

13 August 2008

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

Dear Dr Tamblyn,

**RE : Review of Effectiveness of Competition in Gas and Electricity Markets –
First Draft Report**

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to comment on the 'Review of Effectiveness of Competition in Gas and Electricity Markets - First Draft Report', released by the AEMC on 4 July 2008.

The ERAA welcomes the findings of the draft report showing that the level of competition in the South Australian market is highly effective and leading to beneficial outcomes.

As the draft report indicates, after over four years of full retail competition in South Australian there are now over ten retailers actively selling to small customers in the electricity market and four retailers actively retailing gas to small customers. The ERAA believes that ultimately, the entry or threat of entry of new retailers will provide the best outcomes for customers.

The ERAA is encouraged by the evidence in the draft report of both the level of vigorous competition among retailers and the high degree of customer awareness about retail competition. Such findings are consistent with the commercial experiences of our members operating in South Australia, further indicating that there is effective competition in the market to justify the removal of price regulation.

The Association holds the view that the on-going regulation of retail energy prices for small customers and the cross subsidies that it introduces between customer classes, stifles innovation and therefore overall competition in the market. The Association therefore believes the findings in the draft report clearly justify the removal of price regulation in order to allow competition in the South Australian market to further develop. We await the recommendations of the AEMC's second draft in this regard.

The ERAA agrees with the Commission's comments about the potential for the Carbon Pollution Reduction Scheme (CPRS) to impact on energy prices and retailers' operational costs. The ERAA would note that the deregulation of retail energy pricing is needed to ensure the pass through of the cost of carbon to end customers, a key objective of the Federal Government's Green Paper on the CPRS.

In the context of addressing the impacts of climate change the ERAA also believes that removal of retail price regulation will have a number of specific benefits. These include creating incentives for new investment, improved demand side management (including peak summer demand) and potential reduction overall demand for energy. The removal of retail price regulation would also help make customers more conscious about their energy consumption. Ultimately the removal of price regulation is an essential foundation of any energy efficiency policy aimed at influencing customer behaviour.

The ERAA notes some of the comments from stakeholders' submissions on the issue of energy hardship and would reiterate that market forces are the most efficient method of regulating price in all but the most exceptional circumstances. The ERAA recognises the importance of dealing with energy affordability and highlights how retailers now provide comprehensive hardship programs to assist vulnerable customers. The Association maintains that there is no justifiable link between price regulation and consumer protection, and that well targeted and transparent community service obligations are the most effective way of assisting those customers in genuine financial hardship, while not distorting the market.

In commenting on the issue of energy hardship the Association would draw your attention to the work commissioned by the Association from the Monash Centre for Regulatory Studies entitled Consumer Protection in a Deregulated Retail Energy Market. This report looks at the evolution of the competitive Victorian retail energy market and then outlines a potential consumer framework that would continue to exist after the removal of price controls, incorporating an array of concession schemes provided for by Government.

While the report is based on the Victorian retail energy market the Association believes it would have equal application in South Australia if competition was found to be effective and the regulation of prices was discontinued. A copy of the report is attached to this submission

Should you require any further information in relation to this matter please feel free to contact me on (02) 9437 6180.

Yours sincerely



Cameron O'Reilly
Executive Director
Energy Retailers Association of Australia



Consumer Protection in a Deregulated Retail Energy Market

Final Report

Submitted to



Monash Centre for Regulatory Studies

Faculty of Law, Monash University

April 2008

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The views and interpretations expressed in this Report are those of the authors and do not necessarily represent the views of either the Energy Retailers Association of Australia, or Monash University.

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EXECUTIVE SUMMARY

This Report articulates a feasible consumer protection framework for electricity and gas supplies in Victoria following retail price deregulation. It makes several important points.

It notes firstly that recent Australian Energy Market Commission analyses have found competition in Victoria's electricity and gas markets to be strong based on a wide range of criteria. Moreover, it notes that in terms of the protection of consumer interests in essential energy services, Victoria's existing consumer protection framework is robust in respect to formal regulatory requirements as well as government grants and concession arrangements. Tracing the evolution of Victoria's energy markets, the Report then shows that whilst citizens may regard the reserve pricing power as an important symbolic tool, it is only one out of eight specific safety net regulatory mechanisms and more than a dozen government schemes supporting low income and regional consumers. As well, the Report notes that the use of the government's reserve power to cap retail energy prices was designed to be a transitional policy arrangement, and one which would cease when competition was proven to be effective.

Looking briefly at the views of Victoria's retailers, it was clear that there was strong support for the continuation of an energy specific consumer protection framework, including an industry specific dispute resolution scheme as well as maintaining existing protections under the relevant Acts, Codes, and Guidelines. This included, for example, the continued obligation to supply and sell energy to residential customers. A range of feasible arrangements to this end were identified, specifically the Host Retailer (the status quo) and Financially Responsible Market Participant models.

Reviewing key overseas experience in deregulated markets in the United Kingdom, New Zealand and Texas also added weight to the conclusion that existing consumer safety net arrangements in Victoria are strong. Nonetheless, additional mechanisms to assist in protecting consumers were identified. These included a potential to remove early termination (exit) fees (United Kingdom); options such as price guarantee offers (United Kingdom and Texas); and the importance of maximising the availability of market information through 'rack rate' reporting, the use of independent third parties or the possibility of publishing a snapshot of market contract offers. Another lesson from overseas came from California in terms of understanding the dynamic operation of energy markets and the need to maximise price transparency.

The hypothetical consumer protection framework developed through this Report builds on these insights as well as findings from relevant international empirical experience. The framework recommended at the close of the Report combines the best aspects of Victoria's existing consumer protection mechanisms, along with new initiatives designed to maximise the degree to which citizens using electricity and gas enjoy the continued provision of these essential services.

LIST OF ABBREVIATIONS

Abbreviation	Full Name
2002 Review	Review of the effectiveness of retail competition and consumer safety net in gas and electricity, conducted by the ESC in 2002
2004 Review	Review of the effectiveness of retail competition and consumer safety net in gas and electricity, conducted by the ESC in 2004
ACCC	Australian Competition and Consumer Commission
AEMA	Australian Energy Market Agreement
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
CALC	Consumer Action Law Centre
CAV	Consumer Affairs Victoria
CUAC	Consumer Utilities Advocacy Centre
EIA	<i>Electricity Industry Act 2000 (Victoria)</i>
EIOV	Energy Industry Ombudsman of Victoria
ERC	Energy Retail Code
ESC	Essential Services Commission (Victoria)
ESC Act	<i>Essential Services Commission Act 2001 (Victoria)</i>
EWOV	Energy and Water Ombudsman of Victoria
First Tier Retailer	A retailer responsible under the EIA or GIA for the supply of electricity or gas (as appropriate) to franchise customers in the geographic supply area allocated to that retailer.
FRC	Full retail competition
FRMP	Financially Responsible Market Participant
FTA	<i>Fair Trading Act (Vic) 1999</i>
GIA	<i>Gas Industry Act (Vic) 2001</i>
GJ	Gigajoule
Host Retailer	A retailer that is also one of the three first tier retailers, being: TRUenergy, Origin Energy, and AGL
MCE	Ministerial Council on Energy
MWh	Mega Watt per hour
NEM	National Electricity Market
New Retailer	A retailer that is not a host retailer
NTR	Network Tariff Rebate
ORG	Office of the Regulator General
RoLR	Retailer of Last Resort
Second Tier Retailer	A retailer other than the first tier retailer for a geographic supply area
TPA	<i>Trade Practices Act (Cth)1974</i>
URGS	Utilities Relief Grant Scheme
VCOSS	Victorian Council of Social Service

1 INTRODUCTION

1.1 Background to this Report

Since the progressive introduction of retail competition for electricity and gas for some Victorian consumers in 1994, the Victorian energy markets have been the subject of continual structural and regulatory reform. The introduction of full retail competition (FRC) for all Victorian consumers, including residential consumers, for electricity and gas in 2002 provided these smaller consumers with the opportunity for the first time to enter a competitive energy market. These reforms to the energy retail sector were designed to benefit all Victorian energy consumers 'through more cost-reflective prices, improved product and service quality and innovation'.¹

Bearing in mind the essential nature of energy, the introduction of FRC in Victoria for electricity and gas was underpinned by the implementation of a legislated consumer 'safety net', a key element of which was a 'price oversight mechanism [designed] to protect the interests of customers during the transition to effective competition'.² As highlighted by this statement, the government's reserve power to regulate retail prices for some customers was designed to be a transitional mechanism, and one that would be removed when competition in the state's retail electricity and gas markets was deemed to be effective.³ Despite the implementation of a reserve power for electricity and gas, the Victorian Government has not exercised the power. Rather, the Government and the host electricity and gas retailers have instead opted to negotiate a four year retail price path agreement (2004-07) for standing offer tariffs, which allowed for annual variations in average electricity and gas prices for prescribed customers.⁴ Having expired on 31 December 2007, a new one year price path agreement came into force on 1 January 2008.⁵

Against the backdrop of the negotiated retail price path agreements, Victoria's Essential Services Commission (ESC) undertook a review in 2002 of electricity retail competition for residential and small business consumers,⁶ which was followed in 2004 by an investigation into the effectiveness of the state's retail energy markets for small consumers.⁷ In the latter review, the ESC found that,

competition has now, or will be soon, developed to a stage at which it can be relied on in the majority of cases to discipline attempts to exercise market power by raising prices above efficient costs. As competition continues to strengthen, consideration can be given to progressively rolling back the current retail price

1 AEMC (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Sydney: AEMC, at p.9.

2 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria: First Draft Report*, Sydney: AEMC, at p.viii.

3 AEMC (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Sydney: AEMC, at p.10.

4 Department of Primary Industries (2007), *Victorian Energy Prices Fact Sheet*, Melbourne: Victorian Government.

5 Department of Primary Industries (2007), *Energy Retail Price Adjustments 2008*, Melbourne: Victorian Government.

6 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*: Melbourne: ESC.

7 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC; ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Background Report*, Melbourne: ESC.

arrangements and, ultimately, to their elimination, leaving price setting to the competitive market.⁸

However, having found that the market was only 'generally effective in constraining prices and delivering non-price benefits',⁹ the ESC recommended that there was still a need, at that time, for residential customers to have the protections afforded to them by virtue of the Government's reserve pricing power.¹⁰ As noted above, this mechanism was not seen to be absolute, and in the longer term when competition was found to be effective for all Victorian energy consumers, it was eventually to be phased-out.

The Victorian Government's commitment to removing retail price regulation for energy consumers within competitive energy markets was further reinforced by their commitment to the Australian Energy Market Agreement (AEMA, or the Agreement). As provided by clause 14.11 of the Agreement:

All Parties agree to phase out the exercise of retail price regulation for electricity and natural gas where effective retail competition can be demonstrated and that:

- (a) the AEMC will assess the effectiveness of competition for the purpose of retention, removal or reintroduction of retail energy price controls...

Pursuant to clause 14.13 of the AEMA,

Where competition has been found to be effective under clause 14.11, the Parties agree to implement the phase out of the exercise of retail price regulation in accordance with clauses 14.14 and 14.15.

In accordance with the requirements set out in the AEMA, the Australian Energy Market Commission (AEMC) commenced a review of the effectiveness of retail competition in electricity and gas in Victoria (the Victorian Review) in 2007.¹¹ The Victorian Review is the first such review to be undertaken and is to be followed by a review of South Australia's retail energy markets.¹² As stated by the AEMC,

The purposes of the Victorian Review, and the subsequent retail competition reviews, is to assess whether competition is effective for small customers and to make recommendations in relation to the retention or removal of the tariff component of the safety net arrangements. Where competition is found to not be effective the Commission is to provide recommendations on how competition can be improved.¹³

8 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC.

9 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC, at p.3.

10 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC, at p.4.

11 See generally AEMC (2007), *Review of the Effectiveness of Competition in the Gas and Electricity Retail Markets - Statement of Approach*, Sydney: AEMC; and AEMC (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Sydney: AEMC.

12 Ministerial Council on Energy (2007), *Phase Out of Retail Price Regulation - Commencement of South Australian Assessment of Competition*, 21 December. Canberra, MCE

13 AEMC (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Sydney: AEMC, at p.vi.

As part of the Review process, the AEMC published an Issues Paper and a First Draft Report. These reports called for input from stakeholders regarding competition in the Victorian retail energy markets in a general sense, as well as in regard to specific questions¹⁴ and their preliminary findings.¹⁵ These views, in conjunction with the findings of the AEMC in their First Final Report,¹⁶ are discussed in more detail in Sections 2 and 5 of this Report. In summary, on the basis of the evidence and their analysis, the AEMC found,

that competition in both electricity and gas retailing in Victoria is effective. The majority of energy customers are participating actively in the competitive market by exercising choice among available retailers as well as price and service offerings. There is strong rivalry between energy retailers, facilitated by the current market structures and entry conditions.¹⁷

Having reached the conclusion that Victoria's energy markets have matured so as to be deemed to be effective, pursuant to clause 14.11(c) of the AEMA,¹⁸ the AEMC is required to provide advice to the Victorian Government on the processes by which the current retail price regulation arrangements may be phased out.

As part of this process, the AEMC released a Second Draft Report¹⁹ in December 2007 and a Second Final Report in February 2008.²⁰ These Reports, which are discussed in more detail in Sections 2 and 5 of this Report, recommended that Victoria's reserve retail pricing power for standing offer prices be terminated on 1 January 2009.²¹ In making this recommendation, the Final Draft Report set out the AEMC's advice on the ways in which this could be achieved without detriment to Victorian energy consumers.

Against the backdrop of the AEMC's Victorian Review, the Energy Retailers Association of Australia (ERAA) commissioned the Monash Centre for Regulatory Studies, Faculty of Law, Monash University to examine the different options for competition based consumer protection frameworks in a deregulated Victorian electricity market. The ERAA has been a strong advocate for the removal of retail price regulation in the Victorian energy markets up to and throughout the AEMC's Victorian Review.²²

This Final Report is part of the third and final stage of the consultancy.

14 AEMC (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Sydney: AEMC, at p.1.

15 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria: First Draft Report*, Sydney: AEMC, at p.11.

16 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria: First Draft Report*, Sydney: AEMC

17 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria: First Draft Report*, Sydney: AEMC, at p.viii.

18 Clause 14.11(c) of the AEMA states that 'the AEMC will publicly report on its assessments of effective competition in which it will provide advice to each jurisdiction on their compliance with clauses 14.10–14.14 and on:

(i) ways to phase out the exercise of retail price regulation if competition is determined to be effective and an appropriate timeframe;'

19 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC.

20 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

21 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.viii.

22 ERAA (2007), *RE: Review of Effectiveness of Competition in Gas and Electricity Markets*, Sydney: ERAA.

1.2 Objective of this Report

Having found that ‘competition in electricity and gas retailing in Victoria is effective,’²³ the objective of this Report is to assist the ERAA with developing a hypothetical consumer protection framework and associated transitional arrangements that could be implemented in Victoria alongside the removal of the reserve pricing power. Accordingly, the Report builds on a foundation which makes the primary assumption that the Victorian Government will act upon the AEMC’s advice to remove the reserve pricing power.

As noted in the Project Brief,

such a framework may deal with such matters as ensuring universal access/offers, [community service obligations] CSO’s for rural and remote customers, hardship policies and concession/affordability programs.²⁴

In fulfilling its objective, the Report articulates a potential framework, underpinned by a range of consumer protection measures which are designed to ensure that Victorian consumers are able to continue to benefit from the state’s competitive retail energy markets. A timeline for the removal of the reserve pricing powers and the implementation of the preferred transitional arrangements is also provided in Section 5.

The focus of this Report is on the development of a hypothetical consumer protection framework for Victoria. It is nonetheless envisaged that elements of the proposed framework could be considered by other states as providing a template as they progressively phase out retail price regulation. Increased harmonisation or regulatory consistency in relation to consumer protection frameworks across Australian states would appear to be advantageous as the states transition towards a national framework for retail regulation.

1.3 Report Outline

The Final Report is structured as follows:

- Section 2 summarises the history of FRC in Victoria’s energy markets, with a particular focus on the ESC’s two investigations into the effectiveness of retail competition in the state’s electricity and gas markets (2002 and 2004) and the more recent review by the AEMC (2007-08). It also briefly considers both the Productivity Commission’s Review of Australia’s Consumer Policy Framework (2007-08), and the ESC’s recently initiated Review of Energy Regulatory Instruments (2008).
- Section 3 outlines the current regulatory framework underpinning Victoria’s consumer protection framework for electricity and gas customers. A summary of the regulatory obligations on Victorian retailers, in conjunction with a description of the current energy-specific grants and concessions funded by the state and federal governments, is provided.
- Section 4 examines some of the key experiences of retail price regulation within energy markets in the United Kingdom (UK), New Zealand, Texas and California. Particular attention is paid to the experiences in the first three of these jurisdictions due to their experience with phasing out retail price regulation or the absence of retail price regulation in

²³ AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC, at p.x.

²⁴ ERAA (2007), *Project Brief - Consumer Protection in a Deregulated Retail Energy Market*, Sydney: ERAA, at p.2.

the first place. Lessons and conclusions that can be drawn from the experiences of these markets are summarised.

- Section 5 presents a hypothetical consumer protection framework, along with suggested transitional arrangements to accompany the removal of the reserve pricing powers.

2 REVIEWS OF THE VICTORIAN ENERGY MARKETS

2.1 Introduction

Since the 1980s Victoria's energy markets have undergone significant changes and restructuring, resulting in the progressive commercialisation and privatisation of the government-owned electricity and gas markets. These have been a major part of the state's broader microeconomic reforms.²⁵ As highlighted in Figure 1 below, the introduction of FRC in Victoria's electricity and gas sectors in 2002 signified one of the most important reforms to the state's energy markets to date.²⁶

Since the introduction of FRC, the ESC has conducted two reviews of the effectiveness of retail competition within the state's energy markets. The last of these was undertaken in 2004.²⁷ The findings and recommendations of these two reviews are briefly discussed in Section 2.2. The more recent review of the AEMC into the effectiveness of competition in Victoria's energy markets and the Productivity Commission's Review of Australia's Consumer Policy Framework²⁸ are also summarised in Sections 2.3 and 2.4 respectively. The key lessons and conclusions of these four reviews are lastly articulated in Section 2.5.

25 Ward, T. and G. Hodge (2004), 'Electricity Privatisation: The Victorian Model', in G. Hodge, V. Sands, D. Hayward and D. Scott (eds), *Power Progress: An Audit of Australia's Electricity Reform Experiment*, Melbourne: ASP, pp.39-57.

26 AEMC (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Sydney: AEMC. As noted in the AEMC's Issue Paper, FRC was introduced for all Victorian electricity customers in January 2002 followed by gas in October that year.

27 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC; ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC.

28 Productivity Commission (2007), *Review of Australia's Consumer Policy Framework, Productivity Commission Draft Report*, Canberra: PC. It is anticipated that the Final Report will be delivered to the Australian Government at the end of April 2008.

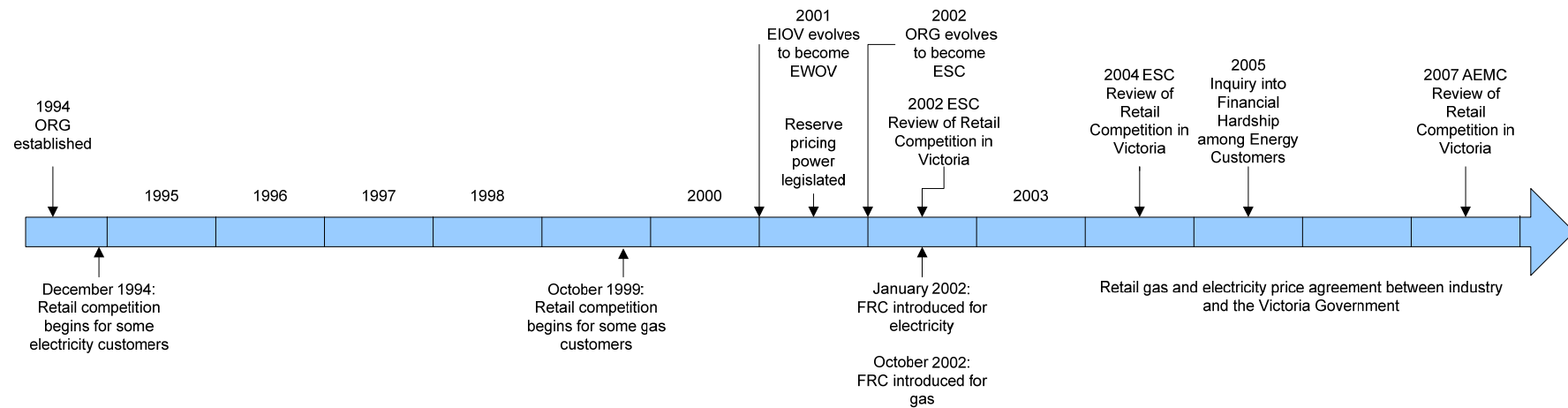


Figure 1: Key Events in Energy Retailing in Victoria (1994-2007)²⁹

²⁹ Source: AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria: First Draft Report*, Sydney: AEMC; Committee of Inquiry into the Financial Hardship of Energy Consumers (2005), *Inquiry into the Financial Hardship of Energy Consumers - Main Report*, Melbourne: Committee of Inquiry; Ward, T. and G. Hodge (2004), 'Electricity Privatisation: The Victorian Model', G. Hodge, V. Sands, D. Hayward and D. Scott (eds), *Power Progress: An Audit of Australia's Electricity Reform Experiment*, Melbourne: ASP, pp.39-57.

2.2 The ESC's 2002 and 2004 Reviews

Pursuant to a referral from the Minister for Energy and Resources in late 2001, the ESC conducted their first review into the effectiveness of Victoria's retail electricity market for domestic and small business customers in 2002 (the 2002 Review).³⁰ Given retail competition was still being progressively introduced into Victoria's retail gas market at that time, the 2002 Review focused solely on the performance of the retail electricity market. In contrast, the ESC's second review (the 2004 Review) examined the effectiveness of competition in both the state's retail electricity and gas markets for domestic and small business customers, in conjunction with a review of the effectiveness of the consumer safety net for energy customers. The 2002 and 2004 Reviews provided invaluable information on the development of Victoria's retail energy markets, including market structure, customer participation and consumer protection information.³¹

This Section of the Report provides a brief overview on the 2002 Review and the 2004 Review.

2.2.1 The 2002 ESC Review

Having been undertaken shortly after the introduction of FRC for electricity in Victoria, it is perhaps not surprising that the ESC's 2002 Review concluded that 'competition is not yet consistent with that expected from an effectively competitive market'.³² The ESC's evidence and analysis, which included an examination of the nature of the electricity retail market, market structure, market conduct and market performance, indicated that a number of impediments to effective competition existed within Victoria's retail electricity market at that time. These included, for instance:

- structural impediments, which had limited the entry of new retailers into the market and 'the competitive advantages of incumbency enjoyed by the established retailers'³³
- performance impediments, with the benefits of competition not having filtered across all segments of the market,³⁴ and
- information impediments, which had limited the capacity of consumers 'to understand and utilise it to make informed retail market choices.'³⁵

30 See for instance, ESC (2002), *Consultative Issues Paper - Review of the Effectiveness of Full Retail Competition for Electricity*, Melbourne: ESC; and ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne, ESC. Domestic and small business customers were defined so as to 'include those customers consuming less than 160MWh per year' (ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC, at p.7).

31 It is also important to note that in addition to the 2002 and 2004 Reviews, the ESC reports annually on the performance of the Victorian retail energy industry. Comparative performance data is reported in relation to: affordability of energy services; access to energy services; and customer service. See generally ESC (2005), *Energy Retail Businesses: Comparative Performance Report for the 2004-05 Financial Year*, Melbourne: ESC; ESC (2006), *Energy Retail Businesses: Comparative Performance Report for the 2005-06 Financial Year*, Melbourne: ESC; and ESC (2007), *Energy Retail Businesses: Comparative Performance Report for the 2006-07 Financial Year*, Melbourne: ESC.

32 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC, at p.79.

33 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC, at p.79.

34 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC.

Despite these findings, the ESC observed that ‘considerable progress ha[d] been made in the development of a competitive electricity retail market’³⁶ and that ‘many of the pre-conditions for the development of competition [were] evident in the market’.³⁷ Due to the early timing of the 2002 Review relative to the commencement of FRC in the electricity sector, the ESC suggested that a further review should be undertaken once the market had had more time to mature. It was suggested that a second review, if conducted after July 2004, would provide the ESC with greater certainty as to the performance of the state’s retail electricity and gas markets.

The strength of this early Review in 2002 was therefore its ability to,

set the scene for the manner in which retailers would be required to have their standing offer tariffs assessed and for the development of the Government’s longer term approach to energy retail price regulation.³⁸

These criteria underpinned the ESC’s analysis in their subsequent 2004 Review, and it is to this second review that this Report now turns.

