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Australian Energy Market Commission

## **RULE DETERMINATION**

# NATIONAL ENERGY RETAIL AMENDMENT (REGULATING CONDITIONAL DISCOUNTING) RULE

### **PROPONENT**

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

27 FEBRUARY 2020

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# RULE

## INQUIRIES

Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

**E** [aemc@aemc.gov.au](mailto:aemc@aemc.gov.au)  
**T** (02) 8296 7800  
**F** (02) 8296 7899

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## ABOUT THE AEMC

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

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## SUMMARY

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

### **Background**

2 The final rule was made in relation to a rule change request submitted by the Honourable Angus Taylor MP, Minister for Energy and Emissions Reduction, on behalf of the Commonwealth Government. The rule change request aimed to improve offer comparability and protect consumers from excessive penalties in retail contracts with conditional discounts. Conditional discounts are pricing structures whereby consumers receive a financial incentive (typically lower energy rates) when a certain payment condition is met. The rule change request noted that missing a payment condition in a contract with large conditional discounts could result in a considerable financial burden to small consumers.

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

### **Rationale for the final rule**

4 Conditional discounts continue to be a material part of the retail energy market. As of January 2020, approximately 16 per cent of offers feature a conditional discount. Since July 2019, the magnitude of conditional discounts, while reduced, remains above likely reasonable costs.

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

6 Where risk allocation between retailers and consumer is no longer balanced or efficient, targeted restrictions on the level of conditional contract terms may be appropriate. Where such a restriction is set at reasonable costs, this approach would not unduly limit retailers' pricing freedom, while also providing a degree of protection for consumers.

7 The Commission also notes that the final rule supplements common law restrictions on contract terms that include penalties. There are significant barriers for small consumers seeking to challenge retail contracts at common law, including financial barriers and lack of awareness of their legal rights and options.

## Final rule

- 8 The final rule restricts the size of conditional discounts and conditional fees (e.g. late payment fees) retailers can prescribe under retail contracts to the reasonable costs incurred, or likely to be incurred, by the retailer when a consumer fails to satisfy a payment condition under a retail contract.
- 9 The final rule protects consumers by prohibiting retailers from recovering excessive costs from consumers who fail to comply with certain payment conditions.
- 10 In order to contribute to the achievement of the national retail energy objective (NERO), coverage of the final rule must be adequate to deal with the issues at hand while supporting competition. Key coverage decisions include:
- Limiting the final rule to contract terms that are related to payment timing or method. Only terms that are triggered as a consequence of satisfying a payment condition (in the case of discounts), or failing to satisfy a payment condition (in the case of fees) are captured by the final rule.
  - Extending reasonable costs restrictions to certain conditional fees (e.g. late payment fees, direct debit dishonour fees). This approach is designed to prevent retailers increasing conditional fees on energy contracts as a way of recovering revenue lost through reduced conditional discounts.
  - The final rule comes into effect on 1 July 2020 and only captures retail contracts entered into from that date.
  - Limiting the duplication of penalties — when a contract includes both a conditional discount and a conditional fee (or multiple conditional discounts or fees) that are triggered by the same payment condition, then the aggregate value of these terms is capped to reasonable costs. This approach is designed to stop retailers from over recovering costs when consumers fail to satisfy a single payment condition.
  - Applying conditional discount and fee restrictions to gas and electricity contracts and to retail contracts in all National energy consumer framework (NECF) jurisdictions, including those with price regulation such as Tasmania, regional Queensland and the Australian Capital Territory (ACT). Limits to the applicability of the rule to a specific fuel type or particular jurisdiction are inefficient because inconsistent regulation may lead to additional regulatory costs, increased consumer confusion and create barriers to efficient risk allocation.
- 11 The Commission has not specifically defined "reasonable costs" in the final rule because this term is a widely understood concept and has been utilised in a range of different industries, including energy. The restriction to reasonable costs is instead made using a principles-based approach.
- 12 The Commission has not required the Australian Energy Regulator (AER) to develop a guideline to determine the level of reasonable costs as it considers that it would be more practical for the AER to enforce the rule on a case-by-case basis. Furthermore, a binding guideline would not be able to provide reasonable costs levels to all types of conditional discounts or account for differences in reasonable costs between retailers.

13 The costs of enforcing the rule are not expected to be material. The AER's access to new offers through EME (Energy made easy) will impose transparency over publicly available conditional discounts and fees in the market. The ease of monitoring the final rule will likely discourage retailers from offering large conditional discounts that may breach the final rule, in turn reducing enforcement costs.

14 The Commission intends to recommend to the COAG Energy Council that breaches of new rules 46C(1) and 52B(1) of the final rule be subject to a civil penalty under the NERL.

#### **Changes from draft to final rule**

15 The final rule contains the following key changes to the draft rule:

- The final rule does not contain transitional provisions to mandate the application of the rule to existing contracts at the end of a benefit period. The Commission considers that consumers with ongoing experience with conditional discounts are in a better position to assess their suitability for these types of offers when compared with new consumers.
- The Commission has made minor adjustments to its definition of conditional fee, conditional discount and payment condition for clarification and to broaden the types of payment conditions that are captured by the rule.
- The Commission has extended the reasonable costs restriction to circumstances where a consumer (due to failure to satisfy a payment condition) is no longer entitled to multiple conditional discounts or becomes liable to pay multiple conditional fees.
- The final rule provides that a term or condition of a market retail contract has no effect to the extent that it provides for a conditional discount that is inconsistent with the reasonable costs restriction.
- The final rule includes a new clear prohibition on retailers with respect to including conditional fees in retail contracts that exceed reasonable costs.

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# 1 AUSTRALIAN GOVERNMENT'S RULE CHANGE REQUEST

## 1.1 The rule change request

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

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

The rule change request outlines two key policy objectives:

- remove excessive penalties for consumers on conditional discounts who fail to meet a contract condition<sup>2</sup>
- improve the comparability of market offers by simplifying and reducing conditional discounts<sup>3</sup>

The rule change request includes a proposed rule. If made, the request would amend Rule 45A of the National retail energy Rules (NERR), and new rules would be made (Rule 46C and Rule 46D).<sup>4</sup>

Copies of the rule change request may be found on the AEMC website, [www.aemc.gov.au](http://www.aemc.gov.au).

## 1.2 Background

Conditional discounts have been a common feature of energy retail pricing practices. The proportion of conditional discounts peaked at 78 per cent of market offers in 2017,<sup>5</sup> decreasing to 47 per cent of market offers in early 2019.<sup>6</sup> The level of conditional discounts have also increased significantly, from an average of five to 10 per cent rates in 2014 to 30 to 40 per cent rates in 2018.<sup>7</sup> Some stakeholders have noted that the popularity of these discounting practices have been driven by their "marketing value", i.e. the ability of large discounts to attract consumers to sign up.

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

2 Ibid p. 2.

3 Ibid.

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

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

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

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

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

## 1.3 Rationale for the rule change request

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

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

### 1.3.1 Improving offer comparability

The rule change request identified two problems faced by consumers comparing offers with large conditional discounts.<sup>11</sup>

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

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

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

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

10 *Ibid* p. 3.

11 *Ibid*.

12 *Ibid*.

13 *Ibid*, p. 2.

### 1.3.2 **Removal of excessive penalties**

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

The realisation rates noted above gave rise to the concerns in the rule change request over excessive penalties, especially because of the increase in the magnitude of conditional discounts experienced since 2014.<sup>15</sup> The rule change request analysis indicates that the costs to an average consumer of not meeting a pay-on-time discount could lead to an increase of up to 50 per cent of that consumer's annual bill.<sup>16</sup> The rule change request considers this increase in the annual bill is not representative of additional costs to retailers from holding debt for consumers. In effect, consumers who miss payment conditions while they are on high conditional discount offers may be paying some of the highest rates in the market.<sup>17</sup>

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

## 1.4 **Current regulatory arrangements**

### 1.4.1 **Inflated discounts rule**

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

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

### 1.4.2 **Electricity Retail Code**

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

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14 Ibid, p. 6.

15 Ibid p. 3.

16 Ibid, p. 3.

17 Ibid.

18 Ibid, p. 2.

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

20 Ibid.

(*Cth*) (CCA). The DMO was a recommendation<sup>21</sup> of the ACCC to the Commonwealth government in REPI.

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

- electricity retailers must not advertise a conditional discount as the most conspicuous price-related matter in the advertisement<sup>22</sup>
- each conditional discount mentioned in an offer must state the difference between the unconditional price and the conditional price; this must be expressed as a percentage of the reference price.<sup>23</sup>

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

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

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

### 1.4.3

#### Common law and the ACL

##### Common law

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

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

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

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

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

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

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

#### **BOX 1: COMMON LAW RESTRICTIONS ON PENALTIES**

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

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

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

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

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

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

#### **Australian Competition Law**

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

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

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

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

#### 1.4.4

#### Conditional fees

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

**Table 1.1: Jurisdiction arrangements regarding late payment fees**

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

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

## 2 FINAL RULE DETERMINATION

This chapter outlines:

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

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

### 2.1 Rule making test

#### 2.1.1 Achieving the NERO

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

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

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

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

#### 2.1.2 Making a more preferable rule

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

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

<sup>27</sup> Section 236(1) of the NERL.

<sup>28</sup> Section 13 of the NERL.

<sup>29</sup> Section 236(2)(b) of the NERL.

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

## 2.2 Assessment framework

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

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

### 2.2.1 Promoting workable competition

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

### 2.2.2 Risk allocation

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

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

### 2.2.3 Administrative and implementation costs

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

## 2.3 Features of the rule

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

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

- Is limited in its application to conditional contract terms that are related to the timing or method of payment of a bill (referred to as "payment conditions" in the final rule). Only terms that are triggered as a consequence of satisfying a payment condition (in the case

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<sup>31</sup> Rules 46C(1) and 52B(1).

of discounts) or failing to satisfy a payment condition (in the case of fees) are captured by the rule.

- Limits duplication of penalties — when a contract includes both a conditional discount and a conditional fee (or multiple conditional discounts or fees) that are triggered by the same payment condition, then the aggregate value of these terms is capped to the reasonable costs the retailer is likely to incur due to the consumer's failure to satisfy that payment condition.<sup>32</sup>
- Provides that a term or condition of a retail contract has no effect to the extent that it provides for a conditional discount or conditional fee that is inconsistent with the reasonable costs restriction.<sup>33</sup>

The Commission considers that the rule is compatible with the Code (see section 1.4.2) and that it can operate independently of it.

