 1 outlines the latest precedent case for penalties in Australia, noting how the High Court has interpreted costs used in setting fees and whether these costs amount to a penalty.

The Commission notes that common law restricts penalties, thus indicating that conditional contract terms (such as fees or discounts) set above the reasonable costs incurred by retailers in energy contracts are likely to be considered penalties and therefore be unenforceable.

21 ACCC, *Retail energy pricing inquiry - Final Report*, July 2018, p. 252. Victoria has also introduced its own retail offer cap mechanism, the Victorian Default Offer (VDO).

22 Australian Government, *Electricity Retail Code of Conduct*, s. 14 (2).

23 *Ibid*, s. 12 (3).

24 This is consistent with ACAT's submission: ACAT, noted drafting of rule should be consistent with Code and also operate on a stand-alone basis. ACAT, consultation paper submission, p. 3.

The Commission notes that while this may provide customers with redress from conditional discounting practices (above reasonable costs), it is difficult for small customers to enforce such rights through the courts

BOX 1: COMMON LAW RESTRICTIONS ON PENALTIES

In *Paciocco v Australia and New Zealand Banking Group Limited*, the High Court of Australia was asked to determine whether late payment fees payable upon failing to make a minimum payments under customer credit card contracts were truly penalties and therefore unenforceable at law. The appeals were pursued by Mr Paciocco as part of a class action.

The High Court ruled that a contractual obligation to pay a specified sum of money upon breach of contract will be enforceable, only if the amount payable is not 'out of all proportion' to the party's interest in ensuring compliance with the relevant obligation.

ANZ argued that in determining the magnitude of its late payment fee it was entitled to have regard to indirect costs associated with a failure of its customers to meet their contractual commitments. The Court accepted that once regard was had to these costs, the magnitude of the late payment fee it imposed upon Mr Paciocco was determined to be not 'out of all proportion' and was therefore enforceable.

The implications for the case include that contracting parties are not limited to considering only the *direct costs* attributable to a potential breach of contract. Instead, regard may be had to the effect of default on their *broader interests*. The fact that a sum is disproportionate to the direct loss suffered as a result of that breach is not determinative.

Paciocco might indicate that high conditional discounts would have to be 'out of all proportion' with costs incurred by retailers in order to be deemed unenforceable.

Source: Adapted from Herbert Smith Freehills, "Australia's law of penalties revisited", 8 August 2016.
<https://www.herbertsmithfreehills.com/latest-thinking/australias-law-of-penalties-revisited>

Australian Competition Law

The Australian Consumer Law (ACL) prohibits unfair contract terms. The Commission considers that conditional discount contracts, while potentially unfair, are covered under the ACL's upfront pricing exception.²⁵ Under this exception, contract terms that are clearly put to customers at the time they sign a contract are exempt from the unfair contract provisions of the ACL. The ACCC has not taken action against retailers for breach of the ACL in regard to conditional discounting practices.²⁶ However, as noted above, the ACCC's REPI report specifically recommended restrictions on conditional discounting practices indicating it considered restrictions on conditional discount practices appropriate when these were not captured by the ACL.

²⁵ *Competition and Consumer Act 2010* (Cth), schedule 2: The Australian Consumer Law, s. 26 (1) and (2).

²⁶ See for example, list of enforcement actions noted under REPI preliminary report, ACCC, Retail Electricity Pricing Inquiry: Preliminary Report, 22 September 2017, Appendix 4.

The Commission notes that the lack of restrictions on conditional discounting under the ACL would not undermine its ability to make energy-specific restrictions on such conduct.

1.4.4

Conditional fees

Conditional fees, such as late payment fees, function similarly to conditional discounts because they impose a financial cost on a customer based on the failure to realise a particular payment condition. Current arrangements regarding late payment fees in jurisdictions are set out on Table 1.1.

Table 1.1: Jurisdiction arrangements regarding late payment fees

JURISDICTION	ARRANGEMENT	RELEVANT LAW AND PROVISION
South Australia	Late payment fees under customer retail contracts with small customers must not exceed the reasonable costs of the retailer in recovering the overdue amount. If the customer lodges a complaint in relation to the bill, the retailer must not take steps to recover the fee while the complaint is being dealt with. "Reasonable costs" are not defined in the legislation.	<i>National Energy Retail Law (South Australia) Act 2011</i> , s. 24.
New South Wales (NSW)	Late payment fees must be waived for hardship program customers and those customers in the following circumstances: <ul style="list-style-type: none"> dual fuel contracts where the customer receives the Low Income Household Rebate or the Medical Energy Rebate bills that are the subject of a matter being considered by the energy ombudsman bills subject to any instalment or payment plans part of the bill is paid by an Energy Accounts Payment Assistance (EAPA) Scheme voucher the retailer is aware that the customer has sought assistance to pay the bill from a community welfare organisation that issues EAPA vouchers. 	National Energy Retail Law (Adoption) Regulation 2013, s. 10.
Tasmania	A retailer must waive a late payment fee if the customer: <ul style="list-style-type: none"> holds a health care card under the <i>Social Security Act 1991</i> (Cth) 	<i>National Energy Retail Law (Tasmania) Act 2012</i> , s. 19.

JURISDICTION	ARRANGEMENT	RELEVANT LAW AND PROVISION
	<ul style="list-style-type: none"> is receiving, as a pensioner, a concession on the customer's accounts with the retailer is on a payment plan has died, the account with the customer has been suspended or the amount owed is set out in a final account to the customer. 	
Queensland	For standard contract customers, the Minister must decide the prices that a retailer may charge its standard contract customers with respect to customer retail services, and charges or fees relating to customer retail services.	<i>Electricity Act 1994, ss. 89E, 90.</i>
Australian Capital Territory (ACT)	No restrictions on late payment fees under ACT law. However, the NSW energy retail law applies to: <ul style="list-style-type: none"> Origin Energy, in relation to the sale and supply of electricity to premises in ACT connected to the distribution system of Essential Energy Essential Energy in relation to the supply of electricity to premises in ACT connected to its distribution system. 	<i>National Energy Retail Law (ACT) Act 2012, s. 17</i> National Energy Retail Law (ACT) Regulation 2012, s. 7.
Victoria (NERR is not applicable)	Late payment fees are prohibited with respect to the sale of electricity to small retail customers. Retailers are permitted to offer an incentive or rebate to small retail customers for paying an electricity bill before the due date. Victorian restrictions are currently being reviewed by the ESC as part of the Thwaites Review.	<i>Electricity Industry Act 2000, s. 40C.</i>

1.5 Consultation on draft rule determination

The Commission invites submissions on this draft rule determination, including the more preferable draft rule, **by 16 January 2020**.

Any person or body may request that the Commission hold a hearing in relation to the draft rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than **28 November 2019**.

Submissions and requests for a hearing should quote project number RRC0028 and may be lodged online at www.aemc.gov.au.

2 DRAFT RULE DETERMINATION

This chapter outlines:

- the rule making test for changes to the NERR and the more preferable rule test
- the assessment framework
- key features of the draft rule
- summary of the Commission's reasons for making the draft rule

Further information on the legal requirements for making this draft rule determination is set out in Appendix B.

2.1 Rule making test

2.1.1 Achieving the NERO

The Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the national energy retail objective (NERO).²⁷ This is the decision-making framework that the Commission must apply. The NERO is:²⁸

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

The Commission must also, where relevant, satisfy itself that the rule is "compatible with the development and application of customer protections for small customers, including (but not limited to) protections relating to hardship customers" (the "consumer protections test").²⁹

Where the consumer protections test is relevant in the making of a rule, the Commission must be satisfied that both the NERO test and the consumer protections test have been met.³⁰ If the Commission is satisfied that one test, but not the other, has been met, the rule cannot be made. There may be some overlap in the application of the two tests. For example, a rule that provides a new protection for small customers may also, but will not necessarily, promote the NERO.

2.1.2 Making a more preferable rule

Under s. 244 of National Energy Retail Law (NERL), the Commission may make a rule that is different (including materially different) to a proposed rule (a more preferable rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule will or is likely to better contribute to the achievement of the NERO.

In this instance, the Commission has made a more preferable rule. The reasons are summarised in section 2.4.

²⁷ Section 236(1) of the NERL.

²⁸ Section 13 of the NERL.

²⁹ Section 236(2)(b) of the NERL.

³⁰ That is, the legal tests set out in s. 236(1) and (2)(b) of the NERL.

2.2 Assessment framework

In the Consultation Paper, the Commission determined the principles it would use to assess the rule change request against the NERO, these were:

- promoting workable competition
- risk allocation
- administrative and implementation costs.

2.2.1 Promoting workable competition

Where feasible, providing for customer choice in the provision of services generally leads to more efficient outcomes. Competitive markets which enable customers to choose also tend to be more flexible to changing conditions because they provide incentives for participants to innovate and minimise costs over time.

2.2.2 Risk allocation

The Commission considers that risks should rest with those parties best placed to manage them. Placing inappropriate risks on customers (or specific customer groups), who may not be best placed to manage these risks, is likely to result in higher prices if these risks cannot be managed and reduced over time.

The Commission may consider solutions that facilitate more efficient allocation of risk between market participants and customers. It may closely consider how regulation of conditional discounting practices impacts the ability of energy retailers to manage credit risk.

2.2.3 Administrative and implementation costs

Changes to regulatory frameworks come with associated costs. These costs include both those imposed to implement change and the ongoing costs associated with new rules. These costs result from necessary changes to information technology systems, billing arrangements and other market process. The implementation and ongoing costs may be ultimately borne by customers and therefore must not exceed the benefits of introducing a solution.

