

**Ministerial Council on Energy
Standing Committee of Officials**

REGULATION IMPACT STATEMENT

*A National Framework for Regulating Electricity and Gas (Energy) Distribution
and Retail Services to Customers*

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1. INTRODUCTION

1.1 ENERGY MARKET REFORM

In June 2001, the Council of Australian Governments (COAG) agreed to a set of core national energy policy objectives and principles to underline the development of effective, open and competitive national energy markets. Australian Governments recognised that such reforms to improve the efficiency and competitiveness of Australia's energy markets would deliver benefits to households, business and industry, including in regional areas. This reform process would build on National Competition Policy Agreements endorsed by all jurisdictions in 1995. In order to execute the reform agenda, COAG established the Ministerial Council on Energy (MCE).

In 2003, the MCE reported to COAG on reform in the energy market, including identifying the strategic issues for Australian energy markets. In line with this review, the MCE made a number of recommendations to develop a truly national and efficient energy market. The MCE identified that further reform was required in the areas of:

- Governance of energy markets;
- Economic regulation and rule making;
- Electricity transmission;
- User participation;
- Natural gas penetration; and
- Greenhouse gas emissions.

In 2004, the energy market reforms developed by the MCE were formalised in the intergovernmental agreement the Australian Energy Market Agreement (AEMA).

The reform program in the AEMA was amended in June 2006 to include, amongst other reforms, the transfer of retail and distribution regulation (other than retail pricing) to a national framework. This initiated the development of the National Energy Customer Framework ("the national framework") – which is a national framework for regulating the supply and sale (i.e. retail and distribution) of electricity and natural gas (energy¹) to customers.

2. BACKGROUND

2.1 OBLIGATIONS UNDER THE AUSTRALIAN ENERGY MARKET AGREEMENT IN DEVELOPING A NATIONAL ENERGY CUSTOMER FRAMEWORK

Section 14.5 of the AEMA provides the guidelines for developing the regulatory framework for the transfer of Laws and Rules to the national framework. Under the AEMA parties agreed to:

¹ Energy refers to both electricity and gas. Where there is reference to "energy" customers or retailers or distributors, unless otherwise stated, this means electricity and gas customers, retailers and distributors. The term energy can be used interchangeably with "electricity and gas", both of which have the same meaning.

- Provide common regulatory arrangements for electricity and gas;
- Improve the transparency of regulatory arrangements;
- Provide an appropriate level of regulatory certainty;
- Reduce overlap between energy specific and generic regulation; and
- Minimise the regulatory compliance burden and associated cost.

The AEMA allows for States and Territories to retain responsibility for community service obligations, measures to maintain existing tariff equalisation schemes, land use and planning approval and environmental policies and the list of items identified as State and Territory functions in Annexure 2 of the AEMA.

Retail price regulation also remains a responsibility maintained by States and Territories, with the phase out of regulation to be managed in accordance with sections 14.10 to 14.16 of the AEMA. However, this is not an obstacle for the development of the national framework for the regulation of retail and distribution functions. The national framework is being developed with a view to accommodating both the continuation of price regulation or removal or phasing out of price regulation where appropriate.

The transfer of the Laws and Rules relating to retail and distribution activities from the jurisdictions to the national framework is the final major stage of the energy market reforms agreed in the AEMA which is yet to be completed.

2.2 PROCESS TO DATE

In 2006, the Retail Policy Working Group (RPWG) was formed to assist the MCE Standing Committee of Officials (SCO) draft the national framework. The RPWG consists of representatives from each jurisdiction that is party to the AEMA, and is chaired by Victoria. On behalf of SCO, RPWG engaged consultants Allens Arthur Robinson (AAR) to develop a number of Working Papers for public consultation on major issues for consideration in developing the Law and Rules of a national framework for regulating distribution and energy retail services to customers (now referred to as the National Energy Customer Framework).

The Working Papers each addressed a specific component of the regulatory framework including:

- Working Paper 1: retailer obligation to supply small customer, small customer market contracts and retailer-customer marketing;
- Working Paper 2: distributor obligation to provide connection services and the interface with retailers and embedded generators;
- Working Paper 3: business authorisation, ring-fencing and retailer failure arrangements;
- Working Paper 4: balancing regime and settlements affecting customer transfer and metering; and
- Working Paper 5: enforcement mechanisms and statutory objectives.

Following this consultation process, AAR was engaged again by SCO to prepare a Composite Paper encompassing all of the components of the regulatory framework in the Working Papers and the issues raised by stakeholders.

Stakeholders were again invited to provide written submissions on the AAR Composite Paper. On 13 June 2008, SCO released its Policy Response Paper and Table of Recommendations which took into consideration the recommendations made in the AAR Composite Paper, and the views of stakeholders who responded to the public consultation processes. The policy response paper and table of recommendations have been developed as the basis for the drafting of Laws and Rules for the national framework, as provided for in the AEMA.

Feedback received through this public consultation process has been used to inform the drafting of the Initial Exposure Draft of the Law and Rules, which were released for public consultation on 30 April 2009.

A Final Exposure Draft of the Law and Rules is expected to be released for public consultation prior to the introduction of the Bill into the South Australian Parliament.

SCO is managing other national energy reform projects that are directly related to the national framework, and is mindful that where these related projects have implications for the implementation of this project, there must be a coordinated approach. Any necessary changes will be coordinated and managed through the various SCO working groups and will be subject to ongoing SCO oversight.

2.3 SCOPE OF THE DECISION REGULATION IMPACT STATEMENT

The national framework is mainly concerned with regulating those entities that are engaged with the sale and supply of energy to small customers (residential and small business customers). Therefore, the package will regulate the activities of distributors, retailers and customers. The Decision RIS aims to finalise the major policy areas that need to be transferred to the national framework and which are currently regulated by jurisdictions.

The Decision RIS will mainly focus on the following **high-level** policy issues:

- Retailer-customer relationships;
- Distributor interactions with customers and retailers;
- Business authorisations; and
- Enforcement and the statutory objective.

The scope of the Decision RIS will not extend to metering and customer transfer. Responsibility for developing these procedures in a national framework rest with the National Electricity Market Management Company (NEMMCO)².

² From 1 July 2009, the new Australian Energy Market Operator (AEMO) will commence operations, including NEMMCO's role in operating of the National Electricity Market. From the commencement of AEMO, all references in this RIS to NEMMCO should be read as AEMO.

Rule change processes through NEMMCO are comprehensive and involve numerous rounds of public consultation. The MCE SCO will work with NEMMCO to make certain that the rules developed in relation to this policy area work effectively with the national framework.

2.3.1 Compliance Costs in the Decision RIS

Unless otherwise stated, compliance costs and burdens referred to in the Decision RIS are generic in content and nature. Such compliance costs refer to stakeholders' costs, amending IT infrastructure to accommodate the national framework, and other additional costs in relation to training staff in new regulatory requirements (although these would be considered short-term costs).

Calculating costs in quantitative values is not possible in this framework as this would require retail and distribution businesses to provide commercially sensitive material. Therefore, for the purpose of identifying whether compliance costs will increase or decrease under the proposed model, normative feedback from stakeholders has been relied upon. The costs and benefits listed in the tables have been logically developed, taking policy implications into consideration within the regulatory environment.

The following tables set out the impacts on stakeholders of the current regulatory arrangements, providing a baseline for assessing the costs and benefits of implementing the national framework.

Impacts on stakeholders

Retailers	Retailers must comply with various jurisdictional regulations. Layering of regulatory obligations impacts on the operating costs of retailers and prevents economies of scale (e.g. through common IT systems being developed).
Distributors	Regulatory inconsistency is problematic for distributors that are currently subject to nationally consistent access requirements under the National Gas Law (NGL) and National Electricity Law (NEL) and adds to compliance burdens.
Energy Consumers	Energy consumers in some States or Territories may have the benefit of a more rigorous suite of consumer protections compared to other States or Territories. However, the compliance burden on retailers and distributors indirectly impacts energy customers through market inefficiencies, less competitive energy pricing and less innovative service offerings.
Regulators	Regulators are not directly impacted by maintaining the current regulatory arrangements as each jurisdictional regulatory authority is only responsible for their own jurisdictional matters.