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

### 2.3.1

#### Changes from the draft rule

The final rule no longer contains a transitional provision that mandates the application of the rule at the end of a benefit period (in relation to conditional discounts) or the date of renewal or extension of a contract term (in relation to conditional fees) for existing contracts. Therefore, Part 12B of the rule has been amended. The rationale for this change can be found in section 4.5.4.

The Commission has made certain changes from the draft rule to enhance the rule's enforceability and effect, but that do not modify its policy decisions. These are:

- Substitution of "reasonable estimate of the costs incurred, or to be incurred..." with "reasonable estimate of the costs incurred, or *likely* to be incurred..." (emphasis added).
- Inclusion of a new clear prohibition on retailers in rule 52B(1) with respect to including conditional fees in retail contracts that exceed reasonable costs.
- Inclusion of new rule 46C(2) providing that a term or condition of a market retail contract has no effect to the extent that it provides for a conditional discount that is inconsistent with the reasonable costs restriction.

The Commission has made certain adjustments to its definition of conditional fee, conditional discount and payment condition to enhance the clarity of this provision. No changes are made to the policy decision. These changes are:

- In the definition of payment condition, the words "imposes a condition in relation to" are substituted with "relates to". The intention is to broaden the types of payment conditions that apply, beyond those that impose a condition on a consumer.
- In the definition of conditional discount and conditional fees, the words "complying with" are substituted with "satisfying". The intention is to also capture circumstances where a payment condition is simply met or satisfied (for example, receiving a discount if a

<sup>32</sup> Rules 46C(a) and 52B(1).

<sup>33</sup> Rules 46C (2) and 52B (2).

consumer chooses to pay by direct debit), as opposed to the consumer being in breach of a payment condition under the contract.

The Commission has also extended the reasonable costs restriction to circumstances where a consumer (due to failure to satisfy a payment condition) is no longer entitled to multiple conditional discounts or is liable to pay multiple conditional fees — see rules 46C(1)(b) and 52B(1)(b). No changes are made to the policy decisions.

## 2.4 Summary of reasons

The Commission considers that the more preferable rule best meets the NERO based on the reasons below.

### 2.4.1 Rationale for restricting conditional discounts

Conditional discounts continue to be a material part of the retail energy market. Approximately 16 per cent of offers include a conditional discount. Moreover, since July 2019 the magnitude of conditional discounts, while reduced, remains above likely reasonable costs.

Energy retailers generally have the freedom to set different types of pricing plans and structures that balance risk between them and consumers. However, in the case of conditional discounts, this flexibility has led to detrimental outcomes for some consumers, with 27 per cent of residential consumers and 58 per cent of hardship consumers failing to meet discount conditions on average according to the ACCC.<sup>34</sup> These findings demonstrate that many consumers have not been well-placed to meet conditional discounts and, as a result, expectations of balanced risk allocation between the parties (and reflected in the ACL's upfront pricing exception)<sup>35</sup> are no longer applicable.

Where risk allocation between parties is no longer balanced or efficient, targeted restrictions on the level of conditional discounts and conditional fees may be appropriate. Where such a restriction is set at reasonable costs, this approach would not unduly limit retailers' pricing freedom, while also providing a degree of protection for consumers.

Retailers will still be able to manage the risk of late payment through either conditional discounts or fees up to the reasonable costs they would incur from late payment. This approach delivers both efficient risk allocation and it is also consistent with common law restrictions on contract terms that include penalties, which have not been adequate to protect consumers thus far due to the onerous nature of a court challenge (see section 1.4.3). This specific gap in the regulatory framework, backed by the economic logic outlined above, supports the rule.

<sup>34</sup> ACCC, Retail energy pricing inquiry - Final Report, July 2018, p. xii.

<sup>35</sup> The ACL's upfront pricing exception enables retailers to apply high conditional discounts provided these conditions are made clear to the consumer. Schedule 2, Section 26 *Competition and Consumer Act 2010* (Cth).

### 2.4.2 Coverage decisions

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

- Types of conditional contracts terms captured: by covering payment conditions related to timing and method, the rule captures contract types which have caused consumer detriment whilst avoiding the creation of additional barriers to pricing innovation.
- Coverage of conditional fees: there is a reasonable risk that retailers may increase conditional fees on energy contracts as a way of recovering revenue lost through reduced conditional discounts.
- Limiting duplication of penalties: Capping to reasonable costs, the aggregate value of conditional discounts and conditional fees resulting from a consumer's failure to satisfy the same payment condition. This approach is designed to stop retailers from over recovering costs when consumers fail to satisfy a single payment condition.
- Capturing gas contracts and retail contracts in all NECF jurisdictions: limits to the applicability of the rule to a specific fuel type or particular jurisdiction are inefficient because inconsistent regulation may lead to additional regulatory costs, increased consumer confusion and create barriers to efficient risk allocation.
- Existing contracts: The final rule does not contain transitional provisions to mandate the application of the rule at the end of a benefit period (in relation to conditional discounts) or the date of renewal or extension of a contract term (in relation to conditional fees) for existing contracts. The Commission considers that consumers with ongoing experience with conditional discounts are in a better position to assess their suitability for these types of offers when compared with new consumers.

### 2.4.3 Design of reasonable costs restriction

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

Given this selected approach, the costs of enforcing the rule are not expected to be material. The AER's access to new offers through EME will impose transparency over publicly available conditional discounts and fees in the market. The ease of monitoring the final rule will discourage retailers from offering large conditional discounts that may breach the final rule, in turn reducing enforcement costs.

Additional costs of implementing the rule for retailers are not expected to be material. Due to the common law's restriction on contract terms that include penalties, the Commission expects that retailers already have processes and information required to calculate and assess reasonable costs of their offers.

#### 2.4.4

##### **Customer protections test**

The more preferable rule results in improved protections for all small consumers by prohibiting retailers from recovering excessive costs from consumers who fail to comply with certain payment conditions and therefore enabling better risk allocation between retailers and consumers. Therefore, the Commission considers that the rule meets the customer protections test.

## 3 ANALYSIS OF ISSUES RAISED AND APPROPRIATE RESPONSE

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

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

### 3.1 Issues raised by the rule change request

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

- improving the comparability of market offers by simplifying and reducing conditional discounts, thereby reducing barriers to effective consumer engagement and enhancing competition<sup>36</sup>
- removal of excessive penalties on consumers (particularly vulnerable consumers) who pay after the due date, which are effectively resulting in those consumers paying the highest prices in the market.<sup>37</sup>

### 3.2 Stakeholder views to the consultation paper

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

#### 3.2.1 Retailers and the South Australian Government

These stakeholders generally focused on the decrease in the proportion and magnitude of conditional discounting brought about by the introduction of the Code since July 2019. They considered that the issues highlighted by the rule change request were no longer material. For example, Alinta Energy noted that the introduction of the DMO has led retailers to change their offers, particularly through a shift away from conditional discounts.<sup>38</sup>

Some retailers also noted that a no rule approach was justified on the basis that there is not yet conclusive data on changes to retailer pricing strategies in response to the Code. For example, AGL noted that the rule change was requested prior to the DMO coming into effect, and therefore the full impact of this change on retail market should be assessed prior to further regulatory changes being made.<sup>39</sup>

<sup>36</sup> Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, p. 2.

<sup>37</sup> Ibid p. 3.

<sup>38</sup> Alinta Energy, consultation paper submission, p. 2.

<sup>39</sup> AGL, consultation paper submission, p. 2.

The South Australian government (Department for Energy and Mining) also noted that the introduction of the Code should overcome many of the concerns raised by the rule change and that it was unclear if further amendments are necessary. A review conducted by the Department indicated that only a limited number of conditional discount offers were currently being made by retailers in the state for both gas and electricity<sup>40</sup>

### 3.2.2 Consumer groups, market bodies and ombudsman

These stakeholders generally cautioned the Commission against interpreting initial pricing data from Energy Made Easy (EME) as a conclusive signal of the decrease in materiality of conditional discounts. The main concern was limited evidence available to reach a conclusion regarding conditional discounting trends, and that this information would not be indicative of future pricing practices. They also expressed concerns that retailers may readjust pricing strategies in the future if no restrictions on their ability to offer large conditional discounts are in place. For example, the Energy and Water Ombudsman NSW (EWON) stated<sup>41</sup>:

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

CHOICE noted that the declining proportion in conditional discounting might be related to increased public pressure applied on retailers, rather than representing a sustained shift in pricing strategy.<sup>42</sup> The Public Interest Advocacy Centre (PIAC) noted that due to the limited application of the Code and issues with the way the Code is worded, comparability issues with conditional discounts and fees may continue to be material.<sup>43</sup>

## 3.3 Analysis of conditional discount materiality

### 3.3.1 Conditional discounting trends since the introduction of the DMO

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

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

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

41 EWON, consultation paper submission, p. 1.

42 CHOICE, consultation paper submission, p. 8.

43 PIAC, consultation paper submission, p. 4.

2019, this number had dropped to 22 per cent on average across all distribution areas (see Figure 3.2)

The magnitude of conditional discounts has also decreased.<sup>44</sup> The rule change request stated that discounts of approximately 30-40 per cent were common in 2018.<sup>45</sup> The average discount rate in September 2019 was approximately eight per cent (Figure 3.3).

### 3.3.2

#### Benchmarking the materiality of conditional discounts

Figure 3.3 demonstrates a significant drop in the magnitude of conditional discounts in the space of six months (i.e. since March 2019). However, as pointed out by stakeholders, there is insufficient historical data on conditional discounting practices since the DMO has been introduced to reach a definitive conclusion over long-term pricing trends. While the proportion and magnitude of conditional discounts has decreased, they could return to a level above reasonable costs at some point in the future with the absence of regulation.