2.3 Features of the draft rule

The more preferable draft rule would limit the level of conditional discounts and conditional fees in energy retail offers to the reasonable costs the retailer is likely to incur when retail contract conditions are not met.³¹

The draft rule applies to all new retail contracts (including gas retail contracts) from 1 July 2020 in jurisdictions subject to the NERR. Additionally, the draft rule also:

- Is limited in its application to conditional contract terms that are related to payment timing or method. Only terms that are triggered as a consequence of a failure to comply

³¹ Subrules 46C (a) and 52B(1) of the Draft Rule.

with a payment condition are captured by the draft rule,³² such as pay-on-time discounts or direct debit dishonour fees.

- Limits duplication of penalties — when a contract includes both a conditional discount and a conditional fee that are triggered by the failure to comply with the same payment condition. The aggregate value of the penalty is capped to the reasonable costs the retailer is likely to incur when retail contract conditions are not met.³³
- Makes transitional provisions which require that existing retail energy contracts with a conditional discount or conditional fee comply with this rule when an existing contract's benefit is reset or the term of the contract is extended or renewed.³⁴

The Commission considers that the draft rule is compatible with the Code and that it can operate independently of it.

The Commission's reasons for making this draft determination are set out in section 2.4.

2.4 Summary of reasons

The Commission considers that the more preferable draft rule best meets the NERO for the following reasons.

2.4.1 Rationale for restricting conditional discounts

Conditional discounts continue to be a material part of the energy retail market. Approximately 20 per cent of offers feature a conditional discount. Moreover, since July 2019 the magnitude of conditional discounts, while reduced, remains above likely reasonable costs.

Energy retailers have the freedom to set different types of pricing plans and structures that balance risk between them and customers. However, in the case of conditional discounts, this flexibility has led to detrimental outcomes for some customers, with 27 per cent of residential customers and 58 per cent of hardship customers failing to meet discount conditions on average according to the ACCC.³⁵ These findings demonstrate that many customers have not been well-placed to meet conditional discounts and, as a result, expectations of balanced risk allocation between the parties (and reflected in the ACL's upfront pricing exception)³⁶ are no longer applicable.

Where risk allocation between parties is no longer balanced or efficient, targeted restrictions on the level of conditional discounts and conditional fees may be appropriate. Where such a restriction is set at reasonable costs, this approach would not unduly limit retailers' pricing freedom, while also providing a degree of protection for customers. Retailers may be able to manage the risk of late payment through either conditional discounts or fees up to the reasonable costs they would incur from late payment. This approach delivers both efficient

32 Definition of subrule 45A of the Draft rule, "payment condition": payment condition means a provision of a contract that imposes a condition in relation to the timing or method of payment of a bill.

33 Subrules 46C(a) and 52B(1) of the Draft Rule.

34 Schedule 2, Part 13, Existing contracts with small customers 2(1) and 2 (2) of the Draft Rule.

35 ACCC, Retail energy pricing inquiry - Final Report, July 2018, p. xii.

36 The ACL's upfront pricing exception enables retailers to apply high conditional discounts provided these conditions are made clear to the customer. Schedule 2, Section 26 *Competition and Consumer Act 2010* (Cth).

risk allocation and is consistent with common law restrictions on contract terms that include penalties, which has not been adequate to protect customers thus far due to the onerous nature of a court challenge. This specific gap in the regulatory framework, backed by the economic logic outlined above, supports the draft rule.

2.4.2

Coverage decisions

Coverage of the draft rule must be adequate to deal with the issues at hand and not have detrimental effects on competition in order to meet the NERO. On the four coverage issues, the Commission's rationale is as follows:

- Types of conditional contracts terms captured; by covering payment conditions related to timing and method, the draft rule captures contract types which have caused customer detriment whilst limiting barriers to pricing innovation.
- Coverage of conditional fees (e.g. late payment fees); there is a reasonable risk that retailers may increase conditional fees on energy contracts as a way of recovering revenue lost through reduced conditional discounts and therefore these should be covered.
- Capture of gas contracts and retail contracts in all National Energy Customer Framework (NECF) jurisdictions; limits to the applicability of the rule to a specific fuel type or particular jurisdiction are inefficient because inconsistent regulation may lead to additional regulatory costs, increased customer confusion and create barriers to efficient risk allocation.
- Capture of existing retail contracts at the end of their benefit period; the proportion of customers on conditional discount offers on retailers' back books coupled with potential for certain retailers to "roll over" benefits means that the suggested approach is necessary to limit the continued practice of large conditional discounts.

2.4.3

Design of reasonable costs restriction

The Commission does not consider that a definition of reasonable costs is required because this is a widely understood legal concept. The Commission has also not required the AER to develop a guideline to determine reasonable costs levels. The Commission considers that given the range of different retailer costs and different business models, it would not be practical for the AER to calculate reasonable costs. Instead, AER enforcement of the rule on a case-by-case basis may enable it to limit conditional discounts in a way that is efficient.

Given this approach, the costs of enforcing the rule to new contracts are not expected to be material. Enforcement experience with similar reasonable cost-based restrictions and the AER's ability to monitor offers through EME indicate to the Commission that retailers may move away from offering large conditional discounts without the necessity of enforcement action. The AER may mitigate costs of enforcing the draft rule to existing retail contracts following expiry of a benefit period by conducting random audits on retailers or seek data from Ombudsman schemes to determine whether action is needed. Costs related to existing contracts will likely cease to be significant after 12 to 18 months from the proposed commencement of the rule given the length of most benefit periods.

Additional costs of implementing the rule for retailers in this case will likely be limited to the development of cost reflective conditional discounts and fees. Costs to retailers are not expected to be significant because they already have processes to determine reasonable costs, including systems to record, classify and action changes to existing customer contracts because of a 2017 rule which requires them to notify customers of the end of their benefit period.³⁷

2.4.4 Consumer protections test

The Commission is of the view that the more preferable draft rule may result in improved protections for all small customers by stopping retailers from recovering excessive costs from customers who fail to comply with certain payment conditions and therefore enabling better risk allocation between retailers and customers. Therefore, the Commission considers that the draft rule meets the consumer protections test.

³⁷ National Energy Retail Amendment (Notification of end of fixed benefit period) Rule 2017 No. 2., Rules 48A and 48B, November 2017

3 ANALYSIS OF ISSUES RAISED AND APPROPRIATE RESPONSE

This section considers the materiality of the issues raised by the proponent and outlines the Commission's analysis and approach to this issue. The key topics covered are:

- issues raised by the proponent
- stakeholder views on the materiality of the issue
- analysis of conditional discount materiality
- risk allocation and the need for the draft rule.

3.1 Issues raised by the proponent

As noted in section 1.3, the proponent identified two key policy issues that motivated its rule change request:

- improving the comparability of market offers by simplifying and reducing conditional discounts, thereby reducing barriers to effective customer engagement and enhancing competition³⁸
- removal of excessive penalties on customers (particularly vulnerable customers) who pay after the due date, which are effectively resulting in those customers paying the highest prices in the market.³⁹

3.2 Stakeholder views

Stakeholders were generally divided into two groups with respect to their views.

3.2.1 Retailers and the South Australian Government

These stakeholders generally focused on the decrease in the proportion and magnitude of conditional discounting brought about by the introduction of the Code since July 2019. They considered that the issues highlighted by the proponent were no longer material. For example, Alinta Energy noted that the introduction of the DMO has led retailers to change their offers, particularly through a shift away from conditional discounts.⁴⁰

Some retailers also noted that a no rule approach was justified on the basis that there is not yet conclusive data on changes to retailer pricing strategies in response to the Code. For example, AGL noted that the rule change was requested prior to the DMO coming into effect, and therefore the full impact of this change on retail market should be assessed prior to further regulatory changes being made.⁴¹

38 Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, p. 2.

39 Ibid p. 3.

40 Alinta Energy, consultation paper submission, p. 2.

41 AGL, consultation paper submission, p. 2.

The South Australian government (Department for Energy and Mining) also noted that the introduction of the Code should overcome many of the concerns raised by the rule change and that it was unclear if further amendments are necessary. A review conducted by the Department indicated that only a limited number of conditional discount offers were currently being made by retailers in the state for both gas and electricity⁴²

3.2.2 Consumer groups, market bodies and ombudsman

These stakeholders generally cautioned the Commission against interpreting initial pricing data from Energy Made Easy (EME) as a conclusive signal of the decrease in materiality of conditional discounts. The main concern was limited evidence available to reach a conclusion regarding conditional discounting trends, and that this information would not be indicative of future pricing practices. They also expressed concerns that retailers may readjust pricing strategies in the future if no restrictions on their ability to offer large conditional discounts are in place. For example, the Energy and Water Ombudsman NSW (EWON) stated⁴³:

"EWON strongly cautions any interpretation of this trend as a sign that the issues raised by the proposed Rule change are now immaterial. There has not been enough time since the reduction in conditional discount market offers to assess whether the trend represents a sustained shift versus a response to recent market price changes. Any proposed changes to the Rules around conditional discounts should therefore focus on the positive and negative impacts of such discounts in the past; and with the view that they may return to prominence in future."

CHOICE noted that the declining proportion in conditional discounting might be related to increased public pressure applied on retailers, rather than representing a sustained shift in pricing strategy.⁴⁴ The Public Interest Advocacy Centre (PIAC) noted that due to the limited application of the Code and issues with the way the Code is worded, comparability issues with conditional discounts and fees may continue to be material.⁴⁵

3.3 Analysis of conditional discount materiality

3.3.1 Conditional discounting trends since the introduction of the DMO

In order to understand the nature of "excessive penalties" identified by the proponent, the Commission collected and analysed the proportion of conditional discounts from the EME comparator website between March 2018 and September 2019.