Benefits and costs

Benefits	
Transitional costs	In the short-term, retailers operating in various jurisdictions will not be required to adhere to new regulatory arrangements therefore saving on the cost of changing operating systems and retraining staff, for example.
Single jurisdictional retailers	Retailers choosing to limit their operations to only one or two jurisdictions benefit from maintaining the current regulatory framework whereby jurisdictions maintain responsibility for the regulation of retail and

	distribution activities.
Tailored jurisdictional energy markets	Where jurisdictions maintain responsibility for this policy issue; they are better equipped to respond to energy market issues according to the specific characteristics (in terms of geography, energy use or social factors, for example) of that market. Individual jurisdictions may be better positioned to respond to specific energy market characteristics.
Costs	
Long-term market design	Maintaining the status quo and not adopting a nationally consistent approach has long-term market design issues. As the retail energy market is increasingly national in scope, maintaining separate jurisdictional requirements is contrary to good market design principles and limits effective competition.
Market efficiency	Not adopting a nationally consistent approach has long-term market efficiency issues. As the retail energy market is increasingly national in scope, energy retailers who operate across numerous jurisdictions are required to comply with multiple jurisdictional regulations, resulting in layered regulatory obligations. It is clear that compliance with numerous regulatory arrangements impacts on retail operating costs and leads to reduced efficiency and therefore less competitive energy pricing.
Barriers to entry	Not adopting a nationally consistent approach has long-term market design consequences in relation to barriers to entry. As the retail energy market is increasingly national in scope, energy retailers who operate across numerous jurisdictions are required to comply with various jurisdictional regulations resulting in layered regulatory obligations. This results in reduced competitive headroom for new retailers entering into the market and may favour incumbent retailers. The cost to retailers associated with operating across more than one jurisdiction presents barriers to new retailers offering services across the market and results in less competitive energy pricing. This is significant for long-term market competition.
Regulatory inconsistency	While regulation for retail supply and distribution activities are retained by States and Territories, regulatory inconsistency will persist where other areas of market reform have progressed to result in nationally consistent regulations for other sectors in the energy supply chain.

3. STATEMENT OF PROBLEM

As noted in the background, the driver for energy reform under the AEMA, including the establishment of the national framework, is the broader range of economic reforms agreed to by Australian governments under the National Competition Policy reforms.

In its review of the impact of energy market reforms in 2002³, COAG observed that while the failure to realise a fully competitive national market was partly due to an incomplete reform process, it also noted the role that inefficient institutional arrangements (due to multiple regulators) had in impeding competition. The different rules between jurisdictions, and between electricity and natural gas, had the effect of increasing entry costs faced by retailers by around one third due to additional IT, capital and operating costs and the inability to take advantage of back-office economies of scale⁴. Subsequently, amendments to the AEMA in 2006 re-emphasised the importance of developing a national framework for the regulation of retail and distribution activities.

States and Territories currently maintain responsibility for regulating the activities of electricity and gas retailers. In part, this reflects historical precedent, where separate State and Territory markets existed in which electricity and gas utilities were publicly owned, and consumers were obliged to purchase energy from a monopoly supplier. The energy sector has undergone significant transformation in the last 15 years.⁵

The Commonwealth holds no specific head of power within the Constitution to make laws in relation to energy and, with the States and Territories, has opted for an approach of cooperative federalism in the development of a national customer framework for the energy sector.

As the energy market reform process has evolved, retailers are no longer restricted to operating in a single jurisdiction. Retail contestability has given retailers the opportunity to enter into other jurisdictional markets and compete with the traditional incumbents of each market. As retailers increasingly operate across a number of jurisdictions in the national energy markets, their compliance burden also increases as they must comply with the different regulatory requirements of each jurisdiction⁶. Increases or reductions in compliance costs are passed through to customers in the form of higher or lower priced (respectively) energy products and services.

For example, a retailer operating across a number of jurisdictions must meet the various regulatory obligations that apply in each jurisdiction that work to complicate billing systems (i.e. frequency of bills and content). This compliance

³ Council of Australian Governments: Towards a Truly National and Efficient Energy Market (the Parer Review), 2002.

⁴ Council of Australian Governments: Towards a Truly National and Efficient Energy Market (the Parer Review), 2002, p 10.

⁵ AER: State of the Energy Market Report 2007 page 1

⁶ Retailers are generally very supportive of developing a national regime, especially those operating across a number of jurisdictions. See submissions on the AAR Composite Paper and Consultation RIS for more detail. Available at the website www.mce.gov.au

burden is also a factor in other areas of a retailer's operations such as their obligations in relation to assisting customers experiencing financial hardship, marketing conduct, terms and conditions of standard and market retail contracts, business entry requirements, and information reporting requirements of jurisdictional regulators. Currently these requirements vary across jurisdictions.

Table 3.1 identifies the electricity retailers actively selling to small customers across Australia, as at June 2008. From the table it clear that many retailers have to comply with four different jurisdictional rules relating to the provision and supply of electricity. This impacts particularly on the larger private retailers that operate across numerous jurisdictions such as AGL Energy, Jackgreen, Origin Energy and TRUenergy.

On average, electricity retailers operating in Australia must comply with at least two different sets of rules. It is reasonable to argue that the greater the number the rules that a retailer must comply with, the greater impact compliance costs and requirements to operate several business systems will have on the business.

Table 3.1 Active electricity retailers: small customer market, June 2008⁷

	RETAILER	OWNERSHIP	NSW	VIC	QLD	SA	TAS	ACT	WA	NT
1	ActewAGL	ACT Govt & AGL Energy								
2	AGL Energy	AGL Energy								
3	Alinta Sales	Babcock & Brown Power								
4	Aurora Energy	TAS Govt								
5	Australian Power & Gas	Australian Power & Gas								
6	Click Energy	Click Energy								
7	Country Energy	NSW Govt								
8	Energy Australia	NSW Govt								
9	Ergon Energy	QLD Govt								
10	Integral Energy	NSW Govt								
11	Horizon Power	WA Govt								
12	Jackgreen	Jackgreen Ltd								
13	Momentum Energy	Momentum Energy								
14	Our Neighbourhood Energy	Our Neighbourhood Energy								
15	Origin Energy	Origin Energy								
16	Perth Energy	Infratil								
17	Power and Water Corp	NT Govt								
18	Powerdirect	AGL Energy								
19	Queensland Electricity	Infratil								
20	Red Energy	Snowy Hydro								
21	Simply Energy	International Power								
22	South Australia Electricity	Infratil								
23	Synergy	WA Govt								
24	TRUenergy	CLP Group								
25	Victoria Electricity	Infratil								

HOST RETAILER

NEW ENTRANT

⁷ Australian Energy Regulator: State of the Energy Market Report, 2008

The Parer Review⁸ sought to establish a monetary value for the cost of regulatory burden and compliance on retailers. According to its sources, the varying regulatory requirements add up to \$12 million dollars per annum⁹ to the operating costs, and depreciation of establishment costs, of a retailer entering a new state market.

Based on Table 3.1 and the costs identified by the Parer Review, significant savings could be made by retailers in Australian electricity retail markets alone. This does not account for the potential savings by gas retailers, and also the harmonisation of requirements across the two energy sectors.

The review further notes that: "A retailer wishing to compete in those markets open to competition is ... required to obtain a separate retail licence in each state, with different licence conditions attaching to each of these licences. Moreover, the codes and guidelines (which include billing, reporting and marketing requirements) that sit under these licences differ in their requirements. The result is that business processes and systems must be tailored for each jurisdiction. The inefficiencies that result from this inhibit a retailer's ability to compete effectively. Energy specific codes duplicating general competition regulations exacerbate this problem."¹⁰

Unnecessary compliance costs layer the burden placed on retailers and distributors, contributing to inefficiencies in the energy market. These inefficiencies pass through to energy customers in the form of less competitive energy pricing and less innovation in product and service offerings. In the longer term, market inefficiencies can lead to distorted price signals that may hamper investment decisions. As the energy sector in Australia is increasingly competitive, price signals to encourage investment are critical for energy security and reliability. Reducing compliance costs and providing transparency and consistency in relation to energy regulation for retailers and distributors is critical to this process.