2.2.2 The 2004 ESC Review

Under the Terms of Reference established by the Minister for Energy Industries, the ESC commenced a second review in 2004. The Terms of Reference required the ESC to investigate and report on:

- a) the extent to which retail competition has been effective or is likely to be effective for or in respect of the sale of electricity to consumers or classes of consumers...;
- b) measures...which could be introduced to enhance the effectiveness of retail competition;
- c) the need for the consumer safety net arrangements for supply of electricity to consumers or classes of consumers...after 31 December 2004...³⁹

The ESC therefore examined, as with the 2002 Review, the nature of the energy retail markets, market structure, market conduct and market performance, in conjunction with reviewing the application of the consumer safety net framework. As noted in Section 1.1, the ESC found that competition within the state’s energy markets had developed to such an extent as to be generally effective for certain sub-markets of customers who ‘consumed more than 6MWh of electricity or 150 GJ of gas annually’.⁴⁰ These sub-markets represented approximately 40 percent of small customers.⁴¹ For those small consumers not yet benefitting from competitive

35 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC, at p.80.

36 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC, at p.79.

37 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC, at p.80.

38 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC, at p.3.

39 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Background Report*, Melbourne: ESC, at p.121.

40 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC, at p.3.

41 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC.

markets, it was suggested that these customers, including low-margin customers, were 'likely to become effective' within the next few years.⁴²

Looking specifically at the issue of market power and pricing, the ESC concluded that,

the competitive market ha[d] developed to a stage where it will discipline any potential to exercise market power and that consideration can now be given to a gradual roll back, and potentially the elimination of retail price regulation, over the coming period without the risk of significant disadvantage to energy customers.⁴³

Notwithstanding their finding that the market had evolved to the point of being generally effective, open and accessible, the ESC recommended that there was a continuing need for an energy consumer safety net due to the essential nature of energy. The energy safety net, including the government's reserve pricing power, was seen by the ESC as guaranteeing that small customers would be assured 'access [to] fair price-service offerings',⁴⁴ while also assisting in 'the orderly transition towards a fully competitive market by protecting consumer interests'.⁴⁵ Indeed, the Commission recommended that the safety net should be extended - albeit subject to a number of modifications - until competition was found to be effective across all customer classes.⁴⁶ It was mooted by the ESC that this may occur by the time at which the four year price path agreement was due to expire (December 2007). Once effective, the ESC argued that 'it will be possible to reduce, and ultimately eliminate, retail price regulation for small customers'.⁴⁷

The recommendations and conclusions of the 2004 Review therefore reiterated the ESC's commitment to establishing an effective energy market within Victoria, and once this had been achieved, the subsequent removal of the government's power to regulate retail energy prices. Importantly, the ESC viewed the reserve pricing power to be independent of the other mechanisms within the safety net, and the broader energy consumer protection arrangements. Accordingly, the removal of one mechanism (the reserve pricing power) would not in itself result in changes to the other components of the safety net.

42 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC.

43 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC, at p.13.

44 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC, at p.27.

45 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC, at p.27. Importantly, for the purposes of this Report, the Commission also concluded, 'that the consumer safety arrangements [alone] cannot address affordability problems that are due to income insufficiently, high energy use and poor energy efficiency, and recommend[ed] that the Government take a whole-of-government policy approach in seeking to address such energy affordability problems' (at p.27).

46 Following on from this recommendation, the Victorian Government passed the *Energy Legislation (Amendment) Act 2004* (Vic), the objective of which was to prevent the consumer safety net framework from 'sun-setting' at the end of 2004; under the Amendment Act, the framework would expiry on 31 December 2007. Pursuant to the *Energy Legislation Further Amendment Act 2007* (Vic), the framework was extended until 31 December 2008.

47 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC, at p.35.

2.2.3 Key Findings and Conclusions

The findings of the ESC's 2002 and 2004 Reviews suggested that competition within Victoria's retail electricity and gas markets was becoming progressively more effective for Victorian customers, and that moreover, this pattern was likely to continue over the next few years. Furthermore, at the time of the 2004 Review, the ESC believed that a number of the initial impediments to effective competition had been addressed by the market, and that the remaining impediments would be addressed as the market itself matured.

In 2002, the ESC suggested that,

the most important indicator of the effectiveness of competition is the extent to which customers are entering into market contracts with either their existing retailer or switching to an alternative retailer.⁴⁸

A key finding of the 2004 Review was therefore the marked increase in the rate of domestic and small business customers accepting market offers and/or switching. In the 2002 Review, the ESC reported that between January and September 2002 approximately 5.0 percent of customers in this class had either accepted a market offer from their existing electricity retailer or switched to a new retailer.⁴⁹ As anticipated by the ESC, and confirmed by the 2004 Review, the rate of customers entering into market contracts and/or switching had steadily increased to between 13-17 percent in the case of electricity and between 12-14 percent for gas.⁵⁰ Despite this steady increase in customer participation in energy markets, the ESC recommended the retention of the consumer safety net, citing the essential nature of electricity and gas.

Importantly, however, the ESC's goal of achieving a level of competition within the Victorian retail energy markets deemed effective enough to warrant the removal of price caps at the conclusion of 2007 was perhaps not as unrealistic as one might have first thought. While the lofty ambition of having the reserve pricing power phased out by the end of 2007 was not achieved, the retail energy market itself was declared to be effective by the AEMC in their in December 2007.⁵¹ It is to this Review that we now turn.

48 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC, at p.58.

49 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC, at p.58.

50 ESC (2002), *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity - Final Report*, Melbourne: ESC, at p.58. In the 2004 Review, the ESC noted 'that as at the end of December 2003, around seventeen per cent of electricity customers (390 000) and fourteen per cent of gas customers (215 000) had accepted market contracts. By the end of April 2004, around thirteen per cent of electricity customers and twelve per cent of gas customers had switched retailers' (ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC, at p.16).

51 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC.

2.3 The 2007-08 AEMC Review

2.3.1 Objective of the Review

As highlighted by Section 2.2, the AEMC's 2007-2008 Victorian Review was the third review in six years assessing the effectiveness of competition in Victoria's retail energy markets. Pursuant to the AEMA, the AEMC is required to review the effectiveness of retail competition in the energy markets of all jurisdictions participating in the National Energy Market (NEM) 'for the purposes of retention, removal or reintroduction of retail energy price controls',⁵² and to publicly report on its assessment.⁵³ As well, under Clause 14.10(a)(i), the criteria for assessing the effectiveness of competition rests with the Ministerial Council of Energy (MCE), in consultation the AEMC and other interested stakeholders.⁵⁴ The Victorian Review is the first of the AEMC's Reviews.⁵⁵

The overarching objective of the Victorian Review is therefore to determine, based on evidence and analysis, whether or not competition has developed in the Victorian retail energy market to such an extent as to be deemed effective. Accordingly, 'if competition is found to be effective, the [AEMC] is required to provide advice to the Victorian Government and the MCE on ways to phase out retail price regulation'.⁵⁶

Sections 2.3.2-2.3.3 below provides a summary of the AEMC's approach, their key findings and recommendations.

2.3.2 The Review Process

Statement of Approach (April 2007)

Following the MCE's provision of 'high level' criteria to the AEMC in November 2006,⁵⁷ and the MCE's subsequent advice to the AEMC regarding the timing of the market reviews,⁵⁸ the Victorian Review was formally commenced by the publication of the Statement of Approach in April 2007.⁵⁹ Central to this Review were the six criteria for assessing the effectiveness of Victoria's retail energy markets. As provided by the MCE under Clause 14.11(a)(i) of the AEMA, these criteria included:

52 Clause 14.10(a)(ii) of the AEMA.

53 With the exception of Western Australia. See: MCE (2006), *Phase Out of Retail Price Regulation - Timetable and Proposed Approach for Assessment of Competition*, 17 November, Canberra: MCE.

54 MCE (2006), *Phase Out of Retail Price Regulation - Timetable and Proposed Approach for Assessment of Competition*, 17 November, Canberra: MCE.

55 MCE (2007), *Phase Out of Retail Price Regulation - Timetable Options for Retail Reviews*, 19 April, Canberra: MCE.

56 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC, at p.viii.

57 MCE (2006), *Phase Out of Retail Price Regulation - Timetable and Proposed Approach for Assessment of Competition*, 17 November, Canberra: MCE.

58 MCE (2007), *Phase Out of Retail Price Regulation - Timetable Options for Retail Reviews*, 19 April, Canberra: MCE.

59 AEMC (2007), *Review of the Effectiveness of Competition in the Gas and Electricity Retail Markets - Statement of Approach*, Sydney: AEMC. It is important to note that the AEMC released a Draft Statement of Approach on 15 March 2007, for the express purpose of eliciting submissions on the Draft Statement from interested parties. The AEMC received eleven submissions from interested parties in relation to the Draft Statement, including, for example, AGL, the Centre for Credit and Consumer Law, the Energy Retailers Association of Australia, Griffith University, the Consumer Action Law Centre, TRUenergy, and the Tenants Union of Victoria.

- independent rivalry within the market
- ability of suppliers to enter the market
- the exercise of market choice by customers
- differentiated products and services
- prices and profit margins, and
- customer switching behaviour.⁶⁰

Accordingly, the AEMC was provided with sufficient flexibility so as to enable the Commission to tailor the Victorian Review to the actual nature and characteristics of the market, including ‘the dynamic interrelationship between the relevant market, its structure, the conduct of participants and resulting performance’.⁶¹

Issues Paper (June 2007)

The subsequent publication of the AEMC’s Issues Paper in June 2007 was designed to elicit, preliminary feedback from stakeholders and other interested parties about the extent and effect of retail competition in the Victorian gas and electricity markets.⁶²

As with the Draft Statement of Approach, a number of stakeholders presented submissions to the AEMC in response to the Issues Paper, including energy retailers and consumer groups.⁶³

Not surprisingly, a range of views were expressed in relation to the Issues Paper. For instance, while energy retailers supported the removal of price regulation within the Victorian energy markets,⁶⁴ other stakeholders stressed the importance of the consumer safety net, and argued for the continuation of the reserve pricing power. The major arguments presented to support the continuation of the reserve pricing power included, for example:

- the lack of ‘any significant price-based competition in the Victorian domestic retail market’⁶⁵

60 See MCE (2006), *Phase Out of Retail Price Regulation - Timetable and Proposed Approach for Assessment of Competition*, 17 November, Canberra: MCE; and AEMC (2007), *Review of the Effectiveness of Competition in the Gas and Electricity Retail Markets - Statement of Approach*, Sydney: AEMC, at p.2.

61 AEMC (2007), *Review of the Effectiveness of Competition in the Gas and Electricity Retail Markets - Statement of Approach*, Sydney: AEMC, at p.9.

62 AEMC (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Sydney: AEMC, at p.1.

63 Twelve submissions were published on the AEMC’s website in response to the Issues Paper. These included submissions from the Consumer Utilities Advocacy Centre, the Energy and Water Ombudsman (Victoria), GridX Power, Origin Energy, and St Vincent de Paul Society. Available at: <http://www.aemc.gov.au/electricity.php?r=20070920.171054>

64 See for instance AGL (2007), *Review of Effectiveness of Competition in the Gas and Electricity Retail Markets: Issues Paper*, St Leonards: AGL; GRIDX Power (2007), *Re: Review of the Effectiveness of Competition in the Retail Gas and Electricity Markets in Victoria*, Rosebery: GRIDX Power; TRUenergy (2007), *Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Victoria Issues Paper*, Melbourne: TRUenergy; Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin; and ERAA (2007), *RE: Review of Effectiveness of Competition in Gas and Electricity Markets*, Sydney: ERAA.

65 VCOSS (2007), *Retail Competition Review - Response to Issues Paper*, Melbourne: VCOSS, at p.2.

- that the markets lacked ‘sufficient matur[ity] to rely on competition to provide adequate protection to customers’⁶⁶
- that the regulated price was the most important feature of the consumer safety net in terms of ‘the protection the standing offer provides consumers against price volatility’,⁶⁷ and
- given ‘evidence that Victoria has the most contestable market in the world...’ this suggested indeed that ‘the safety-net tariff ha[d] not impeded competition’.⁶⁸

Despite the divergence of views on the reserve pricing power, it was nevertheless agreed that the maintenance of the consumer safety net was essential to ensuring that all energy customers continued to access the competitive market. In their submission, Origin stated that,

while Origin does not agree with price regulation, [they] support the principles behind the rest of the safety net arrangements (that is, the obligation to make a standing offer, minimum contractual standards, and a right to reversion to the standing offer) and do not wish to see them phase out. In fact...we would see maintenance of safety net provisions around the obligation to offer and the basic Retail Code provisions as essential to governments and stakeholders ever feeling comfortable with the removal of price controls.⁶⁹

As illustrated by this statement, Victoria’s energy consumer safety net is more than simply just the reserve pricing power. It includes a number of different mechanisms designed to assist all classes of customers. This distinction is important in separating policy arguments for and against the removal of the current retail price cap.

In addition to these views being expressed about the reserve pricing power and the consumer safety net more generally, concerns were also raised by several stakeholders in relation to the analysis framework more generally.⁷⁰

These submissions assisted the AEMC in undertaking their analysis and presenting the Commission’s First Draft Report.⁷¹ As this Draft Report has since been superseded with the publication of the First Final Report⁷² and the Second Final Report,⁷³ it will not be discussed further. Rather, our attention will turn to the key findings and recommendations within the latter two AEMC Reports.

66 CUAC (2007), *AEMC Retail Competition Review - CUAC Response to Issues Paper*, Melbourne: CUAC, at p.2.

67 CUAC (2007), *AEMC Retail Competition Review - CUAC Response to Issues Paper*, Melbourne: CUAC, at p.10.

68 CALC (2007), *Victorian Retail Competition Review - Response to Issues Paper*, Melbourne: CALC, at p.15.

69 Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin, at p.7-8.

70 See for instance, St Vincent de Paul Society (2007), *Australian Energy Market Commission Review of the Effectiveness of Competition in Gas and Electricity Retail Markets, Issues Paper June 2007*, Melbourne: St Vincent de Paul Society; and Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin.

71 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria: First Draft Report*, Sydney: AEMC.

72 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC.

73 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

2.3.3 Key Findings and Recommendations

First Final Report (December 2007)

The First Final Report of the AEMC sets out the evidence, substantive analysis and conclusions of its review in the effectiveness of competition in Victoria's retail energy markets. This Report makes particular reference to customer experiences, the impact of the current regulatory framework, and the experiences of specific classes of customers within the market.

Crucially, the key finding of the AEMC's Victorian Review was that,

competition is effective for both electricity and gas retailing in Victoria. The majority of energy customers are actively participating in the competitive market by exercising choice among available retailers and available price and service offerings. There is strong rivalry between energy retailers, facilitated by the current market structures and entry conditions.⁷⁴

Moreover, while the AEMC noted that competition within the retail electricity market was relatively more effective than that within the gas market, the Commission considered that competition was nevertheless present and effective within the gas market.

The AEMC's findings and conclusions were based on an extensive range of evidence. This included, for example:

- the strong rivalry between retailers, including price rivalry, which had resulted in price and non-price benefits for consumers⁷⁵
- the steady increase in switching figures within the Victorian energy markets⁷⁶
- the increasing market share of new entrants relative to the incumbent retailers within both markets, and⁷⁷
- the observation that retail prices are at a level expected within a competitive market.⁷⁸

74 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC, at p.5.

75 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC. In relation to electricity, the AEMC reported that 'the discounts available under electricity market contracts ranged up to 10 per cent off the standing offer price, with almost all contracts incorporating a price discount of some kind. Discounts are offered by both host and new retailers...' (at p.54). While price-discounts were also observed with the gas market, the AEMC reported that these discounts were between 3-6 percent.

76 The AEMC reported that 'as of 31 December 2006, around 62 per cent of domestic and 43 per cent of small business customers in Victoria had switched from the standing offer to an electricity market contract. Of those customers with mains gas connected, around 60 per cent of domestic and 31 per cent of small business customers had also switched to a gas market contract' (AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC, at p.89).

77 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC, at p.33-35.

78 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC. The AEMC concluded that 'competition appears to have placed a sufficient discipline on retailers' market offers to limit margins to those expected in a competitive market' (at p.146).

The Commission did find, however, that while the majority of customers have access to the full benefits of retail competition, a minority of customers did not. The AEMC singled out two particular groups here. Based on their evidence and analysis, those not appearing to derive the full benefits of competition included:

- 'consumers whose personal circumstances, such as chronic, permanent or temporary financial hardship or personal disability, restricted their ability to access the benefits of the competitive market, and
- consumers who may be less attractive to retailers due to factors such as location, credit history or low consumption volumes'.⁷⁹

To remedy the former, the AEMC noted that a largely 'policy-based solution' was required. To the AEMC, the answer here was one 'that addressed the root cause of issues such as financial hardship or the ability of people with disabilities to participate in the market economy generally.'⁸⁰ Such an approach necessarily involved collaboration between government, industry, and other relevant parties. In respect to the latter group, the AEMC recognised that the issue of financial hardship policies and other frameworks to assist these customers fell outside the scope of the Victorian Review. Despite this limitation, the Commission highlighted the important role that retailers played in working with customers to address issues of hardship, and noted that an appropriate balance had to be found between government and retailers in addressing social policy matters.⁸¹

Having concluded that retail energy competition in Victoria was effective, the AEMC recommended that retail price regulation be phased out in order to further extend the benefits of competition, subject to a number of transitional arrangements being implemented.

The purpose of the Second Draft Report, as discussed in the following section, was therefore to determine the nature of these transitional arrangements with input from stakeholders and interested parties.

2.3.4 Moving Forward

Second Draft Report (December 2007)

Released simultaneously with the First Final Report, the primary purpose of the AEMC's Second Draft Report was to 'set out the Commission's advice to the Victorian Government and the Ministerial Council on Energy (MCE) on ways to phase out retail price regulation in Victoria'⁸² including advice relating to the timeframe associated with the transition.

Having already concluded that competition was effective in Victoria, the AEMC's Second Draft Report recommended that the reserve pricing power should be allowed to expire on 31 December 2008.⁸³ This recommendation was made pursuant to the Victorian Government's

79 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC, at p.154.

80 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC, at p.154.

81 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC, at p.154.

82 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC, at p.1.

83 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.vii-viii.

commitment to the AEMA, and was underpinned by the AEMC's belief that the removal of price regulation would further encourage competition in the Victorian retail energy market.

In making this recommendation, however, the Commission noted both the importance and continuing need for a robust consumer protection framework. To this end, it stated that:

while effective competition negates the need for price regulation, it does not eliminate the need for regulations dealing with other types of market failure, such as those addressed by prudential and consumer protection regulation. The competitive retail energy sector in Victoria is supported by a sound consumer protection framework that is made up of energy specific regulation covering a wide variety of issues including obligations on retailers to disclose detailed energy offer information to customers, as well as general consumer protection laws that prohibit, amongst other things, misleading, deceptive and unconscionable conduct. There are also detailed codes and laws regulating the direct marketing techniques favoured by energy retailers.⁸⁴

Importantly, as part of the transition to a retail energy market without retail price regulation, the AEMC not only recommended the retention of these non-price consumer protection mechanisms, but also the broadening out and introduction of several new mechanisms.⁸⁵ Proposed modifications to the framework included, for instance,

- an extension to the obligation to supply and sell energy to residential customers where there is an existing connection to the 'Financially Responsible Market Participant' (FRMP)⁸⁶
- the mandatory publication of retailers' standing offer prices⁸⁷ in a format prescribed by the ESC,⁸⁸ and
- the introduction of price monitoring for a defined time period in order to 'identify...trends in standing offer prices with a view to providing a timely indication of any future deterioration in the effectiveness of retail competition'.⁸⁹

Stakeholders and interested parties were invited to make submissions to the AEMC in regard to their proposed advice, as well as in respect to several specific issues.⁹⁰ As highlighted by the following discussion, these submissions informed the Second Final Report, and resulted in a number of small modifications to the AEMC's draft recommendations.

84 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.viii.

85 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC.

86 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.30-32. As explained by the AEMC under the FRMP 'the obligation is assigned to the FRMP for the relevant premises/supply point. For new connections a retailer or retailers will be given the obligations to offer to supply and sell energy' (at p.31).

87 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.17.

88 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.18.

89 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.20.

90 In order to elicit feedback on the AEMC's Second Draft Report from industry and consumer organisations, as well as on their preliminary views, the Victorian Department of Primary Industries (DPI) held a stakeholder forum for on 15 February 2008. Participants involved in the forum included, for example, the ESC, EWOV, representatives from St Vincent de Paul, the CUAC and CALC, as well as a number of representatives from a number of Victorian retailers.

Second Final Report (February 2009)

Published on 29 February 2008 the AEMC's Second Final Report reaffirmed the majority of both the Commission's earlier recommendations to the Victorian Government and the MCE on the phase out of retail price regulation by 1 January 2009, and the ways that this could be achieved.

As evidenced by the Second Final Report, submissions from stakeholders were taken into consideration by the AEMC when finalising their advice. This is illustrated by a number of amendments to the Commission's final advice which included, for instance,

- a requirement for all retailer's to publish a summary notice in relevant local newspapers in order to advise the public of changes to their standing offer prices⁹¹
- where conditions suggest a deterioration in the retail energy markets, the ability for the Victorian Government to request the AEMC to undertake a rapid review of the state's retail energy markets⁹²
- the implementation of a reserve statutory power under which the Victorian Government could reinstate retail price regulation once certain predetermined conditions had been met,⁹³ and
- the retention of the status quo in relation to the obligation to supply new connections.⁹⁴

In making these recommendations, the Commission reaffirmed that the removal of retail price regulation was separate from the operation of an energy consumer safety net framework. Accordingly, should the Victorian Government follow the AEMC's advice in relation to the phasing out of retail price regulation, 'it would not involve changing the safety net arrangements in any other way'.⁹⁵

The publication of the AEMC's Second Final Report signalled the conclusion of the Victorian Review.

2.4 The 2007-08 Productivity Commission Report

The Review of Australia's Consumer Policy Framework,⁹⁶ recently undertaken by the Productivity Commission provided yet another relevant input into this study. This Inquiry tackled broad questions of consumer protection across multiple fields of interest concerning products and services. But importantly, it also looked briefly at issues relating to vulnerable and disadvantaged consumers and matters of industry specific regulation. It sought ways to improve

91 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.20.

92 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.26.

93 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.27.

94 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.36-37.

95 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.16.

96 Productivity Commission (2007), *Review of Australia's Consumer Policy Framework, Productivity Commission Draft Report*, Vol 1 and 2, Canberra: PC.

consumer policy frameworks as well as improving institutional arrangements and avoiding regulatory duplication.

In broad terms, this Inquiry recommended the future application of a nationally coherent consumer policy framework through a single generic law applying across Australia. The Commission saw the *Trade Practices Act (Cth)* 1974 as the primary basis for this. It nonetheless acknowledged that 'generic laws (and competitive markets) will not always be sufficient to protect consumers and provide the right incentives to suppliers,'⁹⁷ and that moreover, reliance on such provisions can be 'very costly and slow.'⁹⁸ On this basis, the Commission argued that 'industry-specific approaches will sometimes be warranted.'⁹⁹ The Commission also emphasised the general role of disclosure requirements in empowering consumers, recommending that Australian governments require 'information is comprehensible, with the content, clarity and form of disclosure consumer tested, and amended as required, so that it facilitates good consumer decision-making'.¹⁰⁰

In terms of industry-specific regulation, the Commission was perhaps more concerned with matters such as finance brokers, financial services and the licensing of occupations rather than energy utilities per se. It nevertheless had several important things to say of direct relevance to the present study and made a number of recommendations of note.

First, the Productivity Commission acknowledged that whilst energy services were 'essential' and complex service offerings can make informed choices difficult, 'consumer protection requirements for utility services [were presently] operating reasonably well' in Australia. It also saw a clear case for a national regime to protect energy consumers,¹⁰¹ and argued that it was now a logical time to implement a single consumer protection regime. In this context, the Commission recommended that,

a single consumer protection regime for energy services should be developed and implemented under the auspices of the Ministerial Council on Energy. It should apply to all jurisdictions participating in the national energy market and be enforced by the Australian Energy Regulator.¹⁰²

Second, it observed that retail price caps applied to areas such as telecommunications, and in terms of energy services recommended that,

participating jurisdictions should remove any price caps still applying in contestable retail energy markets...following the establishment of national consumer protection arrangements.¹⁰³

In short, the Commission saw retail price caps as a transitional measure as well as a relatively ineffective means of mitigating hardship.

97 Productivity Commission (2007), *Review of Australia's Consumer Policy Framework, Productivity Commission Draft Report*, Vol 1, Canberra: PC, p.24.