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

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

Figure 3.1 benchmarked current average and highest conditional discount (pay-on-time) rates observed by the Commission in September and October 2019 against a range of different price structures that are set at reasonable costs. These included an estimate of:

- late payment fees in electricity, specifically an average of these fees charged in South Australia, where they are already limited to reasonable costs by legislation.<sup>46</sup>
- late payment fees in the water utility industry, specifically those charged by Sydney Water in 2019.<sup>47</sup>
- late payment fees charged by price-regulated retailers, specifically those charged by ActewAGL and Aurora Energy.<sup>48</sup>

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

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

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

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

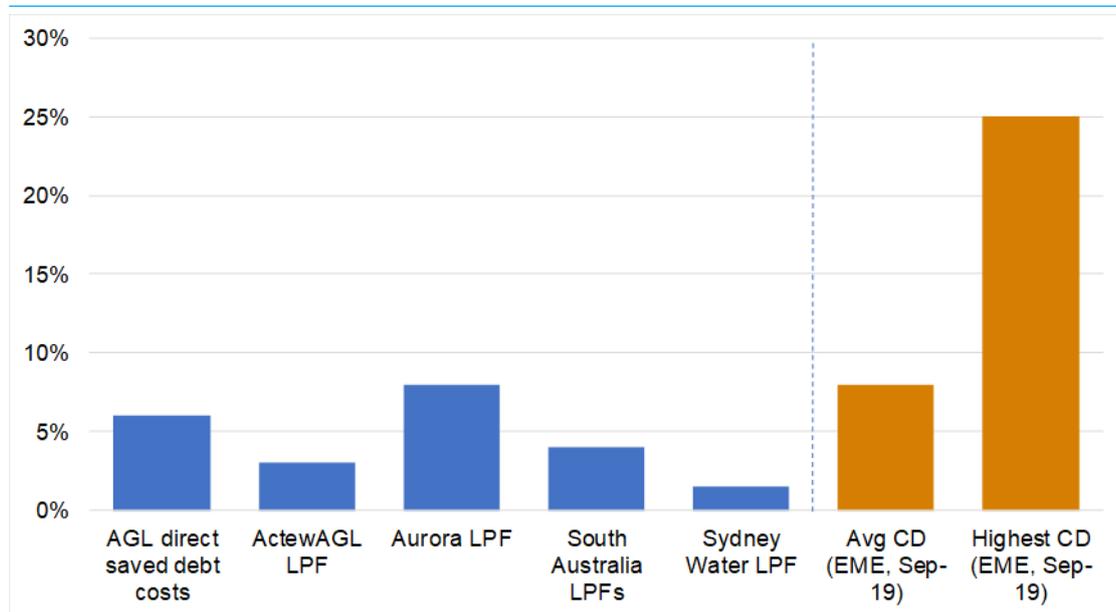
48 The Tasmanian Economic Regulator reviews Aurora Energy's late payment fee and also include a cost reflective interest for overdue accounts. They are currently set at \$5 + RBA set interest rate. ActewAGL's LPF are reviewed by the Independent Competition and Pricing Commission of ACT. They are currently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

- a large retailer's (AGL) direct saved debt costs as a percentage of an average consumer's bill.<sup>49</sup>

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

The Commission's analysis indicates that average conditional discount rates analysed are still higher than four of the reasonable costs benchmarks, and similar to one of them. To illustrate the gap between conditional discounts set at reasonable costs and large conditional discounts seen in the retail market before the DMO (and still observed in the market, albeit less frequently), the Commission inserted the highest pay-on-time conditional discount in its analysis. This is an important point, given the significant number of consumers that are on contracts signed prior to the DMO coming into force — these consumers are likely to be on contracts with conditional discounts of similar magnitude (see Figure 3.1 below).

**Figure 3.1: Estimates of reasonable costs comparison with actual conditional discount rates**



Source: AEMC analysis

Note: LPF: late payment fee; CD: conditional discount; EME: Energy Made Easy website

<sup>49</sup> The "direct saved debt costs" is an estimate of reasonable costs related to interest payments incurred by the retailer when consumers fail to pay-on-time. The following assumptions are used to calculate the interest payments: (a) the interest rate is equal to the financing cost reported in AGL's FY2019 report (5.7 per cent p.a.); (b) the bill is not paid for a year — therefore, the "direct cost" is equal to the annual financing cost; (c) the bill is for a representative residential non-solar consumer on a 2-part tariff in the Ausgrid distribution network area (relevant consumption figures for the representative consumer sourced from the AEMC, Residential Electricity Price Trends, 2019).

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

### 3.3.3 Potential for reversion

The Commission considered that a reliance on conditional discounting advertising restrictions under the Code may be insufficient should the Code may be amended or abrogated. Consumer groups have also questioned whether post-DMO changes to discounting practices represent ongoing shifts in pricing practices or temporary adjustments to regulatory settings and public concern.<sup>50</sup>

In order to minimise the risk of the return of large conditional discount rates, the Commission's draft determination signalled a preference for an enduring restriction on the substance of conditional pricing practices through energy rules.

## 3.4 Stakeholder views on the draft determination

AGL, EnergyAustralia, Simply Energy and the South Australian Government disagreed with the Commission's rationale for making the rule, citing that it was unlikely for the market to revert to offers with large conditional discounts.<sup>51</sup> These stakeholders also highlighted that the DMO and Code advertising restrictions have had the effect of decreasing the magnitude and proportion of offers with conditional discounts in the retail market since 1 July 2019. As a result, they considered the need for regulation of this type of offer is greatly diminished.

PIAC, EWON, The Queensland Consumers Association and AER supported the Commission's rationale for making the rule. Various arguments were given for this:

- conditional discounts remain material<sup>52</sup>
- the rule would address shortcomings of ACL and common law restrictions<sup>53</sup>
- recent reduction in prevalence of conditional discounts do not mean that regulation isn't required.<sup>54</sup>

Stakeholders did not comment on the benchmarking done by the Commission to develop indicative value of reasonable conditional discounts.

## 3.5 Commission's final determination

The Commission continued to monitor the retail market to understand the proportion and magnitude of offers with conditional discounts. The proportion of offers with conditional discounts fell from 22 per cent to 16 per cent, on average, across New South Wales, South Australia and south east Queensland from September 2019 to January 2020 (Figure 3.2).

50 CHOICE, consultation paper submission, p. 8; EWON, consultation paper submission, p. 1.

51 South Australia Dept of Energy and Mining, submission to draft determination, pp. 1-3; Simply Energy, submission to draft determination, p. 2, AGL, submission to draft determination, pp. 1-2.

52 AER, submission to draft determination, p. 2.

53 TQCA, submission to draft determination, p. 2.

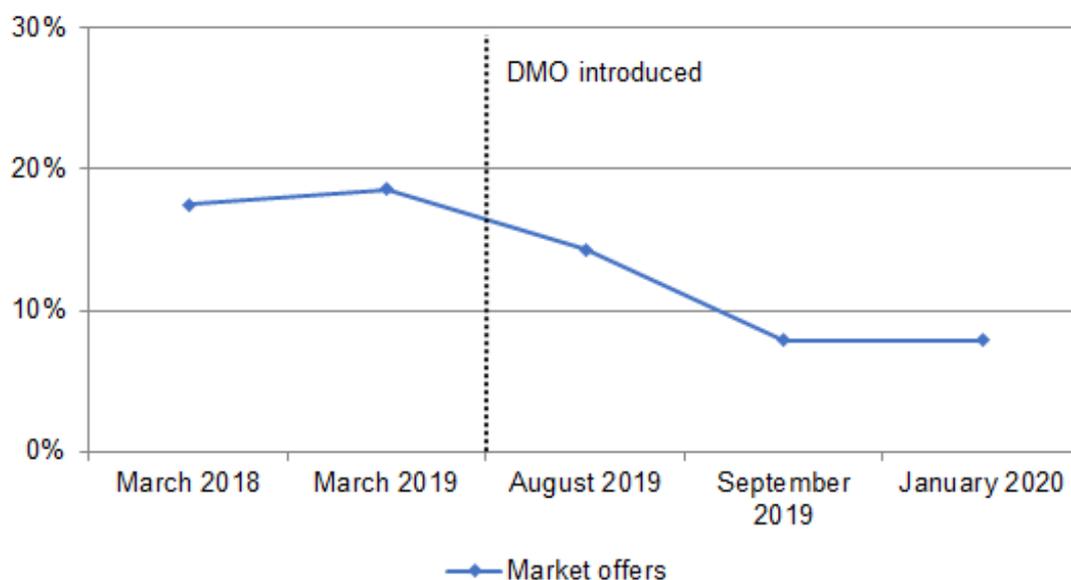
54 EWON, submission to draft determination, p. 2.

The magnitude of average conditional discounts across relevant distribution zones remained stable at around eight per cent (Figure 3.3) between September 2019 and January 2020. The average conditional discount magnitude (currently at about 7.9 per cent) continues to be above most benchmarks of reasonable costs analysed by the Commission in its draft determination. On the basis of available retail market data, the Commission considers that, without further regulatory intervention, conditional discount magnitude is unlikely to decrease further to align with reasonable costs.

The Commission also considers that reversion to high levels of conditional discounting continues to be a risk to consumers. Furthermore, January 2020 data indicates the highest conditional discount being offered sitting at 19 per cent — similar to discount rates offered prior to the introduction of the DMO. This indicates that the move away from conditional discounts is uneven across retailers and that regulatory intervention will provide uniform safeguards for consumers at present and moving into the future.

The Commission continues to consider that the need for a rule to regulate conditional discounts exists. The Commission's views on existing contracts with conditional discounts are discussed in section 4.5.4.

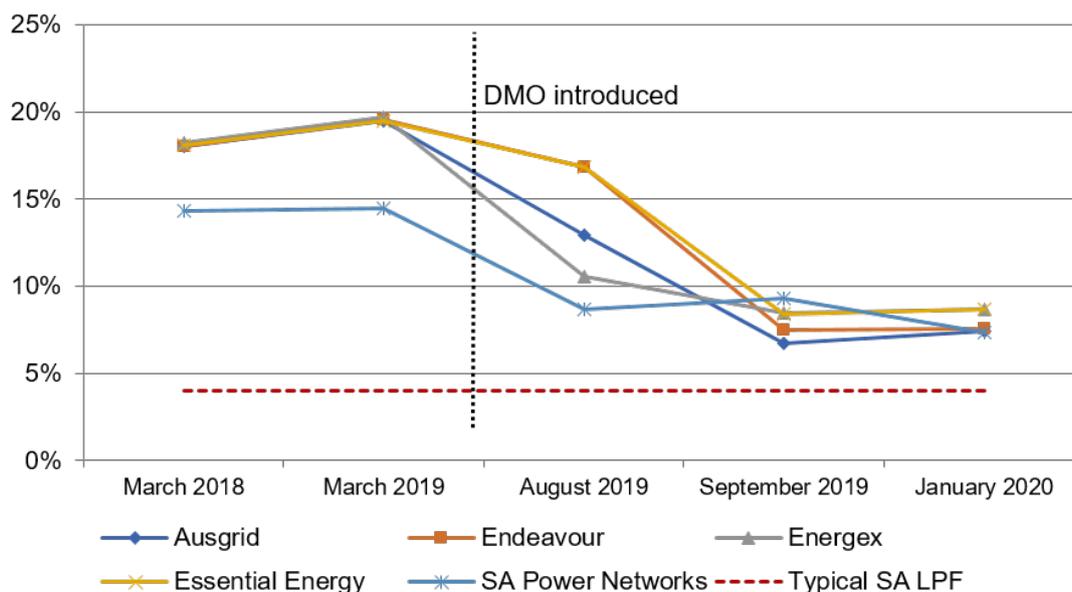
**Figure 3.2: Proportion of offers with conditional discounts across distribution areas**



Source: AEMC analysis of EME data.