In terms of regulating energy retailers, the Parer review notes the benefits of moving to a national regulator, as opposed to jurisdictionally based ones:

Moving to a National Regulator delivers efficiency benefits through the removal of a variety of different jurisdictional protocols and requirements. The United Kingdom's experience with a national regulatory approach was used as a proxy to estimate the potential benefits in Australia. ACIL Tasman has modelled the impact of reforms on the overall economy by assuming that the recommended changes to regulatory arrangements, mainly through reducing regulatory risk, allow electricity and gas prices to fall by 1 percent. This is a conservative assumption.

⁸ Council of Australian Governments: Towards a Truly National and Efficient Energy Market (the Parer Review), 2002

⁹ Based on the initial Parer Review estimate of \$10 million dollars.

¹⁰ Council of Australian Governments: Towards a Truly National and Efficient Energy Market (the Parer Review), 2002, page 75-76.

On the basis of this assumption, it is estimated that cost savings of around \$805 million dollars¹¹ in 5 year net present value terms could be achieved by implementing the recommended governance and regulatory reforms. The reduction in electricity and gas prices would have important implications for the competitiveness of energy intensive industries¹².

Self-regulation is not considered an appropriate option for this industry given that it deals with an essential service which impacts on the well-being and livelihood of individuals, thereby attracting strong public interest. The nature of the industry means that any detriment incurred is likely to be of high risk and high impact. Market forces alone are not considered sufficient mechanisms to provide protection and stability in this industry. Government intervention is required to ensure that small customers are able to access a supply of energy on reasonable terms.

¹¹ Based on the initial Parer Review estimate of \$673 million.

¹² Council of Australian Governments: Towards a Truly National and Efficient Energy Market, 2002, page 253

4. HIGH-LEVEL OBJECTIVES

The high-level principles which guide reform in the energy market are set out in the AEMA. Section 2.1 of the AEMA states these objectives as being to:

- Promote the long-term interests of consumers with regard to the price, quality and reliability of electricity and gas services; and
- Establish a framework for further reform to (relevantly):
 - strengthen the quality, timeliness and national character of governance of the energy markets, to improve the climate of investment; and
 - streamline and improve the quality of economic regulation across energy markets to lower the cost and complexity of regulation facing investors, enhance regulatory certainty, and lower barriers to competition.

4.1 OBJECTIVES IN RELATION TO THE NATIONAL ENERGY CUSTOMER FRAMEWORK

More specifically, the AEMA sets out the guidelines for developing the national framework for the regulation of distribution and retail services. As directed under section 14.5 of the AEMA, the national framework should provide effective regulation to:

- Provide common regulatory arrangements for the electricity and natural gas sectors;
- Improve the transparency of the regulatory arrangements;
- Provide an appropriate level of regulatory certainty;
- Reduce overlap between energy specific and generic regulation; and
- Minimise the regulatory compliance burden and associated cost.

Each of these objectives must be applied to the policy areas discussed in the following sections.

It should be noted that this RIS focuses on the costs and benefits for customers and energy market participants. It is recognised that there may be additional costs and benefits to other parties such as governments, and to society as a whole in relation to the arrangements for the sale and supply of energy, which is an essential service, but which are not explicitly considered in this RIS.

5. RETAILER- CUSTOMER RELATIONSHIP

Retailer-customer arrangements define, in both the Law and Rules, the obligations of retailers and energy customers in the provision of energy services. Defining broadly what these obligations are forms the basis of this Decision RIS; the MCE SCO Policy Response Paper¹³ provides detail surrounding each of these policy options, including which aspects are to be placed in the Law or Rules, and the detail surrounding these obligations.

For the purpose of demonstrating the economic benefits and impacts of each broad obligation, and the rationale for reaching decision on particular options, the Decision RIS will cover options relating to:

- The obligation to offer supply;
- Designating retailers with the obligation to offer supply;
- Which customers are to benefit from the obligation to offer supply by retailers;
- Industry-specific versus generic regulation; and
- Adopting a hardship regime.

5.1 OBLIGATION TO OFFER SUPPLY

An obligation to offer supply places a requirement on all or some retailers to offer to sell energy to a defined group of customers if those customers request supply.

The AEMA recognises the place of the obligation to offer supply in jurisdictional regulatory frameworks. In section 14.12 it states that where jurisdictions agree to phase out the exercise of retail price regulation, that it need not involve the removal of 'obligation to supply' arrangements. This statement recognises that while markets can effectively and efficiently allocate resources there remains a significant risk that not all individuals will be able to access energy supply. It is collectively recognised that the supply of energy affects the well-being and livelihood of every individual in Australia. As such, an obligation to offer supply requirement is considered necessary due to the essential nature of energy services.

5.1.1 Problem

Section 3 outlines the Statement of Problem in relation to harmonisation of arrangements for the sale and supply of energy agreed in the AEMA.

Currently all jurisdictions regulate an obligation to offer supply. Given that this requirement is imposed in all regulatory regimes across jurisdictions, a number of high-level AEMA objectives are already met through the status quo.

¹³ See

http://www.ret.gov.au/Documents/mce/_documents/MCE_SCO_National_Framework20080613111731.pdf

5.1.2 Options

	Option 1	Option 2
Option	Do not adopt an obligation to offer supply on retailers in the national framework	Adopt an obligation to offer supply in the national framework

Option 1: Do not adopt an obligation to offer supply on retailers in the national framework.

This option removes any obligation on some or all retailers to supply electricity or gas to a defined group of customers who request it.

The rationale for removing an obligation to offer supply is persuasive where retail energy markets are deemed to be effectively competitive. Arguably, a fully effective market would not exclude classes of customers on the basis that they are not attractive to any retailer. For instance, in the retail market in personal finance products market forces have seen the development of a range of products tailored to suit a range of customers with varying financial credentials.

The rationale is that where a retail market is fully effective, retailers will attempt to capture market share by tailoring products for niche customer segments including those who would otherwise be considered a financial risk, or who are remotely or regionally located.

However, the difficulty in arguing for not adopting an obligation to offer supply in a national framework is apparent where full retail contestability has not commenced in all jurisdictions. Taking steps to determine whether retail energy markets are fully effective and competitive is only a recent development in the market reform process. At this stage, the Australian Energy Market Commission (AEMC) has finalised reviews of competition in Victoria and South Australia's retail energy markets, for which both reviews found competition to be effective in the retail energy market sectors¹⁴. In response to the AEMC's review, the Victorian Government removed retail price caps as of 1 January 2009 for small energy customers.

The overriding principle that residential consumers should have uninterrupted access to essential services makes it difficult to support an argument for not adopting an obligation to offer supply in a national framework.

Impacts on stakeholders

The impacts of not adopting an obligation to offer supply in the national framework mainly relate to the compliance burden faced by retailers and distributors. It may see consumers going without supply and as a result,

¹⁴ See aemc.gov.au for the Final Reports relating to the effective competition reviews conducted by the AEMC.

ombudsman schemes may face increased workloads where energy customers face greater difficulty in securing supply.

Retailers	<p>Retailer's compliance burden is reduced under this option; however, it is unclear to what extent. It would be conceivable that retailers would find a large majority of customers commercially attractive enough to offer supply irrespective of any regulated imposition.</p> <p>Retailers may choose to limit the geographical areas in which they operate and offer supply. An obligation to offer supply may cause retailers to service an area considered less commercially attractive.</p>
Distributors	<p>The compliance burden on distributors may be reduced where retailers are not obliged to offer supply. Connection and distribution services supplied by distributors are highly dependent on the activities of retailers in terms of their customer base and requirements. Where retailers do not choose to supply a premises there is little imperative (if any) by a distributor to provide connection and distribution services as there is no sale or supply contract at the premises.</p>
Energy Consumers	<p>Potential energy customers cannot be assured of a secure access to energy supply that may have severe consequences on the health and well-being of individuals more broadly. Where an energy customer is located remotely, for example, and where retailers may choose to limit their operations according to economic incentives, an energy customer is limited in accessing a secure energy supply.</p> <p>Energy customers considered to be financially risky may face difficulty in finding a retailer who is willing to supply energy to their premises. This is especially the case where retail markets are not yet contestable or have limited competition.</p>
Regulators	<p>While the impact of not imposing an obligation to offer supply may subsequently mean less monitoring and compliance by regulators, there is likely to be a tangible cost transfer to jurisdictional ombudsman services. It is reasonable to conclude that where retailers do not offer supply to less commercially attractive customers (because of their payment history, location or energy use patterns, for example), that this would facilitate an increase in complaints to ombudsman's offices.</p>

Benefits and costs

Benefits and costs associated with not adopting an obligation to offer supply in the national framework mainly relate to issues of economic efficiency that are derived from reduced compliance and regulatory obligations. However, these gains may be transferred as costs to jurisdictional ombudsman schemes where the number of disenfranchised energy customers would increase without an obligation to offer supply imposed on retailers. It is necessary to consider these costs when assessing the benefits of not adopting the obligation to offer supply in the national framework.