98 Productivity Commission (2007), *Review of Australia's Consumer Policy Framework, Productivity Commission Draft Report*, Vol 1, Canberra: PC, p.33.

99 Productivity Commission (2007), *Review of Australia's Consumer Policy Framework, Productivity Commission Draft Report*, Vol 1, Canberra: PC, p.24.

100 Productivity Commission (2007), *Review of Australia's Consumer Policy Framework, Productivity Commission Draft Report*, Vol 1, Canberra: PC, p.71.

101 Productivity Commission (2007), *Review of Australia's Consumer Policy Framework, Productivity Commission Draft Report*, Vol 2, Canberra: PC, p.93.

102 All three Commission recommendations listed here come from Productivity Commission (2007), *Review of Australia's Consumer Policy Framework, Productivity Commission Draft Report*, Vol 1, Canberra: PC, p.66.

103 Productivity Commission (2007), *Review of Australia's Consumer Policy Framework, Productivity Commission Draft Report*, Vol 1, Canberra: PC, p.66.

In addition, it emphasised that disadvantaged and vulnerable consumers should continue to have sufficient access to utility services at affordable prices. It recommended, however, that this should,

be pursued through transparent community service obligations, supplier-provided hardship programs, or other targeted mechanisms that are monitored regularly for effectiveness.¹⁰⁴

Overall, then, it is evident that the Productivity Commission's arguments were broadly consistent with the overall thrust of earlier market reviews.

2.5 The 2008 ESC Review of Energy Regulatory Instruments

Toward the close of this consulting task, the Victorian ESC announced a Review of Energy Regulatory Instruments. A call for submissions was made in late February 2008,¹⁰⁵ and revealed the aims of the Review.

Inter alia, the ESC's Review will seek to:

- articulate and remove regulatory provisions which may have already become redundant
- modify regulatory obligations to facilitate the future implementation of interval metering
- examine whether obligations currently in regulatory guidelines might be better placed in codes
- assess the obligations relating to the provision of information to customers to improve their access to the competitive market, and
- consider whether existing compliance and reporting requirements could be reduced, to enable the removal of unnecessary regulatory burdens.

Importantly, this call for submissions stated explicitly that,

The Commission's review, therefore, will not impact the fundamental protections for customers, including obligations to ensure disconnection from supply is avoided, assisting customers in financial hardship and cooling-off provisions in the competitive market.

The tenor of this Review seems clear – in that whilst it may include several areas touching on consumer protection, it will not jeopardise the position of either consumers as a whole, or else vulnerable consumers in particular.

¹⁰⁴ Productivity Commission (2007), *Review of Australia's Consumer Policy Framework, Productivity Commission Draft Report*, Vol 1, Canberra: PC, p.66.

¹⁰⁵ Available at: <http://www.esc.vic.gov.au/NR/rdonlyres/5FDA539E-E475-42E4-84C4-A26CF39011BA/0/CallforSubmissions20080213C082173.pdf>

2.6 Lessons and Conclusions

There are several conclusions we could make from Section 2. Energy retailing in Victoria, firstly, has over the past decade and a half been characterised by much activity in terms of support for the protection of energy consumers as well as the completion of four separate market performance reviews. Early Reviews revealed that competition within Victoria's electricity and gas markets was becoming progressively more effective for Victorian customers, and that this pattern was also likely to continue. Importantly, the AEMC's Victorian Review analysed energy markets by reference to six criteria and found that competition was effective in both electricity and gas. Furthermore, it recommended that the government's reserve pricing power should be allowed to expire on 31 December 2008, subject to the implementation of a robust consumer protection framework. Both the removal of the price cap as well as the implementation of a robust consumer protection framework for the energy sector was also supported by a recent Productivity Commission Review.

3 THE CURRENT CONSUMER PROTECTION FRAMEWORK FOR VICTORIAN ENERGY CUSTOMERS

This Section focuses on the many elements making up the current consumer protection framework operating in Victoria's energy markets. This framework was implemented to safeguard Victorian energy consumers in the transition to effective retail competition and includes Acts, Codes and Guidelines as well as a range of energy-specific grants and concessions programs funded by both the state and federal governments.

3.1 Current Regulatory Obligations

There are numerous formal regulatory obligations presently underpinning Victoria's consumer protection framework. Any regulatory regime is typically hotly contested policy terrain, and energy regulation is no different. But in respect to the provision of electricity and gas, mechanisms to protect consumers have been progressively evolving over several decades, and from a consumer perspective, this framework has been widely applauded. CUAC have stated,

[that] the existing regulatory policies have been for the most part very effective in ensuring the participation of consumers in financial hardship – regulatory requirements that necessitate retailers to offer an affordable payment plan particularly have been crucial to ensuring ongoing access to energy for consumers in temporary or chronic hardship.¹⁰⁶

While debate over the consumer protection safety net has often centred on the existence and operation of retail price controls, as this section of the Report will show, the price-based mechanisms are only one component of a far more extensive framework. Moreover, it is important to recall that the reserve pricing power operates independently of the non-price protections.

Figure 1, earlier in this report, and Table 1 following, both summarise how the current regulatory obligations have evolved over time. Both show that obligations towards consumers have increased since the initial establishment in 1994 of the Office of the Regulator-General (ORG), the predecessor of today's ESC. What has been created can only be described as a multi-layered and extensive regulatory suite of obligations towards consumers from Victorian energy retailers. This suite of regulatory protections comprises several structural components:

- the existence of an independent regulator for the sector (the ESC)
- an industry funded consumer complaint resolution scheme (through the EWOV)
- the government's reserve power to regulate standing offer contract prices
- a series of energy codes including limitations on marketing practices
- retail contestability to enable consumers to choose another energy supplier
- compensation for wrongful a disconnection
- mandatory information requirements, and
- mandatory financial hardship policies.

¹⁰⁶ CUAC (2007), *AEMC Retail Competition Review - CUAC Response to Issues Paper*, Melbourne: CUAC, at p.16.

Table 1: The Evolution of Victoria's Energy Consumer Protection Regime

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Independent Industry Regulator (ORG → ESC) ¹⁰⁷															
Industry-funded consumer complaint resolution scheme															
Government reserve power to regulate retail prices (for standing offer contracts) ¹⁰⁸															
Electricity Retail Code (since replaced by the ERC)															
Gas Retail Code (since replaced by the ERC)															
Code of Conduct for Marketing ¹⁰⁹															
Full Retail Contestability for Electricity and Gas (for all Victorian consumers) ¹¹⁰															
Wrongful Disconnection Compensation Obligations ¹¹¹															
Mandatory Product Information Statement Guidelines ¹¹²															
Mandatory Offer Summary Information Requirements ¹¹³															
Mandatory Financial Hardship Policies ¹¹⁴															

107 Ward, T. and G. Hodge (2004), 'Electricity Privatisation: The Victorian Model', in G. Hodge, V. Sands, D. Hayward and D. Scott (eds), *Power Progress: An Audit of Australia's Electricity Reform Experiment*, Melbourne: ASP, pp.39-57.

108 Consumer Law Centre Victoria and Centre for the Study of Privatisation & Public Accountability (2006), *Electricity Reforms in Victoria: Outcome for Consumers*, Melbourne: CLCV and PPAC.

109 ESC (2002), *Discussion Paper: Marketing Code of Conduct - Electricity Full Retail Competition*, Melbourne: ESC; and ESC (2004), *Code of Conduct for Marketing Retail Energy in Victoria*, Melbourne: ESC.

110 ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Background Report*, Melbourne: ESC.

111 ESC (2005), *Final Decision: Review of Interim Operating Procedure – Compensation for Wrongful Disconnection*, Melbourne: ESC.

112 ESC (2005), *Guideline No. 19 - Energy Product Disclosure*, Issue 2, Melbourne: ESC.

113 ESC (2005), *Guideline No. 19 - Energy Product Disclosure*, Issue 2, Melbourne: ESC.

114 ESC (2007), *Guideline No 21: Energy Retailers' Financial Hardship Policies*, Melbourne: ESC.

Policy commentaries made with the introduction of these structural components are interesting. For example, the introduction of FRC in Victoria in 2002 was the catalyst for a number of new components being added to the framework.¹¹⁵ Their rationale was perhaps best summed up by the words of the (then) Minister for State and Regional Development, The Honourable John Brumby during the second reading of the *Electricity Industry Acts (Amendment) Bill*:

the government is concerned that the protection afforded by the competitive market may not be adequate for the last group of franchise customers including domestic and small business customers, particularly in the initial stages of the market's development.¹¹⁶

As a result, the Government proposed the introduction of a number of specific consumer protection mechanisms for domestic and small business consumers, including 'minimum standards, supplier of last resort provisions, delivery of community service obligations and provision of minimum customer rights',¹¹⁷ in addition to a reserve pricing power. The legislative basis for the reserve pricing power is, for electricity and gas, contained in the *Electricity Industry Act (Vic) 2000* (the EIA) and the *Gas Industry Act (Vic) 2000* (the GIA). This is shown in Table 2.

Having introduced these protection mechanisms, the Government's intent was nonetheless that the price oversight mechanism would be a transitional arrangement and not one that was absolute. Again, the Minister noted that,

it is not the intention that the government will try to second-guess a competitive market. Nor is it the intention that the reserve power will be used to prevent or inhibit the development of competition. For that reason, the government is not seeking to regulate retail electricity prices where competition has developed or might reasonably be expected to develop.¹¹⁸

As clearly illustrated by the Parliamentary Debate, the reserve pricing power was only to be employed in specific 'monopoly-like' circumstances and the intention was that once competition was deemed to be effective, Government would move to phase-out the reserve pricing power.¹¹⁹ Interestingly, as noted in Section 1.1 above, the Victorian Government has not had to exercise this power, preferring rather to negotiate a four year and a subsequent one year price path agreement with AGL, Origin and TRUenergy.

Details of the government's reserve pricing power for standing contracts are also outlined in Table 2. What is clear from these parameters is that the standing offer acts, for domestic consumers, as a useful benchmark and practical fall back in the midst of competing market offers.

115 See also ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC; and Committee of Inquiry into the Financial Hardship of Energy Consumers (2005), *Inquiry into the Financial Hardship of Energy Consumers - Main Report*, Melbourne: Committee of Inquiry.

116 Minister for State and Regional Development (2000), *Second Reading of the Electricity Industry Acts (Amendment) Bill*, Legislative Assembly, 4 May, Fifty-Fourth Parliament of Victoria, Parliamentary Debates (Hansard), at p.1317.

117 Minister for State and Regional Development (2000), *Second Reading of the Electricity Industry Acts (Amendment) Bill*, Legislative Assembly, 4 May, Fifty-Fourth Parliament of Victoria, Parliamentary Debates (Hansard), at p.1316.

118 Minister for State and Regional Development (2000), *Second Reading of the Electricity Industry Acts (Amendment) Bill*, Legislative Assembly, 4 May, Fifty-Fourth Parliament of Victoria, Parliamentary Debates (Hansard), at p.1317.

119 Minister for State and Regional Development (2000), *Second Reading of the Electricity Industry Acts (Amendment) Bill*, Legislative Assembly, 4 May, Fifty-Fourth Parliament of Victoria, Parliamentary Debates (Hansard), at p.1317.

Table 2: Price-Based Energy Consumer Safety Net Mechanisms

Mechanism	Energy Product	Legislative Instrument	Section	Explanation
Reserve Pricing Power	Electricity	EIA	s.13 - Regulation of tariffs for prescribed customers	<ul style="list-style-type: none"> This is the 'standard offer tariff' which currently acts as the 'benchmark' for market contracts. Only the three incumbent (host) retailers – AGL, Origin and TRUenergy - are required under the EIA and the GIA to offer residential customers standing offers within their previously franchised areas. Standing offer tariffs must be published in the Government Gazette (see s35(1)(a) of the EIA and s.42(1)(a) of the GIA). To date, Government has not exercised its reserve power as conferred by the Act, but has rather opted to negotiate a 'retail price path' with the retailers. Price path agreements apply to domestic and small business customers using equal to or less than 160MWh of electricity per year and equal to or less than 5 TJ of gas per year who are not on a market contract. Contract type is known as a 'standing offer contract', and must comply with the terms and conditions established under s.35(1) of the EIA and s.42(1) of the GIA. Pursuant to s.35(4A) of the EIA and s.42(4a) of the GIA, a customer may switch between a market contract and a standing offer contract.
	Gas	GIA	s.21 – Regulation of tariffs for prescribed customers	

Pursuant to the AEMC's finding that competition in Victoria's retail energy markets is effective,¹²⁰ it has been recommended that it is now an appropriate time to phase out the price-based component of the energy consumer safety net.¹²¹ This recommendation has been met with mixed responses.¹²² But equally, it is important to acknowledge that the Commission has not advocated for the wholesale removal of the consumer safety net in its entirety. Rather, it has supported the sun-setting of one mechanism within the safety net.¹²³ Accordingly, a wide range of strong regulatory measures will continue to function after the proposed expiry date of the reserve pricing power on 31 December 2008.¹²⁴

Table 3 articulates these various non-price energy consumer protection mechanisms. The key non-price mechanisms are as set out in for example, the EIA, the GIA, the Energy Retail Code (ERC), and various ESC Codes and Guidelines and create eight sets of obligations. These obligations relate to,

- an obligation to offer to supply and sell energy
- mandatory financial hardship policies for all retailers
- retailer of last resort obligations
- minimum contract terms and conditions for energy contracts
- the levying of fees
- billing arrangements
- disconnections, and
- prescribed conduct for marketing.

It is the function of the ESC to oversee retailers' compliance with these eight sets of obligations as part of the overall regulatory regime.

Whilst we will not repeat the intricate details of each of these non-price protection mechanisms, the important point is to recognise their existence and acknowledge the wide extent to which consumers enjoy strong protection through such arrangements. Moreover, as we stated earlier, these arrangements enjoy strong support from citizens and from consumer groups.

120 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - First Final Report*, Sydney: AEMC.

121 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC.

122 For submissions supporting the removal of retail price regulation, see for example: Alinta (2008), *Re: Retail Competition Review - Second Draft Report*, Mount Waverly: Alinta; Origin (2008), *Review of Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: Origin; AGL (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets - Second Draft Report*, St Leonards: AGL; and Simply Energy (2008), *Retail Competition Review - Second Draft Report*, South Yarra: Simply Energy. For submissions opposing the removal of retail price regulation, see for example: CALC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: CALC; CUAC (2008), *AEMC Retail Competition Review - CUAC Response to Draft Report*, Melbourne: CUAC; and Alternative Technology Association (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: ATA.

123 See for example the AEMC (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Sydney: AEMC, where the Commission stated that 'at this stage, it is unclear whether the Victorian Government intends to take further legislative action on the safety net arrangements prior to its current expiration date' (at p.13).

124 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.x.

Table 3: Non-Price Energy Consumer Safety Net Mechanisms

Mechanism	Energy Product	Legislative Instrument	Section	Explanation
Obligation to offer to supply and sell	Electricity	EIA	s.35(1) – Offer to domestic or small business customers	<ul style="list-style-type: none"> Requires a licensed retailer to offer and supply electricity or gas to domestic or small business customers
	Gas	GIA	s.42(1) - Offer to domestic or small business customers	<ul style="list-style-type: none"> 'In practice, this means that the obligation to supply and sell applies only to the host retailers' (AEMC, 2007:49)¹²⁵
Financial hardship policies ¹²⁶	Electricity	EIA	s.43(2) – Financial hardship policies ¹²⁷	<ul style="list-style-type: none"> Requires a licensed retailer to prepare and implement a financial hardship policy, subject to the ESC's approval (s.43 of the EIA and s.48G of the GIA). The EIA and the GIA requires that the Hardship policy must include, as set out in s.43(2): <ol style="list-style-type: none"> flexible payment options for payment of electricity bills; and provision for the auditing of a domestic customer's electricity usage (whether wholly or partly at the expense of the licensee); and flexible options for the purchase or supply of replacement electrical equipment designed for domestic use from the licensee or a third party nominated by the licensee; and processes for the early response by both licensees and domestic customers to electricity bill payment difficulties
	Gas	GIA	48G(2) – Financial hardship policies ¹²⁸	
Retailer of Last Resort ¹²⁹	Electricity	EIA	s.27 – Supplier of Last Resort	<ul style="list-style-type: none"> Requires a host retailer, as part of their license conditions, to in certain circumstances supply and sell electricity or gas to relevant customers.
	Gas	GIA	s.34 – Supplier of Last Resort	<ul style="list-style-type: none"> 'Relevant customers' are those defined as domestic or small business customers who consume equal to or less than 160MWh of electricity or 10TJ of gas per year.

¹²⁵ AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria: First Draft Report*, Sydney: AEMC, at p.47.

¹²⁶ See also ESC (2007), *Guideline No. 21: Energy Industry - Energy Retailers' Financial Hardship Policies*, Melbourne: ESC.

¹²⁷ See generally Division 6 - Hardship Policies, ss.41-46A of the EIA.

¹²⁸ See generally Division 4A - Hardship Policies, ss.48E-K of the GIA.

¹²⁹ ESC (2006), *Energy Retailer of Last Resort - Final Decision*, Melbourne: ESC.

Mechanism	Energy Product	Legislative Instrument	Section	Explanation
Minimum Contract Terms and Conditions	Electricity	EIA	s.36 – Terms and conditions of contracts for sale of electricity to certain customers ¹³⁰	Provide for fundamental protections to be articulated in standing and market contracts, including those related to the:
	Gas	GIA	s.43 – Terms and conditions for sale of gas to certain customers ¹³¹	<ul style="list-style-type: none"> • circumstances in which the supply of electricity may be disconnected (s.36(1)(a) of the EIA and s.43(1)(a)(i) of the GIA) ; • rights and entitlements of customers (s.36(1)(b) of the EIA and s.43(1)(a)(ii) of the GIA); • access to premises for the purpose of reading meters (s.36(1)(a)(iii) of the EIA and s.43(1)(a)(iii) of the GIA); and • confidentiality of customer information (s.36(1)(d) of the EIA and s.43(1)(a)(iv) of the GIA). <p>These provisions have been given effect by their incorporation into the Energy Retail Code.</p>
	Electricity and Gas	ERC	Clause 13 – Grounds for Disconnection	<ul style="list-style-type: none"> • As provided for under clause 13, a retailer may disconnect a customer from the supply of electricity or gas for the non-payment of a bill under certain circumstances, and only after they have followed certain procedures.
			Clause 14 – No Disconnection	<ul style="list-style-type: none"> • Clause 14 sets out the conditions under which a retailer must not disconnect a customer. • These safeguards include, for instance, the non-payment of a bill when the amount payable is less than any amount approved by the ESC, where the customer has made a complaint to the EWOV, and where the customer has applied for a Utility Relief Grant.
Clause 26 – Provision of Information			<ul style="list-style-type: none"> • Clause 26 deals with the provision of information by retailers to customers. • For example, as provided by Clause 26.2(a-b), a retailer must publish and provide to their customers a charter which includes 'details of the rights, entitlements and obligations of retailer and customers'. • Clause 26.3 requires the retailer to provide a copy of the ERC to the customer, while clause 26.4 requires the retailer to provide information pertaining to their tariffs. 	
		Clause 28 – Complaints and Dispute Resolution	<ul style="list-style-type: none"> • Clause 28 of the ERC requires the retailer to provide their customers with information in writing about their rights to raise a complaint within the retail company (clause 28.2(a)) and by the EWOV (clause 28.2(b)). 	

¹³⁰ See generally Division 5 – Terms and Conditions of Sale and Supply of Electricity, ss.35-40E of the EIA.

¹³¹ See generally Division 4 – Terms and Conditions of Sale and Supply of Gas, ss.42-48D of the GIA.

				<ul style="list-style-type: none"> Pursuant to clause 28.3, 'the retailer must include the phone number of the [EWOV] on any disconnection warning'.
			Clause 25 – Access to Supply Address	<ul style="list-style-type: none"> Clause 25 sets out the circumstances under which the retailer or their representative may access the customer's premises for the purpose of reading their meter.
			Clause 29 – Privacy and Confidentiality	<ul style="list-style-type: none"> Pursuant to clause 29, 'a retailer must comply with any condition of its retail license, and with any relevant guideline, concerning the use of or disclosure of personal information about a customer'.¹³²
Fees (Late Payment and Early Termination)	Electricity	EIA	s. 40C – Prohibition on fees for late payment; and s. 40D – Regulation of exit fees	<ul style="list-style-type: none"> Pursuant to s.40C of the EIA and s.48B of the GIA, retailers are prohibited from levying fees for the late payment of energy bills by small retail customers. Victorian retailers may only impose an exit fee which is considered to be 'fair and reasonable' subject to s.40C of the EIA, s.48D of the GIA and clause 24.1 of the ERA.
	Gas	GIA	s.48B – Prohibition on fees for late payment; and s.48C – Regulation of exit fees	
Wrongful Disconnection ¹³³	Electricity	EIA	s. 40B – Compensation for Wrongful Disconnection	<ul style="list-style-type: none"> Where a customer is wrongfully disconnected (pursuant to s.40B(1) of the EIA or s.48(1) of the GIA) from their electricity or gas supply, the customer is entitled to compensation of \$A250 per day until they are reconnected.
	Gas	GIA	s.48A – Compensation for Wrongful Disconnection	
Billing	Electricity and Gas	ERA	Clause 3 – Issuing Bills; Clause 4 – Contents of a Bill; Clause 5 – Basis of Bill; Clause 6 – Adjustment of a Bill; Clause 7 – Payment of a Bill; Clause 19 – Explicit Informed Consent; Clause 23 – Cooling-Off	<ul style="list-style-type: none"> The ERA sets out a number of requirements in relation to, for example, the issuing of bills, the content of energy bills, the manner in which bills may be paid, the need for informed consent and the requirement to provide customers with a 10 day cooling-off period upon signing a new energy contract.

¹³² See also ESC (2002), *Guideline No. 10 - Confidentiality and Informed Consent, Electricity and Gas*, Melbourne: ESC.

¹³³ See also ESC (2007), *Operating Procedure Compensation for Wrongful Disconnection*, Melbourne: ESC.

Marketing

Electricity
and Gas

Marketing
Code of
Conduct

Establishes the minimum standard of conduct for marketing representatives in relation to, for example:

- the times at which they may contact an individual in person
 - the times at which they may contact an individual over the phone
 - the maintenance of a 'no-contact' list, and
 - the need for explicit informed consent
-

The introduction and operation of these mechanisms have 'assisted in ensuring access to supply',¹³⁴ and given rise to effective 'strategies by which vulnerable customers can stay connected and in productive contact with their retailer'.¹³⁵ As well, these mechanisms have, in the words of VCOSS, ensured 'that all customers have access to flexible payment and protection from disconnection due to incapacity to pay if it is warranted'.¹³⁶ Such feedback is important for future regulatory policy.

This does not mean, however, that such mechanisms operate perfectly. In order to enable all residential consumers to access the benefits of competitive energy market offers, suggested improvements on this score were made during the course of the AEMC's Victorian Review. In their submission to the AEMC's Issues Paper, the Consumer Action Law Centre (CALC) argued, for instance, that the levying of early exit fees - even when considered to be 'fair and reasonable' - was problematic. To them, early termination fees actively discouraged customers from switching due to the financial penalty attached to the switching process, and disproportionately impacted on low income customers.¹³⁷ Similar concerns were also expressed by the Tenants Union.¹³⁸ As a solution, the CALC proposed that Victoria follow the lead set within the UK's energy markets, in which 'there is a requirement that a consumer can switch without penalty with 28 days notice'.¹³⁹ As emphasised by the coming discussion in Section 4.2 of this Report, the removal of early termination fees under these conditions does not appear to have had a detrimental effect on the competitiveness of the UK's energy markets.

Likewise, despite the existence of, and general support for, an energy-specific Marketing Code of Conduct,¹⁴⁰ suggestions of widespread marketing misconduct were raised by a number of stakeholders.¹⁴¹ According to EWOV, their cases 'provide extensive evidence of misleading marketing activity at least on the part of some retailers'.¹⁴² Areas of particular concern included misleading marketing and inappropriate marketing, failure to obtain explicit informed consent, and misleading conduct through the use of product inducements.¹⁴³ In their submission, CUAC argued that,

134 EWOV (2007), *Review of the Effectiveness of the Competition in Gas and Electricity Retail Markets in Victoria*. Victoria, Melbourne: EWOV, at p.12, in relation to the Wrongful Disconnection Payment.

135 EWOV (2007), *Review of the Effectiveness of the Competition in Gas and Electricity Retail Markets in Victoria*. Victoria, Melbourne: EWOV, at p.16.

136 VCOSS (2007), *Retail Competition Review - Response to Issues Paper*, Melbourne: VCOSS, at p.11, in relation to the ERC.

137 CALC (2007), *Victorian Retail Competition Review - Response to Issues Paper*, Melbourne: CALC. Concern was also expressed in relation to the levying of reconnection fees on consumers after disconnection for non-payment (at p.20).