EME data indicates that, in the first two months of the DMO (introduced in July 2019), conditional discounts are no longer the predominant type of market offer. Offers with no discounts are now the most common type of market offer. Data from March 2019 indicated that across jurisdictions where the Code applies (South Australia, south east Queensland and NSW), conditional discounts offers made up 52 per cent of offers available. By September

42 South Australia Department for Energy and Mining, consultation paper submission, p. 2.

43 EWON consultation paper submission, p. 1.

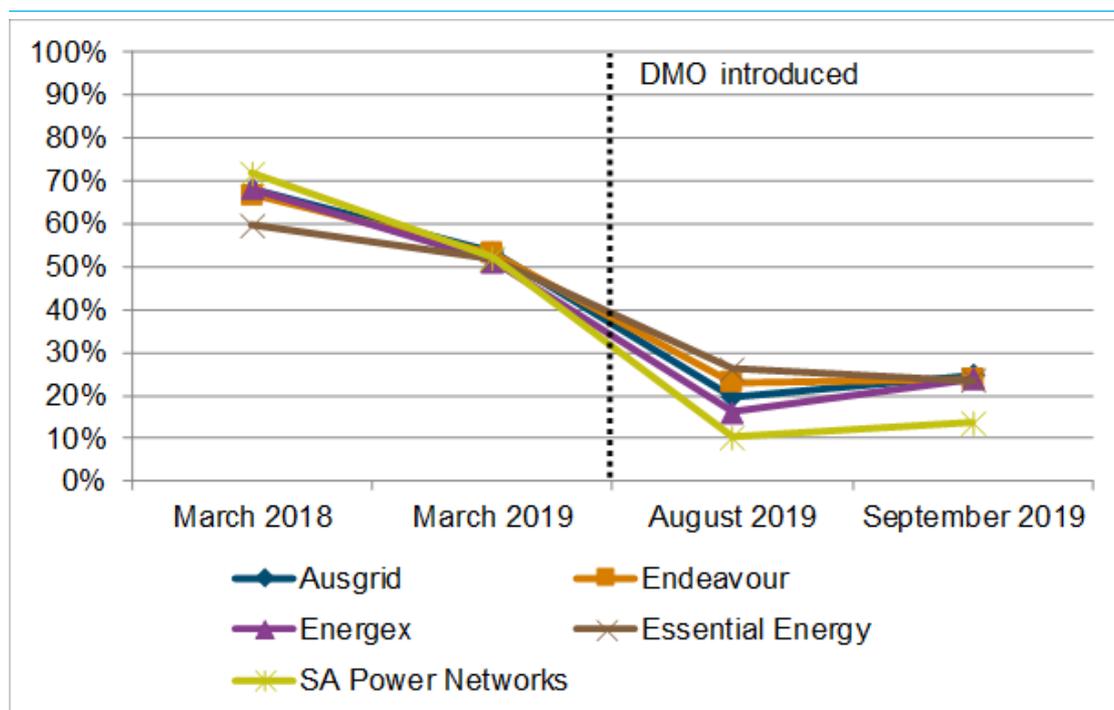
44 CHOICE, consultation paper submission, p. 8.

45 PIAC, consultation paper submission, p. 4.

2019, this number had dropped to 22 per cent on average across all distribution areas (see Figure 3.1).

The magnitude of conditional discounts has also decreased.⁴⁶ The proponent noted in its request that discounts of approximately 30-40 per cent were common in 2018.⁴⁷ As noted in Figure 3.2, the average discount rate in September 2019 was approximately eight per cent.

Figure 3.1: Proportion of offers with conditional discounts across different distribution areas



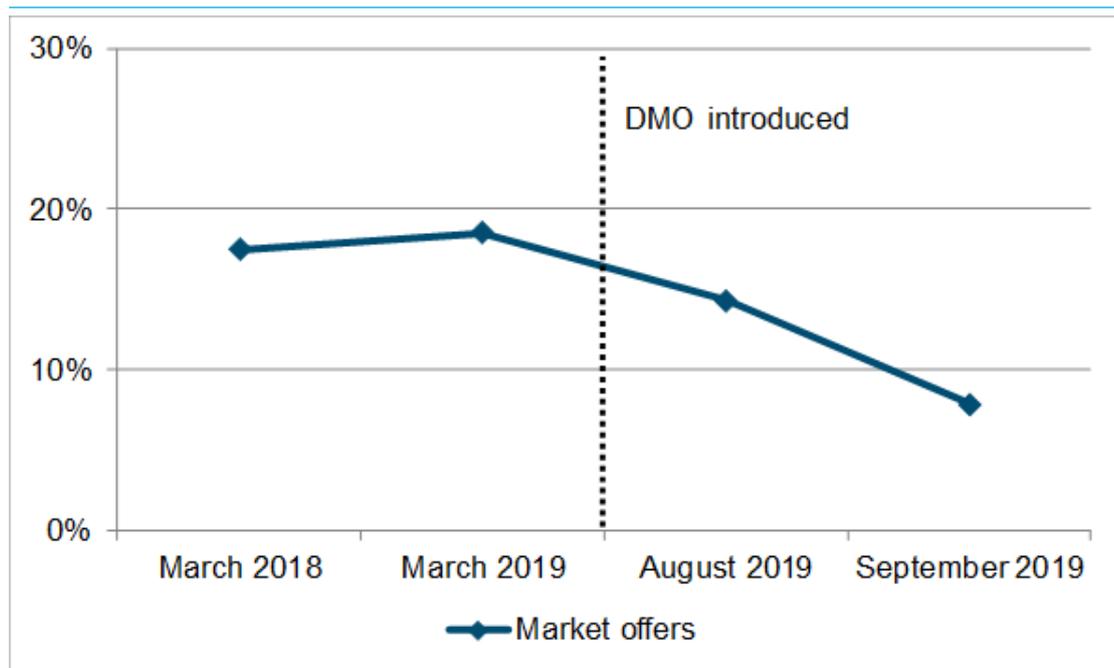
Source: AEMC analysis of EME data

Note: NSW distribution companies: Ausgrid, Endeavour, Essential; SA: SA Power Networks; South East Queensland: Energex

⁴⁶ This trend in conditional discount proportion and magnitude was noted in recent reports published by the AER and ACCC on the DMO and its effect. See for example, AER, *Affordability in energy retail markets*, September 2019, pp. 38-49.

⁴⁷ Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, p.3.

Figure 3.2: Average magnitude of conditional discounts March 2018-September 2019



Source: AEMC analysis of EME data
Note: Excludes Victorian offers.

3.3.2 Benchmarking the materiality of conditional discounts

Figure 3.2 demonstrates a significant drop in the magnitude of conditional discounts in the space of six months (i.e. since March 2019). However, as pointed out by stakeholders, there is insufficient historical data on conditional discounting practices since the DMO has been introduced to reach a definitive conclusion over long-term pricing trends. While the proportion and magnitude of conditional discounts has decreased, they could return in the future in some form at levels above reasonable costs.

The Commission therefore considers that a prudent approach assumes that the proportion and magnitude of conditional discounts may return to pre-DMO levels in the future.

Despite an observed reduction in the magnitude of these offers, the Commission estimates that conditional discounts set at reasonable costs would be lower than the average level currently seen in the market.

Figure 3.3 benchmarks current average and highest conditional discount (pay-on-time) rates observed by the Commission in September and October 2019 against a range of different price structures that are set at reasonable costs. These include an estimate of:

- late payment fees in electricity, specifically an average of these fees charged in South Australia, where they are already limited to reasonable costs by legislation.⁴⁸
- late payment fees in the water utility industry, specifically those charged by Sydney Water in 2019.⁴⁹
- late payment fees charged by price-regulated retailers, specifically those charged by ActewAGL and Aurora Energy.⁵⁰
- a large retailer's (AGL) direct saved debt costs as a percentage of an average customer's bill.⁵¹

Late payment fees are a suitable benchmark given they, like pay on time conditional discounts, are a conditional term related to payment timing and are triggered as a consequence of a failure to comply with a payment condition. An estimate of direct saved debt costs incurred by a large retailer (AGL) is also included in order to provide an alternative estimate not based on late payment fees.

The Commission's analysis indicates that current average conditional discount rates are still higher than four of the reasonable costs benchmarks reviewed, and similar to one of them. To illustrate the gap between conditional discounts set at reasonable costs and large conditional discounts seen in the retail market before the DMO (and still observed in the market, albeit less frequently), the Commission inserted the highest pay-on-time conditional discount in its analysis. This is an important point, given the significant number of customers that are on contracts signed prior to the DMO coming into force — these customers are likely to be on contracts with conditional discounts of similar magnitude (see section 3.3.4 below).

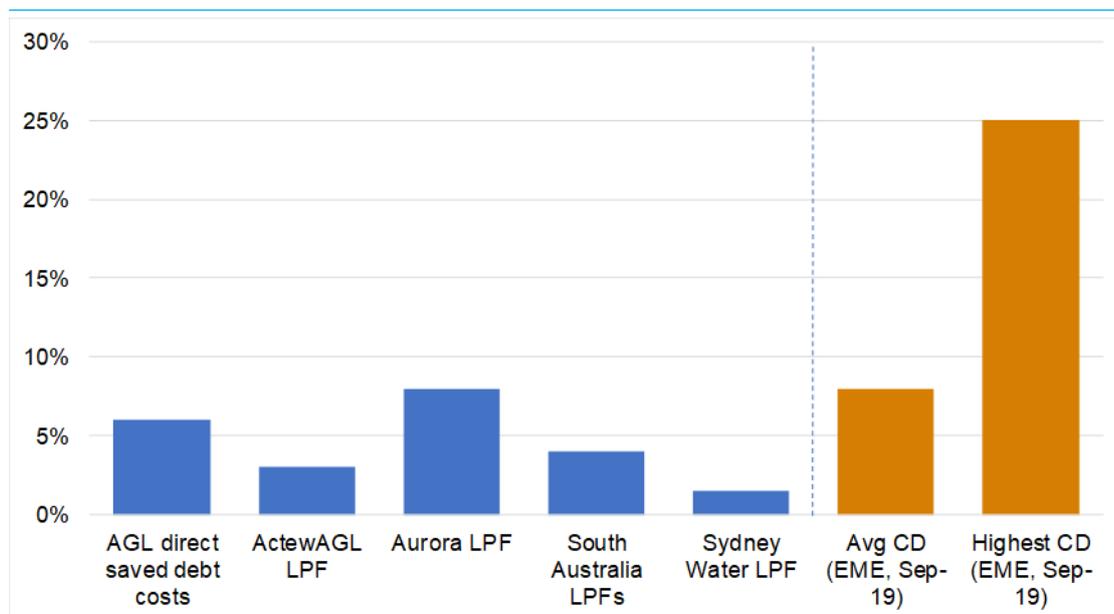
48 This reasonable costs estimate is based on a calculation of the magnitude of late payment fees relative to the magnitude of the bill of an average South Australian customer on a typical SA late payment fee (LPF). A typical late payment fee in South Australia is around \$15/bill. This represents around 4% of the usage component of a typical customer on the median market offer (AER, Final Determination — DMO Prices, April 2019). Late payment fees in South Australia are already restricted to reasonable costs by SA law (s.24 NERL).