Benefits	
Economic efficiency	<p>Retailers would not be obligated to offer supply to less commercially attractive customers, which would better place retailers to promptly recoup payments from customers and tailor a limited range of service offerings to suit their desired classes of customers which is likely to provide efficiencies for retailers.</p>
Lower compliance burden	<p>The reduction in compliance burden would translate to reduced operating costs for retailers and distributors. The extent to which this impact is material is debatable as retailers would consider a very large majority of their energy</p>

	customers attractive ¹⁵ .
Product innovation	Where retailer's compliance burden is reduced, operating costs are also reduced. In the long-term this may benefit energy customers in the form of competitive energy prices and greater scope for product innovation by retailers.
Reduced compliance monitoring	Regulators' monitoring compliance requirements will be reduced with the removal of this obligation as retailers will not be required to comply with further regulatory requirements relating to designated retailer responsibilities and being obligated to offer supply to certain customers.
Competitive markets	As retail energy markets become effectively competitive, imposing an obligation to offer supply may impede the development of effective competition through increasing the compliance burden imposed on retailers and act as a barrier to new entrants, and may be deemed an unnecessary regulatory measure as all energy customers are able to access supply on reasonable terms and conditions.
Costs	
Reliability in accessing supply	Removing the obligation to offer supply in the absence of effectively competitive retail markets would impose costs for small and less commercially attractive customers. Even under an effectively competitive market, a small number of customers may not be able to obtain a supply (or access to supply on reasonable terms and conditions). At the individual level that failure can have significant consequences, potentially denying access to basic services such as lighting, heating and cooking, and may have substantial personal and public health implications.
Limiting customer base and market share	Where retailers are not obligated to supply energy to individuals, this may be to the detriment of future market share and customer base. For example, where energy customers may not be able to access supply in a regional or remote area an obligation to offer supply rectifies this market failure. Without an obligation to offer supply, this may implicitly place a limit on further economic development in this area. In the very long-term this may have the effect of stymieing growth in the customer base and regional development.
Risk in non-contestable markets	Not adopting an obligation to offer supply without fully contestable markets and effective competition in all jurisdictions introduces an element of risk into the framework whereby commercially unattractive and remote and regional energy customers may be disenfranchised from securing energy supply and thus denied access to an essential service.
Increased ombudsman activity	The potential for energy customers to not be able to access a secure energy supply may result in increased complaints and investigations by jurisdictional ombudsman schemes for energy services. Effectively, what may occur by not imposing an obligation to offer supply is that the benefit of reduced compliance burden enjoyed by retailers is transferred as a cost to jurisdictional ombudsman schemes.

Option 2: *Adopt an obligation to offer supply for designated retailers to provide energy services to those customers who request it in the national framework*

Parties affected by the obligation to offer supply are primarily retailers and energy customers.

Currently, all jurisdictions regulate an obligation to offer a contract for the supply or sale of energy to small customers from retailers. In electricity the requirement is expressly stated in all jurisdictions. In contrast, the arrangements for gas

¹⁵ The Essential Services Commission of Victoria: 2006-07 Energy Retail Performance – Consumer Snapshot indicates that less than 1% of customers were disconnected for non-payment. The figure is similar for New South Wales.

differ across jurisdictions and are related to whether gas is viewed as an essential service to customers.

All jurisdictions adopt a similar approach in terms of linking the obligation to offer supply by a retailer with a set of standard terms and conditions under which supply must be offered. In particular, the obligation to offer supply may be linked with a regulated tariff set by that jurisdiction.

Given that a high-level objective of the AEMA is to harmonise the requirements between the electricity and gas sectors, imposing an obligation to offer supply on retailers would be for both electricity and gas supply. In this regard, there may be a degree of increased regulation in retail gas markets as not all jurisdictions extend the obligation to offer supply to gas services¹⁶.

Impacts on stakeholders

Generally, all stakeholders are impacted by an obligation to offer supply in the current regulatory environment. Therefore, the impacts on stakeholders remain unchanged moving into the national framework. The exception to this position is where there would be a change to the obligation to offer supply to gas services in some jurisdictions.

Retailers	Designated retailers with the obligation to offer supply may be required to make operational adjustments in order to meet this requirement. This may impose additional operating costs, and costs relating to marketing, training and education for employees. Further retailers may be required to extend their operations into geographical areas not considered to be economically attractive, such as regional and remote areas where the cost of supplying premises may be higher. However, designated retailers may experience an increase in customer base by offering supply which in itself may promote competition.
Distributors	Distributors are impacted by the adoption of the obligation to offer supply through the auxiliary connection services that are required at a premises in order to receive supply. This may impact on the operating costs to the extent that distributor connection services must be provided to remote or regional areas. However, by the same logic a distributor's customer base may be expanded by the obligation to offer supply, providing greater revenue into the future.
Energy Consumers	An obligation to offer supply by a designated retailer ensures that energy customers are able to reliably access energy supply, which is considered to be an essential service that impacts on the health and well-being of individuals. An obligation to offer supply protects vulnerable customers, who for reasons such as financial difficulty or geographical location may find accessing energy supply on reasonable terms and conditions to be difficult.
Regulators	Regulators will be required to monitor compliance in this area. However, given the obligation would be imposed as a simple regulatory measure applying to all customers across the relevant class, the costs involved in this would be minimal, and it can be reasonably expected that instances of non-compliance would be rare. Jurisdictional ombudsman schemes may be relieved of a heavy workload where the potential for energy customers not being able to access supply is reduced.

¹⁶ Tasmania does not extend the obligation to offer supply to gas services, see table 5.3

Benefits and Costs

The benefits and costs of imposing an obligation to offer supply balance possibly lower economic efficiencies with guaranteed access to essential services for customers. Regulating an obligation to offer supply to customers, including vulnerable or 'less commercially attractive' customers, is consistent with the operational objective of the Productivity Commission (PC) *Review of Australia's Consumer Policy Framework* to “meet the needs of those who, as consumers, are most vulnerable, or at greatest disadvantage”¹⁷.

Benefits	
Reliability in accessing energy supply	In the absence of effectively competitive retail markets across the national energy markets, the absence of an obligation to offer supply may lead to detriment for a particular class, or classes, of customers where retailers with market power may choose to exclude customers that are considered less commercially attractive. For these reasons, and even if competition is deemed to be effective in all retail markets, there is a strong argument to continue to impose an obligation to offer supply energy, which is considered to be an essential service.
Reducing risk	A statutorily imposed obligation to offer supply is a simple regulatory measure to reduce the risk of customers not reliably accessing energy supply ¹⁸ .
Reduced information asymmetries	Where retailers are obligated to supply energy customers, the long-term effect through monitoring and compliance is that better quality information is available to regulators. This (clearer) information can be conveyed to the market for informed investment and product decisions and to better understand the range and nature of hardship experienced by energy customers.
Market share	An obligation to offer supply supports ongoing economic development, which in the long-term supports an expanding customer base for designated retailers with the obligation to offer supply. Where contestable markets are not yet developed, and especially in relation to regional areas, jurisdictions have imposed an obligation to offer supply in order to support ongoing economic development. Distributors will also experience an increase in their customer base through consequential new connections which will increase future revenue.
Affordability	Imposing an obligation to offer supply which can be accessed on a published tariff is the basis for making certain that customers have access to affordable energy. This is especially the case where retail markets are not fully contestable and where potential exists for retailers to exploit market power.
Market failure	The market may fail to provide energy security for energy customers living in regional areas, or are otherwise considered less commercially attractive (i.e. because they pose a financial risk to retailers). Market failure in these areas means that energy customers are limited in their participation in the market. This also applies in circumstances where customers do not have sufficient choice of, or information available on, products in order to effectively participate in the market ¹⁹ .
	Transferring this responsibility to a single national regulator should afford

¹⁷ Productivity Commission: Review of Australia's Consumer Policy Framework page 12.