138 Tenants Union of Victoria (2007), *Submission to Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Melbourne: Tenants Union. According to their submission, 'the fact remains that to benefit from competition a tenant would have to enter into a market energy contract in the knowledge that the rental lease period would almost certainly lead to a breach of that contract. It would be a curious outcome for a regulator such as the AEMC to conclude that such a breach was not a concern based on the size of the termination fee. A more appropriate conclusion must be that a tenant making an informed choice would choose a standing offer or evergreen contract without a termination fee in preference to a market contract with a termination fee' (at p.12).

139 CALC (2007), *Victorian Retail Competition Review - Response to Issues Paper*, Melbourne: CALC, at p.12.

140 ESC (2004), *Code of Conduct for Marketing Retail Energy in Victoria*, Melbourne: ESC.

141 Tenants Union of Victoria (2007), *Submission to Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Melbourne: Tenants Union; CALC (2007), *Victorian Retail Competition Review - Response to Issues Paper*, Melbourne: CALC; CUAC (2007), *AEMC Retail Competition Review - CUAC Response to Issues Paper*, Melbourne: CUAC; VCOSS (2007), *Retail Competition Review - Response to Issues Paper*, Melbourne: VCOSS; and EWOV (2007), *Review of the Effectiveness of the Competition in Gas and Electricity Retail Markets in Victoria*. Victoria, Melbourne: EWOV.

142 EWOV (2007), *Review of the Effectiveness of the Competition in Gas and Electricity Retail Markets in Victoria*. Victoria, Melbourne: EWOV, at p.5.

143 CALC (2007), *Victorian Retail Competition Review - Response to Issues Paper*, Melbourne: CALC.

there is clearly enough evidence of ongoing anti-competitive and misleading behaviour to demonstrate the need for robust consumer protection to provide some assurance that consumers enter into contracts with their explicit informed consent, understanding the tariff, terms and conditions attached to the product.¹⁴⁴

These criticisms can be contrasted to the submission of Origin, which stated that ‘there is no evidence of significant anti-competitive or misleading marketing activity that would reflect market failure or would warrant the retail energy market to not be found fully competitive’.¹⁴⁵ TRUenergy similarly suggested that retailers’ behaviour was characterised by ‘high standards of market contact’.¹⁴⁶

Given the central place of EWOV in resolving industry disputes and their knowledge of the behaviour of at least some industry players, it is hard to dismiss the evidence presented by the EWOV in relation to their case statistics. Notwithstanding this, however, it would *prima facie* appear that the Marketing Code of Conduct is in itself an important tool within the consumer protection framework. Concern in itself does not therefore necessarily relate to the existence and nature of the mandatory obligations contained within it, but compliance with these obligations, and the regulator’s enforcement of them. Arguably, where retailers engage in activities that breach their obligations under Code, the relevant regulator ought to rightly take speedy and appropriate action to remedy the situation.

Of course, as we have already acknowledged, in addition to the extensive energy-specific framework set out above, Victorian energy retailers must also comply with generic federal and state consumer protection legislation including the *Trade Practices Act (Cth) 1974* and the *Fair Trading Act (Vic) 1999*. Matters dealt with under these Acts include, for instance, unfair contract provisions, and they create a prohibition against unconscionable conduct, misleading and deceptive conduct, false and misleading representation, and harassment and coercion. While many of these obligations are simultaneously regulated under the current Victorian energy-specific framework, commentators such as Gilbert and Tobin have argued that ‘the scope of energy specific consumer protection regulation is broader and in most instances...this additional scope of business regulation is appropriate’.¹⁴⁷

Such views broadly accord with the general conclusions of the Productivity Commission in their recent review of consumer protection policy frameworks. As noted in Section 2.4 of this Report, the Productivity Commission saw consumer protection regimes ‘operating reasonably well’ for electricity and gas in Australia, despite the often complex service offerings. They also recommended a single national protection regime enforced by the Australian Energy Regulator (AER) following the removal of price caps.

144 CUAC (2007), *AEMC Retail Competition Review - CUAC Response to Issues Paper*, Melbourne: CUAC, at p.5.

145 Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin.

146 TRUenergy (2007), *Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Victoria Issues Paper*, Melbourne: TRUenergy.

147 Gilbert and Tobin Lawyers (2005), *Public Consultation on a National Framework for Energy Distribution and Retail Regulation*, Sydney: NERA Economic Consulting, at p.44.

3.2 Government Energy Related Concessions and Grants

Victoria's consumer protection framework is further underpinned by an extensive government funded energy assistance regime. This is designed to 'improve the affordability of essential services for low income individuals and families in Victoria'¹⁴⁸ through the provision of financial concessions and grants. Government funded energy concessions and grants administered by the Department of Human Services (DoHS) provide eligible consumers with, for example, set discounts on their energy bills at specified periods of the year, assistance to repair or replace faulty essential appliances, and rebates under certain conditions.

Again, consumer feedback on the policy effectiveness of these arrangements has been positive. EWOV, for example, stated that they 'have been effective in ensuring access to supply in Victoria'.¹⁴⁹ As well, the ERAA also noted that these direct and transparent subsidies are pivotal to ensuring that all classes of customers are able to engage in the competitive market.¹⁵⁰

Table 4 below provides details on the range of state government funded concession/grant schemes currently available to Victorian energy consumers. Some twelve schemes providing concessions, grants or fee waivers are available here.

Table 4: Victorian Government Energy Related Concessions and Grants¹⁵¹

Concession/Grant Scheme	Description
Winter Energy Concession	<ul style="list-style-type: none"> 17.5 percent discount on electricity and gas bills incurred between May and November inclusive
Non-Mains Winter Energy	<ul style="list-style-type: none"> Three-tiered flat rate annual rebate available to consumers of LPG, and alternatives fuels such as diesel or heating oil which are used as the main domestic heating source
Life Support Machines	<ul style="list-style-type: none"> Quarterly rebate on electricity bills which is available to households in which a member utilises certain life support machines
Summer Multiple Sclerosis Concession	<ul style="list-style-type: none"> 17.5 percent discount on electricity bills incurred on the final quarterly summer bill
Group Home Winter Energy	<ul style="list-style-type: none"> 17.5 percent discount on electricity and gas bills incurred between May and November inclusive
Electricity Transfer Fee Waiver	<ul style="list-style-type: none"> Waiver of transfer fee when a change in occupancy occurs
Service to Property Charge	<ul style="list-style-type: none"> Reduction on electricity supply charge when supply charge exceeds cost of electricity consumption
Off-Peak Concession	<ul style="list-style-type: none"> 13 percent discount on the off-peak electricity tariff rate component of the bill

148 ESC (2007), *Energy Retail Businesses: Comparative Performance Report for the 2006-07 Financial Year*, Melbourne: ESC, at p.32.

149 EWOV (2007), *Review of the Effectiveness of the Competition in Gas and Electricity Retail Markets in Victoria*, Victoria, Melbourne: EWOV, at p.11.

150 ERAA (2007), *RE: Review of Effectiveness of Competition in Gas and Electricity Markets*, Sydney: ERAA

151 DoHS (2007), *Annual Report 2006-07*, Melbourne: Victorian Government; DoHS (2007), *Victorian State Concessions - Energy Concessions*, Melbourne: Victorian Government, available at: <http://www.office-for-children.vic.gov.au/concessions/concessions/energy>; DPI (2007), *Energy - Consumer Information*, Melbourne: Victorian Government, available at: <http://www.dpi.vic.gov.au/DPI/dpinenergy.nsf/childdocs/-844E6406280EB3D5CA25729D00101732?open#bate>

Utility Relief Grant Scheme	<ul style="list-style-type: none"> Assistance to domestic customers who are unable to pay their utility bills due to short term financial hardship¹⁵²
Non-Mains Utility Relief Grant	<ul style="list-style-type: none"> Once-off assistance to domestic customers of LPG gas who are unable to purchase LPG gas due to short term financial hardship
Capital Grant Scheme ¹⁵³	<ul style="list-style-type: none"> Once-off assistance to repair or replace faulty major essential appliances
Network Tariff Rebate	<ul style="list-style-type: none"> Rebate to rural and regional electricity consumers to minimise the gap between metropolitan and regional/rural electricity prices

In addition to the eleven assistance arrangements provided by the DoHS to low income customers, the abovementioned Network Tariff Rebate (NTR) program is also administered by the Department of Primary Industry (DPI). This subsidy is designed to 'address the structural cost disadvantage faced' by over 1.1 million rural and regional consumers by closing 'the gap in electricity prices between city and country'.¹⁵⁴ The Victorian Government's commitment to the NTR alone has been sizable, at around \$A110 million over the period 2005-2008.¹⁵⁵

Table 5 provides details on the spending of the Victorian government over 2006/07 on the Off-Peak Concession program, the Service to Property Charge Concession and the Winter Energy Concession (electricity and gas). As shown here, the government committed \$A90 million to these three schemes in 2006 alone and a further \$93 million in 2007. In 2007, the major portion of this expenditure (approximately \$A86 million) was directed to the Winter Energy Concession program.

Table 5: Victorian Government's Expenditure on Energy-Related Concessions (2006 and 2007)¹⁵⁶

Energy Product	Concession	2006 (\$A)	2007 (\$A)
<i>Electricity</i>			
	Off-peak Concession	5 115 595	4 814 725
	Service to Property Charge Concession	1 647 354	1 533 822
	Winter Energy Concession	45 873 479	46 715 216
<i>Gas</i>			
	Winter Energy Concession	37 076 547	39 610 948
Total		89 712 975	92 674 711

152 For this purpose, and for the purpose of the Non-Mains Utility Relief Grant, short term hardship is defined by the DoHS as being within the last twelve months.

153 In their submission to the AEMC's Victorian Review, the Tenants Union recommended that government undertakes a review of the eligibility guidelines of some of the DoHS programs. In particular, they noted the Capital Grants Program for better targeting of assistance provided (Tenants Union of Victoria (2007), *Submission to Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Melbourne: Tenants Union).

154 Theophanous, T. (2004), *Media Release: Network Tariff Rebate Extended for Another Year*, 11 March, Melbourne: Minister for Energy and Resources, Victorian Government; DPI (2007), *Energy - Consumer Information*, Melbourne: Victorian Government, available at: <http://www.dpi.vic.gov.au/DPI/dpinenergy.nsf/childdocs/-844E6406280EB3D5CA25729D00101732?open#bate>

155 CUAC (2006), 'Minister says Victorian consumers will be protected in national energy framework', *CUAC Rural & Regional Network Newsletter*, September, Melbourne: CUAC, at p.3.

156 ESC (2007), *Energy Retail Businesses: Comparative Performance Report for the 2006-07 Financial Year*, Melbourne: ESC, at p.32.

As noted above, the Victorian Government also 'provides financial assistance to low income customers who are unable to pay their utility account and may be at risk of disconnection'¹⁵⁷ through its Utility Relief Grant Scheme (URGS). Figures reported by the ESC for this scheme show that in the 2006-07 financial year, the Victorian Government assisted 9 065 energy customers in this category at a cost of approximately \$A3.0 million.¹⁵⁸

In addition to this range of twelve Victorian government energy related assistance schemes, eligible Victorian customers may also receive benefits from the federal government under the Centrelink administered Utilities Allowance. This allowance provides eligible age pension cardholders and certain other benefit recipients with a flat rate annual allowance - paid in two instalments - to assist in the payment of utility bills.¹⁵⁹

It is crucial to acknowledge the importance of this broad range of government concessions and arrangements. Given citizen expectations of the future of Victoria's energy markets, it is also crucial that they are maintained on the grounds of social policy. Equally, such social arrangements should not unduly impede market dynamics. Clause 14.11 of the AEMA recognised this explicitly, stating that,

All Parties agree to phase out the exercise of retail price regulation for electricity and natural gas where effective retail competition can be demonstrated and that:...

(b) social welfare and equity objectives will be met through clearly specified and transparently funded State or Territory community service obligations that do not materially impede competition;...

Prime facie, it would appear that the range of government funded concession and grant programs outlined above do not appear to unnecessarily impede competition within Victoria's energy markets. They appear therefore to be consistent with the Victorian Government's ongoing obligations under the AEMA. Maintenance of these programs by government will continue to be an important part of social policy obligations and protecting citizens facing issues of financial and social hardship, regardless of whether or not the Victoria government retains its reserve pricing power. Given the importance of such social policy arrangements in energy, it is also incumbent on governments to ensure that funding is targeted to the most needy, and that it gets, as a priority, to those most deserving and most in need. Sound decisions to improve the effectiveness of these grants and concessions will no doubt need to be underpinned by ongoing analysis and continued strong social research.

3.3 Lessons and Conclusions

This section has outlined the current consumer protection framework for Victorian energy customers. It noted the long evolution of arrangements up to the present day and has argued that the government's reserve pricing power is but one of the many regulatory mechanisms presently in force to protect consumers in energy markets. Specifically, eight non-price safety net mechanisms as well as more than a dozen government grant and concession schemes all play a crucial role.

157 ESC (2007), *Energy Retail Businesses: Comparative Performance Report for the 2006-07 Financial Year*, Melbourne: ESC, at p.33.

158 Approximately \$A1.9 million was provided under the URGS to 5 504 electricity customers, with a further \$A1.1 million in grants to 3 561 gas customers. The size of the average grant to electricity customers was slightly higher than the average gas grant (\$A347 compared to \$A313) (ESC (2007), *Energy Retail Businesses: Comparative Performance Report for the 2006-07 Financial Year*, Melbourne: ESC, at p.33-34; and ESC (2007), *2006-07 Energy Retail Performance – Consumer Snapshot*, Melbourne: ESC, at p.2).

159 Centrelink (2007), *Payments - Utilities Allowance*, Canberra: Australian Government, available at: http://www.centrelink.gov.au/internet/internet.nsf/payments/utilities_allowance.htm

While the AEMC has recommended that the Victorian Government's reserve pricing power be removed at the end of 2008, it is therefore apparent that a comprehensive framework of non-price protection mechanisms will remain. Accordingly, Victorian energy consumers will continue to benefit from a high level of protection. Notwithstanding this observation, some improvements to non-price consumer protection frameworks may still be desirable and feasible. In addition, while the framework itself does not directly address broader social objectives, the ESC argued in its 2004 Review that the safety net arrangements '(cannot) address direct affordability problems that are due to income insufficiency, high energy use and poor energy efficiency'.¹⁶⁰ A 'whole of government' approach was deemed to be more appropriate in addressing these broader affordability issues.¹⁶¹

¹⁶⁰ ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC, at p.7.

¹⁶¹ ESC (2004), *Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity - Overview Report*, Melbourne: ESC.

4 EXPERIENCES OF 'DEREGULATED' ENERGY MARKETS

4.1 Introduction

Having briefly considered key aspects in the evolution of Victoria's retail energy markets, and after articulating the fundamental components of the state's energy consumer protection regime, this part of the Report briefly examines the experiences and regulatory approaches of four international energy markets. The Section focuses primarily on energy markets which are currently operating without retail price regulation although the experience of the retail price regulated electricity market of California in 2000 is also briefly considered because of its notoriety. The objective of this Section is to highlight the lessons – both positive and negative – within these energy markets so as to inform debate on the proposed Victorian reforms.¹⁶²

The experiences of the UK's energy market and NZ's electricity market are considered in Sections 4.2 and 4.3 respectively, followed by a discussion of two US electricity markets – Texas and California.

4.2 United Kingdom

The history of market reforms within the UK's electricity and gas sectors is one of the longest within the context of the international literature on privatisation and the liberalisation of energy markets. The gas market was privatised in 1986, followed by the subsequent privatisation of the electricity market in 1990-91.¹⁶³ Since this period, the UK energy markets have moved towards retail competition with FRC having been gradually implemented within the gas market during 1996-1998, and somewhat more rapidly in the electricity sector with FRC introduced in 1999.¹⁶⁴ Considered by commentators such as Crow to have been perhaps 'the largest system to undertake radical reform,'¹⁶⁵ this liberalisation process has, according to some observers, 'to a large extent set the pattern for subsequent restructuring'¹⁶⁶ within other jurisdictions. The restructuring process was accompanied by the establishment of an independent economic regulator¹⁶⁷ for each of the gas and electricity arenas. This was done in order to protect 'the

162 Due to the unique nature of each of the markets considered in this section in terms of historical, political and structural parameters, these brief case studies should be regarded as primarily informative. The specific experiences of each jurisdiction cannot necessarily be extrapolated wholesale to the current Victorian context.

163 Price, C. W. (1997), 'Competition and regulation in the UK gas industry', *Oxford Review of Economic Policy*, 13(1), 47-63; Parker, D. (2004), 'International experience in restructuring electricity', in G. Hodge, V. Sands, D. Hayward and D. Scott (eds), *Power Progress: An Audit of Australia's Electricity Reform Experiment*, Melbourne: ASP, pp.216-232.

164 Price, C.W. (1997), 'Competition and regulation in the UK gas industry', *Oxford Review of Economic Policy*, 13(1), 47-63; and Price, C.W. (2005), 'The Effect of Liberalizing UK Retail Energy Markets on Consumers', *Oxford Review of Economic Policy*, 21(1), 128-144.

165 Crow, R. T. (2002), 'What Works and What Does Not in Restructuring Electricity Markets', *Business Economics*, 37(3), 41-56, at p.42.

166 Woo, C.-K., D. Lloyd and A. Tishler (2003), 'Electricity market reform failures: UK, Norway, Alberta and California', *Energy Policy*, 31(11), 1103-1115, at p.1105.

167 The UK's initial independent regulators, the Director General of Gas Supply (Ofgas), and the Office of Electricity Regulation (Offer), have since been subsumed under the Office of Gas and Electricity Markets (Ofgem).

interests of all consumers,¹⁶⁸ and the implementation, at least initially, of retail price regulation.¹⁶⁹

Operationally the general success of the UK's competitive market is difficult to dispute, having 'been at the forefront of utility customer switching activity since full market opening in 1999'.¹⁷⁰ For instance, in March 2007 alone approximately 333 000 residential gas customers and 441 000 residential electricity customers (or 1.5 percent and 1.7 percent of gas and electricity domestic consumers respectively) switched their energy suppliers.¹⁷¹

In order to understand the nature of the UK's competitive energy markets during the post market-reform period, annual reviews of the markets were undertaken by the Office of Gas and Electricity Markets (Ofgem), the eventual regulator of both sectors. The aim of their 2001 Review was, however, to not only gain a better understanding of the state of these markets, but 'to assess whether competition ha[d] developed sufficiently to enable Ofgem to remove price caps applying to BGT [British Gas Trading] and ex-PES [i.e. electricity] suppliers'.¹⁷² Despite only two years of FRC within the electricity market, in November 2001 the regulator indeed deemed competition to be effective, and argued that it had developed to such a level as to protect the interests of energy consumers. This conclusion was based on data relating to a number of market criteria, including switching rates, market share, entry and exit of retailers, and price, and was made despite evidence of a number of market impediments.¹⁷³ This finding, though, is perhaps less surprising given the decreasing retail energy prices observed in the UK between 1990 and 2001.¹⁷⁴

Pursuant to this finding, Ofgem recommended the removal of residual retail price regulation by 1 April 2002.¹⁷⁵ In their view, consumers' interests across all classes and payment categories¹⁷⁶ would be best protected under a regulatory regime underpinned by the investigative and enforcement powers of the *Competition Act 1998* and not price controls.¹⁷⁷ It was asserted that as the complexity within the energy markets amplified, 'through increased innovation and price/service offerings...the scope for unintended and distortionary effects of retaining price controls increases'.¹⁷⁸ Accordingly, in the opinion of Ofgem, the possible risks to customers associated with the retention of retail price regulation outweighed the theoretical risks associated with their removal. Reliance on other regulatory mechanisms, including

168 Ofgem (2002), *Review of domestic gas and electricity competition and supply price regulation - Conclusions and final proposals*, London: Ofgem, at p.3.

169 Price, C. W. (1997), 'Competition and regulation in the UK gas industry', *Oxford Review of Economic Policy*, 13(1), 47-63; and Price, C.W. (2005), 'The Effect of Liberalizing UK Retail Energy Markets on Consumers', *Oxford Review of Economic Policy*, 21(1), 128-144.

170 First Data and VaasaEMG (2007), *World Energy Retail Market Rankings - Utility Customer Switching Research Project*, New York: First Data and VassaEMG, at p.3.

171 Ofgem (2007), *Domestic Retail Market Report - June 2007*, London: Ofgem.

172 Ofgem (2001), *Review of domestic gas and electricity competition and supply price regulation - Evidence and Initial Proposals*, London: Ofgem, at p.1.

173 Ofgem (2001), *Review of domestic gas and electricity competition and supply price regulation - Evidence and Initial Proposals*, London: Ofgem. See also Ofgem (2001), *Experience of the competitive domestic electricity and gas markets*, Research study conducted for Ofgem by MORI, London: Ofgem.

174 Price, C.W. (2005), 'The Effect of Liberalizing UK Retail Energy Markets on Consumers', *Oxford Review of Economic Policy*, 21(1), 128-144.

175 Ofgem (2001), *Review of domestic gas and electricity competition and supply price regulation - Evidence and Initial Proposals*, London: Ofgem.

176 This included standard credit and pre-payment customers.

177 Ofgem (2001), *Review of domestic gas and electricity competition and supply price regulation - Evidence and Initial Proposals*, London: Ofgem.

178 Ofgem (2002), *Review of domestic gas and electricity competition and supply price regulation - Conclusions and final proposals*, London: Ofgem, at p.16.

competition and consumer laws,¹⁷⁹ was also deemed to be favourable due to the more flexible and dynamic nature of these instruments.¹⁸⁰

Underpinning these reforms was a commitment to broader social initiatives as well, in order to assist the access of vulnerable and 'fuel poor' consumers to market benefits. Strategies here included the government's Fuel Poverty Strategy¹⁸¹ and Ofgem's Social Action Plan.¹⁸²

Consumer protection was also provided in the form of extensive license obligations including an obligation to supply domestic customers, marketing procedures for domestic customers, the creation of a Priority Service Register (PRS)¹⁸³ and the implementation of a number of Codes of Practice relating to billing, payment, debt recovery and energy efficiency advice.¹⁸⁴ Interestingly, and in contrast to other jurisdictions including Victoria, an energy specific ombudsman scheme was not implemented as part of this UK framework.¹⁸⁵

The subsequent removal of retail price regulation was, according to Yarrow, 'by any standard, a remarkably swift transition'.¹⁸⁶ And despite some vocal opposition to the phasing out of retail price regulation,¹⁸⁷ it was reported at the time of their removal that approximately 37 percent and 38 percent of residential gas and electricity customers respectively had already entered into market contracts.¹⁸⁸ These customers were therefore not subject to the retail price controls at the time retail price regulation was removed.

179 These included the *Competition Act 1998* and the *Fair Trading Act 1973*.

180 Ofgem (2002), *Review of domestic gas and electricity competition and supply price regulation - Conclusions and final proposals*, London: Ofgem.

181 Published in November 2001, the government's Fuel Poverty Strategy was designed to eliminate fuel poverty within the UK. The Strategy set out targets, objectives, and policies for meeting this objective. Despite its lofty early aim, it was reported in 2007 that some 2.5 million households in the UK were still considered to be in fuel poverty. This increase in 0.5 million from 2005 was largely attributed to increasing energy costs (Defra and BERR (2007), *The UK Fuel Poverty Strategy: 5th Annual Progress Report 2007*, London: HM Government). Other reported figures suggest that as of mid-2007, 4 million households were in fuel poverty (Ofgem (2007), *Ofgem's Review of Suppliers' Voluntary Initiatives to Help Vulnerable Customers*, London: Ofgem).

182 Ofgem (2002), *Review of domestic gas and electricity competition and supply price regulation - Conclusions and final proposals*, London: Ofgem. Launched in 2000, the Social Action Plan (SAP) was 'a framework for action across a wide range of activities to ensure that the economic benefits of liberalisation are spread fairly among vulnerable and disadvantaged customers' (HM Government (2001), *The UK Fuel Poverty Strategy*, London: BERR, at p.20). The SAP was seen as providing the framework for Ofgem to eliminate fuel poverty and meet its statutory objectives to protect consumer interests.

183 Under the license obligations, each retailer is required to create and maintain a PSR. Certain customers, including elderly, disabled and ill customers may be placed on the PSR, at which time they become eligible for a number of services from the retailer including free safety checks, quarter meter readings, and redirecting of bills (Energy Retail Association (2004), *Protecting Vulnerable Customers from Disconnection*, London: ERA).

184 Ofgem (2002), *Preventing debt and disconnection - Good practice guidelines developed by energywatch and Ofgem*, London: energywatch and Ofgem.