49 The Independent Pricing and Regulatory Tribunal of NSW determines the maximum allowable late payment fees for Sydney Water. IPART noted that "Sydney Water's proposed (late payment) fee is reasonable...the fee reflects the combined interest and debt recovery costs across a range of plausible customer scenarios." IPART, Review of prices for Sydney Water Corporation, Water - Final Report, June 2016, p. 209.

50 The Tasmanian Economic Regulator reviews Aurora Energy's late payment fee and also include a cost reflective interest for overdue accounts. They are currently set at \$5 + RBA set interest rate. ActewAGL's LPF are reviewed by the Independent Competition and Pricing Commission of ACT. They are currently set at \$15.

51 The "direct saved debt costs" is an estimate of reasonable costs related to interest payments incurred by the retailer when customers fail to pay on time. The following assumptions are used to calculate the interest payments: (a) the interest rate is equal to the financing cost reported in AGL's FY2019 report (5.7% p.a.); (b) the bill is not paid for a year – therefore, the "direct cost" is equal to the annual financing cost; (c) the bill is for a representative residential non-solar customer on a 2-part tariff in the Ausgrid distribution network area (relevant consumption figures for the representative customer sourced from the AEMC, Residential Electricity Price Trends, 2019).

Figure 3.3: Estimates of reasonable costs comparison with actual conditional discount rates



Source: AEMC analysis

Note: LPF: late payment fee; CD: conditional discount

It is worth noting that some of these estimates of reasonable costs are based on direct costs incurred by retailers when customers do not pay on time, and that additional costs could be included in an estimate.

3.3.3 Potential for reversion

The Commission considers that a reliance on conditional discounting advertising restrictions under the Code may be insufficient should the Code may be amended or abrogated. Consumer groups have also questioned whether post-DMO changes to discounting practices represent ongoing shifts in pricing practices or temporary adjustments to regulatory settings and public concern.⁵²

In order to minimise the risk of the return of large conditional discount rates, the Commission considers that an enduring restriction on the substance of conditional pricing practices through energy rules may be more appropriate.

3.3.4 Existing contracts with conditional discounts

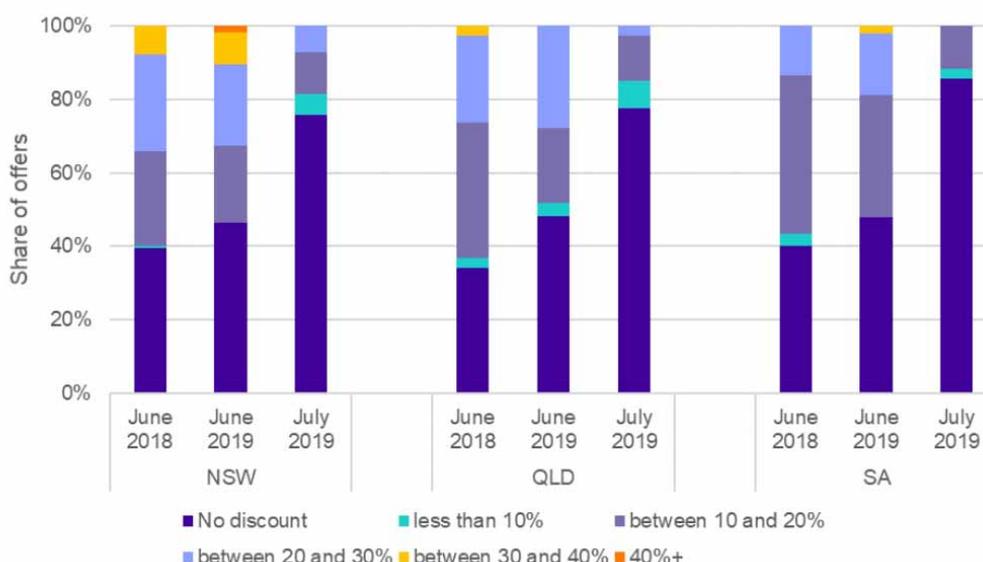
The reduced but ongoing materiality of conditional discounting practices outlined in section 3.3.2 provides an indication of offers available for customers entering into contracts since the introduction of the DMO. However, the Commission considers it important that customers on

⁵² CHOICE, consultation paper submission, p. 8.

retail contracts signed before the introduction of the DMO are also taken into account in an analysis of materiality.

For example, according to the ACCC, in June 2018, about 60 per cent of market offers had a conditional discount set above 10 per cent (see Figure 3.4). Given these trends, the Commission considers it plausible that a material proportion of a retailer's "back book" are made up of contracts that include high conditional discounts. These contracts are usually on a fixed benefit period, after which the discount may end. The Commission considers that in many instances retailers may seek to "roll over" the benefit at the end of the period, i.e. continue offering the customer the same conditional discount deal for a longer period.

Figure 3.4: Historical proportion and magnitude of conditional discounts



Source: ACCC and AER analysis of Energy Made Easy Data, Inquiry into the National Electricity Market August 2019 Report, September 2019, p. 10.

Low realisation rates across all customer cohorts identified by the ACCC (see Figure 3.5) mean that risks of high conditional discounts for customers on contracts signed prior to the DMO coming into force are likely to outweigh benefits gained by customers who satisfy their discount conditions. In the absence of regulatory intervention, a material number of customers would continue to be exposed to the excessive risks placed on them by retailer pricing strategies that have been largely discontinued since the introduction of the DMO.

3.4 Risk allocation and the need for the draft rule

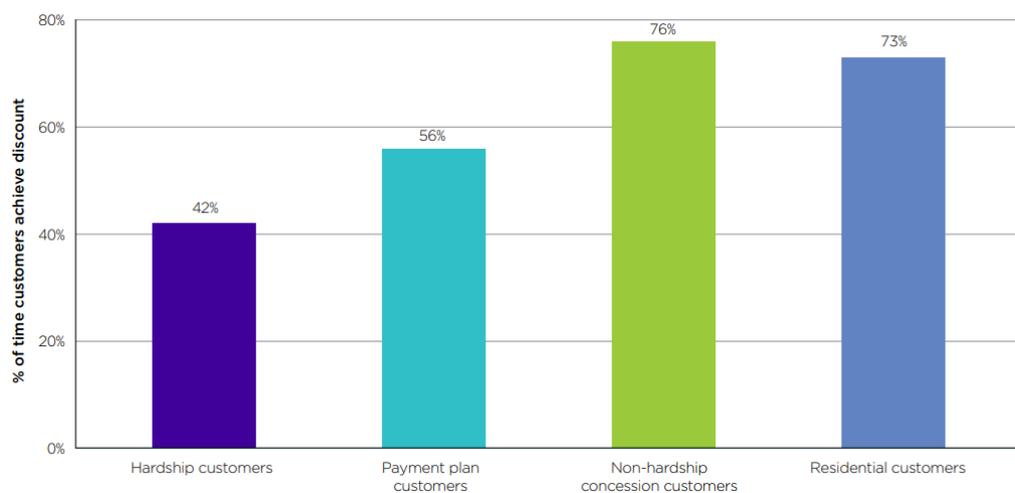
The Commission considers customers are generally best served by a competitive energy market where retailers retain the flexibility to design and set pricing structures to best suit their customers. Market forces, such as customer preferences, encourage retailers to offer pricing structures which benefit customers. However, critical to this dynamic is the ability of

customers to identify, choose and remain on contracts with tariffs that benefit them. In this case, this includes the ability of customers to predict their ability to meet the discount conditions.

The dynamic between the ability of customers to select offers in their best interests and a degree of pricing freedom by retailers enables risk allocation between parties to be balanced. The ACL enshrines these principles, by enabling retailers to set different types of pricing structures, so long as key conditions are clearly disclosed to customers prior to the contract being signed.⁵³

However, evidence indicates that pricing freedom for energy retailers in the case of conditional discounts has led to negative outcomes for material groups of customers (see Figure 3.5 below). The ACCC identified that 27 per cent of all residential customers failed to meet discount conditions, with 58 per cent of hardship customers defaulting.

Figure 3.5: Conditional discount realisation rates across different customer cohorts, 2016-7



Source: ACCC, Retail energy pricing inquiry - Final Report, July 2018, p. xii

Realisation rates observed in the market indicate that, in the case of conditional discounts, many customers are not well-placed to meet contract conditions, particularly customers in hardship. By either underestimating their ability to pay, or the development of unforeseen circumstances, many customers are missing conditional discount payments.⁵⁴ This is symptomatic of Energy Consumers Australia's (ECA) description of the energy retail market as being a "confusopoly".⁵⁵ The related expectation that market dynamics are leading to

53 The ACL's upfront pricing exception enables retailers to apply high conditional discounts provided these conditions are made clear to the customer. Schedule 2, Section 26 *Competition and Consumer Act 2010* (Cth). However, the view of the ACCC (the body that enforces the ACL) is that this regulatory gap must be addressed, as evidenced by its recommendation 33 of REPI.

54 EWOQ noted that conditional discounting is not a prevalent practice in other industries and that this may be a contributing factor to explain failure to meet conditions. EWOW, consultation paper submission, p.1.