Note: NSW distribution companies: Ausgrid, Endeavour, Essential; South Australia: South Australia Power Networks; south east Queensland: Energex.

**Figure 3.3: Average magnitude of conditional discounts March 2018-January 2020**



Source: AEMC analysis of EME data.

Note: Excludes Victorian offers. Lines in the graph refer to the average conditional discounts offered across six distribution areas with no price regulation. NSW distribution companies: Ausgrid, Endeavour, Essential; South Australia: South Australia Power Networks; south east Queensland: Energex.

### 3.6 Risk allocation and the need for the rule

The Commission considered that consumers are generally best served by a competitive energy market where retailers retain the flexibility to design and set pricing structures to best suit their consumers. Market forces, such as consumer preferences, encourage retailers to offer pricing structures which benefit consumers. However, critical to this dynamic is the ability of consumers to have a reasonable ability to identify, choose and remain on tariffs that benefit them. In this case, this includes the ability of consumers to predict their ability to meet discount conditions.

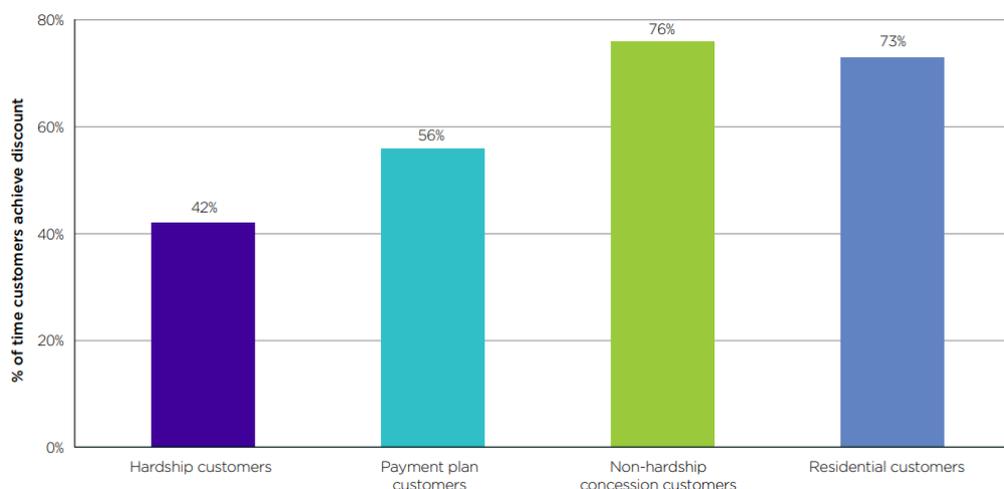
The dynamic between the ability of consumers to select offers in their best interests and a degree of pricing freedom by retailers enables risk allocation between parties to be balanced. The ACL enshrines these principles, by enabling retailers to set different types of pricing structures, so long as key conditions are clearly disclosed to consumers prior to the contract being signed.<sup>55</sup>

However, evidence indicates that pricing freedom for energy retailers in the case of conditional discounts has led to negative outcomes for a material number of consumers (see

<sup>55</sup> The ACL's upfront pricing exception enables retailers to apply high conditional discounts provided these conditions are made clear to the consumer. Schedule 2, Section 26 *Competition and Consumer Act 2010* (Cth). However, the view of the ACCC (the body that enforces the ACL) is that this regulatory gap must be addressed, as evidenced by its recommendation 33 of REPI.

Figure 3.4 below). The ACCC identified that 27 per cent of all residential consumers failed to meet discount conditions, with 58 per cent of hardship consumers defaulting.

**Figure 3.4: ACCC findings on conditional discount realisation rates across consumer cohorts, 2016-7**



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

Realisation rates observed in the market indicate that, in the case of conditional discounts, many consumers are not well-placed to meet contract conditions, particularly consumers in hardship. By either underestimating their ability to pay, or the development of unforeseen circumstances, many consumers are missing conditional discount payments.<sup>56</sup> This is symptomatic of Energy Consumers Australia's (ECA) description of the retail energy market as being a "confusopoly".<sup>57</sup> The related expectation that market dynamics are leading to balanced risk allocation between the parties is not accurate in this case for a material group of consumers. Where risk allocation between parties is no longer balanced or efficient, targeted restrictions on the level of conditional discounts and fees may be appropriate.

Where such a restriction is set at reasonable costs, this approach would not unduly limit retailers' pricing freedom, while also providing a degree of protection for consumers. Retailers will also retain the ability to manage the risk of missed payment through either conditional discounts or conditional fees up to the reasonable costs they would incur from missed payments.

The Commission also notes that the final rule supplements common law restrictions on contract terms that include penalties. There are significant barriers for small consumers

<sup>56</sup> EWOQ noted that conditional discounting is not a prevalent practice in other industries and that this may be a contributing factor to explain failure to meet conditions. EWOW, consultation paper submission, p.1.

<sup>57</sup> ECA, consultation paper submission, p. 2. ECA states that "These low realisation rates may be indicative of the retail energy market 'confusopoly', where big headline discounts might catch the eye, but can be illusory once conditions and other fees are taken into account. Further, the complexity of retailer offers means consumers may not immediately understand the risk of not being able to achieve the discount."

seeking to challenge retail contracts at common law, including financial barriers and lack of awareness of their legal rights and options.

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

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

The Commission therefore considers that pricing freedom available to retailers should enable consumers to continue to be offered pricing structures that provide them with value, noting that many retailers have already decided not to continue to offer conditional discounts since the introduction of the Code.<sup>58</sup>

### 3.6.1

#### Vulnerable consumers

Stakeholder submissions by consumer groups signalled that risks inherent to high conditional discounts are not uniformly distributed across all consumer groups.<sup>59</sup> Noticeably low realisation rates for hardship and concession consumers noted by the ACCC also highlight that risks may be high for certain groups.<sup>60</sup> Energy retail rules already recognise the fact that certain consumer groups should not bear the risks of certain types of conditions — rule 73 of the NERL states that a retailer must waive late payment fees for consumers on hardship programs. The Commission considers that the proposed rule may substantially lessen the risk of conditional discounting practices for all consumers, with vulnerable consumers in particular benefiting from this approach.

The Commission opted not to make specific provisions in the draft rule for vulnerable consumers on the basis that certain changes to retail hardship programs came into effect in October 2019.<sup>61</sup> These changes are related to a November 2018 determination by the Commission to introduce rules to strengthen protections for consumers in hardship.<sup>62</sup> These rules require the AER to develop hardship guidelines that include consistent and specific statements that retailers must include in their hardship policies. One such obligation is a requirement that retailers' hardship policies includes steps to review a consumer's contract so that they are on appropriate market contracts.<sup>63</sup> Given this obligation, the Commission would expect that retailers are actively working with hardship consumers so that they are not placed on, or are not encouraged to stay on, riskier types of market contracts (such as those with conditional discounts) when a chronic payment issue is identified.

58 For example, see EnergyAustralia, consultation paper submission, p. 1.

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

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

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

62 AEMC, *Strengthening protections for consumers in hardship - Rule determination*, November 2018.

63 NERL, s. 44 (f).

On balance, the Commission considered that the effectiveness of revised hardship policies as well as the benefits delivered to all consumers through capping conditional discounts and fees to reasonable costs are the appropriate mechanisms to minimise risks for vulnerable consumers.

### 3.7 Stakeholder views on the draft determination

Only EnergyAustralia and Choice provided feedback on the analysis of risk to all residential consumers. EnergyAustralia noted that analysis and evidence provided in the rule change request and the ACCC focused on extreme cases of harm caused by conditional discounts, and cautioned the Commission against designing a regulatory solution based on this data alone.<sup>64</sup> EnergyAustralia further stated that risk imbalance concerns would be not addressed by regulating the quantum of discounts, and that increased transparency by retailers in explaining tariffs may be a more suitable solution.<sup>65</sup>

Choice noted that greater transparency brought by the Code regarding the marketing of conditional discounts would not be sufficient to offset the fact that many consumers will continue to overestimate their ability to meet conditional discounts.<sup>66</sup> Choice also referred to behavioural bias research that indicates that consumers will place a high value on immediate rewards at the expense of long-term intentions.<sup>67</sup> Choice advocated for a ban on conditional discounting to protect consumers from the risks of this pricing practice.<sup>68</sup>

Views surrounding the Commission's approach to vulnerable consumers varied across stakeholder groups.

- The South Australian government, Meridian Powershop and Simply Energy noted that vulnerable consumers should already be covered by broader protections under the NERL, which mandate that retailers review the appropriateness of a hardship consumer's market retail contract.<sup>69</sup>
- EnergyAustralia asked the Commission to consider banning retailers from offering pay-on-time discounts to hardship consumers or require retailers to provide them unconditionally.<sup>70</sup>
- Momentum and the AER have asked the Commission to consider mandating application of conditional discounts for all consumers on a hardship program on an unconditional basis.<sup>71</sup>

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64 EnergyAustralia, submission to draft determination, p. 6.

65 Ibid, p. 8.

66 Choice, submission to draft determination, p. 6.

67 Ibid.

68 Ibid.

69 South Australia Department of Energy and Mining, submission to draft determination, p. 2; Simply Energy, submission to draft determination, p. 2; Meridian Powershop, submission to draft determination, p. 1.