¹⁸ If an obligation to offer supply is imposed, regulatory efficiency is brought into question when considering how this obligation should be imposed, and which retailers are best placed to carry out the obligation.

¹⁹ MCE SCO Policy Paper, page 17

Compliance and reporting	cost savings overall through reduced duplication and greater efficiencies of scale for the regulator. Given that this is (essentially) already the status quo for all jurisdictions, it is reasonable to expect that the incidences of non-compliance would be rare and therefore monitoring requirements for this obligation would be minimal. As noted elsewhere, imposing this obligation may result in fewer complaints to jurisdictional energy ombudsman schemes which overall may present a greater cost saving measure than not imposing the obligation.
Regulatory harmony	Where this is adopted in the national framework, regulatory harmony will be achieved across jurisdictions, and across energy sectors for gas and electricity. The obligation will apply across participating jurisdictions, regardless of the degree of effective competition in any particular market.
Costs	
Compliance burden	Retailers are faced with compliance burden as they must supply energy and connection services in a regulatory environment that includes associated reporting requirements. Where connection obligations also exist, distributors will also face a similar compliance burden.
Less competitive energy pricing	This option may in the longer term lead to less competitive pricing as retailers and distributors must provide energy and connection services to energy customers they would otherwise find commercially unattractive. By doing so, retailers and distributors are unable to allocate their resources in a competitive manner. The flow on effect for energy customers is less competitive energy prices and products. However, the full extent of this cost is debatable, as retailers would consider a large majority of their customers to be financially viable, so that the effect of supply to a small proportion of commercially unattractive customers may be relatively immaterial to the operating costs of retailers.
Compliance monitoring	The costs of transferring this obligation to a national framework are considered to be negligible as jurisdictions already impose this function on retailers.
Monitoring compliance for regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

5.1.3 Consultation

As noted elsewhere, consultation on policy issues proposed in the national framework has been extensive. The following comments made in written submissions reflect the more recent comments made by stakeholders and are based on submissions in relation to the MCE SCO Policy Paper and Table of Recommendations and the Consultation RIS.

In written submission received from stakeholders there was little, if any, resistance to imposing an obligation to offer supply on designated retailers. That an obligation to offer supply is already a jurisdictional requirement may be the grounds for this.

Consumer groups and some retailers²⁰ were explicit in their support for an obligation to offer supply. The National Consumers Roundtable on Energy

²⁰ See for example Simply Energy submission to the Consultation RIS, page 2

submission noted that "we strongly support the obligation to supply being placed in the Law. The obligation to supply supports the overriding principles that residential customers should have uninterrupted access to essential services and that they should not be disconnected due to an incapacity to pay alone"²¹.

Origin Energy considers that an obligation to offer supply for gas is doubtful as this energy type is considered a fuel of choice and is used as a substitute for electricity, especially for business owners.

Ergon Energy considers that in the absence of price regulation, service obligations linked to minimum terms and conditions may limit the retailer's willingness to offer a market contract. On the issue of whether material gains would be delivered to retailers in the absence of an obligation to offer supply, Ergon Energy noted that some marginal gains may be realised, but believes that the cost to customers would outweigh retailer benefits²².

While retailers supported the obligation to offer supply, this issue is closely linked to the definition of small customer, and therefore which customers benefit from the obligation to offer supply. This debate is driven especially by the issue of retailers being obligated to offer supply on a published tariff. This issue is addressed further in section 5.3.

While retailers do not consider the obligation to offer supply problematic, the finer policy issue of the way in which it is imposed raised concerns for both retailers and consumer groups.

5.1.4 Conclusion

The MCE SCO recommends adopting Option 2 – imposing an obligation to offer supply – for reasons relating to access to an essential service and economic development.

The MCE SCO recommends adopting Option 2: an obligation to offer supply for designated retailers to provide energy services to those customers who request it in the national framework, essentially maintaining the status quo currently in place in jurisdictions.

In assessing the benefits of including an obligation to offer supply in the national framework it is useful to analyse the impacts on retailers and energy customers, as these are the two stakeholders affected the greatest by this regulatory imposition to offer supply.

While retailers may make some efficiency gains by not having an obligation to offer supply imposed, these are minor in comparison to the severe and potentially detrimental impacts for energy customers. Removing the obligation to offer supply may reduce operating costs for retailers that can be passed on to

²¹ National Consumers Roundtable on Energy Joint Response to SCO Policy Paper page 1-2

²² Ergon Energy submission to the Consultation RIS, page 3

customers in the form of competitive energy prices. However, the extent and quantity of efficiency gains, given limited access to data and modelling, is unknown.

It is reasonable to assume that where the obligation is removed, vulnerable energy customers (mainly financially risky and also remote and regional energy customers) may be denied reliable access to energy supply where retailers choose to limit their operations to geographical areas, or customer types, based on an economic imperative. Given the known risks of removing the obligation to offer supply, compared to the possible efficiency losses through imposing the obligation, adopting an obligation to offer supply in the national framework is beneficial.

The arguments in favour of imposing an obligation to offer supply are persuasive and include security of supply issues. As an essential service, ensuring energy supplies is critical to the health and well-being of individuals. Compromising this in favour of possible market efficiency gains at this stage of market contestability introduces a degree of unacceptable risk into the regulatory framework.

While it is recognised that highly efficient and functioning markets are more likely to accommodate all customer types, not all regions in the national energy market, for example, are yet contestable. Further, the AEMC has only completed two reviews of the effectiveness of competition in jurisdictions party to the AEMA – Victoria and South Australia. While both these jurisdictions were found to have effective competition in retail energy markets, no assumptions can be made on the state of competition in other jurisdictions.

Market contestability and effective competition are significant imperatives for maintaining the status quo. Tasmania, the Northern Territory and Western Australia are yet to introduce full retail contestability into their retail markets. Further, full retail contestability was introduced in Queensland retail markets only as recently as July 2007. Contestable and competitive markets must be in operation before the obligation to offer supply could be removed without necessarily introducing significant risk into the regulatory framework.

While one submission from Origin questioned imposing the obligation to offer supply in relation to the gas sector, this does not meet the high-level AEMA objective of harmonising the regulatory requirements for electricity and gas.

For the most part electricity is viewed as an essential service to maintain health and well-being. As such, an argument for an obligation to offer for gas is regulatory simplicity.

The option of not including gas in the obligation to offer supply introduces other policy questions relating to whether gas is a fuel of choice for all customers in all instances and, where it is, how to regulate appropriately in this area. Introducing regulatory inconsistency with gas and electricity in the obligation to offer supply introduces uncertainty and complexity into this policy area, which moves further away from the high-level objectives of the AEMA. In addition, it is strongly arguable that, where a customer is being supplied by gas, it can be

viewed as an essential service for that customer. This is because the cost of switching from gas to electric appliances should gas no longer be available may be prohibitive for some customers.

5.2 DESIGNATING RETAILERS WITH THE OBLIGATION TO OFFER SUPPLY

Where an obligation to offer supply is placed on retailers the design framework must consider how the obligation to offer supply should operate and upon which retailers it should be imposed. Any design framework must account for:

- The potential of fully contestable national retail energy markets;
- How to best support competition;
- Competitive limitations where a market is not fully contestable;
- The cost of compliance on the retailer; and
- Providing continuity in supply as customers move in and out of premises.

5.2.1 Problem

Section 3 outlines the Statement of Problem in relation to harmonisation of arrangements for the sale and supply of energy agreed in the AEMA.