55 ECA, consultation paper submission, p. 2. ECA states that "These low realisation rates may be indicative of the retail energy market 'confusopoly', where big headline discounts might catch the eye, but can be illusory once conditions and other fees are taken into account. Further, the complexity of retailer offers means consumers may not immediately understand the risk of not

balanced risk allocation between the parties is not accurate in this case for a material group of customers. Where risk allocation between parties is no longer balanced or efficient, targeted restrictions on the level of conditional discounts and fees may be appropriate.

Where such a restriction is set at reasonable costs, this approach would not unduly limit retailers' pricing freedom, while also providing a degree of protection for customers. Retailers may still be able to manage the risk of late payment through either conditional discounts or conditional fees up to the reasonable costs they would incur from late payment.

The Commission notes that this approach is consistent with common law restrictions on contract terms that include penalties. However, the onerous nature of enforcing common law restrictions on conditional discounting through court renders these protections inadequate for energy customers.

The Commission understands that many customers have been satisfied with their current conditional discount arrangements as they have complied with payment conditions and subsequently earned attractive discounts. The draft rule proposes to cap conditional discounts and, as a result, conditional discount rates for some customers may be reduced. However, the draft rule's effects on retail competition are likely to be mitigated because it does not:

- impede access to conditional discounts limited to reasonable costs
- impede retailers from offering generous discounts on a non-conditional basis

The Commission therefore considers that pricing freedom available to retailers should enable customers to continue to be offered pricing structures that provide them with value, noting that many retailers have already decided not to continue to offer conditional discounts since the introduction of the Code.⁵⁶

3.4.1

Vulnerable customers

Stakeholder submissions by consumer groups signalled that risks inherent to high conditional discounts are not uniformly distributed across all customer groups.⁵⁷ Noticeably low realisation rates for hardship and concession customers noted by the ACCC also highlight that risks may be high for certain groups.⁵⁸ Energy retail rules already recognise the fact that certain customers groups should not bear the risks of certain types of conditions — rule 73 of the NERR states that a retailer must waive late payment fees for customers on hardship programs. The Commission considers that the proposed rule may substantially lessen the risk of conditional discounting practices for all customers, with vulnerable customers in particular benefiting from this approach.

The Commission has opted not to make specific provisions in the draft rule for vulnerable customers. This is made with knowledge that certain changes to retail hardship programs

being able to achieve the discount."

56 For example, see Energy Australia, consultation paper submission, p. 1.

57 For example, South Australian Council of Social Services (SACOSS), consultation paper submission, pp. 1-3.

58 ACCC, *Retail energy pricing inquiry - Final Report*, July 2018, p. xii.

came into effect in October 2019.⁵⁹ In November 2018, the Commission introduced rules to strengthen protections for customers in hardship.⁶⁰ These rules requires the AER to develop hardship guidelines that include consistent and specific statements that retailers must include in their hardship policies. One such obligation⁶¹ is a requirement that retailers' hardship policies includes steps to review a customer's contract so that they are on appropriate market contracts. Given this obligation, the Commission would expect that retailers are actively working with hardship customers so that they are not placed on, or are not encouraged to stay on, riskier types of market contracts, such as those with conditional discounts when a chronic payment issue is identified.

On balance, the Commission considers that the effectiveness of revised hardship policies as well as the benefits delivered to all customers through capping conditional discounts and fees to reasonable costs may be sufficient to minimise risks for vulnerable customers.

3.5 Conclusion: the need for a rule change

While conditional discount proportion and magnitude have decreased since the introduction of the Code, the Commission still considers it a material problem. The main factors that support this conclusion are:

- realisation rates for conditional discounts contract indicate that customers are having difficulty in selecting adequate types of contracts, thus justifying a targeted restriction on the level of conditional discounts and fees
- average conditional discounts observed in the market are likely still above estimated reasonable costs
- material numbers of customers in retailers' back books remain on contracts with high conditional discounts
- potential reversion of the trend in discounting practices, in the absence of restrictions to the substance of conditional discounting practices.

The Commission considers that where such a restriction is set at reasonable costs, this approach would not unduly limit retailers' pricing freedom, while also providing a degree of protection for customers. This approach is consistent with common law restrictions.

These considerations have led the Commission to consider it appropriate to regulate conditional discounting practices.

59 This fact was also highlighted by Red Energy and Lumo Energy. Red Energy and Lumo Energy, consultation paper submission, p. 2.

60 AEMC, *Strengthening protections for customers in hardship - Rule determination*, November 2018.

61 NERL (s. 44 (f)).

4 COVERAGE OF THE DRAFT RULE

Chapter 3 outlined the Commission's view that issues with conditional discounts remain material and that a draft rule restricting conditional discounts and fees is needed. This chapter sets out our approach on key coverage issues related to the Commission's proposed restriction. These are:

- types of conditional contract terms (i.e. conditional discounts or conditional fees) captured by the draft rule
- conditional fees and duplication
- coverage of gas contracts and contracts in all NECF jurisdictions
- the rule's treatment of existing retail contracts

4.1 Issues raised by the proponent

4.1.1 Types of conditional contract terms captured

In its submission, the proponent defines a conditional price discount as "the amount by which a price otherwise payable under a contract is, or would be, reduced as a consequence of complying with one or more provisions of the contract".⁶²

The proponent noted in the rule change request that certain types of conditional contract terms should be the focus of restriction. These are:

- pay-on-time
- direct debit
- online sign-up.⁶³

4.1.2 Conditional fees and duplication

The proponent did not specifically call for the limitation of conditional fees. However, the proponent's rule change request proposed that duplication not be allowed. "Duplication" means the practice whereby a conditional discount and a conditional fee exist in the same retail contract and the condition that triggers those terms is similar. For example, a customer that pays their bill late may be exposed to both a pay-on-time conditional discount and a late payment fee.

4.1.3 Gas contracts and retailer contracts in all NECF jurisdictions

The proponent's rule change request and its suggested rule called for coverage to be extended to gas contracts. The proponent asked that the Commission consider the application of the rule to various NECF jurisdictions.⁶⁴

⁶² Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, p. 9.

⁶³ *Ibid*, p.12.

⁶⁴ *Ibid*, pp. 3-4.

4.1.4 Existing retail contracts

The proponent's rule change request did not present a view on this issue.

4.2 Stakeholder views

4.2.1 Types of conditional contract terms captured

Retailers generally opposed extension of the rule's coverage to additional types of conditional contract terms. AGL noted that the draft rule should only capture conditional pay-on-time discounts and that the Commission should not restrict product attributes such as dual fuels and digital-only offers.⁶⁵

Consumer groups noted that a more expansive definition would be suitable given the need to restrict contract terms that imposed penalties on customers. The Queensland Consumers Association (QCA) noted that:⁶⁶

"it is essential that any new rule should: cover any type of penalty (including loss of a benefit) for non-compliance with the terms and conditions of an energy contract and prohibit any that exceed the reasonable costs...a new rule would potentially cover not only late payment discounts but also other financial penalties associated with late payment (e.g. loss of a fixed amount of money) and other financial penalties incurred due to non-compliance with a term or condition."

4.2.2 Conditional fees and duplication

Retailers generally noted that issues raised by the proponent were confined to pay-on-time conditional discounts, and opposed extension of the rule's coverage to additional types of conditional contract terms. For example, the Australian Energy Council (AEC) noted that:⁶⁷

"Whilst there is a view that conditional discounts deliver negative outcomes to consumers, in practice the perceived issues regarding conditional discounts largely relate to pay-on-time discounts. We suggest that any rule made is characterised in a manner that limits its application to a discount that might impact a particular bill."

Consumer groups, such as the QCA generally noted the importance for rule coverage to be expansive in order to drive broader change in pricing practices and avoid "work arounds" which may be put in place if the Commission decides on a narrow restriction.⁶⁸ CHOICE noted that retailers "double dip" by charging penalties incurred through lost conditional discount and late payment fees and that this behaviour should be limited.⁶⁹

65 AGL, consultation paper submission, p. 2.

66 Queensland Consumer Association, consultation paper submission, p. 2.

67 Australian Energy Council, consultation paper submission, p. 2.

68 Queensland Consumer Association, consultation paper submission, pp. 2-3.

69 CHOICE, consultation paper submission, p. 10.

4.2.3 Gas contracts and retailer contracts in all NECF jurisdictions

Consumer groups generally supported broad application of the rule, including extension to gas offers and to all NECF jurisdictions.

Some retailers also supported consistent coverage across all types of contracts. Simply Energy noted that should a new rule be introduced, it would prefer that it apply to both electricity and gas.⁷⁰ The AER was also supportive of coverage being extended to gas contracts on the basis that it aided customer comprehension and engagement.⁷¹ The ACT's Civil and Administrative Tribunal (ACAT) supported the extension of the rule to all NECF jurisdictions on the basis that the Code covers only electricity retailers and that problems around conditional discounting may arise in ACT and Tasmania where the DMO is not applicable.⁷²

Powershop noted that industry and consumer groups had not raised conditional discounting for gas contracts as a significant issue.⁷³ ActewAGL did not support the extension of the rule to ACT on the basis that local small customers rarely fail to meet conditional discounts and that therefore the costs associated with the rule change might exceed the benefits.⁷⁴

4.2.4 Existing retail contracts

The rule change request did not address this coverage issue, and therefore few stakeholders commented on this topic.