70 EnergyAustralia, submission to draft determination, p. 2.

71 Momentum, submission to draft determination, p. 1; AER, submission to draft determination, p. 2.

### 3.8 Commission's final determination

The Commission considers its analysis of risks faced by consumers and its decision on vulnerable consumers remains valid. Conditional discounting practices continue to harm a material group of consumers.

The Commission considers that the large conditional discounts prevalent in the market prior to 1 July 2019 (usually in excess of 20 per cent) signal that the risks imbalances related to conditional discounts are widely distributed across the market and individually significant in terms of their monetary impact for consumers. The Commission disagrees that large penalties are confined to a few offers as indicated by some stakeholders — even a smaller penalty than one calculated in the rule change request could have a material effect on a consumer experiencing vulnerability but outside a hardship scheme.

The Commission considers that its decision balances pricing freedom for retailers and the protection of consumers against risks faced by conditional discount offers. As a result, the Commission's final determination is to regulate conditional discounting practices through a targeted restriction. This balance would not be present in scenarios contemplated by stakeholders such as an outright ban on conditional discounts, unconditional application of conditional discounts or unrestricted continuation of conditional discounts.

The Commission will not make an additional rule targeting vulnerable consumers. New hardship guidelines have only recently come into effect<sup>72</sup> and, if implemented effectively, should protect vulnerable consumers from large conditional discounts.

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72 AEMC, Strengthening protections for consumers in hardship - Rule determination, November 2018

## 4 COVERAGE OF THE RULE

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

- types of conditional contract terms (i.e. conditional discounts or conditional fees) captured by the draft rule
- conditional fees and duplication conditional discounts or fees
- gas contracts and contracts in all NECF jurisdictions
- existing retail contracts at the end of a benefit period

### 4.1 Issues raised by the rule change request

#### 4.1.1 Types of conditional contract terms captured

The rule change request defines a conditional price discount as "the amount by which a price otherwise payable under a contract is, or would be, reduced as a consequence of complying with one or more provisions of the contract".<sup>73</sup>

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

- pay-on-time
- direct debit
- online sign-up.<sup>74</sup>

#### 4.1.2 Conditional fees and duplication of penalties

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

#### 4.1.3 Gas contracts and retailer contracts in all NECF jurisdictions

The rule change request and its suggested rule called for coverage to be extended to gas contracts. The rule change request asked that the Commission consider the application of the rule to various NECF jurisdictions.<sup>75</sup>

<sup>73</sup> Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, p. 9.

<sup>74</sup> *Ibid.*, p.12.

<sup>75</sup> *Ibid.*, pp. 3-4.

#### 4.1.4 Existing contracts

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

## 4.2 Stakeholder views to the consultation paper

### 4.2.1 Types of conditional contract terms captured

Retailers generally opposed extension of the rule's coverage to additional types of conditional contract terms. AGL noted that the draft rule should only capture conditional pay-on-time discounts and that the Commission should not restrict product attributes such as dual fuels and digital-only offers.<sup>76</sup>

Consumer groups noted that a more expansive definition would be suitable given the need to restrict contract terms that imposed penalties on consumers. The Queensland Consumers Association (TQCA) noted that:<sup>77</sup>

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

### 4.2.2 Conditional fees and duplication of penalties

Retailers generally noted that issues raised in the rule change request were confined to pay-on-time conditional discounts, and opposed extension of the rule's coverage to additional types of conditional contract terms. For example, the Australian Energy Council (AEC) noted that:<sup>78</sup>

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

Consumer groups, such as the TQCA generally noted the importance for rule coverage to be expansive in order to drive broader change in pricing practices and avoid "work arounds" which may be put in place if the Commission decides on a narrow restriction.<sup>79</sup> CHOICE noted that retailers "double dip" by charging penalties incurred through lost conditional discount and late payment fees and that this behaviour should be limited.<sup>80</sup>

76 AGL, consultation paper submission, p. 2.

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

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

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

80 CHOICE, consultation paper submission, p. 10.

### 4.2.3 Gas contracts and retailer contracts in all NECF jurisdictions

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

Some retailers also supported consistent coverage across all types of contracts. Simply Energy noted that should a new rule be introduced, it would prefer that it apply to both electricity and gas.<sup>81</sup> The AER was also supportive of coverage being extended to gas contracts on the basis that it aided consumer comprehension and engagement.<sup>82</sup> The ACT's Civil and Administrative Tribunal (ACAT) supported the extension of the rule to all NECF jurisdictions on the basis that the Code covers only electricity retailers and that problems around conditional discounting may arise in ACT and Tasmania where the DMO is not applicable.<sup>83</sup>

Powershop noted that industry and consumer groups had not raised conditional discounting for gas contracts as a significant issue.<sup>84</sup> ActewAGL did not support the extension of the rule to ACT on the basis that local small consumers rarely fail to meet conditional discounts and that therefore the costs associated with the rule change might exceed the benefits.<sup>85</sup>

### 4.2.4 Existing contracts

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

Retailers generally opposed the possibility that the rule's coverage extend to existing contracts when a benefit period is reset. The AEC noted that the rule must capture new contracts only given that an attempt to apply the rule to existing offer might create significant implementation issues for energy retailers, resulting in higher costs.<sup>86</sup>

Conversely, PIAC noted that any contracts with conditional terms should be transitioned at the end of the consumer's existing benefit period to minimise disruption or confusion.<sup>87</sup>

## 4.3 Commission's draft decision

### 4.3.1 Types of conditional contract terms captured

In the rule change request, the proponent identified certain types of conditional discounts that may inflict most harm on consumers. The Commission has been broadly guided by this scope in considering the types of contract terms that ought to be captured by the draft rule.<sup>88</sup>

The Commission balanced the need to capture the types of conditional contract terms outlined in the rule change request, while not introducing inefficient barriers to pricing

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

82 AER, consultation paper submission, p. 9.

83 ACAT, consultation paper submission, p. 3.

84 Powershop, consultation paper submission, p. 4.

85 ActewAGL, consultation paper submission, p. 2.

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

87 PIAC, consultation paper submission, p. 3.

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

innovation. The Commission also considered the practicality of estimating reasonable costs for certain types of offers, given this is crucial to the enforcement of the rule.

The Commission's proposed approach was to limit the draft rule to conditional contract terms that imposed a condition in relation to the timing or method of payment of a bill (referred to in the draft rule as "payment conditions").<sup>89</sup> The draft rule captured conditional discounts triggered as a consequence of complying with a payment condition, and conditional fees triggered as a consequence of failing to comply with a payment condition. Typical conditions under this category include, but are not limited to:

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

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

- terms related to installing or operating of energy equipment (e.g. batteries)
- terms related to the "bundling" of gas and electricity and energy and non-energy services
- "passive" conditional terms. These are contract terms which automatically provide consumers with the benefit (i.e. do not require consumer action)<sup>90</sup>
- sign up conditional terms.<sup>91</sup>

The Commission also noted the potential for restrictions on the types of conditional contract terms not captured by the rule could potentially have a stifling effect on pricing innovation.<sup>92</sup> Similarly, sign up and passive conditional contract terms outlined above are unlikely to cause consumer detriment given their structure.

#### 4.3.2

#### **Conditional fees and duplication of penalties**

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

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89 Rule 45A of the Draft Rule.

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

91 For example, an online payment sign up discount, where a consumer is given a large discount rate only if payment is made online.

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

The Commission considers that conditional fee restrictions are necessary. This approach is designed to prevent retailers increasing conditional fees on energy contracts as a way of recovering revenue lost through reduced conditional discounts.

The Commission considers it inappropriate that small consumers be penalised twice for the same breach of contract. The Commission's proposed approach under the draft rule capped, to reasonable costs, the aggregate value of a conditional discount and a conditional fee triggered by the same payment condition.<sup>93</sup> Under this approach, a consumer's overall penalty for the same breach of contract would not exceed reasonable costs.

#### 4.3.3 Gas contracts and retail contracts in NECF jurisdictions

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

The Commission considered the potential for unintended consequences derived from its proposed rule. One such risk is that retailers may increase conditional discounts on gas contracts as a way of recovering revenue lost through reduced conditional discounts in electricity contracts. The Commission therefore considers that gas contracts for small consumers should be subject to the draft rule. The risk of revenue recovery was first articulated by the Commission in its 2019 Retail competition review.<sup>94</sup>

The Commission's 2019 Retail energy competition review also noted the relatively quick development of retail markets across the national electricity market (NEM) over the past decade, with ACT in particular having a more competitive market in recent years.<sup>95</sup> The AER also noted the development of conditional discounts in ACT, noting that the territory was the only region surveyed where it saw an increase in the average magnitude of conditional discounts between 2018 and 2019.<sup>96</sup> Extension of conditional discount restrictions across Tasmania, regional Queensland and ACT would provide consumers in these markets with robust protections if retail competition develops.

#### 4.3.4 Existing contracts

The draft rule applied to new contracts from the date of the rule's commencement on 1 July 2020.

Figure 4.1 highlights there has likely been a build-up of consumers on conditional discount contracts on retailers' back books. About 60 per cent of market offers had a conditional discount set above 10 per cent. Given these trends, the Commission considered it plausible that a material proportion of a retailer's "back book" are made up of contracts that include high conditional discounts. These contracts are usually on a fixed benefit period, after which the discount may end. The Commission considered that in many instances retailers may seek

93 Rule 46C (b) of the Draft Rule

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

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

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

to "roll over" conditional discounts at the end of a benefit the period, i.e. continue offering the consumer a similar conditional discount deal for an extended period.

In order to address the potential effect of consumer "roll over," the draft rule captured existing contracts from the date where an existing contract's benefit was reset (with respect to conditional discounts) and the date where the term of the contract was extended or renewed (with respect to conditional fees).<sup>97</sup> In effect, this meant that whenever a new benefit was offered to a retail consumer, that benefit must be limited to reasonable costs.<sup>98</sup>

**Figure 4.1: Historical proportion and magnitude of conditional discounts**



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

Low realisation rates across consumer cohorts identified by the ACCC (see Figure 3.4) meant that risks of high conditional discounts for consumers on contracts signed prior to the DMO coming into force needed to be carefully weighed against the benefits gained by consumers who satisfy their discount conditions. In the absence of regulatory intervention, a material number of consumers may continue to be exposed to high conditional discounts that have been largely discontinued since the introduction of the DMO.