An obligation to offer supply, requires jurisdictions to identify which retailers are designated with the obligation to offer supply. In all jurisdictions, except Queensland for electricity, the retailer with the obligation is designated through a jurisdictional instrument and is based on the retailer's designated supply area (the Local Area Retailer (LAR) model).

Queensland has adopted the Financially Responsible Retailer (FRR) model for existing electricity connection points²³. In this model, the retailer with the obligation to offer supply is the retailer who is financially responsible to NEMMCO for energy consumed at that premises (i.e. the retailer supplying the current, or most recent, if there is no customer consuming energy at the premises, customer at the premises).

5.2.2 Options

	Option 1	Option 2	Option 3
Option	Local Area Retailer	Financially Responsible Retailer	All retailers

Option 1: Local Area Retailer

The LAR model imposes an obligation to offer supply on retailers as designated by jurisdictional instruments where retailers are appointed for a certain class of customers, usually over a geographical area. The supply remit of a LAR can be specified according to a number of parameters including a geographical area or a particular class of premises or customers²⁴.

²³ In Queensland's electricity market the Local Area Retailer has the obligation to supply customers at new connection points.

²⁴ MCE SCO Policy Paper, page12

Currently all jurisdictions (except for Queensland for electricity) have the LAR model for designated retailers. All jurisdictions currently assign the obligation to offer supply for new connections to the LAR in defined geographical areas.

Impacts on stakeholders

The two stakeholder groups chiefly impacted by this policy option are retailers and energy customers.

This model benefits retailers and customers for its regulatory simplicity. The model does not provide for longer term benefits such as economic benefits flowing from increased competition. Where a retailer is designated by jurisdictional remit, the economic incentive to seek new customers is compromised as retailers may not be rewarded when the move in customer takes supply at a premises previously supplied by an individual retailer, as the obligation rests with the LAR.

Retailers	The LAR model provides ease of regulatory compliance by retailers but compromises economic incentives.
Distributors	Distributors are minimally impacted by this policy issue in general, as an obligation to connect an energy customer in order for their premises to be energised is required regardless of the model adopted in the national framework.
Energy Consumers	Energy customers benefit under this model due to easy identification of their designated retailer where this is mainly based on geographical parameters and there is minimal disruption to the customer in this process. Further, in a competitive market, with a greater amount of customer churn, the fall back to the LAR model may avoid customer confusion, especially in 'move-in customer' circumstances. However, the benefits of easy identification may be limited; as time goes on and more retailers gain a substantial market share, customers may no longer remember who the LAR is.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Benefits and costs

The LAR model offers regulatory simplicity for retailers and ease for energy customers in identifying their host retailer. For this reason, the LAR model offers a regulatory design that is simple to execute. However, this model impedes the development of effectively competitive markets.

Benefits	
Compliance costs	Compliance cost for retailers would be reduced if this were to be adopted in the national framework, as retailers operating across jurisdictional boundaries would only need to comply with one set of regulatory requirements in relation to identifying the host retailer with the obligation to offer supply, and only the relevant LAR would be required to provide default (i.e. deemed or standard) contractual arrangements to customers.
Regulatory ease and certainty	This model was identified by AAR as providing regulatory ease and simplicity in its execution. ²⁵ This model is easy to execute, and given the status quo arrangements would easily be applied across all jurisdictions except for Queensland's electricity market, which would have to revert to the LAR model.
Costs	
Competition effects	The costs of this model relate to the broader competition effects in retail energy markets as this model favours incumbent retailers. Under this model, even where a customer enters a contract for supply with a retailer other than the LAR, the obligation to supply will remain with the LAR and responsibility for the site may revert to the LAR when the customer vacates the premises. As a result, the LAR has an advantage in contracting for supply with the next customer at that premises. This occurs despite the 'investment' made by the non LAR to 'win' the customer at that premise, thereby perpetuating the LAR's incumbent advantage ²⁶ .
Barriers to entry	Allowing incumbent LARs to maintain market share creates a barrier to entry for new market entrants. The incentive for new market entrants to seek out new energy customers is compromised under this model as the reward for winning customers is temporary and can terminate when that customer moves out. This may have residual effects in temporary and rental accommodation in particular, where energy customers may not benefit from marketing by retailers.
Transaction costs	The LAR model requires market operators and other market participants (distributors) to amend the responsible retailer for a premises to be the LAR when the obligation is triggered and the previous customer at the premises had been taking supply from a different retailer. These additional transactions would have a marginal cost.

Option 2: Financially Responsible Retailer model

The FRR model imposes an obligation to offer supply on retailers who are the financially responsible retailer²⁷ for a premises (the retailer responsible for paying, in the wholesale market for energy consumed at that premises). Given that financial liability to settle in the wholesale market (i.e. with NEMMCO in the National Electricity Market (NEM) is a pre-condition in order to identify the designated the retailer, it follows that this model can only apply to premises that are already connected to the distribution network²⁸.

²⁵ AAR Composite Working Paper pages 8-9

²⁶ MCE SCO Policy Paper, page 20

²⁷ The financially responsible retailer in electricity markets is generally referred to as the Financially Responsible Market Participant and in gas markets as the Financially Responsible Organisation.

²⁸ The LAR would be the designated retailer for new connections.

Impacts on stakeholders

This policy model mainly impacts on energy customers who may incur search costs in identifying their host retailer. However, it is expected over time that these search costs would be reduced as this model becomes entrenched in energy retail markets.

Retailers, other than the LAR, are positively impacted by this model, as it sets up suitable economic incentives for retailers to gain greater market share.

Distributors may face increased operating costs as energy customers attempt to identify who their host retailer is. However, this is an issue that can be resolved in policy detail by establishing a clear process for how customers get information.

Retailers	The FRR model offers the opportunity for retailers to gain and retain market share on a competitive basis. Where a retailer 'wins' a customer, they are able to recoup the costs of winning that customer by now being the host retailer for that premises when the customer moves out.
Distributors	Distributors are impacted by the manner in which energy customers determine who their host retailer is when they move into a premises. Distributors may be impacted where energy customers seek their distributors' advice on their host retailer.
Energy Consumers	This policy option impacts on energy customers by way of easy identification of their designated retailer. The FRR may introduce search costs for energy customers as they attempt to identify their host retailer. However, this is a finer policy issue that can be resolved in the policy detail stage. As this model becomes entrenched in markets, the search costs for energy customers will be reduced over time.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Benefits and Costs

The benefits of this model relate more broadly to market design and competition issues. The FRR offers suitable economic imperatives for retailers to compete on price and non-price terms in an attempt to increase their market share. The flow-on effects of competitive behaviour by retailers relate to increased economic efficiency and reduced barriers to entry.

The costs of this model are mainly incurred by energy customers, in terms of search costs. However, this is a short-term cost and can be resolved in the details of the policy design.

Benefits	
Competition effects	A major benefit of the FRR model is that it rewards competitive behaviour by allowing retailers who 'win' customers to maintain a supply relationship with the customer's premises even after the customer has vacated the premises. Unlike the LAR model, when a retailer has been successful in winning a customer, that retailer becomes the FRR and may be able to obtain ongoing value from the initial effort invested, even