Retailers generally opposed the possibility that the rule's coverage extend to existing contracts. The AEC noted that the rule must capture new contracts only given that an attempt to apply the rule to existing offer might create significant implementation issues for energy retailers, resulting in higher costs.⁷⁵

Conversely, PIAC noted that any contracts with conditional terms should be transitioned at the end of the customer's existing benefit period to minimise disruption or confusion.⁷⁶

4.3 Commission's approach to coverage

4.3.1 Types of conditional contract terms captured by draft rule

In the rule change request, the Commonwealth identified certain types of conditional discounts that may inflict most harm on customers. The Commission has been broadly guided by this scope in considering the types of contract terms that ought to be captured by the draft rule.⁷⁷

70 Simply Energy, consultation paper submission, p. 4.

71 AER, consultation paper submission, p. 9.

72 ACAT, consultation paper submission, p. 3.

73 Powershop, consultation paper submission, p. 4.

74 ActewAGL, consultation paper submission, p. 2.

75 Australian Energy Council, consultation paper submission, p. 2.

76 PIAC, consultation paper submission, p. 3.

77 Australian Government, Improving consumer outcomes and competition by regulating conditional discounting, rule change request, 18 February 2019, p. 12.

The Commission balanced the need to capture the types of conditional contract terms outlined in the rule change request, while not introducing inefficient barriers to pricing innovation. The Commission also considered the practicality of estimating reasonable costs for certain types of offers, given this is crucial to the enforcement of the rule.

The Commission's proposed approach is to limit the draft rule to conditional contract terms that are related to *payment timing or method*.⁷⁸ Only terms that are triggered as a consequence of a failure to comply with a payment condition are captured by the draft rule. Typical conditions under this category include, but are not limited to:

- pay-on-time discount or late payment fee
- direct debit dishonour fee
- cheque dishonour fee
- discounts or fees to incentivise early payment or purchase of power ahead of usage
- online payment or over-the-counter payment discount

The Commission has also considered, and decided against capturing the following conditional contract terms on the basis of being out of scope of the rule change request:

- terms related to installing or operating of energy equipment (e.g. batteries)
- terms related to the "bundling" of gas and electricity and energy and non-energy services
- "passive" conditional terms. These are contract terms which automatically provide customers with the benefit (i.e. do not require customer action)⁷⁹
- "sign up" conditional terms.

The Commission also notes the potential for restrictions on the types of conditional contract terms not captured by the rule could potentially have a stifling effect on pricing innovation.⁸⁰ Similarly, sign up and passive conditional contract terms outlined above are unlikely to cause customer detriment given their structure.

4.3.2

Conditional fees and duplication

The Commission considers that certain conditional discounts have a similar effect to conditional fees. A pay-on-time discount and a late payment fee are both meant to encourage customers to pay before a certain date, and both are triggered when this date is missed. While the discount applies a higher rate to energy costs of the customer, a late payment fee imposes a financial penalty to the customer when the payment deadline is missed. Similar dynamics are in place for other types of conditional contract terms such as direct debit conditional discounts and direct debit dishonour fees.

The Commission considers that conditional fee restrictions are necessary to mitigate the unintended consequences of its proposed rule. Namely, to mitigate the risk that retailers

⁷⁸ Subrule Rule 45A of the Draft Rule, definition of "payment condition": payment condition means a provision of a contract that imposes a condition in relation to the timing or method of payment of a bill.

⁷⁹ For example, a loyalty discount, where a customer is given a large discount rate when he stays with the same retailer for a specified time.

⁸⁰ This was supported by AGL in its submission: AGL, submission to consultation paper, p. 2.

increase conditional fees on energy contracts as a way of recovering revenue lost through reduced conditional discounts.

The Commission considers it inappropriate that small customers be penalised twice for the same breach of contract. The Commission's proposed approach would cap, to reasonable costs, the *aggregate* value of a conditional discount and a conditional fee triggered by the failure to comply with the same payment condition.⁸¹ Under this approach a customer's overall penalty for the same breach of contract would not exceed reasonable costs.

4.3.3 Gas contracts and retail contracts in NECF jurisdictions

The Commission considers that limits of the applicability of the rule to a specific fuel type or particular jurisdiction may be inefficient as it may lead to additional regulatory costs and increased customer confusion.

The Commission has considered the potential for unintended consequences derived from its proposed rule. One such risk is that retailers may increase conditional discounts on gas contracts as a way of recovering revenue lost through reduced conditional discounts in electricity contracts. The Commission therefore considers that gas contracts for small customers should be subject to the draft rule. The risk of revenue recovery was first articulated by the Commission's in its 2019 Retail competition review.⁸²

The Commission's 2019 Retail energy competition review also noted the relatively quick development of retail markets across the national electricity market (NEM) over the past decade, with ACT in particular having a more competitive market in recent years.⁸³ The AER also noted the development of conditional discounts in ACT, noting that the territory was the only region surveyed where it saw an increase in the average magnitude of conditional discounts between 2018 and 2019.⁸⁴ would extension of conditional discount restrictions across Tasmania, regional Queensland and ACT would provide customers in these markets are provided with robust protections when prices are deregulated.

4.3.4 Existing retail contracts with conditional terms

The Commission intends that the rule apply to new contracts from the date of the rule's commencement on 1 July 2020.

As noted in section 3.3.4, there has likely been a build-up of customers on conditional discount contracts on retailers' back books. Where retailers have offered evergreen contracts with fixed benefit periods and conditional discounts cease to apply at the end of the benefit period, the Commission's draft rule will capture existing contracts when a benefit is reset.

The Commission understands that in many instances retailers may seek to "roll over" the benefit at the end of the period, i.e. continue offering the customer the same conditional

81 Subrule 46C (b) of the Draft Rule

82 The AEMC noted that: "there may be an increase in gas prices where retailers seek to recover decreases in electricity revenue." AEMC, 2019 Retail Energy Competition Review, 28 June 2019, p. 52.

83 AEMC, 2019 Retail Energy Competition Review, 28 June 2019, pp. 29, 35.

84 AER, Affordability in energy retail markets, September 2019, p. 20.

discount deal for a longer period.⁸⁵ In order to address the potential effect of customer "roll over," the Commission intends to capture existing contracts under its draft rule when an existing contract's benefit is reset.⁸⁶ In effect, this means that whenever a new benefit is offered to a retail customer, that benefit must be limited to reasonable costs.⁸⁷

4.4 Conclusion: proposed rule coverage

Table 4.1 summarises the Commission's approach to the major coverage issues considered in this chapter.

Table 4.1: Commission's approach on coverage issues under draft rule

COVERAGE ISSUE	COMMISSION'S APPROACH
Conditional fees	Cap conditional fees to reasonable costs.
Duplication	Cap the aggregate value of a conditional discount and a conditional fee in the same contract at reasonable costs.
Types of conditional contract terms captured by draft rule	Limit the draft rule to conditional contract terms that are related to payment timing or method. Only terms that are triggered as a consequence of a failure to comply with a payment condition are captured by the draft rule.
Gas contracts	Extension of conditional discount and fee restrictions to retail gas contracts.
Retail contracts in all NECF jurisdictions (i.e. coverage of ACT, Tasmania and regional Queensland)	Extension of conditional discount and fee restrictions across Tasmania, regional Queensland and ACT.
Existing retail contracts with conditional terms	Capture existing contracts under its draft rule when an existing contract's benefit is reset.

⁸⁵ Data from retailers is needed to understand the proportion of this practice, and the Commission welcomes any such disclosure from stakeholders.

⁸⁶ Schedule 3, Part 13, Existing contracts with small customers 2(1) and 2 (2) of the Draft Rule.

⁸⁷ Given that customers would ordinarily see their rates and/or contracts varied at the end of a benefit period, the Commission's approach to applying the rule enables a smoother transition into compliance. This approach also supports retailer certainty and a gradual transition of their customer base.

5 APPROACH TO REASONABLE COSTS RESTRICTION AND IMPLEMENTATION

This chapter sets out the Commission's approach to the proposed reasonable costs restriction and certain implementation issues.

5.1 Issues raised by the proponent

The proponent suggested in its proposed rule that the AER be empowered to develop a binding guideline that would set the level of reasonable costs. The proponent suggested that reasonable costs should not include "lost supply or profits", but could include:

- administrative costs (such as customer service)
- costs of holding debt
- regulatory compliance with new rule.

The proponent also stated that the guideline should allow for flexibility to enable retailers continue to design market products and allow the market and other stakeholders to help inform guideline design.

5.2 Stakeholder views

Retailers were generally supportive of a "principles-based approach", whereby retailers set conditional discount levels based on their internal estimates of reasonable costs and reported on those to the AER. Simply Energy, for example, noted that varying financing and operating costs incurred by energy retailers justified an approach whereby conditional discounts reflect their individual business circumstances.⁸⁸ Retailers regarded a principles-based approach as more efficient because it would enable the AER to seek information and engage in enforcement action only when it saw a significant problem emerge, rather than preventing business practices ex ante. The AEC noted in its submission that the AER could request information about any offers from retailer to confirm whether it would be reasonable.⁸⁹

Consumer groups were split on their approach to establishing reasonable costs. The QCA, for example, expressed support for a principles-based approach, with the caveat that it be accompanied by effective monitoring by the AER of compliance with the rule.⁹⁰ PIAC supported an AER guideline on the basis that it would clearly signal to retailers reasonable levels of conditional discounts.⁹¹

The AER did not express a clear preference for either approach. However, it noted the need for explanatory materials about the circumstances in which costs are likely to be considered reasonable. The AER asked the Commission to consider different factors in making its decision, including:

88 Simply Energy, consultation paper submission, p. 6.

89 Australian Energy Council, consultation paper submission, p. 2.

90 Queensland Consumer Association, consultation paper submission, p. 3.

91 PIAC, consultation paper submission, p. 6.

- a workable, enforceable definition of 'reasonable' costs
- an appropriate methodology for calculating reasonable costs with view of developing an objective standard of reasonability
- how frequently these costs should be reviewed, and
- appropriate lead times for setting the reasonable costs.⁹²

5.3 Principles-based restriction to reasonable costs

The Commission does not consider a definition of reasonable costs to be required given this is a widely used and understood legal concept.

The draft rule does not require the AER to develop a binding guideline of reasonable cost levels, nor will it be defining these in the draft rule. This approach is justified on the basis that the diversity of retailer costs, pricing structures and different business models would make it unlikely that the AER would be able to set an efficient level of reasonable costs.⁹³ The Commission considers it necessary to provide appropriate flexibility to both the AER and retailers through a principles-based restriction.