<sup>97</sup> Schedule 3, Part 13, Existing contracts with small consumers 2(1) and 2 (2) of the Draft Rule.

<sup>98</sup> Given that consumers would ordinarily see their rates and/or contracts varied at the end of a benefit period, the Commission's approach to applying the rule enables a smoother transition into compliance. This approach also supports retailer certainty and a gradual transition of their consumer base.

## 4.4 Stakeholder views on the draft determination

### 4.4.1 Types of conditional contract terms captured

Momentum, TQCA, EWON, PIAC supported the Commission's decision to capture contract terms related to payment timing or method.<sup>99</sup> The AER supported the Commission's decision and also asked the Commission to consider emerging practices not covered by the decision and may cause harm to consumers.<sup>100</sup>

Other retailers did not express a view on types of conditional contract terms captured, however AGL and Origin expressed the desire for greater clarity in the drafting of the rule to ascertain the types of conditional fees that would be captured by the rule.<sup>101</sup>

### 4.4.2 Conditional fees and duplication of penalties

TQCA and EWON supported the Commission's decision to capture conditional fees and restrict duplication of conditional fees and discounts.<sup>102</sup>

### 4.4.3 Gas contracts and retail contracts in NECF jurisdictions

Retailers did not express views on the application of the rule to gas contracts or to all NECF jurisdictions. EWON, PIAC, AER and TQCA supported the Commission's decision on these matters.<sup>103</sup>

### 4.4.4 Existing contracts

Meridian Powershop, Simply Energy, AEC and the South Australia Government opposed the application of the rule to existing contract at the end of benefit period. These stakeholders noted the potential negative effects of this coverage decision, such as to increase effective prices paid by some consumers meeting discount conditions.<sup>104</sup>

TQCA, EWON and PIAC supported the application of the rule to existing contracts with conditional discounts when a benefit period is reset.<sup>105</sup> PIAC noted that retailers have the option to continue to offer competitive discount rates on an unconditional basis to consumers.<sup>106</sup>

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99 Momentum, submission to the draft determination, p. 2; TQCA, submission to the draft determination, p. 2; EWON, submission to the draft determination, p. 2; PIAC, submission to the draft determination, p. 1.

100 AER, submission to draft determination, p. 4.

101 Origin, submission to draft determination, p. 1; AGL, submission to draft determination, p. 3.

102 TQCA, submission to draft determination, p. 2; EWON, submission to draft determination, p. 2.

103 EWON, submission to the draft determination, p. 2; PIAC, submission to the draft determination, p. 1; AER, submission to the draft determination, p. 1; TQCA, submission to the draft determination, p. 2.

104 South Australia Department of Energy and Mining, submission to draft determination, p. 2; AEC, submission to draft determination, p. 2; Meridian Powershop, submission to draft determination, p. 2; Simply Energy, submission to draft determination, p. 2.

105 TQCA, submission to draft determination, p. 2; EWON, submission to draft determination, p. 2; PIAC, submission to draft determination, p. 1.

106 PIAC, submission to draft determination, p. 1.

## 4.5 Commission's final determination

### 4.5.1 Types of conditional contract terms captured

The Commission maintains its policy decision regarding the types of conditional discounts and fees captured by the rule. In order to provide stakeholders with greater clarity, the Commission has made minor modifications to the definitions of conditional fee, conditional discount and payment condition. Changes to the rule are summarised in section 2.3.1. The Commission considers that the scope of conditional contract terms captured is consistent with available evidence of harm to consumers raised by stakeholders.

### 4.5.2 Conditional fees and duplication of penalties

The Commission continues to consider that conditional fee restrictions are necessary to mitigate risk that retailers increase conditional fees to recover revenue lost through reduced conditional discounts.

The Commission has maintained its policy decision in respect of conditional discounts and conditional fees being triggered by the same payment condition (i.e. duplication). In order to provide stakeholders with greater clarity, the Commission has made small modifications to relevant section of the final rule. Changes to the rule are summarised in section 2.3.1.

### 4.5.3 Gas contracts and retailer contracts in all NECF jurisdictions

The Commission maintains its decisions regarding the application of the rule to gas contracts and all NECF jurisdictions.

### 4.5.4 Existing contracts

The draft determination proposed to capture large conditional fees in existing contracts if they were extended or renewed. In reaching this decision, the Commission noted that restricting conditional discounts was unlikely to benefit all consumers and that consumers that had been earning conditional discounts may face higher prices in some circumstances.<sup>107</sup> However, the Commission considered the detriment to these consumers would be outweighed by the benefits to other consumers.

The Commission's position in the final determination is that the rule should not apply to existing contracts when a benefit period is reset or when an existing contract term is extended or renewed.

The Commission considers that while the rationale for the rule continues to be valid overall, the exposure to risk for consumers *already* on conditional discount contracts is of a different nature, as are the likely effects of the rule on the energy prices they can access when they meet a payment condition. The Commission considers that three factors support this conclusion:

- exposure and experience to the risks and rewards of conditional discounts means that consumers on existing contracts with conditional discounts are more likely to be able to

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<sup>107</sup> Draft determination p. 21

make an informed decision about whether a conditional discount tariff is in their interest (i.e. can they meet the conditions) in the future.

- since the introduction of the DMO, consumers shopping around for more competitive offers now have a variety of low-priced, comparable options that are not conditional discount offers. This makes it unlikely that engaged consumers would be forced to stay on conditional discounts simply because these are, or appear to be, the cheapest in the market.
- the introduction of strengthened hardship guidelines in October 2019 indicates that existing consumers that frequently miss conditional discounts and are in hardship should be moved onto more appropriate tariffs by their retailers.

The Commission is cognisant of the trade-off between the likely detriment of reduced discounts for consumers that meet these discounts against the benefits afforded by stronger safeguards for a smaller number of consumers that frequently miss conditional discounts.

In addition to the points above, the Commission notes the existence of certain legal and enforcement issues of the application of the rule to existing contracts for both conditional fees and conditional discounts. These issues further support the removal of the transitional provisions from the final rule. These concerns include:

- Conditional fees are typically evergreen contract terms and not linked to benefit periods — this structure would not present retailers with a "trigger point" where conditional fees can be reset to comply with the rule
- Evergreen benefit periods; an ongoing benefit period would not present retailers with a "trigger point" where conditional discounts under the benefit can be reset to comply with the rule
- Availability of data for the AER to monitor this rule; the AER does not have access to ongoing data on resetting of benefit periods, so it would have to source information from various sources — a process which may not be efficient or comprehensive. For example, the AER may have to conduct regular audits of retailers to monitor compliance or work with ombudsman schemes.

The Commission considers that, on balance, the factors outlined above indicate that the rule should not apply to existing contracts when a benefit period is reset or when an existing contract term is extended or renewed. The final rule therefore applies only to new contracts entered into after 1 July 2020.

## 4.6 Summary: proposed rule coverage

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

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

<b>COVERAGE ISSUE</b>	<b>COMMISSION'S APPROACH: DRAFT DETERMINATION</b>	<b>COMMISSION'S APPROACH: FINAL DETERMINATION</b>
Conditional fees	Cap conditional fees to reasonable costs.	No change from the draft determination.
Duplication	Cap the aggregate value of a conditional discount and a conditional fee in the same contract at reasonable costs.	No policy change from the draft determination, the final rule has been amended to make clear that it captures multiple conditional discounts and multiple conditional fees.
Types of conditional contract terms captured by final rule	Limit the draft rule to conditional contract terms that impose a condition in relation to the timing or method of payment of a bill. Only terms that are triggered as a consequence of complying with a payment condition (in the case of discounts) or failing to comply with a payment condition (in the case of fees) are captured by the draft rule.	No policy change from the draft determination, the definition of payment condition has been expanded so that it captures provisions that "relate to" the timing or method of payment of a bill (not only those provisions that impose a condition).
Gas contracts	Extension of conditional discount and fee restrictions to retail gas contracts.	No change from the draft determination.
Retail contracts in all NECF jurisdictions (i.e. coverage of ACT, Tasmania and regional Queensland)	Extension of conditional discount and fee restrictions to Tasmania, regional Queensland and ACT.	No change from the draft determination.
Existing retail contracts with conditional terms	Capture existing contracts under its draft rule when an existing contract's benefit is reset or the term of a contract is extended or renewed.	The final determination does not capture existing contracts when an existing contract's benefit is reset.

## 5 APPROACH TO REASONABLE COSTS RESTRICTION AND IMPLEMENTATION

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

### 5.1 Reasonable costs restriction

#### 5.1.1 Issues raised by the rule change request

The rule change request suggested that the AER be empowered to develop a binding guideline that would set the level of reasonable costs and that reasonable costs should not include "lost supply or profits." Reasonable costs could include:

- administrative costs (such as consumer service)
- costs of holding debt
- regulatory compliance with new rule.<sup>108</sup>

The rule change request also stated that the guideline should allow for flexibility to enable retailers continue to design market products and allow the market and other stakeholders to help inform guideline design.<sup>109</sup>

#### 5.1.2 Stakeholder views to the consultation paper

Retailers were generally supportive of a "principles-based approach", whereby retailers set conditional discount levels based on their internal estimates of reasonable costs and reported on those to the AER. Simply Energy, for example, noted that varying financing and operating costs incurred by energy retailers justified an approach whereby conditional discounts reflect their individual business circumstances.<sup>110</sup> Retailers regarded a principles-based approach as more efficient because it would enable the AER to seek information and engage in enforcement action only when it saw a significant problem emerge, rather than preventing business practices ex ante. The AEC noted in its submission that the AER could request information about any offers from retailers to confirm whether it would be reasonable.<sup>111</sup>

Consumer groups were split on their preference for establishing reasonable costs. The TQCA, for example, expressed support for a principles-based approach, with the caveat that it be accompanied by effective monitoring by the AER of compliance with the rule.<sup>112</sup> PIAC supported an AER guideline on the basis that it would clearly signal to retailers reasonable levels of conditional discounts.<sup>113</sup>

108 Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, pp. 9, 12.