185 An energy specific ombudsman scheme was not implemented within the UK's energy markets until 2006, at which time the Energy Supply Ombudsman scheme was established. This action was taken in response to the 'super-complaints' being made in relation to billing practices by the industry. See Energy Supply Ombudsman (2007), *An independent view: Annual Report 2007*, London: ESO.

186 Yarrow, G. (2008), *Report on the impact of maintaining price regulation*, Oxford: Regulatory Policy Institute, at p.33.

187 See for instance Robertson, L. and C. Simes (2001), 'Ending power price controls "will hit poor"', *The Herald*, London, 27 November; McKechnin, A. (2002), *Re: Review of domestic gas and electricity competition and supply price regulation - Conclusions and Final Proposals*, Glasgow Maryhill: Member for The Community of Glasgow Maryhill. See also energywatch (2003), *energywatch Annual Report April 2002 – March 2003*, London: energywatch 'On 1 April 2002 Ofgem removed the remaining price controls for retail energy supply. energywatch expressed concern about the impact this would have on the prices paid by consumers living in areas where competition was non-existent or less developed. Where consumers are on price regulated energy supply, such as through teleswitch meters, we have sought to ensure they are not disadvantaged' (at p.13).

188 Ofgem (2002), *Annual Report 2002-2003*, London: Ofgem. According to their research in November 2001, this equated to approximately 15 million UK energy customers having switched electricity or gas supplier. By the end of the 2002-2003 reporting period, Ofgem reported that 'eight million domestic gas and 11 million domestic electricity [consumers] ha[d] exercised their choice to switch suppliers' (at p.13).

Twelve months after the removal of retail price regulation, Ofgem reported that ‘competition ha[d] become an even more powerful influence on the behaviour of companies in the market, and [was being] effective in creating a range of consumer benefits’.¹⁸⁹ While acknowledging that the market was still not ‘perfect’, the regulator continued to assert that consumer interests were better protected under the new regulatory regime.¹⁹⁰ In their view, periodic retail market monitoring and reporting on the state of energy competition was essential to ensuring that the market continued to function effectively and also crucial in order to enable the regulator to identify barriers to consumer participation.¹⁹¹ Moreover, the obligation on retailers to publish tariff information on all of their market offers¹⁹² clearly enabled Ofgem to accurately report on criteria such as price and product innovation.

Development of competition within the retail energy markets was evident over the subsequent years, with Ofgem reporting ‘substantial benefits’ for customers by mid-2004.¹⁹³ Importantly, this increased competition had slowly begun to erode away the pattern of ‘two-tiered’¹⁹⁴ pricing, a practice which had begun with the introduction of FRC.¹⁹⁵ Data on retail energy pricing pre and post the removal of retail price regulation suggests, according to Yarrow,

that residential customers did well from deregulation, particularly in the period around the time of withdrawal of the price caps but also later too;...the out-turn has been favourable to a benchmark based upon full wholesale cost pass-through, which itself may be a little lower than prices that would have been allowed if price regulation had continued.¹⁹⁶

Despite the retail price decrease observed immediately following the removal of retail price regulation, Yarrow notes that volatility within the wholesale market resulted in significant retail price increases for residential consumers since 2004¹⁹⁷ with double digit price rises reported in, for example, July 2005.¹⁹⁸ A reversal of this upward trend was reported by Ofgem in their recent Retail Market Report, at which time the regulator noted that their ‘analysis suggests that competition between suppliers ha[d] saved all domestic customers more than £100 on average by protecting them from the full impact of rising wholesale prices over the last 4 years. Customers who did shop around saved even more - £279’.¹⁹⁹ With five of the major energy

189 Ofgem (2003), *Domestic gas and electricity supply competition - Recent Developments*, London: Ofgem.

190 Ofgem (2003), *Domestic gas and electricity supply competition - Recent Developments*, London: Ofgem.

191 Ofgem (2003), *Domestic gas and electricity supply competition - Recent Developments*, London: Ofgem.

192 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC.

193 Ofgem (2004), *Domestic Competitive Market Review 2004*, London: Ofgem, at p.1.

194 This practice involved incumbents enticing new customers through the offering of lower prices while existing customers continued to pay higher prices.

195 Ofgem (2004), *Domestic Competitive Market Review 2004*, London: Ofgem.

196 Yarrow, G. (2008), *Report on the impact of maintaining price regulation*, Oxford: Regulatory Policy Institute, at p.30.

197 Yarrow, G. (2008), *Report on the impact of maintaining price regulation*, Oxford: Regulatory Policy Institute. See also energywatch (2004), *Press Release: energywatch advises consumers how to tackle further prices increases*, 25 August, London: energywatch; energywatch (2004), *Press Release: energywatch wants explanations for massive price rises*, 17 September, London: energywatch; and energywatch (2005), *Annual Report and Accounts 2004 – 2005*, London: energywatch.

198 energywatch (2006), *Annual Report and Accounts 2005-2006*, London: energywatch. In a recent report, these increases were quantified, with the energywatch contending that ‘successive price rises between 2003 and 2006 saw average domestic gas bills increase by 94 per cent and average electricity bills rise by 60 per cent. Taken together, these increases saw average household energy bills break through the £1000 barrier in 2006’ (energywatch (2007), *A Social Responsibility? The energywatch consultation on the nature of social tariffs in the energy market: report and recommendations*, London: energywatch, at p.3).

199 Ofgem (2007), *Domestic Retail Market Report - June 2007*, London: Ofgem, at p.1.

suppliers having announced price increases in the first five weeks of 2008,²⁰⁰ this downward trend appears to have been short-lived however.

Against this backdrop of rising retail prices, significant product innovation has occurred within the UK's domestic retail energy market in an attempt by retailers to differentiate themselves from their competitors and increase their market share. One notable voluntary initiative has been the introduction of 'price guarantee tariffs,' including fixed and capped price deals designed to provide customers with greater certainty over their bills. These products have clearly been popular, with Ofgem reporting that as of March 2007, 'around 6 million product accounts (gas and electricity) – or around 13% of the market - were on a price guarantee tariff'.²⁰¹ Interestingly, all retailers now offer some form of price guarantee offer. Competition within this product sector has also resulted in the voluntary removal of contract exit fees, thereby allowing customers to switch between market offers without penalty.²⁰² This has been another notable initiative. Other innovative products have included online tariffs and green tariffs.²⁰³ With the UK energy markets acknowledged as a world leader, these new retail market initiatives might also be interpreted as best competitive practice. They certainly provide food for thought as interesting examples for potential policy transfer into Victoria's energy markets.

Somewhat more unusual has been the development of 'social tariffs,' which provide eligible customers, primarily low income customers, with discounted energy.²⁰⁴ First introduced by retailers in 2005 on a voluntary basis as part of their corporate social responsibility activities, by 2007 all UK energy retailers were offering some form of social tariff and/or rebate program. While the discounts vary under the social tariff, it has been suggested that the average annual saving to consumers in 2007 ranged between £15 and £160,²⁰⁵ with approximately 769 000 energy customers benefiting from these discounts.²⁰⁶

The voluntary nature of the social tariffs has resulted in significant variation in the discounts offered, the eligibility criteria, and the approaches taken to the tariffs by retailers. In response to these variations, there have been calls to legislate a minimum standard to regulate social tariffs.²⁰⁷ This suggestion has been highly controversial and the subject of much recent debate. Retailers have perhaps understandably favoured 'retaining the freedom to develop a diverse range of products for the benefit of low-income customers as they saw fit'.²⁰⁸ In this respect, the Energy Retail Association (ERA) contended that,

200 energywatch (2008), *Press Release: Four rises in four weeks - what competition?*, 01 February, London: energywatch; and energywatch (2008), *Press Release: Price hike by E.ON makes it the High Fives*, 07 February, London: energywatch.

201 Ofgem (2007), *Domestic Retail Market Report - June 2007*, London: Ofgem, at p.13.

202 Ofgem (2007), *Domestic Retail Market Report - June 2007*, London: Ofgem.

203 Ofgem (2007), *Domestic Retail Market Report - June 2007*, London: Ofgem.

204 Ofgem (2005), *Social Action Strategy*, London: Ofgem.

205 Ofgem (2007), *Domestic Retail Market Report - June 2007*, London: Ofgem. It is important to note however that there has been some debate over whether or not social tariffs are effectively in alleviating fuel poverty, with research suggesting that a number of retailer's standard tariffs offer customer's greater savings than their social tariffs (Baker, W. (2006), *Social Tariffs: a Solution to Fuel Poverty?*, Bristol: Centre for Sustainable Energy).

206 Ofgem (2007), *Ofgem's Review of Suppliers' Voluntary Initiatives to Help Vulnerable Customers*, London: Ofgem.

207 energywatch (2007), *A Social Responsibility? The energywatch consultation on the nature of social tariffs in the energy market: report and recommendations*, London: energywatch.

208 energywatch (2007), *A Social Responsibility? The energywatch consultation on the nature of social tariffs in the energy market: report and recommendations*, London: energywatch, at p.6.

the proposition to impose a national social tariff is a short-term fix to the more complex challenge of social equity for all customers in a world of higher prices and the deep-rooted problem of social exclusion.²⁰⁹

In arguing for the retention of the status quo, the ERA suggested that by placing a mandatory minimum standard, a situation would be created whereby retailers withdraw their financial support from other CSR programs in order to fund the social tariff programs.²¹⁰ Despite these arguments, and the support of Ofgem in favour of the status quo, energywatch recommended that 'legislation is required which obliges suppliers to offer social tariffs as a component part of 'Energy Assistance Packages' and in accordance with minimum standards'.²¹¹ While it would appear that the government has been reluctant to act upon this recommendation, the issue itself is unlikely to disappear, especially in the context of across the board increases in retail energy prices.

In contrast to jurisdictions such as Victoria, one hallmark of the UK's energy markets has been its strong reliance on self-regulation. Under this philosophy, many industry practices - including social tariffs – have been implemented, and have exceeded the retailers' obligations set out in their licence conditions. Apart from the social tariff, initiatives have included the development of voluntary strategies to assist vulnerable consumers under Good Practice Guidelines (which focuses on six key areas),²¹² the development of 'safety net' procedures,²¹³ and the creation of a Code of Practice for the marketing of energy. This Code of Practice is underpinned by the EnergySure Accreditation Scheme, as well as a range of compliance and auditing activities.²¹⁴ It has been estimated that the industry itself provides approximately £110 million per year in assistance to energy customers through a range of initiatives and partnerships.²¹⁵

4.3 New Zealand

While the UK may have been one of the most visible reform examples in opening up energy markets, Hogan argues that, 'in many ways, the New Zealand [electricity] market design has been at the forefront of best practice'.²¹⁶ While this assertion will not be tested within the context of this Report, it is important to recognise the fundamental differences in the approach taken by New Zealand when compared to Victoria in relation to the perceived need for both an independent economic regulator and price regulation for retail electricity prices.²¹⁷

209 Energy Retail Association (2006), *Energy Retail Association response to an energywatch consultation on the nature of social tariffs in the energy market*, London: ERA.

210 Energy Retail Association (2006), *Energy Retail Association response to an energywatch consultation on the nature of social tariffs in the energy market*, London: ERA.

211 energywatch (2007), *A Social Responsibility? The energywatch consultation on the nature of social tariffs in the energy market: report and recommendations*, London: energywatch, at p.13.

212 Ofgem (2002), *Preventing debt and disconnection - Good practice guidelines developed by energywatch and Ofgem*, London: energywatch and Ofgem; Sohn Associates (2007), *Preventing Debt and Disconnection - the Review: An independent review*, London: Sohn Associates.

213 Energy Retail Association (2004), *Protecting Vulnerable Customers from Disconnection*, London: ERA.

214 EnergySure (2007), *AES Code annual report: For the year ended 31 December 2006*, London: EnergySure.

215 Ofgem (2007), *Ofgem's Review of Suppliers' Voluntary Initiatives to Help Vulnerable Customers*, London: Ofgem.

216 Hogan, W.W. (2002), 'Electricity Market Restructuring: Reforms of Reforms', *Journal of Regulatory Economics*, 21(1), 103-132, at p.124.

217 One key structural difference between the two electricity markets includes New Zealand's heavy reliance on hydroelectricity generation (Electricity Commission (2007), *Annual Report 2006/07*, Wellington: EC).

The New Zealand Government took an ‘unusually radical’²¹⁸ approach to both the market reform process and the subsequent regulation of the electricity market. Importantly, it did not initially establish an independent economic regulator to oversee the market function.²¹⁹ As aptly described by one commentator, this was to ‘to create regulation without regulators.’²²⁰ General competition laws, which included extensive information disclosure requirements and heavy dependence on self-regulation, were instead relied upon by the Government to govern the electricity market.²²¹ During the extensive reform periods of the 1980s and 1990s New Zealand electricity supplies,²²² as noted by the Electricity Commission, ‘had been subject to few legislative and government restrictions.’²²³ While this has since changed, with a competitive wholesale market being established in 1996 and the subsequent divestiture of distribution businesses, the fundamental features of this regime remained in place until as recently as 2003, albeit subject to progressively stronger regulatory requirements.²²⁴ Accordingly, while consumer protections including an obligation to supply electricity existed,²²⁵ New Zealand customers did not have the benefits of a comprehensive electricity specific protection framework.²²⁶ Hogan has suggested that increasing concerns over the performance of the electricity market, in particular retail competition,²²⁷ motivated the New Zealand government to implement a new round of reforms around early 2000. Following on from an inquiry into the state of the electricity

218 Bertram, G. and D. Twaddle (2005), ‘Price-cost margins and profit rates in New Zealand electricity distribution networks since 1994: the cost of light handed regulation’, *Journal of Regulatory Economics*, 27(3), 281-307.

219 Parker, D. (2004), ‘International experience in restructuring electricity’, in G. Hodge, V. Sands, D. Hayward and D. Scott (eds), *Power Progress: An Audit of Australia’s Electricity Reform Experiment*, Melbourne: ASP, pp.216-232.

220 Hogan, W.W. (2002), ‘Electricity Market Restructuring: Reforms of Reforms’, *Journal of Regulatory Economics*, 21(1), 103-132, at p.124.

221 Bertram, G. and D. Twaddle (2005), ‘Price-cost margins and profit rates in New Zealand electricity distribution networks since 1994: the cost of light handed regulation’, *Journal of Regulatory Economics*, 27(3), 281-307.

222 While this Report does not provide a detailed description of the history of New Zealand’s electricity market development, the major reforms to New Zealand’s electricity market commenced around the same as those of the UK and Victoria, as part of a broader economic reform agenda. Importantly, the reforms were seen to be a way to increase efficiency in what was then the government’s largest state-owned department, while at the same time decreasing prices for customers through the introduction of competition. As part of this process, the NZ Electricity Department was corporatized and superseded by the Electricity Corporation of NZ (ECNZ), the transmission and distribution networks were restructured, and a competitive wholesale market was established in 1996. Further reforms within the market occurred in the late 1990s with the passing of the Electricity Industry Reform Act (NZ) 1998, under which companies were required to divest their distribution from their retail and generation businesses, and the subsequent split of the ECNZ – at the time – into two state-owned enterprises (SOEs). As observed by Bertram and Twaddle, ‘with no regulator, the regime relied heavily upon Government’s declared expectation that self-regulation would result simply as a result of transparency’ (at p.282). See generally Forster, T.H, V.S. Mouly, and J.K Sankaran (2006), ‘Deregulation and Industrial Change: A Comparative Study of the Electricity Sector of New Zealand and the Gambia’, *Journal of Change Management*, 6(3), 321-347; Hogan, W. W. (2002), ‘Electricity Market Restructuring: Reforms of Reforms’, *Journal of Regulatory Economics*, 21(1), 103-132; New Zealand Geothermal Association (2005), *Market Structure*, New Zealand: New Zealand Geothermal Association; Ministry of Economic Development (2006), *Electricity - Specific Legislation*, Wellington: New Zealand Government, available at: http://www.med.govt.nz/templates/Page_13565.aspx; and Bertram, G. and D. Twaddle (2005), ‘Price-cost margins and profit rates in New Zealand electricity distribution networks since 1994: the cost of light handed regulation’, *Journal of Regulatory Economics*, 27(3), 281-307.

223 Electricity Commission (2006), *About the Commission - Background to regulation*, Wellington: EC, available at: www.electricitycommission.govt.nz/aboutcommission/regtogovt

224 Electricity Commission (2004), *Annual Report 2003/04*, Wellington: Electricity Commission; and Ministry of Economic Development (2000), *Inquiry into the Electricity Industry*, Wellington: New Zealand Government.

225 As provided for under section 62 of the *Electricity Act 1992*, and is scheduled to expire on 31 March 2013. The obligation to supply has been recently the subject of a major review by the Ministry of Economic Development (see generally Ministry of Economic Development (2007), *Review of Section 62 of the Electricity Act 1992 ‘Continuance of Supply’ (2013 review) - Discussion paper*, Wellington: New Zealand Government. At the time of writing this Report, it was still unclear whether the obligation would be extended beyond its current expiry date of March 2013.

226 This was provided under provisions contained in, for example, the *Commerce Act 1986*, and the *Fair Trading Act 1986*.

227 Hogan, W.W. (2002), ‘Electricity Market Restructuring: Reforms of Reforms’, *Journal of Regulatory Economics*, 21(1), 103-132.

market,²²⁸ a Government Policy Statement was released in late 2000. This provided a blue-print for the restructuring, including matters such as new self-regulatory arrangements which would include an Electricity Governance Board.²²⁹ As shown by the Statement,²³⁰ limited government intervention in the market clearly remained the government's preference. The inability of industry stakeholders, however, including market participants and consumer organisations, to reach a consensus on the self-governance arrangements, combined with the 'government concerns over the management of the electricity industry and the security of supply in dry years',²³¹ finally resulted in the creation of an independent economic regulator, the Electricity Commission (EC), in September 2003. While the EC has been charged with overseeing the wholesale and retail markets to 'ensure that they run fairly and efficiently',²³² it must do so in a 'light-handed' manner.

Turning our attention now to the specific issue of retail price regulation, the introduction of FRC in 1999 in New Zealand was not accompanied at the time by any form of price oversight mechanism.²³³ This was in line with the minimalistic government intervention philosophy. Retail price monitoring of residential prices was however undertaken by the Minister for Economic Development on a quarterly basis, in conjunction with an annual survey of domestic and commercial prices.²³⁴ Unlike many other jurisdictions with competitive energy markets, including Victoria, the New Zealand Government has therefore never had to grapple with the issue of determining the appropriate time to phase out retail price caps.²³⁵ This is a significant difference between the Victorian and New Zealand experiences. Despite the absence of a power to cap prices, consumer switching activity has remained steady within the New Zealand electricity market,²³⁶ and it was most recently ranked sixth ('active') in the World Retail Market Rankings.²³⁷

Another important measure of how this market fared without retail price regulation is by reference to retail prices. While somewhat out of date, the most recent publicly released Electricity Prices and Retail Competition by the New Zealand Minister of Economic Development observed that residential retail prices had continued to steadily increase in terms of both nominal and real cost. This increase was explained in part due to the removal of cross

228 See Ministry of Economic Development (2000), *Inquiry into the Electricity Industry*, Wellington: New Zealand Government.

229 Minister of Energy (2000), *Government Policy Statement: Government's Policy Objective for Electricity*, Wellington: New Zealand Government.

230 For instance, the Government stated that, 'To meet this objective, the Government favours industry solutions where possible, but is prepared to use regulatory solutions where necessary' (Minister of Energy (2000), *Government Policy Statement: Government's Policy Objective for Electricity*, Wellington: New Zealand Government).

231 Electricity Commission (2004), *Annual Report 2003/04*, Wellington: EC, at p.9. At the time of EC's establishment, Wright reported that, 'the commission is the government's response to electricity shortages in 2001 and earlier this year. Low rainfall pushed wholesale power prices to very high levels, causing industry to curtail production' (Wright, S. (2003), 'NZ Govt Names Electricity Commission', *Dow Jones International News*, Wellington, 14 September).

232 Electricity Commission (2004), *Annual Report 2003/04*, Wellington: EC, at p.10.

233 Ministry of Economic Development (2000), *Inquiry into the Electricity Industry*, Wellington: New Zealand Government.

234 See for example, Ministry of Economic Development (2004), *Electricity Prices and Retail Competition Report*, Wellington: New Zealand Government; and Ministry of Economic Development (2007), *Schedule of Domestic Electricity Prices: Updated to 15 November 2007*, Wellington: New Zealand Government.

235 In his study of the impact of maintaining price regulation, Yarrow noted that neither Sweden or Norway had implemented retail price controls 'when opening the market to retail competition' (Yarrow, G. (2008), *Report on the impact of maintaining price regulation*, Oxford: Regulatory Policy Institute, at p.60).

236 Electricity Commission (2007), *Annual Report 2006/07*, Wellington: EC.

237 First Data and VaasaEMG (2007), *World Energy Retail Market Rankings - Utility Customer Switching Research Project*, New York: First Data and VassaEMG.

subsidies between different customer classes, and in part, increased generation costs.²³⁸ Importantly, the market does not appear to have suffered from any form of significant market failure since the introduction of FRC.

Against this backdrop, it is also notable that a range of consumer protection mechanisms have been strengthened in accordance with the requirements set out in paragraphs 18 and 19 of the Government Policy Statement.²³⁹ These measures include, for example, an industry specific dispute resolution scheme in January 2002,²⁴⁰ the creation of a 'Low Fixed Charge' tariff in 2004 for domestic consumers,²⁴¹ the establishment of a Retailer of Last Resort (RoLR) scheme,²⁴² as well as billing and disconnection guidelines.²⁴³

Of course not all commentators have seen New Zealand's energy reforms as 'best practice', and this policy terrain has inevitably had its fair share of criticisms. Despite Hogan's claim of market best practice, Bertram and Twaddle for instance asserted that,

New Zealand's unsuccessful experiment with information disclosure in its electricity (and natural gas) network industries demonstrates that the reduction of information asymmetries ma[ke] a poor substitute for industry regulation in achieving effective regulation of network industries.²⁴⁴

Others have claimed that the individual 'New Zealand domestic electricity consumer had been failed "quite substantially" by reforms in the electricity industry so far'.²⁴⁵ Whatever our judgement on these various assertions, they do not suggest that any lack of success in New Zealand's energy markets was due to the lack of retail price regulation.

238 Ministry of Economic Development (2004), *Electricity Prices and Retail Competition Report*, Wellington: New Zealand Government.

239 Minister of Energy (2000), *Government Policy Statement: Government's Policy Objective for Electricity*, Wellington: New Zealand Government.

240 Electricity Complaints Commission (2002), *Watt's Up, Newsletter from the Electricity Complaints Commission*, Issue 2, Wellington: ECC. The ECC has since evolved to become the Electricity and Gas Complaints Commission.

241 As provided for under s172B of the *Electricity Act 1992* and *Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004*. See also Ministry of Economic Development (2007), *Proposed amendments to the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004*, Wellington: New Zealand Government.

242 Minister of Energy (2000), *Government Policy Statement: Government's Policy Objective for Electricity*, Wellington: New Zealand Government.

243 Electricity Commission (2005), *Guideline on arrangements to assist low income consumers*, Wellington: EC; and Electricity Commission (2007), *Guideline on arrangements to assist low income and vulnerable consumers*, Wellington: EC.

244 Bertram, G. and D. Twaddle (2005), 'Price-cost margins and profit rates in New Zealand electricity distribution networks since 1994: the cost of light handed regulation', *Journal of Regulatory Economics*, 27(3), 281-307, at p.306.

245 This was the alleged statement by Mr Russell of the New Zealand Consumer Institute, as reported by Bennett, A. (2003), 'Call for Greater Consumer Say on New Electricity Commission', *New Zealand Press Association*, 6 November.

4.4 Other Markets

Texas

Recently described as 'competitive electricity's greatest success story in the United States, if not the world',²⁴⁶ the experience of Texan electricity market reform processes provides our third case study. Importantly for the purposes of this Report, the latest chapter in the state's 'ambitious restructuring plan'²⁴⁷ occurred as recently as 1 January 2007 with the phasing out of the state government's retail pricing control. While it remains too early to determine what the full impact of the removal of the retail pricing regulation will be on the state's vast electricity market, a number of early observations may be made. As with the other markets considered within this Report, these comments are brief, but informative.

As outlined by Yarrow and analysts such as Zarnikau, Curet, and Alexander, reforms to the electricity market in Texas were initiated in 1995, with FRC introduced for most of the state's electricity customers in January 2002.²⁴⁸ In order to immediately foster competition for residential and small business customers, a mandated price rate cut was imposed by the Texas Public Utility Commission (PUC) 'on the prices charged by REPs [retail electric providers] affiliated with the incumbent utility.'²⁴⁹ Accordingly, the price cap applied only to incumbents and not to new competitive suppliers. Known as the 'price-to-beat' (PTB) tariff, the rate was set at 6 percent below the 1999 price.²⁵⁰ It was anticipated that the implementation of a retail price cap would save 'Texans up to \$US1 billion in just a year.'²⁵¹ The PTB expired on 1 January 2007, at which time the remaining PTB customers became subject to market tariffs.²⁵² In discussing the removal of the PTB tariff, it was suggested that Texas customers were unlikely to

246 Michaels, R. J. (2007), *Competition in Texas Electric Markets- What Texas did right and what's left to do*, Austin: Texas Public Policy Foundation, at p.4.