	if that customer later vacates the premises. It does not give an automatic advantage to a retailer simply on the basis of historical and geographical circumstance and so reduces barriers to entry ²⁹ .
Market power	A further benefit of this model is that it supports competitive markets, providing an incentive for retailers to enter into new markets. The scope of the obligation grows or diminishes in proportion to a retailer's share of the market ³⁰ and does not rely on jurisdictional instruments that can affect the behaviour of retailers operating in jurisdictions by creating barriers to entry for other retailers.
Economic efficiency	<p>The FRR model is considered economically efficient because it:</p> <ul style="list-style-type: none"> • prevents transfer to another retailer without competitive effort; • encourages retailers to target commercially attractive customers and rewards them for the effort of attracting such customers; and • ensures retailers do not lose the benefit of their 'investment' in attracting customers to the incumbent retailer, provided they continue to offer competitively priced services. <p>The AEMC has noted that the FRR model has advantages over other models used to impose the obligation to offer supply. The AEMC considered that the FRR model best met the criteria of:</p> <ul style="list-style-type: none"> • ensuring universal access to supply on reasonable terms and conditions for residential customers; • ensuring equitable access of responsibilities for retailers; and • limiting impacts on market entry conditions for retailers. <p>As the AEMC observes, "the FRR model is consistent with principles of good regulation: it is a clear and simple approach to regulation of the obligation, imposes costs unlikely to be higher than under the alternative options and is likely to distribute those costs more fairly"³¹.</p>
Market design	<p>Where energy reform is designed to support competitive markets, the FRR model is suited to this objective. The retail market broadly consists of two types of retailers – first-tier (traditional incumbent) and second-tier (entrant) retailers. Where the a second tier retailer wins a customer, they are able to maintain the obligation to offer supply to the premises, which in the longer term assists second-tier retailers to maintain market share. By design, this model encourages competition by all level of retailers in retail markets, and does not favour incumbents, as the LAR model does.</p> <p>Also, as this model does not rely on jurisdictional instruments it can provide a nationally consistent approach to designating retailers.</p>
Costs	
Search costs	This model may introduce search costs for customers in terms of being able to identify their host retailer. Energy customers limited in their capacity to exercise choice in securing energy supply must revert to the retailer with the obligation to offer supply to their premises. Under this model, the host retailer is not consistent across a segment of the market (i.e. jurisdictionally based) and customers may incur search costs in identifying their host retailer, although retailers may choose to limit their geographic location. However these costs can be minimised through regulatory design.
Regulatory inconsistency with new connections	<p>The FRR model requires elaboration to account for circumstances where no FRR exists for premises (e.g. new premises). A single retailer will need to be designated with the obligation to supply for each new connection.</p> <p>The LAR is the appropriate retailer to designate for new connections as together the remits of LARs should cover all potential new connections.</p>

²⁹ MCE SCO Policy Paper, page 21

³⁰ Allens Arthur Robinson: Consultation Paper on the National Framework Distribution and Retail Regulation, page 9

³¹ AEMC Second Report on Retail Energy Competition in Victoria page 32.

Option 3: All retailers operating in the national market would be imposed with an obligation to offer supply.

As energy retailing becomes increasingly national, with retailers operating across several jurisdictions and incumbency derived from historical government ownership or designation of local retail areas becoming less relevant over time, it may be considered more equitable to place the obligation to offer supply equally on all retailers.

The costs to regulators can be expected to remain unchanged, as regulators already monitor for compliance in this area, but according to different rules.

Impacts on stakeholders

This model may impact on energy retailers, especially recent new entrants. Obligating all retailers to offer supply has critical impacts on the prudential requirements for retailers, and may stymie the capacity of some retailers to operate in retail energy markets.

Retailers	Retailers would be significantly impacted under this model, having reduced control over the scope and scale of their activities. This means retailers would be required to compete for larger supplies of energy from electricity and gas wholesale markets, reflecting potential increases in supply required due to the obligation to offer, which would consequentially increase prudential requirements.
Distributors	Distributors are minimally impacted by this option as connection and energisation services to energy customers are required, irrespective of which retailer is designated to offer supply to the energy customer.
Energy Consumers	Energy customers are impacted under this model as all retailers will have to maintain the standing offer, which may raise costs to the consumer. While energy customers can be assured of an offer of supply from any retailer, in the longer term, they may do so at the cost of higher energy prices.
Regulators	The cost to regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance with this obligation, noting the efficiencies of scale that result from the transfer to a single national regulator.

Benefits and costs

The costs of this model are significant and can impact on other sectors of the energy market, such as generators. The cause of such costs relate to retailers being able to accurately forecast supply where they are obligated to offer supply to any (eligible) energy customer, nationally, who requests it.

Benefits	
Competitive energy pricing	Where all retailers have the obligation to offer supply, retailers are encouraged to compete on the grounds of price competition and product innovation and not rely on any comparative advantage of incumbency status. As customers need not rely on one retailer to be guaranteed an offer of supply, they may choose a retailer on the basis of competitive

	pricing and non-price offers.
Market power	Obligating all retailers to offer supply to energy customers places competitive pressures on large or established retailers to maintain market share. It places equal obligations on all retailers irrespective of market share, where as the FRR model dispersed the obligation to offer supply in proportion to the retailer's market share, or capacity for market share.
Costs	
Economic efficiency	<p>The costs of imposing the obligation on all retailers are significant and may create implementation difficulties in a national market, such as where retailers choose to limit themselves to particular geographic areas or customer classes³².</p> <p>For example, it may be impracticable and costly for a retailer that wished to operate only in Queensland to have an obligation to offer supply to customers in South Australia, or for a retailer focussing on industrial customers to be obliged to supply residential customers with much lower individual consumption needs and different consumption patterns³³.</p> <p>The possibility that a retailer could be required to supply any customer significantly increases their risk as they cannot control the scope and scale of their operations and may face significant prudential requirements. These risks would inevitably increase costs and would be passed on to customers. Ergon Energy noted that retailers would be limited in their ability to manage operational costs and wholesale risks under this model³⁴.</p> <p>In addition, retailers may divert greater resources to improving their brand recognition rather than developing innovative and low cost service offerings as being known in the market may become more important than providing the best price-service offerings.</p>
Barriers to entry	<p>Placing the requirement on all retailers may impose unreasonable costs on smaller and new entrant retailers in terms of the need to procure potentially very large and uncertain quantities of energy³⁵.</p> <p>As noted in AAR Working Paper 1, the creation of an obligation to offer supply implies a need for the retailer to maintain the financial, business systems and energy trading capacity to satisfy supply requests from potentially significant numbers of energy customers on a more or less immediate basis. Not all new market entrants will have these requirements in place³⁶.</p>
Product innovation	As noted by Ergon Energy, where all retailers are obligated to offer supply, this would limit a retailer's ability to provide specialist services, for example, the ability to only offer energy services to a specific market segment ³⁷ . Product innovation may also be hampered as retailers may have an increased focus on developing a standing offer capable of applying to a wide range of potential customers.

³² MCE SCO Policy Paper, page 21

³³ Retailers are only limited to offer supply in the jurisdictions in which they operate if they elected to do so under the Local Area Retail model. Otherwise, the FRR model, and this model do not limit the obligation to offer supply by jurisdiction in which the retailer operates.

³⁴ Ergon Energy submission to Consultation RIS, page 4

³⁵ MCE SCO Policy Paper, page 21

³⁶ AAR Working Paper 1, page 18

³⁷ Ergon Energy submission to Consultation RIS, page 4

5.2.3 Consultation

Feedback from stakeholders to the MCE SCO Policy Response Paper and the Consultation RIS generally support the adoption of the FRR model in the national framework. In particular, retailers noted that the FRR model equitably imposes the obligation to offer supply in accordance with the size of each retailer's customer base³⁸.

The consultation process from the MCE SCO Policy Response Paper revealed some concern from stakeholders over the manner in which the FRR model would practicably work. This concern relates to move-in energy customers identifying who their designated (or host) retailer is. Without any clear policy surrounding this issue, energy customers may be left with the arduous and untimely task of identifying their host retailer should they be unable to source a competitive retail offer. The Energy and Water Ombudsman of Victoria (EWOV) noted in their submission examples of the difficulties faced by some energy customers in identifying their host retailer and in particular the rights and responsibilities of retailers and distributors in assisting energy customers to identify their host retailer.

Distributors also noted this issue. While they had no particular view on the model adopted in the national framework, they were concerned with how the move-in customer will identify their host retailer. The concern for distributors is that where there was no clear policy guiding this issue, distributors may be faced with increased operating costs as energy customers sought to identify their host retailer through distribution companies. For this reason, SP AusNet advocated the adoption of a 'neutral' party to respond to energy customer's concerns, irrespective of the level of Distributor-Retailer ring-fencing³⁹.

Retailers and consumer groups noted that the choice of the FRR model over the LAR model was a decision that best suited the evolution of competitive retail markets across Australia. Given the current rates of churn and the increase in competition over time, the concept of a LAR will eventually be rendered obsolete⁴⁰.

Ergon Energy noted that the LAR model is likely to impede competition as the incumbent retailer in a designated retail area would have an advantage that new retailers trying to enter the market would not have. By contrast, the FRR model facilitates competition by providing for the equitable allocation of responsibilities between retailers and also encourages market entry which is largely achieved by allowing the obligation to supply to grow in line with the retailer's market share⁴¹.