109 Ibid, p. 7.

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

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

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

113 PIAC, consultation paper submission, p. 6.

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

- a workable, enforceable definition of 'reasonable' costs
- an appropriate methodology for calculating reasonable costs with view of developing an objective standard of reasonability
- how frequently these costs should be reviewed, and
- appropriate lead times for setting the reasonable costs.<sup>114</sup>

### 5.1.3

#### Commission's draft decision

##### Principles-based restriction to reasonable costs

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

The draft rule did not require the AER to develop a binding guideline of reasonable cost levels, and did not provide such guidelines in the draft rule. The diversity of retailer costs, types of conditional discounts pricing structures and different business models would make it unlikely that the AER would be able to set a single level of reasonable costs.<sup>115</sup> The Commission considered it necessary to provide appropriate flexibility to both the AER and retailers through a principles-based restriction.

Based on the enforcement experience with similar reasonable cost-based restrictions<sup>116</sup> and effect of the DMO in improving offer comparability, the Commission expected that retailers would move away from offering large conditional discounts without the necessity of enforcement action by the AER. Given that non-compliant retailers could easily be identified through the AER's EME, they would be unlikely to set high rates for their conditional discounts.<sup>117</sup>

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

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<sup>114</sup> AER, consultation paper submission, p. 11.

<sup>115</sup> Rule 46C(a) of the Draft Rule.

<sup>116</sup> As per discussions with the AER in developing the rule, the Commission understands that the AER's past approach to existing rules that deal with the concept of reasonable costs (such as rule 49A of the NER or section 24 of the NERL, South Australia) has not led to increase in costs to that body given that no enforcement action has been taken to date. The Commission considers this is partly due to the deterrent effect of the rule, where it organically reduced prohibited behaviour.

<sup>117</sup> See Red Energy and Lumo Energy's submission regarding the fact retailers are naturally moving away from conditional discounts because of the DMO and its support for a light handed approach whereby the AER would monitor conditional discounts and request information from retailers when they appear to exceed reasonable costs. Red Energy and Lumo Energy, consultation paper submission, pp. 3-4.

Retailers may be required to provide evidence that their pricing practices for relevant conditional fees and discounts are reflective of reasonable costs. Due to the need to comply with the common law's restriction on terms and conditions that include penalties, the Commission expects that retailers already have processes and information required to reflect reasonable costs on their offers. As a result, additional costs of implementing the rule for retailers are not expected to be material.

### **Estimates of reasonable costs**

As noted in above, the Commission will not be setting, nor will it be requiring the AER to create, a reasonable costs guideline. However, as guidance, the Commission noted the approach that various bodies have taken on analogous issues in the past. The Commission considered three case studies to be instructive:

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

#### **BOX 2: BAN ON PAYMENT SURCHARGES UNDER THE CCA**

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

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

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

surcharge include:

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

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

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

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

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

#### 5.1.4

#### Stakeholder views on the draft determination

Stakeholders were largely divided into two groups based on their preference for a principles-based approach or a fixed cap set by the AER.

A majority of stakeholders supported a principles-based approach:

- AER, PIAC, Origin, TQCA, Momentum supported the Commission's approach to limit conditional discounts to reasonable costs without mandating a fixed cap or methodology.<sup>118</sup> For example, Momentum supported the approach on the basis that it enabled different energy businesses to account for costs differently and that this would be the least costly method of applying the rule.<sup>119</sup>
- AEC supported a principles-based approach but noted that the Commission's desire to provide retailers and the AER with flexibility might be hampered by the Commission's description of certain factors as guidance for the determination of reasonable costs.<sup>120</sup>

<sup>118</sup> AER, submission to the draft determination, p. 2; PIAC, submission to the draft determination, p. 1; Origin, submission to the draft determination, p.1; TQCA, submission to the draft determination, p. 2; Momentum, submission to the draft determination, p. 2.

<sup>119</sup> Momentum, submission to the draft determination, p. 2.

<sup>120</sup> AEC, submission to the draft determination, p. 1.

A smaller group of stakeholders was in favour of a fixed cap set by the AER:

- AGL and EnergyAustralia supported the introduction of a fixed numerical cap on conditional discounts on the basis that it provides certainty while avoiding administrative and enforcement costs.<sup>121</sup> For example, EnergyAustralia noted a fixed cap approach would be consistent with the ESC's draft decision on conditional discounts.<sup>122</sup>
- Choice also supported the introduction of a fixed numerical cap on conditional discounts on the basis that retailers were likely to exploit the lack of clear limits by bundling high costs into a late payment fees in a way that harms consumers.<sup>123</sup>

### 5.1.5

#### Commission's final determination

The Commission's final determination is to remain with a principles-based approach to restrict conditional discounts. The Commission considers that this is the most flexible and least costly approach to minimise the harm caused by large conditional discounts to some consumers. Conversely, the Commission considers that a fixed numerical cap would unlikely be in the long-term interest of consumers for several reasons, including:

- diversity of retailers and types of conditional discounts and fees means a single cap number may be inappropriate. The AER would need to create multiple caps for each type of conditional contract term — this is unlikely to be efficient or accurate.
- annual recalculation and consultation process around multiple fees is also unlikely to be efficient.
- should a low, single cap be set for all conditional contract terms, retailers with different cost structures may respond to this by increasing prices with the aim of accounting for the risk and costs of consumers missing payment conditions. This outcome is likely to be detrimental to consumers.

In regard to the provision of reasonable costs precedents in the draft decision, the Commission notes that the AER stated in its submission that its compliance and enforcement function will be aided by the provision of appropriate interpretative information by the Commission.<sup>124</sup> The Commission also notes that AGL and EnergyAustralia supported an approach with greater clarity and lower of enforcement costs, indicating that the Commission's approach may be in principle aligned to the requirements of market participants.<sup>125</sup>

The Commission considers that the reasonable costs precedents presented in the draft determination are appropriate and maintains this approach for the final determination. This approach provides both retailers and the AER with appropriate guidance about the final rule, and is likely to reduce the risk retailers inadvertently breaching the rule.

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121 EnergyAustralia, submission to the draft determination, p.11; AGL, submission to the draft determination, p. 2.

122 Ibid, p. 3; Essential Services Commission Victoria, Ensuring energy contracts are clear and fair, Draft Decision, 10 December 2019, pp. 47-50.

123 Choice, submission to the draft determination, p. 6.

124 AER, submission to the draft determination, p. 3.

125 EnergyAustralia, submission to the draft determination, p. 11; AGL, submission to the draft determination, p. 2.

## 5.2 Transitional and implementation issues

### 5.2.1 Commission's draft decision

#### **Rule commencement**

The Commission considered that the rule should commence from 1 July 2020 and apply to benefit periods ending after that date in line with the Commission's approach detailed in section 4.5.4.

#### **Civil penalties**

The Commission intended to recommend to the COAG Energy Council that breaches of rules 46C and 52B of the draft rule be subject to a civil penalty under the NERL. Having these provisions of the draft rule subject to a civil penalty would allow the AER to issue infringement notices with penalties of up to \$100,000 (for a body corporate) per breach. The Commission noted that the rule change request specifically proposed the addition of civil penalties.<sup>126</sup>

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

- Potential for large conditional discounts to cause financial detriment to consumers who miss payment conditions. An estimate of the potential detriment was calculated in the rule change request.<sup>127</sup> Given the material nature of this potential detriment, the existence of civil penalties would likely to be in the long-term interests of consumers and would contribute to the achievement of the objectives of the national energy laws.
- The rule exists, in part, to operationalise fundamental consumer protections already present, but not practically enforced, under common law (i.e. the penalty prohibition in contracts). In the past, large conditional discount rates in potential breach of common law had been a common practice. This evidence of widespread non-compliance with common law prohibition justifies the introduction of civil penalties.
- The Commission noted the potential for investigation of breaches of the rule to be difficult for the AER, especially with regard to the calculation of reasonable costs. Given this, civil penalties are appropriate as an effective deterrent to potential breaches of the rule.

### 5.2.2 Stakeholder views to the draft determination

#### **Rule commencement**

With the exception of EnergyAustralia, stakeholders did not comment on the 1 July 2020 commencement date proposed by the draft rule for new and existing contracts when a benefit period is reset. EnergyAustralia asked the Commission to consider clearer transitional

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<sup>126</sup> Australian Government, *Improving consumer outcomes and competition by regulating conditional discounting*, rule change request, 18 February 2019, pp. 4-5.

<sup>127</sup> *Ibid*, pp. 2-3.

requirements for existing contracts when a benefit period is reset to cater for scenarios it may not have contemplated.<sup>128</sup>

### **Civil penalties**

AER, EWON & TQCA supported the Commission's recommendation to COAG Energy Council for the breaches of the rules to be subject to a civil penalty under NERL.<sup>129</sup>

## **5.2.3**

### **Commission's final determination**

#### **Rule commencement**

Given the Commission's decision not to proceed with the application of the rule to existing contracts at the end of their benefit period, EnergyAustralia's concern about the application date for existing contracts when a benefit period is reset is no longer relevant. The Commission's final decision is that the rules apply to new contracts from 1 July 2020.

#### **Civil penalties**

The Commission's final determination is identical to its draft decision — it will recommend to COAG Energy Council that breaches of rules 46C(1) and 52B(1) be civil penalties.

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<sup>128</sup> EnergyAustralia, submission to the draft determination, p. 3.

<sup>129</sup> AER, submission to the draft determination, p. 1; EWON, submission to the draft determination, p. 2; TQCA, submission to the draft determination, p. 2.