247 Zarnikau, J. (2005), 'A review of the efforts to restructure Texas' electricity market', *Energy Policy*, 33, 15-25, at p.15.

248 Yarrow, G. (2008), *Report on the impact of maintaining price regulation*, Oxford: Regulatory Policy Institute; Zarnikau, J. (2005), 'A review of the efforts to restructure Texas' electricity market', *Energy Policy*, 33, 15-25; Curet, S. (2003), 'The opening of European retail electricity markets to competition: lessons learned from the United States', *23rd IAEE North American Conference*; and Alexander, B. R. (2002), *The Transition to Retail Competition in Energy Markets: How Have Residential Consumers Fared? Part One: An Analysis of Residential Energy Markets in Georgia, Massachusetts, Ohio, New York and Texas*, Butte: prepared for the National Energy Affordability and Accessibility Project, National Center for Appropriate Technology.

249 Zarnikau, J. (2005), 'A review of the efforts to restructure Texas' electricity market', *Energy Policy*, 33, 15-25, at p.19.

250 See § 25.41(b) of the *Texas Administrative Code* which states that 'Purpose. The purpose of this section is to promote the competitiveness of the retail electric market through the establishment of the price to beat that affiliated REPs must offer to retail customers beginning on January 1, 2002 pursuant to PURA §39.202'. Importantly, § 25.41(g) of the Code allows for adjustments in the PTB tariff to be made twice a year [under] prescribed conditions. This provision has been relied upon by most incumbents at least once since 2002 (Grisales, C. (2006), 'Stage set for deregulation debate', *Austin American-Statesman*, Austin, 10 November, at p.D1). See also: Kiesling, L. (2001), *Getting Electricity Deregulation Right: How other states and nations have avoided California's mistakes*, Policy Study No. 281, Los Angeles: Reason Public Policy Institute.

251 Energy Institute (2002), *Electricity Industry Restructuring in Texas: A White Paper*, Houston: Bauer College of Business, Energy Institute, University of Houston, at p.1.

252 Customers of Texan retailer Reliant Energy who had not voluntarily entered into a market contract as of this date were simply rolled over into the retailer's default rate and rebates of \$US50 were also provided to these customers (Power Market Today (2006), 'Retailers in Texas roll out their new plans while most default rates are above gas prices', *Power Market Today*, 9 October).

experience any sudden price shocks, 'since they [were] already paying top dollar for their power.'²⁵³

Since January 2007 and November 2007 Yarrow found that, 'prices have fallen in three out of five regions. In some cases, prices have been reduced by between 6-10%'.²⁵⁴ Yarrow also observed that the removal of the retail price cap had appeared to also act as a catalyst for product innovation within the retail market.²⁵⁵ In understanding these outcomes, it needs to be recognised that this deregulated market may not have had the competitive purity often assumed. This is because the removal of the PTB saw numerous bills introduced into the Texas legislature in an attempt to, as one reported described, 'tweak the state's retail electric deregulation program and other aspects of the power market following consumer ire over high electric bills'.²⁵⁶ Such action would appear to highlight, at a minimum, an underlying political unease in the period immediate following the removal of retail price regulation in Texas.

Importantly, and as with Victoria's energy market, retail price caps were just one of the specific consumer protection mechanisms that had been implemented as part of the introduction of FRC in Texas's electricity market. Complementing the PTB tariff was, and still is, an extensive energy specific consumer protection framework. This framework was implemented pursuant to Section 39.101(f) of the *Texas Public Utilities Regulatory Act* (PURA), which states that,

the commission shall modify its current rules regarding customer protections to ensure that at least the same level of customer protection against potential abuses and the same quality of service that exists on December 31, 1999, is maintained in a restructured electric industry.

The substantive requirements for the consumer protection framework are set out in *Texas Administrative Code*, Title 16, Part II, Chapters 25 - Subchapter B Customer Service and Protection (§ 25.21-25.43). The purpose of the subchapter, as stated in § 25.21(b), 'is to establish minimum customer service standards that electric utilities must follow in providing electric service to the public.' Consumer protections include, for example, a right to service, which is reinforced by the presence of a provider of last resort (PoLR) scheme, rules relating to the disconnection of supply, complaints handling, switching, and billing. Pursuant to PURA §39.903, eligible consumers may also benefit from a 'low-income discount'.²⁵⁷

These mechanisms continue to be a feature of the Texan consumer protection framework for electricity, and although apparently based on preliminary observations, were regarded as adequate to protect residential consumers during the removal of retail price caps. Switching rates among residential and small business customers having continued to increase steadily immediately prior to and after the phasing out of the PTB tariff and increased competition

253 Kelemen, J. (2006), 'UPDATE: Texas Power Deregulation Begins Amid Slim Hopes For Savings', *Dow Jones Business News*, Houston, 29 December. In discussing the removal of retail price caps more broadly within US states, Keleman reported that 'in states without rate caps, prices have jumped, on average, 8.8% a year since 2002, while regulated states and those with rates caps have seen their annual power bills rise 5.2%...' according to a report by Public Citizen's director Tyson Slocum. Keleman further reported that 'on average, Texans paid 13.21 cents per kilowatt hour in September, above the 10.94-cent national average. Nonetheless, Texas is often touted as the nation's most successful case study for power deregulation'.

254 Yarrow, G. (2008), *Report on the impact of maintaining price regulation*, Oxford: Regulatory Policy Institute, at p.48.

255 Yarrow, G. (2008), *Report on the impact of maintaining price regulation*, Oxford: Regulatory Policy Institute.

Michaels has suggested that 'the diversity of offerings available at the close of 2006 suggested that most REPs expected competition to become even more rigorous after the end of the PTB' (Michaels, R. J. (2007), 'Competition in Texas Electric Markets - What Texas did right and what's left to do', *Texas Public Policy Foundation*, at p.12).

256 Editorial (2007), 'Bills Introduced to Prod Texas Retail Competition', *Power Market Today*, 9 February.

257 Public Utility Commission of Texas (2007), *News Release: Electric Customers get Low-Income Discount*, 22 June, Austin: PUC, available at: <http://www.puc.state.tx.us/nrelease/2007/062207.pdf>

appears to have been the catalyst for the introduction of a range of innovative products during this period.²⁵⁸ This has included, for instance, the development of ‘price guarantee tariffs’ similar to those found in the UK, which enable Texan electricity customers to ‘lock-in’ their electricity tariff for periods of up to two years.²⁵⁹ Accordingly, it would appear that competition within the Texas electricity market has been effective for the majority of the state’s customers. This suggests that where effective competition exists in combination with a strong market design, retail price regulation can be phased out with limited disruption to the relevant consumers.

California

Without doubt, California’s experiment with retail electricity markets rate as the most infamous example of an energy market ‘meltdown’. Commentators such as Oppenheim and MacGregor have, for example, described the 2000/01 event as a ‘catastrophic failure of competition,’²⁶⁰ while others such as Jurewitz have accurately characterised it as ‘a crisis allowed to spin out of control’.²⁶¹

This Report will not detail the complexities behind this failure. It is important for the purposes of this Report to note simply that the Californian electricity crisis was caused by fundamentally poor regulatory design. The causes of the meltdown have been largely attributed to the significant flaws in market design,²⁶² including limited generation capacity, barriers to market entry, poor risk contracting and the exercise of market power, in addition to abnormal weather conditions and increased consumer demand.²⁶³ Crucially, the very existence of retail price caps played a central role. As reported by the United States General Accounting Office (GAO), retail price caps – which in 1998 had already been frozen for a period of four years²⁶⁴ at the 1996 pre-restructuring price – have been seen as one of the two major market design flaws and therefore a primary contributor to the market’s collapse:

258 In the lead up to the removal of the PTB, the PUC reported that ‘As of September 2006, 33.9% of all residential customers were taking service from a non-affiliated REP. There has been a very smooth trend of residential switching, with about 7% of residences joining the ranks of non-affiliated customers each year since 2002’ (Public Utility Commission of Texas (2007), *Report to the 80th Texas Legislature - Scope of Competition in Electric Markets in Texas*, Austin: PUC, at p.65). As noted by Yarrow, ‘since the expiration of the PTB in January 2007, customer switching across all customer types has continued. More specifically, some 2.5% of residential customers have switched to a competitive supplier over the six months from January to June 2007’ (Yarrow, G. (2008), *Report on the impact of maintaining price regulation*, Oxford: Regulatory Policy Institute, at p.51).

259 Electricity Texas (2008), *Manual on choosing a Texas electricity company: A Consumers Opinion*, Austin: Electricity Texas, available at: <http://www.electricity-texas.com/#9>.

260 Oppenheim, J. and T. MacGregor (2002), ‘Breakdown in the electricity supply: the experience of California’, *The Bergen Conference*, Bergen, 11 March, at p.1.

261 Jurewitz, J. L. (2002), ‘California’s Electricity Debacle: A Guided Tour’, *The Electricity Journal*, 15(4), 10-29, at p.10.

262 Wolak, F. (2005), *Lessons from International Experience with Electricity Market Monitoring*, World Bank Policy Research Working Paper 3692, Washington DC: World Bank.

263 Puller, S. (2007), ‘Pricing and Firm Conduct in California’s Deregulated Electricity Market’, *The Review of Economics and Statistics*, 89(1), 75-87; General Accounting Office (2002), *Restructured Electricity Markets- California Market Design Enabled Exercise of Market Power*, Washington DC: GAO; Hughes, W.R. and A. Parece (2002), ‘The Economics of Price Spikes in Deregulated Power Markets’, *The Electricity Journal*, 15(6), 31-44; Energy Institute (2002), *Electricity Industry Restructuring in Texas: A White Paper*, Houston: Bauer College of Business, Energy Institute, University of Houston; and In Koo, C. and K. Hyunsook (2007), ‘Market Power and Network Constraint in a Deregulated Electricity Market’, *The Energy Journal*, 28(2), 1-34.

264 Or, as noted by the GAO, ‘until the utilities recovered certain costs incurred under the prior deregulated market’ (General Accounting Office (2002), *Restructured Electricity Markets- California Market Design Enabled Exercise of Market Power*, Washington DC: GAO, at p.18). By 1999, San Diego Gas and Electricity Company had recovered its costs and was therefore able to pass on the increased cost of electricity to their consumers until legislation was passed in September 2000 in order to reintroduce the price cap.

Prominent experts on market design and industry experts generally agree that two principle market flaws increased wholesale suppliers' incentive and ability to raise prices above competition levels: (1) retail prices were frozen, and (2) with few exceptions, the California Public Utilities Commission prohibited or discouraged long-term contracts between utilities and wholesale suppliers.²⁶⁵

The GAO went on to explain that the presence of the retail price cap therefore artificially shielded consumers from the increasing electricity prices within the deregulated wholesale market. This, in turn, ensured that there was no economic incentive for consumers to reduce their consumption patterns.²⁶⁶

While this is a somewhat simplified account of events, it is clear that the (initial) absence of price caps within the wholesale market²⁶⁷ combined with the presence of retail price caps were fundamental factors contributing to the catastrophe.²⁶⁸ The subsequent effect was huge economic and financial damage for consumers and retailers, with one of California's largest utility companies having been forced to file for bankruptcy, and with a second company having threatened bankruptcy. Additionally, this collapse destroyed widespread public trust in regulatory arrangements. California's market meltdown therefore, rather than being a lesson against competitive energy arrangements, provides a perfect lesson on the need to jointly design market and regulatory arrangements so that they are able to self steer through economic ups and downs. It shows a practical example of the potential perils of retail price caps when prices are set too low, as eloquently explained by Yarrow.²⁶⁹

4.5 Lessons and Conclusions

What is clear from the above discussion is that while a number of energy markets have undergone significant reforms over the past two decades, including privatisation and market liberalisation, there is no single model under which these reforms have been uniformly successful. This is perhaps best highlighted by the contrasting approaches taken by the UK and New Zealand. To date, Victoria's reform experience appears to be closer to that of the UK and perhaps Texas, where the advent of retail competition has occurred under the watchful eye of an economic regulator in conjunction with statutory retail price regulation. Only when competition was deemed to be effective in the UK and Texas was the removal of the price

265 General Accounting Office (2002), *Restructured Electricity Markets- California Market Design Enabled Exercise of Market Power*, Washington DC: GAO, at p.5.

266 General Accounting Office (2002), *Restructured Electricity Markets- California Market Design Enabled Exercise of Market Power*, Washington DC: GAO. See also Hughes, W.R. and A. Parece (2002), 'The Economics of Price Spikes in Deregulated Power Markets', *The Electricity Journal*, 15(6), 31-44, who argued that 'retail rate caps created a price squeeze that weakened the utilities financially, making producers reluctant to sell to them as bad credit risks. In addition, by resisting rate increases the California regulators failed to use retail prices as a means of controlling demand. If the retail cap had been substantially raised, demand would have been significantly less (at p.42).

267 It is important to note that on request from the state of California, Federal Energy Regulatory Commission (FERC) implemented a so called 'soft price cap' in the state's wholesale market in July 2000 in an effort to constrain wholesale prices. Despite these efforts, the GAO noted that 'despite the caps, overall wholesale electricity prices remained higher than the previous two years). Despite the implementation of caps by the FERC in December 2000, prices did not realistically fall until June 2001 (General Accounting Office (2002), *Restructured Electricity Markets- California Market Design Enabled Exercise of Market Power*, Washington DC: GAO at p.10; Hughes, W.R. and A. Parece (2002), 'The Economics of Price Spikes in Deregulated Power Markets', *The Electricity Journal*, 15(6), 31-44).

268 These retail price caps were ultimately shown to be too low when compared to the wholesale energy cost.

269 Yarrow, G. (2008), *Report on the impact of maintaining price regulation*, Oxford: Regulatory Policy Institute.

oversight mechanism phased out. Increased competition within these markets upon the removal of retail price regulation would, though, appear to have acted as a catalyst for product innovation, and this has pushed retailers to offer new suites of energy products, including 'price guarantee tariffs' and the removal of early termination fees, in order to attract new customers. Customers have clearly benefitted from a greater range of offers available, and initiatives such as these may well transfer effectively into Victoria's energy markets, as well as other Australian energy markets. It is also worthwhile recognising that an incremental approach to the reform process appears to have worked well within the UK and Texas.

This is not to say that these markets are perfect, and that energy markets have not been subject to fierce criticism over the years - especially when consumers have been faced with increased retail prices. We should acknowledge such criticism as a valid part of public policy decision making. But such criticism is not new, and nor is it confined to these reforms within the energy sector.

Looking more broadly to New Zealand's reform experience, another lesson stands out. Even when retail prices have increased, including double digit increases, regulators and governments have not deemed the situation or the state of the market to be so dire as to require the (re)introduction of retail price regulation. Preference has instead been given to the development and implementation of focused assistance programs to those vulnerable customers most in need. Accordingly, the consumer protection frameworks within these jurisdictions have been maintained, and in some instances strengthened, upon the removal of retail price regulation.

5 A HYPOTHETICAL CONSUMER PROTECTION FRAMEWORK FOR A VICTORIAN ENERGY MARKET WITHOUT RESERVE PRICING POWERS

5.1 Introduction

Given that competition has been found to be effective in Victoria's energy markets and that as a consequence, Victoria's reserve pricing power may cease at the end of 2008, it is now important to consider the potential nature and scope of the energy consumer protection framework which might best suit the state. As highlighted in Sections 3 and 4, there are numerous non-price protection mechanisms that can be integrated together to form a consumer protection framework. Moreover, each mechanism may take a number of different forms, thereby giving rise to an extensive range of possible permutations and combinations for any one framework. On a practical note as well, the AEMC recently published its Second Final Report, providing advice 'on the ways to phase out retail price oversight in Victoria'.²⁷⁰ This Report also included advice on the form that specific consumer protection mechanisms should take, including the obligation to offer, supply and sell energy, as well as the publishing of standing offer prices and price monitoring.

Victoria's current consumer protection framework was set out in Section 3. The objective of this present Section is to therefore consider in depth the various forms that each of the consumer protection mechanisms may take. In doing so, this Section of the Report draws heavily upon the submissions made by stakeholders and interested parties to the AEMC's Victorian Review, and the arguments raised by these parties. Drawing upon the AEMC's Reports, the public submissions to the Victorian Review, and the international experiences presented in Section 4, a hypothetical consumer protection framework for Victoria's energy markets is presented in Section 5.3-5.4. The framework has been specifically designed to further protect Victorian consumers while simultaneously promoting competition in the absence of retail price regulation.

5.2 Key Elements for an Energy Consumer Protection Framework

As a starting point, we should recall that while Victorian retailers do not support the use of retail price caps as a consumer protection mechanism, they do strongly support the basic philosophy of a consumer protection framework. Origin's statement, quoted earlier, reflected this when they noted 'the maintenance of safety net provisions around the obligation to offer and the basic Retail Code provisions were essential'.²⁷¹ A number of retailers have expressed similar commitment to the continuation of industry specific consumer safety net provisions for residential customers, as well as acknowledging their role in assisting vulnerable consumers through their hardship assistance programs.²⁷² AGL stated, for instance, that,

²⁷⁰ AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.1.

²⁷¹ Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin, at p.7-8.

²⁷² Within the context of discussing vulnerable consumers, the role of government and society in addressing this issue, and their Hardship Assistance Program, AGL noted, for instance, that 'nevertheless, retailers recognise their

there appears to be a view that the phase out of price controls will weaken customer protection generally and impact on arrangements for assisting the vulnerable customers (customers experiencing financial hardship). This will not be the case. In our view the **only** difference to the current customer protection arrangements will be that efficient retail prices will be determined by market forces continuously, rather than by a regulator or government attempting to predict that outcome for several years...²⁷³

For some stakeholders however, the reserve pricing power is a fundamental component of the Victorian energy consumer safety net, with the VCOSS stating that the overall success of the safety net has been in part due to 'the role of the price cap in disciplining the market'.²⁷⁴ For the EWOV, 'the regulated tariffs are of value in protecting the interests of some specific consumer groups, that is low income consumers generally...'.²⁷⁵ Going further, the Consumer Action Law Centre (CALC) argued that,

in [their] view, the safety-net tariffs that are currently achieved through the price path negotiated between licensed retailers and the Victorian Government actually contribute to competition by providing retailers with a 'price to beat'. Evidence that Victoria has the most contestable market in the world demonstrates that the safety-net tariff has not impeded competition.²⁷⁶

This argument is the diametrically opposing view of that asserted by retailers during the course of the Victorian Review.²⁷⁷ Moreover, in his report to the AEMC, Yarrow stated that 'price control in competitive market situations generally harms economic efficiency'.²⁷⁸

While these views are important to the overall policy landscape, the objective of our present Report is not to make an assessment of the effectiveness of competition in the Victorian energy markets, nor debate the pros and cons as to the removal or continuation of the reserve pricing power. These roles rest with both the AEMC and the Victorian Government. Rather, the focus of this Report is on developing a hypothetical consumer protection framework that could be implemented in Victoria alongside the removal of the reserve pricing power should the Victorian Government proceed down that path. In fulfilling this objective it must be stressed that the issue

appropriate role in assisting customers' (AGL (2007), *Review of Effectiveness of Competition in the Gas and Electricity Retail Markets: Issues Paper*, St Leonards: AGL, at p.8). GridX Power stated that 'consumer protection should not include the Regulated Prices in a competitive market – it should include the types of protections already available under Competition Law, Ombudsman Schemes, State base[d] consumer protection, etc. and in our view a period of market monitoring and price discovery' (GRIDX Power (2007), *Re: Review of the Effectiveness of Competition in the Retail Gas and Electricity Markets in Victoria*, Rosebery: GRIDX Power, at p.4). See also Origin (2007), *Review of Effectiveness of Competition in Electricity and Gas Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin, at p.7.

273 AGL (2007), *Retail Competition Review - First Draft Report*, St Leonards: AGL, at p.2.

274 VCOSS (2007), *Retail Competition Review - Response to Issues Paper*, Melbourne: VCOSS, at p.7.

275 EWOV (2007), *Review of the Effectiveness of the Competition in Gas and Electricity Retail Markets in Victoria*, Melbourne: EWOV, at p.11.

276 CALC (2007), *Victorian Retail Competition Review - Response to Issues Paper*, Melbourne: CALC, at p.15.

277 See for instance, ERAA (2007), *RE: Review of Effectiveness of Competition in Electricity and Gas Markets*, Sydney: ERAA ('It is our view that the most significant issue that stifles competition and innovation in the Victorian market is the maintenance of retail prices, which effectively inhibits competition by introducing cross subsidy between the classes of customers, and results in customers avoiding cost reflective pricing', at p.10). See also Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin, at p.15; TRUenergy (2007), *Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Victoria Issues Paper*, Melbourne: TRUenergy, at p.1.

278 Yarrow, G. (2008), *Report on the impact of maintaining price regulation*, Oxford: Regulatory Policy Institute, at p.15.

of whether the reserve pricing power should, and ultimately is, phased out is in a technical sense independent from issues surrounding the continued operation of the broader non-price consumer protection framework.

With that in mind, the Report will now turn its attention to considering the individual components of that framework, the potential permutations within, and the various arguments for and against the alternatives.

5.2.1 Obligation to Supply and Sell Energy

The obligation to supply and sell energy to residential customers is without question a fundamental component of Victoria's consumer protection framework, as well as many other jurisdictions. It provides customers with the ability to access energy supplies. As highlighted by Table 3 (see Section 3.1 above), the obligation to supply and sell energy in Victoria presently rests with the host retailers (the Host Retailer model).²⁷⁹ Due to the dominant market shares of the host retailers at the time FRC was introduced, this model was preferred as it provided for an equitable allocation of the responsibility. As of December 2007, these three retailers still supply and sell electricity and gas to approximately 80.3 percent and 88.8 respectively of all Victorian energy customers.²⁸⁰

As part of the Victorian Review, the AEMC recommended that this obligation be maintained as it 'will provide a fair and reasonable basis for supply to those customers who may not access the maximum benefits of competition'.²⁸¹ Retailers have generally, through their submissions to the Victorian Review, supported the continuation of this obligation.²⁸² This commitment in itself is therefore not in debate.

What is in debate, however, is the precise model under which the obligation should exist. There is clear support for the retention of status quo arrangements from a number of stakeholders, with one Victorian retailer, Simply Energy, having argued that they do 'not consider there to be a compelling case...for changing the existing obligation'.²⁸³ In their opinion, the incumbent retailers still derive the benefits of their incumbent status, including large market shares in their host regions. Given the benefits enjoyed by these retailers by virtue of being an incumbent, Simply Energy believes that they should also retain the responsibilities associated with that position.²⁸⁴

279 Pursuant to s.35(1) of the EIA and s.42(1) of the GIA.

280 ESC (2007), *Energy Retail Businesses: Comparative Performance Report for the 2006-07 Financial Year*, Melbourne: ESC, at p.3.

281 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.31.

282 See for instance AGL (2007), *Retail Competition Review - First Draft Report*, St Leonards: AGL; Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin; Australian Power and Gas (2008), *Second Draft Report - Review of the Effectiveness of Competition in Electricity and Gas Retail in Markets in Victoria*, Milsons Point: APG. TRUenergy did however make the point that 'given the Commission's findings in the first final report that no customers are being excluded from the competitive market, retention of the standing offer obligation is unnecessary'. Having made that point, the company nonetheless did go on to say that 'we recognise that this is an issue of concern for some consumer representatives, and is not an unreasonable transitional measure' (TRUenergy (2008), *Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Second Draft Report*, Melbourne: TRUenergy, at p.2).