Based on the enforcement experience with similar reasonable cost-based restrictions⁹⁴ and effect of the DMO in improving offer transparency, the Commission expects that retailers would move away from offering large conditional discounts without the necessity of enforcement action by the AER. Given that non-compliant retailers could easily be identified through the AER's EME they would likely not be willing to set high rates for their conditional discounts.⁹⁵

In enforcing the draft rule to existing retail contracts following expiry of a benefit period, the AER may choose a low-cost approach where random audits are performed on certain retailers on a regular basis. This may be sufficient to determine whether broader enforcement action is required. Additional data may be sought from consumer groups and Ombudsman schemes to minimise monitoring costs. Given the typical length of current benefit periods, these enforcement costs would likely cease to be significant after 12 to 18 months from the proposed commencement of the rule.

Retailers may be required to provide evidence that their pricing practices for captured fees and discounts are reflective of reasonable costs. Many retailers already have well-established processes to determine reasonable costs, including systems to record, classify and action

⁹² AER, consultation paper submission, p. 11.

⁹³ Rule 46C(a) of the Draft Rule.

⁹⁴ As per discussions with the AER in developing the rule, the Commission understands that the AER's past approach to existing rules that deal with the concept of reasonable costs (such as rule 49A of the NER or section 24 of the NERL, South Australia) has not led to increase in costs to that body given that no enforcement action has been taken to date. The Commission believes this is partly due to the deterrent effect of the rule, where it organically reduced prohibited behaviour.

⁹⁵ See Red Energy and Lumo Energy's submission regarding the fact retailers are naturally moving away from conditional discounts because of the DMO and its support for a light handed approach whereby the AER would monitor conditional discounts and request information from retailers when they appear to exceed reasonable costs. Red Energy and Lumo Energy, consultation paper submission, pp. 3-4.

changes to existing customer contracts. For example, retailers are already required to notify customers of the end of their benefit period under rules introduced in 2017.⁹⁶

5.4 Estimates of reasonable costs

As noted in section 5.3, the Commission will not be setting, nor will it be requiring the AER to set, a reasonable costs guideline. However, as guidance, the Commission notes the approach that regulatory bodies have taken on analogous issues in the past. The Commission believes three case studies are instructive:

1. The calculation of reasonable costs presented in section 3.3.2 and based on various estimates of late payment fees and direct saved debt costs. This approach would be useful for pay-on-time conditional discounts.
2. The approach taken by the High Court in *Paccioco*, highlighted in Box 1. The case is the current precedent in Australia with respect to the law of penalties. In this case, the High Court determined that reasonable costs are not limited to direct costs attributable to a potential breach of contract. While the Commission notes that the precedent is focused on credit card fees within the financial sector and may not be entirely applicable to conditional contract terms in retail energy contracts, it is nevertheless a useful approach to determining the types of costs that may be taken into account.
3. The ban on payment surcharges enforced by the ACCC (see Box 2 below).

BOX 2: BAN ON PAYMENT SURCHARGES UNDER THE CCA

Concerns over excessive surcharging of customers utilising card payment methods were considered by the 2014 Financial System Inquiry (FSI). The FSI recommended the Reserve Bank of Australia (RBA) clarify the definition of 'reasonable' costs in its surcharging rules.

In 2016, changes were made to surcharging rules in the *Payment Systems (Regulation) Act* and CCA. The new rules limit the amount of any surcharge to what it costs the business to accept a card payment. Consumers using payment cards from designated payment systems cannot be surcharged in excess of a business's cost of acceptance for that card. Eligible costs are clearly defined in the rules and new transparency requirements promote compliance with the new framework.

The RBA has said that as a guide, payments through the domestic EFTPOS system are usually quite low, mostly below 0.5 per cent. Credit cards usually have a higher cost for businesses (e.g. up to 1-1.5 per cent for Visa). Different businesses have different costs of acceptance, with smaller merchants' costs usually being higher. Costs that may be included in the surcharge include:

- merchant service fees

⁹⁶ National Energy Retail Amendment (Notification of end of fixed benefit period) Rule 2017 No. 2., Rules 48A and 48B, November 2017.

- fees paid for the rental and maintenance of payment card terminals
- any other fees incurred in processing card transactions, including cross-border transaction fees.

Additional types of costs paid to other providers can be included if they are directly related to accepting a particular card type:

- gateway fees paid to a payment service provider
- the cost of fraud prevention services paid to an external provider
- any fees paid for the rental or maintenance of card terminals paid to a provider other than the payment facilitator
- the cost of insuring against forward delivery risk.

The ACCC has the power to issue Surcharge Information Notices to assist it to enforce the rules. The ACCC can also take court action against businesses and seek pecuniary penalties. The infringement notice penalties are 600 penalty units (\$126,000) for a listed corporation. The ACCC continues to receive reports of smaller businesses that are alleged to be imposing excessive surcharges and had sent out over 750 warning letters to small businesses. In addition, it conducted more than 60 investigations into businesses alleged to have imposed excessive surcharges.

Source: Adapted from: <https://www.accc.gov.au/business/pricing-surcharging/payment-surcharges/qa-payment-surcharges>; <https://www.accc.gov.au/publications/payment-surcharges-only-charge-what-it-costs-you>; Dark, C., Fisher, C., McBey K., and E. Tellez, 2018, *Payment Surcharges: Economics, Regulation and Enforcement*, RBA Bulletin, December, pp. 1-20.

5.5

Transitional and implementation issues

5.5.1

Rule commencement

The Commission considers that the rule should commence from 1 July 2020 and apply to benefit periods ending after that date in line with the Commission's approach detailed in section 4.3.4.

The final determination is scheduled for mid-February 2020. The Commission believes that a decision on this date would provide retailers and the AER with sufficient time to prepare to comply with the rule.

5.5.2

Civil penalties

The Commission intends to recommend to the COAG Energy Council that breaches of rules 46C and 52B of the draft rule be subject to a civil penalty under the NERL. Having these provisions of the draft rule subject to a civil penalty would allow the AER to issue infringement notices with penalties of up to \$100,000 (for a body corporate) per breach. The Commission notes that the rule change request specifically proposed the addition of civil penalties.⁹⁷

⁹⁷ Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, pp. 4-5

The Commission sees three main reasons for the application of civil penalties under this draft rule:

- Potential for large conditional discounts to cause financial detriment to customers who miss payment conditions. An estimate of the potential detriment was calculated by the proponent in his rule change request.⁹⁸ Given the material nature of this potential detriment, the existence of civil penalties is likely to be in the long-term interests of consumers and would contribute to the achievement of the objectives of the national energy laws.
- The draft rule exists to operationalise fundamental customer protections already present, but not practically enforced, under common law (i.e. the penalty prohibition in contracts). In the past, large conditional discount rates in potential breach of common law had been a common practice. This evidence of widespread non-compliance with common law prohibition justifies the introduction of civil penalties.
- The Commission notes the potential for investigation and enforcement of breaches of the draft rule to be difficult for the AER, especially with regard to enforcing transition of customers on existing contracts to comply with the rule at the end of their benefit period. Given this, civil penalties are appropriate as an effective deterrent to potential breaches of the rule.

⁹⁸ Ibid, pp. 2-3.

ABBREVIATIONS

ACCC	Australian Competition and Consumer Commission
ACL	Australian Competition Law
ACT	Australian Capital Territory
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AGL	AGL Energy Ltd
CCA	<i>Competition and Consumer Act (2010)</i>
Cth	Commonwealth
Commission	See AEMC
COAG	Council of Australian Governments
Code	Electricity Retail Code of Conduct
DMO	Default market offer
ECA	Energy Consumers Australia
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEO	National electricity objective
NERL	National Energy Retail Law
NERR	National Energy Retail Rules
NECF	National Energy Consumer Framework
NERO	National energy retail objective
NGL	National Gas Law
NGO	National gas objective
PIAC	Public Interest Advocacy Centre
QCA	Queensland Consumers Association
REPI	Retail electricity pricing inquiry

A SUMMARY OF ISSUES RAISED IN SUBMISSIONS

This appendix sets out the issues raised in the first round of consultation on this rule change request and the AEMC's response to each issue. If an issue raised in a submission has been discussed in the main body of this document, it has not been included in this table.

Table A.1: Summary of other issues raised in submissions

STAKEHOLDER	ISSUE	AEMC RESPONSE
ACAT	Noted they had observed that the cause for payment default could be caused by, amongst other things, administrative error by the customer, utility or the bank causing a direct debit failure (p.3)	This issue is outside the scope of this rule change.
AGL	The AEMC's annual review of retail energy competition may be an appropriate point to review the market and determine whether the proposed rule is required or not. (p.2)	The Commission believes that the issue of conditional discounting is of sufficient materiality and requires immediate action. The Commission extended stakeholder consultation periods in order to give stakeholders more time to understand changes brought about by the DMO. Additionally, the Commission considers that sufficient benchmarks of reasonable levels of conditional discounts exist as presented in chapter 3 of this document.
AGL	Noted that certain conditional contract terms are benefits rather than penalties and therefore not covered at common law. (p.1)	The Commission notes that certain retailers consider their conditional discounting practices offer customers "benefits" rather than penalties. The Commission considers that the effect of conditional contract terms is the critical factor to be considered determining whether a term constitutes a penalty or a benefit. Conditional contract terms normally increase rates customers expect to pay and/or impose a financial obligation based on realisation of a condition. The framing of this contract term to customers as a benefit for purposes of the promotion of the offer does not detract from its ultimate effect, which is

STAKEHOLDER	ISSUE	AEMC RESPONSE
		equivalent to that of a penalty.
Alinta Energy	Stated that the Department of Prime Minister and Cabinet (DPMC) Regulatory Impact Statement(RIS) on the DMO (April 2019) had the same objectives of the consultation paper and rule change request. (p. 3)	Given that the rule change request specifically targeted the capping of excessive penalties caused by large conditional discounts and that discounts were not mentioned by the DPMC extract highlighted by Alinta Energy, the Commission considers that the two documents had distinct objectives in that regard.
Alinta Energy	Noted it considers a conditional discount as a benefit rather than a penalty. p. 4	The Commission notes that certain retailers consider their conditional discounting practices offer customers "benefits" rather than penalties. The Commission considers that the effect of conditional contract terms is the critical factor to be considered determining whether a term constitutes a penalty or a benefit. Conditional contract terms normally increase rates customers expect to pay and/or impose a financial obligation based on realisation of a condition. The framing of this contract term to customers as a benefit for purposes of the promotion of the offer does not detract from its ultimate effect, which is equivalent to that of a penalty.
AER	Noted disproportionate impact of high conditional discounting practices on vulnerable customers. It also notes the fact that vulnerability can be widespread and derive from a range of personal and market specific issues. (p.5)	The Commission deals with these issues related to vulnerable customers and whether specific measures are needed in section 3.4.1. Matters related to the extension of coverage of hardship programs are outside the scope of the rule change and are best dealt by jurisdictional governments and the AER. For example, on the matter of late payment fees, the NSW government has made arrangements to ensure the exemption applies to a broader group of vulnerable customers (see, National Energy Retail Law [Adoption] Regulation 2013, s. 10). The AER also has the power to issue and revise a binding Hardship Guideline under rules made by the Commission.