## ABBREVIATIONS

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

## A SUMMARY OF ISSUES RAISED IN SUBMISSIONS TO CONSULTATION PAPER

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

**Table A.1: Summary of other issues raised in submissions to the consultation paper**

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

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

STAKEHOLDER	ISSUE	AEMC RESPONSE
AEC	Expressed concern that, if the rule change is too strict (i.e. limiting the ability for retailers to offer conditional discounts of the nature that they are today) then the availability of these low- priced offers might decline. (p.2)	The Commission's rule does not prescribe any advertising restrictions on conditional discounts. The focus of the draft rule is on the substance or level of discounts offered.
CHOICE	Noted disproportionate impact of high conditional discounting practices on vulnerable consumers. It also notes the fact that vulnerability can be widespread and derive from a range of personal and market specific issues. (p.6)	The Commission deals with these issues related to vulnerable consumers and whether specific measures are needed in section 3.4.1. Matters related to the extension of coverage of hardship programs are outside the scope of the rule change and are best dealt by jurisdictional governments and the AER. For example, on the matter of late payment fees, the NSW government has made arrangements to apply the exemption to a broader group of vulnerable consumers (see, National Energy Retail Law [Adoption] Regulation 2013, s. 10). The AER also has the power to issue and revise a binding Hardship Guideline under rules made by the Commission.
CHOICE	Indicated a preference for the banning of conditional discounts so that only guaranteed discounts are offered (p. 9)	The Commission notes the need to balance the need for it to balance retailers' ability to manage risk and pricing flexibility while protecting consumers in section 3.4 of the determination. The Commission's view is that banning of conditional discounts would unduly limit retailers risk management and pricing flexibility.
ECA	Noted that eligibility criteria for some offers may increase the transparency and certainty of prices that consumers are likely to face when signing up to an electricity plan as opposed to opaque conditional discounts. (p.3)	The Commission's rule does not affect the ability for retailers to advertise offers with eligibility criteria or sign up conditions.
ECA	Differences in the application of the discounts (to	The Commission has opted not to regulate the application of conditional

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

STAKEHOLDER	ISSUE	AEMC RESPONSE
		<p>the critical factor to be considered determining whether a term constitutes a penalty or a benefit. Conditional contract terms normally increase rates consumers expect to pay and/or impose a financial obligation based on realisation of a condition. The framing of this contract term to consumers as a benefit for purposes of the promotion of the offer does not detract from its ultimate effect, which is equivalent to that of a penalty.</p>
TQCA	<p>Notes that additional costs imposed by a retailer on consumers for late payments should be done by charging a fair interest rate applied to the amount unpaid and the time the bill remains unpaid. It noted that this is a widely used approach by businesses, including telcos. (p.3)</p>	<p>The Commission's draft rule and its expected enforcement approach are broadly aligned with these comments. The Commission expects that the AER's case-specific enforcement of the rule would most likely yield a similar outcome to an interest rate- based approach. The Commission welcomes feedback from stakeholders on how this approach to "fair charging" can be incorporated into its draft rule.</p>
South AustraliaCOSS	<p>Noted the emergence of energy deals with sign-up incentives (e.g. gift cards for signing up online) and bundling of services may make offer comparability more difficult. (p.2)</p>	<p>The Commission has not been provided with sufficient data to determine the materiality of this particular issue and encourages stakeholders to provide the Commission with information required to assess whether a restriction on additional types of offers are feasible and necessary.</p>
South AustraliaCOSS	<p>Noted disproportionate impact of high conditional discounting practices on vulnerable consumers. It also notes the fact that vulnerability can be widespread and derive from a range of personal and market specific issues. (p.2)</p>	<p>The Commission notes that 1.4 per cent figure quoted in the consultation paper was meant as an example of figures that may be utilised by stakeholders in their submission rather than the Commission's position.</p> <p>The Commission deals with these issues related to vulnerable consumers and whether specific measures are needed in section 3.4.1. Matters related to the extension of coverage of hardship programs are outside the scope of the rule change and are best dealt by jurisdictional governments and the AER. For example, on the matter of late payment fees, the NSW government has made arrangements to apply the exemption to a broader</p>

STAKEHOLDER	ISSUE	AEMC RESPONSE
		group of vulnerable consumers (see, National Energy Retail Law [Adoption] Regulation 2013, s. 10). The AER also has the power to issue and revise a binding Hardship Guideline under rules made by the Commission.
PIAC	Notes that the Code includes several provisions that make its interpretation and applicability problematic (pp. 1-2)	The Commonwealth government is responsible for the introduction and revision of the Code.
PIAC	Recommends that discount advertising be those utilising a simple dollar figure given percentages are often not well understood by consumers. (pp. 2,4)	The Commission's approach has been to focus on the substance of conditional discounts rather than advertising practices. It acknowledges that not all consumers may understand the concept of percentage discounts. At the same time, retailer practices centred on increasingly high discounts prior to the DMO indicate consumers responded to percentage discounts. In short consumers understood percentage discounts, but they did not understand their value because of different base rates set. This indicates that the issue was not the percentage per se. The Commission welcomes further data on this matter to establish its materiality.

## B SUMMARY OF ISSUES RAISED IN SUBMISSIONS TO THE DRAFT DETERMINATION

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

**Table B.1: Summary of other issues raised in submissions to the draft determination**

	<b>ISSUE</b>	<b>AEMC RESPONSE</b>
AEC	The AEC does not support the draft determination's proposed transitional provisions. This provision has a retrospective application. The AEC notes that the NERL does not appear to consider retrospectivity, nor is there precedence in this regard. It is our view that this provision is not consistent with best regulatory practice and should be removed.	The Commission has opted not to capture existing contracts when a benefit period is reset as noted in section 4.5.3. Given this decision, this issue is no longer relevant.  However, the Commission notes that the proposed transitional provisions in the draft determination were not retrospective application. This is because the rule would be triggered at the point of extension or renewal of the term of an existing contract or benefit period. Accordingly, conditional fees or conditional discounts in effect at commencement of the rule would not be impacted.
Meridian Powershop	Noted its concern with the proposed transitional provisions catering for a retrospective application of the draft determination. Powershop noted that the National Energy Retail Law does not appear to accommodate the retrospective application of new rules. Furthermore, introducing a rule with a retrospective application sets a destabilising precedence for the industry at a time when the industry is undergoing significant change. The transitional provision also introduces regulatory risk for retailers due the number of market retail contracts consumers have entered when the promise of discounted	As above.

	<b>ISSUE</b>	<b>AEMC RESPONSE</b>
	energy for paying on time.	
TQCA	Implementation of the rule should be accompanied by a consumer education campaign that explains the possible impact on different types of consumers (including those who do and don't have difficulty paying their bills on time) and encourages all consumers to shop around to ensure that they are on a contract that best suits their requirements and circumstances.	This issue is beyond the immediate scope of this rule change request and beyond the powers of the AEMC. However, the Commission has supported relevant agencies to take action in this regard. For example, in its 2019 Retail Competition Review, the Commission recommended that the Australian Government carry out actions to improve awareness of the enhanced EnergyMade Easy to allow to consumers benefit from the website.
TQCA	Retailer compliance with the rule should be closely monitored, especially soon after it becomes effective. The effects of the rule on consumers and retailers should be monitored and the results made public.	The Commission has been in close contact with the AER in the development of this rule to facilitate effective enforcement of the final rule.
AGL	We also recommend that the AEMC consider allowing for an exception post 1 July 2020 for consumers that have been lost in error that may wish to return to the same plan they were on when they had been incorrectly transferred out.	If a consumer has been transferred out of a contract incorrectly, this does not signify that a contract has ended. Therefore, existing benefits under the original contract should continue to be applicable and no new contract is required.
EA	EA supports the ACCC's recommendation for targeted financial assistance. The Commission may also wish to explore progress on this recommendation in making its final rule and otherwise in monitoring outcomes for vulnerable consumers.	This issue appears to be beyond the Commission's scope in this rule change request.
EA	Irrespective of approach, we urge the Commission to engage with the ESC to ensure alignment in regulations between Victoria and NECF states.	The Commission has been in close contact with the ESC (Victoria) in the development of this rule. However, the Commission notes the different contexts of each policy process and statutory processes which might lead to different policy outcomes.
EA	These comparisons suggest more about the spread of offers in the market, retailer pricing strategies and the state of	The Commission has considered the magnitude of existing and legacy contracts on consumer welfare in section 3.8. Risks

	<b>ISSUE</b>	<b>AEMC RESPONSE</b>
	competition. They do not provide a basis to determine whether or not discount conditions result in consumers paying too much. To emphasise our point, a lack of correlation between annual bills and the size of discounts undermines the rationale for regulating discounts, at least from the perspective that they systematically result in consumers paying more. (p.5.)	imbalances related to conditional discounts are widely distributed across the market and individually significant in terms of their monetary impact for consumers. Even a smaller penalty than one calculated in the rule change request could have a material effect on a consumer experiencing vulnerability but outside a hardship scheme.
EA	Commission has access to limited information to adequately consider how these different consumer cohorts would be affected by restricting conditional discounts, in terms of their existing and expected total bill payments. An analysis of total bills for hardship consumers would be especially useful.	The Commission requested data needed to understand relevant retail market dynamics in its consultation paper (Consultation Paper, p.8; section 3.1.1, Question 3). Stakeholders did not provide additional information needed to conduct a detailed quantitative analysis as suggested by EA. The Commission considers that retailers in particular have access to relevant data.
EA	A material proportion of consumers meeting discount conditions are being supplied energy at very low or even below cost, with any cross-subsidises falling to consumers who do not meet conditions or from higher unconditional priced offers. The ACCC does not appear to have found recent evidence of this in current market offers, information on legacy contracts would be required to monitor the impact of the Commission's rule change.	The Commission considers that the cross subsidy issue is a secondary cause to the harm caused to consumers from large penalties derived from conditional discounts. The key rationale for the decision, as noted in section 3.6 is the risk allocation imbalances inherent from conditional discounting practices. Stakeholders have not provided the Commission with information to analyse this issue in detail.
EA	Restrictions on conditional discounting may also push retailers further towards offering non-price benefits in designing new products. The nature of these benefits means they are difficult for regulators to monitor over time, including in terms of consumer value. For the same reason, they also potentially run counter to the effectiveness of reference pricing in ensuring consumers can easily compare offers.	The Commission's decision is restricted to a well-defined set of contract types. The Commission has not been provided with evidence that other types of non-price benefits have been causing consumer harm and therefore it considers the issue raised as not material at this stage.

## C LEGAL REQUIREMENTS UNDER THE NERL

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

### C.1 Final rule determination

In accordance with s. 259 of the NERL the Commission has made this final rule determination in relation to the rule proposed by the Commonwealth Minister for Energy and Emission Reduction, on behalf of the Commonwealth government.

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

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

### C.2 Power to make the rule

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

### C.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NERL to make the rule
- the rule change request
- submissions received during two rounds of consultation
- the Commission's analysis as to the ways in which the rule will or is likely to, contribute to the achievement of the NERL.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.<sup>130</sup>

### C.4 Civil penalties

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

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

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<sup>130</sup> Under s. 225 of the NERL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for energy. On 1 July 2011, the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated council is now called the COAG Energy Council.

The Commission considers that rules 46C(1) and 52B(1) be classified as civil penalty provisions for the reasons set out in section 5.2.1.

## C.5 Conduct provisions

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

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