283 Simply Energy (2008), *Retail Competition Review - Second Draft Report*, South Yarra: Simply Energy.

284 Simply Energy (2008), *Retail Competition Review - Second Draft Report*, South Yarra: Simply Energy. Victoria Electricity has also supported the retention of the status quo in relation to this obligation at this time. They have however suggested that an assessment of the obligation be undertaken in 2012 to determine whether the obligation should be modified at that time in recognition of changes in the market (Victoria Electricity (2008), *Submission to the Australian Energy Markets Commission Second Draft Report on Effectiveness of Competition (Victoria)*, Melbourne:

Retention of the status quo is not however supported by the incumbent retailers. A difference in opinion does exist between the three retailers in relation to their preferred alternative, though. In their submissions to the Victorian Review, AGL and TRUenergy noted their support for the Financially Responsible Market Participant (FRMP) model, which places the obligation on 'the retailer who the market operator sees as the party responsible for supply to a site'.²⁸⁵ This is the AEMC's preferred model as it,

allows the obligation to offer to supply and sell energy to be allocated to new retailers in line with growth in their share of the market. Correspondingly it diminishes the obligation to supply and sell energy for the host retailers in line with the reduction in their market shares in their former franchise areas....²⁸⁶

The other benefits of this model, as argued by the AGL, TRUenergy and the AEMC, include that it complements the existing deemed supply provisions, does not place a disproportionately broad obligation on retailers (compared to, for example, the Universal model), and has already been shown to be successful within the context of Queensland's electricity market.²⁸⁷ In AGL's view, the FRMP model offers the 'most logical and simplest outcome for retailer, distributors and customers'.²⁸⁸ This model has also been supported by the EWOV.²⁸⁹

Contrasting this, Origin has argued for the adoption of the Defined Area model, under which the obligation to supply and sell energy would be shifted 'to all retailers within the region having this obligation, with the offers extended to all residential consumers'.²⁹⁰ It was suggested that should this create too broad an obligation on some of the smaller retailers, the obligation could be narrowed.²⁹¹ A 'defined area' could be determined for example by reference to an area's postcode, electoral boundaries, or some other criteria. This approach, they claim, would not only provide universal access to residential consumers, but would create a 'parallel competitive market' within the area, and 'remove the regulatory risk,' while providing 'all consumers with a

VE; and Victoria Electricity (2008), *Submission to Monash University regarding ERAA Monash Study on Proposed Hypothetical Models for a Consumer Protection Framework (Victoria)*, Melbourne: VE).

285 AGL (2007), *Retail Competition Review - First Draft Report*, St Leonards: AGL, at p.3. See also TRUenergy (2008), *Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Second Draft Report*, Melbourne: TRUenergy, at p.2.

286 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.32.

287 AGL (2007), *Retail Competition Review - First Draft Report*, St Leonards: AGL; and AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.31. While CALC noted the benefits of this FRMP model, it did raise concerns over the fact that 'the model is untested and would require material changes to current consumer protection arrangements'. On this basis, the CALC supported the retention of the Host Model until further evidence of the success of the FRMP model in Queensland had been generated (CALC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: CALC, at p.4).

288 AGL (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, 19 December 2007, St Leonards: AGL, at p.2.

289 EWOV (2007), *Review of the Effectiveness of the Competition in Gas and Electricity Retail Markets in Victoria*, Melbourne: EWOV. In contrast, retailers including Australian Power & Gas and Simply Energy have stated that they do not support the adoption of the model, as the transfer of the obligation to the FRMP would impose a significant cost on the current second tier retailers due to the need to implement new systems, as well as creating a significant barrier to entry for new market participants (Australian Power and Gas (2008), *Second Draft Report - Review of the Effectiveness of Competition in Electricity and Gas Retail in Markets in Victoria*, Milsons Point: APG; Simply Energy (2008), *Retail Competition Review - Second Draft Report*, South Yarra: Simply Energy).

290 Origin Energy (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin, at p.8.

291 Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin.

real choice.²⁹² Despite these assertions, this model was dismissed by the AEMC.²⁹³ According to the Commission's findings, the Defined Area model had the potential to impose disproportionate obligations on some of the second tier retailers as well as potentially creating a barrier to entry for 'new retailers because of the increased wholesale risk and administrative costs that would be incurred with such a broad obligation'.²⁹⁴

A fourth and final model, the Universal model, was also considered by the AEMC as a potential model, at least in concept. To date, this model has not been advocated for by any of the retailers, nor was it deemed to be a viable option by the AEMC,²⁹⁵ who suggested that this model suffered from the same shortfalls as the Defined Area model.

This review therefore suggests that the two most viable options for the obligation to supply and sell energy would be either the Host Retailer model or the FRMP model.

Obligation to Supply and Sell Energy to Residential Customers at New Connections (The 'New Connection Obligation')

Somewhat less contentious is the obligation to supply and sell energy to residential customers at new connections to ensure that these customers can access competitive energy supplies. As with the obligation to supply and sell energy to existing residential customers, this obligation rests with Victoria's incumbent retailers. As part of the Victorian Review, the AEMC considered the appropriateness of the current Host Retailer model for fulfilling this obligation. It would appear that retailers support the continuation of this obligation,²⁹⁶ with AGL stating that they 'do not see the allocation of this obligation as a major issue as retailers will generally connect customers that request a connection'.²⁹⁷ Accordingly it would appear that this commitment is not in debate.

Having assessed the appropriateness of the current model and three other proposed models including the Universal model, the Defined Area model and the Distributor Tender model, the AEMC has recommended that the current status quo be retained.²⁹⁸ This recommendation was supported by a number of stakeholders in their submissions to the Second Draft Report including, for example, AGL,²⁹⁹ Alinta, CALC, CUAC, and Simply Energy.³⁰⁰ This advice was

292 Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin, at p.8.

293 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

294 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.35.

295 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

296 Prior to stakeholders' submissions to the Second Draft Report, there had been little discussion on this obligation. This was remarked upon by the AEMC, who stated that 'during the course of the Victorian Review stakeholders did not directly comment on the New Connection Obligation. Those retailers who recommended that the general obligation to offer to supply and sell energy should be more evenly allocated did not specifically state that the New Connection Obligation should be extended to new retailers' (AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.33).

297 AGL (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report, 19 December 2007*, St Leonards: AGL, at p.2.

298 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

299 This recommendation was made on the condition that the obligation on the incumbent retailers be for a 'transitional period only', at which time a review of the obligation be undertaken (AGL (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report, 19 December 2007*, St Leonards: AGL, at p.2).

provided despite the Commission's view that the notion of incumbency and the benefits thereof were 'becoming increasingly irrelevant'.³⁰¹ In the AEMC's view the only potential alternative model to retaining the status quo was the Distributor Tender model, under which 'the relevant distributor tenders out to interested retailers the right to provide the New Connection Obligation'.³⁰² However, in the Second Final Report the Commission concluded that this model was unlikely to be a viable model at this time due to a number of practical limitations.³⁰³ The Commission's advice to the Victorian government and the MCE in relation to retaining the status quo at this time has been supported by the EWOV.³⁰⁴

The Host Model therefore appears at this time to be the only viable model for giving effect to the New Connection Obligation.

Retailer of Last Resort Schemes (RoLR) and Associated Pricing

A key component of Victoria's consumer protection framework is the obligation on some retailers to supply and sell electricity and gas in prescribed circumstances, under approved terms, to residential and small business customers.³⁰⁵ The objective of the scheme, as stated by the ESC, is 'to maintain continuity of electricity and/or gas to customers' premises by requiring another retailer to sell electricity and/or gas to these customers when their existing retailer is unable to do so.'³⁰⁶ As of February 2008, only one 'RoLR event' had occurred in Victoria.³⁰⁷

As with the other obligations discussed within the context of this section, the RoLR obligation rests with Victoria's three incumbent retailers. A number of stakeholders have highlighted the importance of the scheme in protecting vulnerable customers.³⁰⁸ Victorian retailers appear to also recognise the significance of the scheme for all citizens, and therefore support its continuation.

300 Alinta (2008), *Re: Retail Competition Review - Second Draft Report*, Mount Waverly: Alinta; CALC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: CALC; CUAC (2008), *AEMC Retail Competition Review - CUAC Response to Draft Report*, Melbourne: CUAC; and Simply Energy (2008), *Retail Competition Review - Second Draft Report*, South Yarra: Simply Energy.

301 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.33.

302 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.33.

303 'While a distributor tender model, is in the Commissions' view, more in keeping with a competitive retail energy sector, the practical considerations raised by stakeholders have lead the Commission to conclude that it would be appropriate to maintain the current host retailer model for the obligation to supply new connections, at least until sufficient time has passed for the removal of price regulation to be bedded down and the issue can be thoroughly reviewed' (AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.37).

304 EWOV (2007), *Review of the Effectiveness of the Competition in Gas and Electricity Retail Markets in Victoria. Victoria*, Melbourne: EWOV.

305 ESC (2006), *Energy Retailer of Last Resort - Final Decision*, Melbourne: ESC.

306 ESC (2008), *Retailers of Last Resort Customer Charges - Draft Decision*, Melbourne: ESC, at p.1.

307 This occurred on 22 June 2007 when the National Electricity Market Management Company (NEMMCO) issued a default and suspension notice to Energy One. Having been suspended, Energy One was prevented the company from purchasing electricity from the National Energy Market (ESC (2008), *Retailers of Last Resort Customer Charges - Draft Decision*, Melbourne: ESC).

308 See for example, CALC (2007), *Victorian Retail Competition Review - Response to Issues Paper*, Melbourne: CALC; St Vincent de Paul Society (2007), *Australian Energy Market Commission Review of the Effectiveness of Competition in Gas and Electricity Retail Markets, Issues Paper June 2007*, Melbourne: St Vincent de Paul Society; and CUAC (2007), *AEMC Retail Competition Review - CUAC Response to Issues Paper*, Melbourne: CUAC.

As part of the Victorian Review the AEMC considered the pricing of the RoLR scheme due to the impact that the phasing out of the regulated standing offer tariff would have on the operation of pricing under the RoLR scheme.³⁰⁹ This aspect of the Review elicited responses from a number of stakeholders, including the St Vincent de Paul Society who argued that,

removing the current standing offer would strip away the current RoLR tariff and create further issues leaving regulators or government to develop and implement a specific RoLR tariff to deal with a RoLR event.³¹⁰

While the AEMC acknowledged that the ESC would need to revise the criteria under which RoLR prices ought to be set should the reserve pricing power be removed, it noted that the ESC had exercised a broad discretion in regard to the operation and pricing of the RoLR scheme.³¹¹ This is illustrated by the ESC's current review of RoLR tariffs and charges for electricity and gas; a Final Decision is expected within the first half of 2008.³¹²

In light of the ESC's broad legislative discretion in relation to RoLR prices, it would appear that the ESC is best placed to deal with decisions relating to the RoLR tariffs and fees should the reserve pricing power be phased out. Given the ESC's current review on RoLR charges, any further consideration of the RoLR scheme would appear to fall outside the scope of this Report. Accordingly, while this Report recommends that the RoLR scheme continues, no further consideration will be given to RoLR arrangements.

5.2.2 Price Disclosure and the Potential Role of Price Monitoring/Market Reporting

Price Disclosure

A basic protection within Victoria's consumer protection framework is the legislative requirement for incumbent retailers to publish their standing offer prices in a range of designated locations, including the Government Gazette, and retailers' web-sites. Moreover, pursuant to s.36A of the EIA and s.43A of the GIA, all Victorian retailers are under an obligation to continually publish at least one market tariff and its associated terms and conditions for small retail customers on their website.³¹³ The publication of these offers must comply with a minimum format as set out by the ESC.³¹⁴ The objective of the price disclosure requirements is, as stated by the ESC, 'to facilitate the growth and effectiveness of competition in the retail energy markets, by making comparison of market offers easier for customers...' ³¹⁵ For residential customers, this obligation increases the transparency in the market and is regarded as a minimal requirement in gaining public, and most likely, political, trust in future.

309 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC.

310 St Vincent de Paul Society (2007), *Australian Energy Market Commission Review of the Effectiveness of Competition in Gas and Electricity Retail Markets, Issues Paper June 2007*, Melbourne: St Vincent de Paul Society, at p.3.

311 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

312 ESC (2008), *Retailers of Last Resort Customer Charges - Draft Decision*, Melbourne: ESC.

313 The 'guideline also creates similar obligations for certain written information to be provided by retailers to small retail customers' (ESC (2005), *Guideline No. 19 - Energy Product Disclosure*, Issue 2, Melbourne: ESC, at p.1).

314 ESC (2005), *Guideline No. 19 - Energy Product Disclosure*, Issue 2, Melbourne: ESC.

315 ESC (2005), *Guideline No. 19 - Energy Product Disclosure*, Issue 2, Melbourne: ESC, at p.1.

This obligation to publish information pertaining to standing offers and market offers was considered by the AEMC as part of the Victorian Review. Not surprisingly, the question over whether or not Victorian retailers should be under a legal obligation to publish a standing offer price (or 'rack-rate' price) upon the phasing out of the reserve pricing power has engendered considerable debate. The discussion was often however intertwined with the broader debate over the function of the regulated price, and the 'benchmarking' task often associated with its publication.³¹⁶ Should retail price regulation be phased out, the AEMC recommended that an obligation ought be imposed on all Victorian retailers to publish, in a format determined by the ESC, their rack-rate offer.³¹⁷ This, they argue, 'will provide points of comparison against which consumers can assess market offers and facilitate an appropriate level of price transparency in the absence of a regulated price'.³¹⁸

Retailers, as illustrated by AGL, Origin and TRUenergy's submissions to the Second Draft Report, have supported this recommendation.³¹⁹ They do not however appear to support the creation of a new Guideline under which these offers would have to comply, due to the potential to stifle innovation, and the risk that they may result in unnecessary duplication and associated compliance costs.³²⁰ As an alternative, AGL has proposed that the current price disclosure guidelines be amended so as to include "default prices' [which] will ensure that retail prices are transparent and effectively communicated'.³²¹ This would appear to be a pragmatic solution.

An obligation to continually publish a so-called 'rack-rate' or 'default-offer' on the company's website as a minimum, in conjunction with being required to provide hard copies of these offers to consumers upon request, appears to be a logical requirement to place on retailers upon the removal of retail price regulation.

In the Second Draft Report, the AEMC also raised for discussion the possibility of retailers being required to publish their standing offer tariffs in relevant newspapers when changes in these offers were made.³²² As highlighted by the submissions to the Second Draft Report, a number of consumer oriented stakeholders strongly supported the creation of such an obligation.³²³ In contrast, the proposed obligation was criticised by a number of retailers who have argued that any such requirement would offer little benefit to consumers due to the dynamic nature of offers,

316 VCOSS (2007), *Retail Competition Review - Response to Issues Paper*, Melbourne: VCOSS.

317 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

318 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.17. In making this recommendation, the AEMC suggested that these published prices would provide customers with a new benchmark against which they could compare market offers.

319 See for instance AGL (2007), *Retail Competition Review - First Draft Report*, St Leonards: AGL; Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin; and TRUenergy (2008), *Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Second Draft Report*, Melbourne: TRUenergy.

320 Simply Energy (2008), *Retail Competition Review - Second Draft Report*, South Yarra: Simply Energy; Origin (2008), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets in Victoria - Second Draft Report*, Melbourne: Origin; AGL (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report, 19 December 2007*, St Leonards: AGL; and TRUenergy (2008), *Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Second Draft Report*, Melbourne: TRUenergy.

321 AGL (2007), *Review of Effectiveness of Competition in the Gas and Electricity Retail Markets: Issues Paper*, St Leonards: AGL, at p.4.

322 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC.

323 See for instance Alternative Technology Association (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: ATA; and CALC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: CALC.

while representing an administrative burden to the industry.³²⁴ In their opinion, the provision of information via their website, over the phone or through direct marketing programs represented the most efficient and practical way of distributing price information.³²⁵

TRUenergy suggested that should such an obligation be implemented, it 'should only require retailers to publish a summary notice, advising customers of new prices on their web-site or available on request, rather than publishing the full list of prices'.³²⁶ This, as TRUenergy pointed out, was consistent with the current practices in Victoria in relation to the regulated prices, and consistent with South Australia. This compromise of requiring retailers to publish a summary notice in relevant newspapers as soon as practicable after amending their standing offer tariffs was ultimately adopted by the AEMC in their advice to the Victorian Government and MCE.³²⁷

A more contentious issue is the extension of the price disclosure obligation to not only cover retailers' rack-rate offers, but all market offers. As noted in Section 4, this extended obligation was the position taken by the Ofgem in relation to the price disclosure obligations within UK electricity and gas markets. It is likely that should the Victorian Government remove retail price regulation, a comprehensive price disclosure obligation would be pursued by a number of stakeholders. Such a position is likely to be supported by a wide range of stakeholders due to the increased level of transparency, as well as providing customers with greater confidence and informed choice within the market.³²⁸ Contrasting this, the AEMC suggest in their Second Draft Report that,

comprehensive price disclosure, and universal availability has the potential to facilitate coordinated pricing, facilitating agreement and to deter customer poaching through price discounting and "special[s]".³²⁹

This recommendation was highly criticised by a number of consumer organisations in their submissions to the AEMC's Second Draft Report due to the potential problems of information asymmetry, limited transparency, and the time investment required by customers before they will be able to make a meaningful comparison between different offers.³³⁰ Moreover, the CALC have argued that without universal price disclosure obligations, third parties will have difficulties in entering the market and providing meaningful comparison sites.³³¹ Victorian retailers are unlikely to be convinced of the benefits of any such universal price disclosure obligations.

324 Australian Power and Gas (2008), *Second Draft Report - Review of the Effectiveness of Competition in Electricity and Gas Retail in Markets in Victoria*, Milsons Point: APG; and AGL (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report, 19 December 2007*, St Leonards: AGL.

325 Simply Energy (2008), *Retail Competition Review - Second Draft Report*, South Yarra: Simply Energy.

326 TRUenergy (2008), *Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Second Draft Report*, Melbourne: TRUenergy, at p.2.

327 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

328 See for example the arguments of St Vincent de Paul Society (2007), *Australian Energy Market Commission Review of the Effectiveness of Competition in Gas and Electricity Retail Markets, Issues Paper June 2007*, Melbourne: St Vincent de Paul Society, at p.3.

329 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.8.

330 CUAC (2008), *AEMC Retail Competition Review - CUAC Response to Draft Report*, Melbourne, CUAC; Alternative Technology Association (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: ATA.

331 CALC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: CALC.

Despite these concerns, the AEMC has ‘not recommend[ed] that retailers be required to publish all market contract prices on offer, or requir[ed] all prices to be universally available’.³³²

Bearing this in mind, it would appear that as a minimum, an obligation to continually publish the so-called ‘rack-rate’ or ‘default-offer’ on company’s websites is a logical requirement to place on Victorian retailers upon the removal of retail price regulation. This obligation could be further extended so as to also require all retailers to provide a ‘snap-shot’ of their market offers for residential customers at all times. Such an approach would be merely an extension of the current price disclosure requirements and would appear, along with the first option, to be a viable alternative to a comprehensive price disclosure regime.

The Potential Role of Price Monitoring/Market Reporting

As part of the Second Draft Report, the AEMC recommended that a ‘form of price monitoring of retailers’ published standing offer prices be adopted for a transition period of at least three years following the removal of price regulation’ by the ESC.³³³ This draft recommendation was again reaffirmed by the AEMC in their Second Final Report.³³⁴ This recommendation is consistent with clause 14.14(b) of the AEMA, which provides for ‘a period of price monitoring and/or price agreements with retailers.’ It is important to note that price monitoring is not a pre-condition to the removal of retail price regulation, and as such, the Victorian Government may choose not to implement any form of price monitoring/market reporting regime as part of the transition process. Such an approach is unlikely, though. It is therefore concluded that some form of monitoring will be implemented by the Victorian Government with the removal of price oversight mechanisms.

As suggested by the AEMC, the objective of any such monitoring would be,

to identify and publish trends in standing offer prices with a view to providing a timely indication of any possible future deterioration in the effectiveness of retail competition and in the competitiveness of observed prices. If concerns...are identified through the monitoring of retailers’ standing offer prices and other available information sources this could provide the trigger for an urgent inquiry by the AEMC.³³⁵

According to the AEMC, the reporting function would therefore serve a dual purpose: to provide factual information on standing offer prices to all stakeholders, and provide a trigger for further market investigation should deterioration in the market be observed. Data collected as part of the monitoring process could be reported in the ESC’s Energy Retail Businesses: Comparative Performance Reports. These annual reports already provide data on a range of market indicators, including for example, price and non-price offerings, average energy bills, and market transfers.³³⁶

332 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.17-18.

333 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.20.

334 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

335 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.21.

336 See for example, ESC (2006), *Energy Retail Businesses: Comparative Performance Report for the 2005-06 Financial Year*, Melbourne: ESC; and ESC (2007), *Energy Retail Businesses: Comparative Performance Report for the 200-07 Financial Year*, Melbourne: ESC.

A number of stakeholders supported the introduction of some form of monitoring in the absence of retail price regulation. St Vincent de Paul Society, for instance, argued that the AEMC,

must recommend the development and oversee the implementation of [a] process that provides the mechanism for third parties to scrutinise the fairness and reasonableness of all tariff[s] being offered in the market. This is critical given the demand elasticities and the essential nature of energy.³³⁷

However, organisations such as CALC have questioned the value of price reporting if it is limited to the standing offer price. In their view, 'to be useful, price monitoring should examine prices across the whole market or would otherwise provide a distorted analysis'.³³⁸ A broader reporting regime has similarly been supported by the ATA.³³⁹

While AGL and TRUenergy supported the principle of price monitoring, they raised a number of concerns regarding its potential scope, nature and form.³⁴⁰ Specifically, AGL did not want the reporting function to be interventionist or 'become a de facto retail price review'.³⁴¹ The term 'monitoring' itself was deemed to be problematic in the eyes of TRUenergy due to its implied threat of regulatory intervention. In their view, price 'reporting' was preferable. Origin also argued that where price is reported, the reporting should be based on factual assessments and should not rely on the interpretation of price trends 'as indicators of the effectiveness of the competitive market'.³⁴²

AGL proposed that the introduction of any such form of reporting should be focused on the 'state of the market'³⁴³ and the effectiveness of competition within, rather than merely retail prices.³⁴⁴ This argument has much merit. Clearly the range of criteria to be considered within this form of reporting could be based on those adopted by the AEMC in their Victorian Review. These could include for instance: retailer rivalry, conditions of entry, expansion and exit; changes to retailer shares; product innovation; and marketing practices. This form of 'retail market reporting' would be similar to the approach adopted by Ofgem, who publish an annual report 'to inform the debate about the health of the retail energy markets'.³⁴⁵ Such an approach would enable the ESC/AER to monitor the state of the market without retail price regulation for a

337 St Vincent de Paul Society (2007), *Australian Energy Market Commission Review of the Effectiveness of Competition in Gas and Electricity Retail Markets, Issues Paper June 2007*, Melbourne: St Vincent de Paul Society, at p.3.

338 CALC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: CALC, at p.6.

339 Alternative Technology Association (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: ATA.

340 AGL (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, 19 December 2007, St Leonards: AGL; and TRUenergy (2008), *Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Second Draft Report*, Melbourne: TRUenergy. Concerns were also raised by, for example, Origin in relation to the purpose, objectives and benefits of the proposed price monitoring regime (Origin (2008), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets in Victoria - Second Draft Report*, Melbourne: Origin).

341 AGL (2007), *Retail Competition Review - First Draft Report*, St Leonards: AGL, at p.4.

342 Origin (2008), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets in Victoria - Second Draft Report*, Melbourne: Origin, at p.4.

343 AGL (2007), *Retail Competition Review - First Draft Report*, St Leonards: AGL, at p.4.

344 This form of ongoing monitoring and reporting would be consistent with that proposed by Victoria Energy after they dismissed the concept of price monitoring outright (see Victoria Electricity (2008), *Submission to the Australian Energy Markets Commission Second Draft Report on Effectiveness of Competition (Victoria)*, Melbourne: VE; and Victoria Electricity (2008), *Submission to Monash University regarding ERAA Monash Study on Proposed Hypothetical Models for a Consumer Protection Framework (Victoria)*, Melbourne: VE).

345 Ofgem (2007), *Domestic Retail Market Report - June 2007*, London: Ofgem, at p.2.

period of time, and where the evidence indicates deterioration in the effectiveness of competition, a further in-depth market review could be undertaken by the AEMC.

Based on the above discussion, it would appear that 'retail market reporting' where price is merely one criterion, is a practical model for a reporting regime. This could be limited to the reporting of the standing offer, or rack-rate, prices as recommended by the AEMC,³⁴⁶ or could be more substantive. For instance, retailers could be required to provide the ESC with information pertaining to a snap-shot of their market offers, which could then be reported in addition to the rack-rate tariffs. Another alternative is that retailers could be required to provide information to the ESC relating to their entire suite of market offers, with the regulator then reporting on a snap-shot of these offers. This form of retail market reporting would provide stakeholders additional information regarding the price rivalry, tariff design and non-price rivalry, and the effectiveness of competition within it. Each of these suggestions would appear to represent viable options for providing the marketplace with factual information regarding price, without being interventionist. Moreover, as none of the alternatives presented here recommend the reporting of all market contract tariffs on offer, it would appear that the 'risk of deterring discounting and facilitating price coordination'³⁴⁷ would be minimal.