STAKEHOLDER	ISSUE	AEMC RESPONSE
AEC	Expressed concern that, if the rule change is too strict (i.e. limiting the ability for retailers to offer conditional discounts of the nature that they are today) then the availability of these low- priced offers might decline. (p.2)	The Commission's rule does not prescribe any advertising restrictions on conditional discounts. The focus of the draft rule is on the substance or level of discounts offered.
CHOICE	Noted disproportionate impact of high conditional discounting practices on vulnerable customers. It also notes the fact that vulnerability can be widespread and derive from a range of personal and market specific issues. (p.6)	The Commission deals with these issues related to vulnerable customers and whether specific measures are needed in section 3.4.1. Matters related to the extension of coverage of hardship programs are outside the scope of the rule change and are best dealt by jurisdictional governments and the AER. For example, on the matter of late payment fees, the NSW government has made arrangements to ensure the exemption applies to a broader group of vulnerable customers (see, National Energy Retail Law [Adoption] Regulation 2013, s. 10). The AER also has the power to issue and revise a binding Hardship Guideline under rules made by the Commission.
CHOICE	Indicated a preference for the banning of conditional discounts so that only guaranteed discounts are offered (p. 9)	The Commission notes the need to balance the need for it to balance retailers' ability to manage risk and pricing flexibility while protecting customers in section 3.4 of the determination. The Commission's view is that banning of conditional discounts would unduly limit retailers risk management and pricing flexibility.
ECA	Noted that eligibility criteria for some offers may increase the transparency and certainty of prices that customers are likely to face when signing up to an electricity plan as opposed to opaque	The Commission's rule does not affect the ability for retailers to advertise offers with eligibility criteria or sign up conditions.

STAKEHOLDER	ISSUE	AEMC RESPONSE
	conditional discounts. (p.3)	
ECA	Differences in the application of the discounts (to the whole bill, or just one component of the bill), in addition to the use of conditional discounting and additional fees and charges (such as late payment fees) all add complexity for the consumer. (p.2)	The Commission has opted not to regulate the application of conditional discounts on different parts of the tariff at this stage. Advertising restrictions put in place by the Code are likely to have improved offer comparability to the extent that a material issue is not evident on this specific issue. The Commission would be happy to be furnished with more specific data highlighting this issue should stakeholders think this is a material issue that can be dealt within the scope of this rule change.
EWON	Noted a range of issues related to financial difficulty and the fact that "Not all customers experiencing financial difficulty are part of these programs for reasons such as lack of awareness, lack of referral by retailer contact centre staff, discomfort in admitting financial difficulty, or being refused entry to programs either at the initial request or due to prior failed adherence." (p. 2)	The Commission deals with these issues related to vulnerable customers and whether specific measures are needed in section 3.4.1. Matters related to the extension of coverage of hardship programs are outside the scope of the rule change and are best dealt by jurisdictional governments and the AER. For example, on the matter of late payment fees, the NSW government has made arrangements to ensure the exemption applies to a broader group of vulnerable customers (see, National Energy Retail Law [Adoption] Regulation 2013, s. 10). The AER also has the power to issue and revise a binding Hardship Guideline under rules made by the Commission.
EWON	Suggested an alternative approach where retailers would guarantee conditional discounts for any customer that engages with their retailer by requesting payment	As above.

STAKEHOLDER	ISSUE	AEMC RESPONSE
	<p>assistance and then meeting their agreed affordable payment arrangement would encourage ongoing adherence to that payment arrangement. (p.3)</p>	
Powershop	<p>Noted it considers a conditional discount as a benefit rather than a penalty. (p. 3)</p>	<p>The Commission notes that certain retailers consider their conditional discounting practices offer customers "benefits" rather than penalties. The Commission considers that the effect of conditional contract terms is the critical factor to be considered determining whether a term constitutes a penalty or a benefit. Conditional contract terms normally increase rates customers expect to pay and/or impose a financial obligation based on realisation of a condition. The framing of this contract term to customers as a benefit for purposes of the promotion of the offer does not detract from its ultimate effect, which is equivalent to that of a penalty.</p>
QCA	<p>Notes that additional costs imposed by a retailer on customers for late payments should be done by charging a fair interest rate applied to the amount unpaid and the time the bill remains unpaid. It noted that this is a widely used approach by businesses, including telcos. (p.3)</p>	<p>The Commission's draft rule and its expected enforcement approach are broadly aligned with these comments. The Commission expects that the AER's case-specific enforcement of the rule would most likely yield a similar outcome to an interest rate- based approach. The Commission welcomes feedback from stakeholders on how this approach to "fair charging" can be incorporated into its draft rule.</p>
SACOSS	<p>Noted the emergence of energy deals with sign-up incentives (e.g. gift cards for signing up online) and</p>	<p>The Commission has not been provided with sufficient data to determine the materiality of this particular issue and encourages stakeholders to provide the Commission with information required to assess whether a restriction on</p>

STAKEHOLDER	ISSUE	AEMC RESPONSE
	bundling of services may make offer comparability more difficult. (p.2)	additional types of offers are feasible and necessary.
SACOSS	Noted disproportionate impact of high conditional discounting practices on vulnerable customers. It also notes the fact that vulnerability can be widespread and derive from a range of personal and market specific issues. (p.2)	<p>The Commission notes that 1.4 per cent figure quoted in the consultation paper was meant as an example of figures that may be utilised by stakeholders in their submission rather than the Commission's position.</p> <p>The Commission deals with these issues related to vulnerable customers and whether specific measures are needed in section 3.4.1. Matters related to the extension of coverage of hardship programs are outside the scope of the rule change and are best dealt by jurisdictional governments and the AER. For example, on the matter of late payment fees, the NSW government has made arrangements to ensure the exemption applies to a broader group of vulnerable customers (see, National Energy Retail Law [Adoption] Regulation 2013, s. 10). The AER also has the power to issue and revise a binding Hardship Guideline under rules made by the Commission.</p>
PIAC	Notes that the Code includes several provisions that make its interpretation and applicability problematic (pp. 1-2)	The Commonwealth government is responsible for the introduction and revision of the Code.
PIAC	Recommends that discount advertising be those utilising a simple dollar figure given percentages are often not well understood by customers. (pp. 2,4)	The Commission's approach has been to focus on the substance of conditional discounts rather than advertising practices. It acknowledges that not all customers may understand the concept of percentage discounts. At the same time, retailer practices centred on increasingly high discounts prior to the DMO indicate customers responded to percentage discounts. In short customers understood percentage discounts, but they did not understand their value because of different base rates set. This indicates that the issue was not the

STAKEHOLDER	ISSUE	AEMC RESPONSE
		percentage per se. The Commission welcomes further data on this matter to establish its materiality.

B LEGAL REQUIREMENTS UNDER THE NERL

This appendix sets out the relevant legal requirements under the NERL for the AEMC to make this draft rule determination.

B.1 Draft rule determination

In accordance with s. 256 of the NERL the Commission has made this draft rule determination in relation to the rule proposed by the Commonwealth Minister for Energy and Emission Reduction.

The Commission's reasons for making this draft rule determination are set out in section 2.4.

A copy of the more preferable draft rule is attached to and published with this draft rule determination. Its key features are described in section 2.3.

B.2 Power to make the rule

The Commission is satisfied that the more preferable draft rule falls within the subject matter about which the Commission may make rules. The more preferable draft rule falls within s. 237 of the NERL as it relates to the provision of energy services to customers and the activities of persons (retailers) involved in the sale and supply of energy to customers.

B.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NERL to make the rule
- the rule change request
- submissions received during first round consultation
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the NERO.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.⁹⁹

B.4 Civil penalties

The Commission cannot create new civil penalty provisions. However, it may recommend to the COAG Energy Council that new or existing provisions of the NERR be classified as civil penalty provisions.

The Commission's draft more preferable rule includes the addition of rules 46C and 52B into the NERR.

⁹⁹ Under s. 225 of the NERL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for energy. On 1 July 2011, the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated council is now called the COAG Energy Council.

The Commission considers that the new provisions should be classified as civil penalty provisions for the reasons set out in section 5.5.2.

B.5 Conduct provisions

The Commission cannot create new conduct provisions. However, it may recommend to the COAG Energy Council that new or existing provisions of the NERR be classified as conduct provisions.

The draft rule does not amend any rules that are currently classified as conduct provisions under the NERL or the National Energy Retail Regulations. The Commission does not propose to recommend to the COAG Energy Council that any of the proposed amendments made by the draft rule be classified as conduct provisions.