5.2.3 Financial Hardship Policies

The obligation to develop financial hardship policies for domestic customers is one of the more recent statutory requirements that have been placed on all Victorian retailers. As stated by the ESC this obligation was,

placed upon retailers because they have the principal relationship with domestic customers and should continue to have the major responsibility to respond to domestic customers in financial hardship.³⁴⁸

As part of their financial hardship policy, retailers are required to provide, for example, flexible payment options to customers in financial hardship, auditing of the customer's energy usage, flexible options for the purchase or supply of replacement energy appliances, and early responses to bill payment difficulties (see Table 3 for more details).³⁴⁹ The effectiveness of the retailer's hardship policies will continue to be evaluated and reported on by the ESC.³⁵⁰

It is important to recognise as well that in addition to these mandatory requirements, Victorian retailers have implemented, on a voluntary basis, a number of mechanisms to assist Victorian energy customers in need. As illustrated by the 'snap shot' presented in Table 6, these voluntary initiatives include the establishment of a retrofitting fund, debt reduction programs, discretionary appliance replacement programs and energy efficiency programs.

For consumers in financial hardship including, for example, the projected 17 286 new Victorian customers assisted by AGL under their *Staying Connected* programme at an anticipated cost of

346 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC.

347 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.17.

348 ESC (2007), *Guideline No 21: Energy Retailers' Financial Hardship Policies*, Melbourne: ESC, at p.5.

349 ESC (2007), *Guideline No 21: Energy Retailers' Financial Hardship Policies*, Melbourne: ESC.

350 ESC (2007), *Energy Financial Hardship Policy Performance Indicators - Final Decision*, Melbourne: ESC. Retailers are required to supply the first tranche of data on the fifteen performance indicators to the ESC by 28 July 2008. This data is to cover the period of 1 January 2008 to 30 June 2008.

\$A4.5 million in 2006-07 alone, both the mandatory policies and voluntary mechanisms act as fundamental components of Victoria's consumer protection framework.³⁵¹

Table 6: Examples of Voluntary Initiatives by Victorian Retailers to Assist Customers in Financial Hardship

Retailer	Voluntary Initiatives
AGL ³⁵²	<ul style="list-style-type: none"> • Power2Save Program includes two levels of incentive arrangements - 1. On Track - customers who sign up to Centrepay and make five consecutive payments receive a discount. 2. Reward 5 - involve a 5:1 payment match for customers in long-term hardship. Reward 5 is an ongoing incentive program, under which AGL will match one payment up to the value of \$50 when a customer makes five consecutive fortnightly payments.
Aurora Energy ³⁵³	<ul style="list-style-type: none"> • debt reduction arrangements and payment plans • creation of EasyPay, which provides for level and regular payments
Country Energy ³⁵⁴	<ul style="list-style-type: none"> • incentive plans linked to payment plans - in exceptional circumstances, Country Energy may match a customer's regular agreed payment when the customer has successfully made a set number of payments over a defined period of time • partial debt waiver
Origin Energy ³⁵⁵	<ul style="list-style-type: none"> • retrofit fund to cover costs associated with retrofitting door seals, light bulbs etc. • appliance assistance fund to replace old energy appliances • energy efficiency road show
Power Direct ³⁵⁶	<ul style="list-style-type: none"> • incentive plans linked to payment plans – in certain circumstances Power Direct may reward a customer who has made five consecutive payments with a \$50 rebate
TRUenergy ³⁵⁷	<ul style="list-style-type: none"> • discretionary debt waivers • appliance replacement program • fridge buyback scheme

The importance of effective financial hardship policies was highlighted by a number of submissions to the AEMC's Victorian Review within the broader context of vulnerable consumers, and the ability of these customers to access competitive energy supplies. VCOSS, for instance, noted that,

351 AGL (2006), *Staying Connected - Hardship Policy and Program Details (Victoria)*, St Leonards: AGL.

352 AGL (2006), *Staying Connected - Hardship Policy and Program Details (Victoria)*, St Leonards: AGL.

353 Aurora Energy (2007), *Aurora's Hardship Policy: Assisting customers in need*, Hobart: Aurora.

354 Country Energy (2007), *Victorian Domestic Hardship Guidelines*, Queanbeyan: Country Energy.

355 Origin (2007), *Hardship Policy of Origin Energy: The Power On Programme*, Melbourne: Origin.

356 Power Direct (2007), *Financial Hardship Policy for Victorian Residential Customers*, Melbourne: Power Direct.

357 TRUenergy (2006), *Policies and Pilot Programs: TRUenergy Hardship Assistance Program*, Melbourne: TRUenergy.

many retailers deal sensitively with customers having payment difficulties, and offer generous repayment terms to help them deal with debt and manage, over time, their ongoing consumption. In particular, the incumbent retailers generally have effective hardship programs and internal systems that ensure most customers in hardship receive the attention they need.³⁵⁸

While support for the hardship policies and retailers' voluntary initiatives was similarly provided by EWOV,³⁵⁹ their submission did nevertheless raise concerns over retailers removing customers from their hardship programs due to non-adherence with their payment plans.³⁶⁰

Victorian retailers have, as illustrated by their submissions to the Victorian Review, supported the continuation of this obligation.³⁶¹ For instance, AGL stated that 'all arrangements with respect to assistance to vulnerable customers are expected to remain unchanged,'³⁶² while the ERAA has stated on behalf of its members that,

retailers are committed to continuing the development of their support programs for customers experiencing genuine financial hardship in an endeavour to mitigate the risk of increasing debt and disconnection.³⁶³

Retailers' commitment to the continuation of this aspect of the consumer protection framework is therefore not in debate.

358 VCOSS (2007), *Retail Competition Review - Response to Issues Paper*, Melbourne: VCOSS, at p.11.

359 EWOV (2007), *Review of the Effectiveness of the Competition in Gas and Electricity Retail Markets in Victoria*. Victoria, Melbourne: EWOV.

360 EWOV (2007), *Review of the Effectiveness of the Competition in Gas and Electricity Retail Markets in Victoria*. Victoria, Melbourne: EWOV.

361 See for instance, Origin (2007), *Review of Effectiveness of Competition in Gas and Electricity Retail Markets: Issues Paper - Submission of Origin Energy*, Melbourne: Origin; and AGL (2007), *Retail Competition Review - First Draft Report*, St Leonards: AGL.

362 AGL (2007), *Submission to Retail Competition Review - First Draft Report*, St Leonards: AGL, at p.5.

363 ERAA (2005), *Vulnerable Customer Position Paper*, Sydney: ERAA, at p.8, which was submitted by the ERAA as part of their submission to the AEMC's Issue Paper (ERAA (2007), *RE: Review of Effectiveness of Competition in Gas and Electricity Markets*, Sydney: ERAA).

5.3 Proposed Hypothetical Consumer Protection Framework

Having considered a range of mechanisms that may underpin Victoria’s energy specific consumer protection framework and some of the strengths and weaknesses of these options, this section of the report presents a hypothetical consumer protection framework that could be employed in Victoria upon the phasing out of retail price regulation. This proposed framework, the components of which are presented in Table 7, would provide consumers with a high level of protection within a competitive energy market, and would ensure that consumers continue to access competitive energy supplies. The rationale for the framework is presented in Section 5.4.

Table 7: Proposed Hypothetical Consumer Protection Model for Victoria’s Energy Markets

	Proposed Model
<i>1. Obligation to supply and sell energy to residential customers</i>	
Retain status quo (Host Retailer Model) for set period of time, subject to review in 2011	Mandatory
<i>2. New connection obligation</i>	
Retain status quo, subject to review in 2011	Mandatory
<i>3a. Publication of Retailers’ Prices</i>	
Continuous publication of rack-rate offers and a ‘snap-shot’ of market price offers	Mandatory
<i>3b. How should ‘Rack-Rate’ Price Offers be Published (subject to a minimum prescribed format and updated as soon as practicable)?</i>	
Retailers’ own web-sites	Mandatory
ESC	Mandatory
Independent Third Parties	Voluntary
<i>3c. How Should Market ‘Snap-Shot’ Offers be Published (subject to a minimum prescribed format and updated as soon as practicable)?</i>	
Retailers’ own web-sites	Mandatory
Independent Third Parties	Voluntary

4. Retail Market Reporting

Annual market reporting by the ESC/AER in which standing offer prices and a 'snap-shot' of market offers are reported in addition to a range of other criteria, for a set period of time.

Mandatory

Where market reporting suggests deterioration in market conditions, a further in-depth market review may be undertaken by the AEMC upon request by the Victorian Government.

5. The Consumer Safety Net

a. Continuation of an industry specific consumer safety net for residential customers

Mandatory

b. Continuation of an industry specific dispute resolution scheme

Mandatory

c. Continuation of existing state and federal government energy related concessions and grants

Mandatory

6. New Consumer Protection Initiatives

a. Retailers to offer at least one market offer that does not incur early exit fees as part of their suite of market offers

Mandatory

b. Retailers to offer at least one market offer with a price guarantee deal (e.g. fixed price or capped price) as part of their suite of market offers

Voluntary

c. Annual industry generated report on industry trends and corporate social responsibility activities

Voluntary

5.4 Rationale for Proposed Model

Obligation to supply and sell energy

Should the Victorian Government act upon the AEMC's advice and phase out the reserve pricing power, it is recommended that the current status quo arrangement regarding the obligation to supply and sell energy to residential customers be retained. This would leave the obligation with the three incumbent retailers, and in doing so, departs from the AEMC's recommendation. As articulated below, the retention of the Host Retailer model would not however be absolute. It is proposed that a review of the obligation should occur at the end of 2011.³⁶⁴

While the AEMC argued that the notion of incumbency 'is becoming less relevant at the market develops',³⁶⁵ the three retailers clearly still enjoy a dominant market share in their particular areas, as highlighted by the figures presented in Section 5.2. It therefore appears equitable that while the incumbents enjoy the benefits associated with incumbency, they retain some of the obligations associated with that position. Moreover, as pointed out by Simply Energy, such 'retailers already have the systems and processes in place that are necessary for managing an obligation to offer and supply'; other retailers do not.³⁶⁶ Given the costs associated with second tier retailers implementing these systems, combined with their relatively small market share at this time, these additional costs could be prohibitive for some retailers, and may furthermore act as a barrier for new entrants into the market. This should be discouraged due to the potential to dampen competition within some areas.

It is recognised however that the combined market share of the three incumbent retailers has historically decreased with time in Victoria. It is also likely to continue doing so within a competitive marketplace, if we learn from observations made in the UK. Accordingly, the market will reach a point where the Host Retailer model no longer provides for an equitable allocation of the obligation among the retailers. To ensure that this does not occur and presuming that the reserve pricing power ceases at the end of 2008, it is proposed that a review of the obligation to supply and sell energy is undertaken by the ESC/AER at the end of 2011 based on pre-determined criteria. Should it be determined that the notion of incumbency has become redundant after an additional three years of competition, the regulator could propose changes to the obligation so as to give effect to a more equitable allocation of this regulatory obligation under the FRMP model. This would then bring Victoria into line with the regulatory arrangements recently implemented in Queensland.

Importantly however, as illustrated by the above discussion, all retailers are committed to ensuring that a general obligation to supply and sell energy to residential customers is retained within an energy market without retail price regulation. While it is clear that AGL and TRUenergy would prefer the adoption of the FRMP model, and Origin would prefer the Defined Area model in preference to the FRMP model, it would appear that retailers would be willing to reach a compromise with the Victorian Government over the precise model should the reserve pricing power be phased out.

364 This recommendation is in line with the CALC's suggestion that the Host Model be maintained for a period of time (CALC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: CALC).

365 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC, at p.34.

366 Simply Energy (2008), *Retail Competition Review - Second Draft Report*, South Yarra: Simply Energy, at p.2.

New Connection Obligation

The obligation to supply and sell energy to residential customers presently rests with Victoria's incumbent retailers. As illustrated by the discussion in Section 5.2, at this time the Host Model represents the only viable model for giving effect to the new connection obligation. As all retailers are committed to the continuation of this new connection obligation, it is proposed that the status quo is retained at this time. This recommendation is consistent with that of the AEMC.³⁶⁷

Under this proposed framework, the retention of the Host Retailer model would again not however be absolute. In recognition of the changing nature of the market, including market share, it is proposed that the new connection obligation be reviewed along side the obligation to supply and sell energy to residential customers at the end of 2011. This would provide the regulator with the ability at that time to determine whether another model, such as the Distributor Tender model, might provide for a more equitable allocation of the obligation.

Publication of Retailers' Prices

As highlighted by Table 7, it is proposed that all Victorian retailers be under an obligation to publish their rack-rate offer/s and the associated terms and conditions of the offers on their website as a minimum form of price disclosure. This recommendation is consistent with the AEMC's advice³⁶⁸ and would require offers to be published in accordance with a minimum format so as to promote price transparency within the market and enable energy customers to compare retailers' rack-rate offers. Retailers would be required to update their offers as soon as practicable when the tariffs are altered. This obligation could be created by amending the current Product Disclosure Guideline so as to include the standing offer prices, rather than through the creation of a new Guideline. Retailers would also be required to provide the ESC with information on their standing offer tariffs, which would be displayed by the ESC on their website in a tabular format, as well as being required to provide hard copy of the tariff information to consumers on request.

In contrast to the AEMC's advice, the hypothetical framework would not require retailers to publish a summary notice in Victorian daily newspapers in relevant geographical regions as soon as practicable when revisions are made to their standing offer tariffs. While the AEMC has suggested that the publication of a summary notice advising consumers of changes in standing offer tariffs would result in wide dissemination of the changes, especially for consumers with limited internet access, it would appear that the intermittent publication of summary notices indicating revised rack-rate offers may be of limited value due to the dynamic nature of the market.

Instead, it is also proposed that all retailers be under an obligation to publish a minimum number of market offers designed for residential customers on their website. These offers would be required to be published in accordance with a minimum format as specified by the ESC in order to provide consumers with points of comparison for different market offers. The extension of this obligation to a minimum number of market offers would go some way in addressing

367 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

368 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

stakeholder concerns regarding price transparency,³⁶⁹ and would provide customers with the necessary information to make more informed basic choices. This obligation could be created by amending the current Product Disclosure Guideline.

It is further proposed that retailers should be encouraged to voluntarily supply a range of their market offers to an independent third party for the purpose of establishing an independent online comparator tool. The third party could, for instance, be a consumer organisation funded through the Victorian Government. The AEMC has noted that even without a legal obligation to publish market offers, 'it is likely that there would be some publication of rates in any case'.³⁷⁰ Accordingly, this requirement is unlikely to be too onerous on retailers, and is likely to merely formalise a practice that the AEMC believes to be inevitable.

Retail Market Reporting

As part of the consumer protection framework it is proposed that the ESC/AER undertake an annual review of Victoria's retail energy market for a minimum period of three years, starting in 2009. This obligation, including the principles and guidelines to underpin the Retail Market Report, is consistent with the AEMC's recommendations.

However as part of the retail market reporting function, it is proposed that the regulator reports not only on standing offer price offers, but also a range of other pre-determined market performance measures. In addition to this obligation, it is proposed that an extra obligation be created under which retailers are required to provide pricing information to the ESC/AER on either a 'snap-shot' of their market offers or on their entire suite of market offers. A 'snap-shot' of these market offers, including prices, would be included in the Retail Market Report in a factual, de-identified manner. This reporting requirement would provide stakeholders with ongoing information regarding the competitiveness of the market. While this obligation in itself will not go far enough to address the concerns of some stakeholders,³⁷¹ it will give rise to greater transparency in relation to market prices and product innovation. Importantly, as with the AEMC's proposal, this more extensive form of market reporting would not be interventionist. Nor would it be designed to function as a de facto retail price review.

It is recommended that the retail market reporting function be initially undertaken by the ESC and then transferred to the AER. It is also recommended that if evidence suggests deterioration in the effectiveness of competition within the Victorian energy markets, an in-depth market review be undertaken by the AEMC at the request of the Victorian Government. As per the AEMC's recommendation, it is proposed that should the Victorian Government request such a review, it should be undertaken in a timely fashion.

Consistent with the AEMC's advice,³⁷² only after an in-depth review of the state of the Victorian retail energy markets has been undertaken by the AEMC, the results of which indicate market failure (as defined in accordance with pre-determined criteria), may the Victorian Government exercise a reserve power to reintroduce retail price regulation. Unless these conditions are satisfied, the Victorian Government would be constrained from re-regulating retail energy prices.

369 See for example Alternative Technology Association (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: ATA; CALC (2007), *Victorian Retail Competition Review - Response to Issues Paper*, Melbourne: CALC

370 AEMC (2007), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Sydney: AEMC, at p.17.

371 CUAC (2008), *AEMC Retail Competition Review - CUAC Response to Draft Report*, Melbourne: CUAC; CALC (2007), *Victorian Retail Competition Review - Response to Issues Paper*, Melbourne: CALC; and Alternative Technology Association (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report*, Melbourne: ATA.

372 AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Final Report*, Sydney: AEMC.

The Consumer Safety Net

As evidenced by many of the submissions to the AEMC's Victorian Review, the current consumer safety net plays an important function in assisting Victorian energy consumers. This consumer safety net, as explained earlier in this report, has been built up over several decades and covers a wide range of Acts, Codes, Guidelines and other agreed regulatory obligations aimed at protecting consumer interests. Enforcement of these regimes to ensure compliance is a similarly important component of this safety net. Accordingly, it is proposed that the industry specific consumer safety net for residential customers is continued in a retail market without price regulation. This would include the continuation of an industry specific dispute resolution scheme. It would also assume as well the continuation of effective consumer consultation and participation mechanisms with groups able to contest broad future policy and service directions.

These mechanisms must be underpinned by targeted government-funded concession and grant schemes in order to assist all consumers in accessing the competitive market. Accordingly, it is recommended that the current range of concessions and grants schemes administered by the state and federal governments be retained.

New Consumer Protection Initiatives

In recognition that some consumers may not be fully benefitting from the competitive energy market, it is incumbent on all retailers to encourage Victorian customers to enter and fully engage in the market. One persistent barrier to switching, from the perspective of the CALC and the Tenants Union,³⁷³ is the presence of early termination fees. This argument holds water, in the judgement of the authors, despite the obligation that any such fees must be at a cost level which is 'fair and reasonable'. In recognition that early termination fees may be a barrier for some residential consumers, it is recommended that the removal of retail price regulation be accompanied by the creation of an obligation which requires all retailers to offer at least one market contract for residential customers that does not incur early termination fees, assuming 28 days notice is provided. Retailers would of course be able to price this market offer in a way that they see fit. This form of product innovation, which is a key feature of the UK's energy markets, is likely to be welcomed by consumer organisations. It also supports the notion that retailers are genuinely committed to not only encouraging greater energy market competition but also ensuring customers have a stronger capacity to make choices amongst differing offers and services. It is recommended that this product be continuously advertised on the retailer's websites.

How might the introduction of 'no-early exit fee' products be best encouraged? We should acknowledge that under perfect market conditions, consumer demand for new products including those without early termination fees is likely to drive product innovation. Accordingly, it is in one sense possible to suggest philosophically that the removal of early termination fees should be left to the market. Under such a philosophy, regulatory intervention would not be required at this time. On the other hand, however, this Report recommends that all Victorian retailers be under an obligation to offer at least one market contract for residential customers that does not incur early termination fees. In doing this, we recognise firstly the essential nature of energy and the continued differing expectations of citizens with respect to the provision of essential services. We also recognise the fact that the Victorian energy market is not a perfect

373 CALC (2007), *Victorian Retail Competition Review - Response to Issues Paper*, Melbourne: CALC; and Tenants Union of Victoria (2007), *Submission to Review of the Effectiveness of Competition in Gas and Electricity Retail Markets - Issues Paper*, Melbourne: Tenants Union.

market in the sense of differing power of participants, market information imperfections and asymmetries and significant transaction costs.

This recommendation stops short of suggesting the mandatory removal of early termination fees for all offers. While such a recommendation is likely to be applauded by a number of stakeholders, including the CALC and the Tenants Union, any such proposal may be premature at this time. Based on the experience of the UK retail energy market, demand for energy products that are exit free is likely to increase, with the consequence that significant product innovation within this area is expected in the short term. In other words, as competition develops, it is probable that Victorian retailers will voluntarily offer an increasing number of exit fee free products in order to attract new energy customers.

It is also proposed that energy retailers voluntarily develop and offer one 'price guarantee tariff' offer. As with the UK and Texas markets, the price guarantee tariff could include: fixed price, capped price and tracker deals.³⁷⁴ The introduction of price guarantee tariffs as one component of a retailer's broader product innovation regime designed to attract new customers is likely to be welcomed by consumer organisations as it provides customers with greater certainty over their future energy bills. It is recommended that this market offer be continuously advertised on the retailer's websites. As the UK market suggests, the popularity of these tariffs is likely to further encourage competition within this product category.³⁷⁵

Finally, as a 'whole-of-industry' initiative, it is proposed that all Victorian retailers voluntarily contribute to their own annual 'state of the market' report, to be published for example, by the ERAA. The objective of the report would be to provide factual information to all stakeholders on, for example, industry trends, CSR initiatives, assistance programs and industry 'best practices'. This would be done in a consolidated, de-identified manner. While the report would highlight the range of initiatives and activities undertaken by retailers, it would also potentially serve as an important reference tool for the Victorian Government, providing them with the much needed data to more effectively target their energy related concession and grants schemes.

5.5 Preferred Transitional Arrangements

As highlighted by Section 5, appropriate transitional arrangements will need to be implemented should the Victorian Government phase out retail price regulation. A finite period exists for these arrangements to be agreed and subsequently implemented should the reserve pricing power cease on 31 December 2008. Three of the obligations discussed in this Section include time arrangements: the obligation to supply and sell, new connections, and annual retail market reporting. Whilst the AEMC recommended specific timelines for a number of obligations, the reality is that in terms of political decision making, timing may well be a highly sensitive issue. In this regard, it is important to recognise that transitional arrangements and associated timelines are, to a large extent, flexible as a policy dimension.

374 As reported by Ofgem (2007), 'the first price guarantee tariff was introduced in 2003, and by March 2007 all suppliers offered a price guarantee tariff. These tariffs have evolved over time. For example, all suppliers have removed exit charges and allow customers to switch without penaltyAs of March [2007] around 6 million product accounts (gas and electricity) – or around 13% of the market – were on price guarantee tariffs' (Ofgem (2007), *Domestic Retail Market Report - June 2007*, London: Ofgem, at p.13).

375 Ofgem also notes that 'fixed price deals are particularly popular and four years after they were introduced 6 million have signed up to these products. Those that did have enjoyed lower prices and have been protected from much of the rise in wholesale prices' (Ofgem (2007), *Domestic Retail Market Report - June 2007*, London: Ofgem, at p.2).

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APPENDIX ONE: LISTING OF STAKEHOLDER CONSULTATIONS

Date of Consultation	Organisation	Name of Person/s Consulted With
16 November 2007	Energy Retailers Association (United Kingdom)	Dr Duncan Sedgwick Chief Executive
18 December 2007	Office of Peter Batchelor MP Minister for Energy & Resources Minister for Community Development	Susanne Legena Chief of Staff Andrew Dillon Senior Advisor
19 December 2007	ERAA Retail Energy Market Standing Working Group	Graeme Hamilton Regulatory Manager TRUenergy Nicholas Convery Regulatory Strategy Manager – Retail Energy Australia Anna Stewart Manager Regulatory Development AGL Energy Mal Jones Regulatory Manager NSW/ACT Retail EnergyAustralia Randall Brown Manager, Regulatory Development Origin Energy Bev Hughson National Regulatory Manager – Retail Origin Energy
14 January 2008	ERAA Retail Energy Market Standing Working Group	Graeme Hamilton Regulatory Manager TRUenergy Nicholas Convery Regulatory Strategy Manager – Retail Energy Australia Anna Stewart Manager Regulatory Development AGL Energy Mal Jones Regulatory Manager NSW/ACT Retail EnergyAustralia Bev Hughson National Regulatory Manager – Retail Origin Energy Alex Fleming Legal Counsel Simply Energy Elizabeth Hawker Regulatory & Compliance Manager Victoria Australian Power & Gas

15 January 2008	Second Tier Victorian Retailers	<hr/> Alex Fleming Legal Counsel Simply Energy <hr/> Nick Gilbertson Debt Services Manager Simply Energy <hr/> Nick Thodos Director ClickEnergy <hr/> Aneta Graham Customer Services Manager Victoria Electricity <hr/>
31 January 2008	ERAA Retail Energy Market Standing Working Group	<hr/> Cameron O'Reilly Executive Director ERAA <hr/> Graeme Hamilton Regulatory Manager TRUenergy <hr/> Nicholas Convery Regulatory Strategy Manager – Retail Energy Australia <hr/> Anna Stewart Manager Regulatory Development AGL Energy <hr/> Alex Fleming Legal Counsel Simply Energy <hr/> Elizabeth Hawker Regulatory & Compliance Manager Victoria Australian Power & Gas <hr/>
8 February 2008	Australian Energy Market Commission	<hr/> Dr John Tamblyn Chairman <hr/> Anne Pearson Director <hr/> Catherine McKay Senior Advisor <hr/>