One retailer sought clarification on how the FRR model would be compatible with a Retailer of Last Resort (ROLR) scheme in the event of a second tier

³⁸ See, for example, the TruEnergy submission to the SCO Policy Paper at page 2

³⁹ SP AusNet submission to the SCO Policy Paper, page 9

⁴⁰ Origin Energy submission to the SCO Policy Paper page 4

⁴¹ Ergon Energy submission to the Consultation RIS, page 4

retailer failure⁴². The matter of ROLR is being dealt with in a separate work stream that will be included in the national Law and Rules at a future point and stakeholders will have the opportunity to comment⁴³. The arrangements for the ROLR scheme should be compatible with the FRR model and should work complementarily in the event that there is a retailer failure.

One energy retailer, Integral Energy, did not support the adoption of the FRR model in the national framework. Integral Energy noted that the FRR model persisted with similar problems to the LAR model in relation to benefiting the incumbent by historical and geographical circumstances: "Under the FRR model the new customer is bound by the decisions (astute or otherwise) of a previous occupant and would be forced to pay additional costs to the FRR both in search costs for the previous customers' retailer and energy costs if the customer would otherwise have had the protection of price caps"⁴⁴.

This assertion fails to acknowledge that where price caps continue to be applied and the designated retailer is obligated to offer supply, energy customers are able to access supply on standard terms, conditions and price. The FRR model does not preclude energy customers seeking supply on regulated energy prices, where applicable.

Integral Energy also notes that customers face increased search costs under the FRR model. However, these would likely be incurred irrespective of whether the designated retailer determined according to the LAR or FRR model. Where an energy customer moves into a premises under the LAR model and wishes to seek alternative supply or does not know who the LAR is (which is expected to increasingly be the case over time as competition develops), they would incur similar search costs in seeking supply.

5.2.4 Conclusion

The MCE SCO recommends the adoption of the Option 2 – the Financially Responsible Retailer model – for reasons relating to economic efficiency and the increasingly national scope of the energy retail market.

The MCE SCO Policy Response Paper recommended the adoption of the FRR model in the national framework. For reasons noted above, the FRR model was viewed as best accommodating competitive retail markets – the obligation to offer supply under this model is commensurate with a retailer's market share. Further, competitive behaviour by retailers is rewarded where retailers invest in recruiting new customers, their efforts are rewarded by maintaining that premises as host retailer.

⁴² ActewAGL submission to the SCO Policy Paper, page 13

⁴³ The MCE SCO commissioned NERA and AAR to draft a report on the Retailer of Last Resort Scheme, which was released on 19 June 2008. Stakeholders had an opportunity to provide written feedback on this matter, and a public forum on the issue was held in Sydney on 16 October 2008.

⁴⁴ Integral Energy submission to the Consultation RIS, page 3

By comparison the LAR model does not support competitive behaviour. While the LAR model may be considered superior to the FRR model in terms of ease of regulatory execution, the FRR model comparatively offers significantly greater benefits in the longer term. As retail markets become increasingly national in scope and full retail contestability is introduced into all jurisdictions, the concept of a LAR is likely to become somewhat obsolete.

The policy approach of option 3, imposing the obligation to offer supply on all retailers, is contrary to the principles of the high-level objectives of the AEMA and places retailers, especially second-tier retailers, in a compromised market position. Under such a policy, retailers would be required to invest in infrastructure (including IT) beyond their market strategy in order to meet regulatory obligations which they would otherwise consider economically unfeasible.

For the reasons outlined, the MCE SCO recommends adopting the FRR model in the national framework. This model meets the high-level objectives of the AEMA and is conducive to the evolution of competitive retail gas and electricity markets.

Where stakeholders⁴⁵ have raised the issue of identifying the host retailer by energy customers, the MCE SCO resolved this issue by including SCO Policy Paper, a requirement for certain energy market participants, if contacted by energy customers, to provide the name of the host retailer for the premises that the energy customer is calling for. This will be a matter of detail to be addressed in the Law and Rules for the national framework, which will be made available for stakeholder comment via Exposure Drafts.

To date, the issue of identifying the host retailer in Queensland, which has adopted this model since 2007, has not evidently caused any major concern for the energy regulator in that jurisdiction.

Integral Energy also raised concern that designating retailers according to the FRR model is in violation of the AEMA, Annexure 2 which states that "distribution and retail service areas – specification of geographical areas in which responsibilities/obligations apply" should remain a jurisdictional responsibility⁴⁶. In essence, Integral Energy argues that designated retailer obligations and responsibilities should be removed from the Consultation RIS and therefore the national framework as it remains a jurisdictional responsibility.

In response, the specification of jurisdictional areas remains a jurisdictional responsibility and where the LAR will operate for new connections, jurisdictional orders/instruments will specify the geographical areas that the LAR has responsibility for. However, where jurisdictions adopt the national framework and that includes the FRR model as the means of defining the designated retailer with the obligation to offer supply, this does not contravene the terms of the AEMA. For example, Queensland has adopted the FRR model for electricity, which is not based on the geographical precedent.

⁴⁵ See, for example, the Integral Energy submission to Consultation RIS page 3

⁴⁶ See Integral Energy submission to the Consultation RIS page 3

5.3 CUSTOMERS TO BENEFIT FROM THE OBLIGATION TO OFFER SUPPLY

Where the national framework imposes an obligation to offer supply on retailers, it must subsequently determine which energy customers should be entitled to receive the obligation to offer supply by retailers.

At the centre of this policy issue is determining which energy customers should be classified as needing the protection of published (which may be regulated) tariffs and other associated consumer protections. AAR Working Paper 1 and the Composite Paper recognised the contentious nature of this matter⁴⁷.

5.3.1 Problem

Section 3 outlines the Statement of Problem in relation to harmonisation of arrangements for the sale and supply of energy agreed in the AEMA.

All jurisdictions currently demarcate which customers may receive the benefit of the obligation to offer supply according to a small customer definition. Generally, small customers are defined with reference to a consumption threshold; for electricity the consumption threshold varies between 100 to 160 megawatt hours (MWh) per annum, where as gas varies significantly more between 1 and 10 terajoules (TJ) per annum.

Table 5.3⁴⁸ details the current thresholds applied by jurisdictions in defining small customers and therefore, which energy customers benefit from the obligation to offer supply by jurisdictions. It should be noted that while the definition of a small customer applies in determining the obligation to offer, not all jurisdictions require that this obligation should be offered on a regulated tariff (note New South Wales, Queensland and Victoria).

AAR Working Paper No. 1 canvassed the issue of who should benefit from the obligation to offer supply. The paper presupposed that the objective of defining small customers, or those who would benefit from the obligation, is to protect vulnerable customers – those that may not be able to secure energy supply at an affordable price and on reasonable terms and conditions in a competitive market⁴⁹.

Jurisdiction	Electricity Threshold	Gas Threshold	Comment
	MWh per annum	TJ per annum	
New South Wales	160	1	The obligation applies to all electricity customers, however only small customers are entitled to be supplied under the obligation on regulated

⁴⁷ AAR Composite Working Paper, pg. 11. AAR noted this issue in reference to discussion of defining small energy customers according to a consumption threshold.

⁴⁸ Based on the table provided in the MCE SCO Policy Paper, page 23

⁴⁹ Allens Arthur Robinson Working Paper Number 1, page19

			terms (including price)
Victoria	160	5	As of 1 January 2009, regulated prices no longer only (small customers have the benefit of the obligation to offer on regulated terms, excluding price)
South Australia	160	1	
Queensland	100	1	Gas prices are not regulated for any customers, however small gas customers have the benefit of the obligation to offer supply at the LAR's standard terms and conditions Large non-market electricity customers also have the benefit of the obligation.
Australian Capital Territory	160	1	
Tasmania	150	10	The obligation applies only to small electricity customers. There is no obligation to offer supply for small gas customers, however small gas customers do have the benefit of consumer protection provisions under the Tasmanian Gas Retail Code.

5.3.2 Options

	Option 1	Option 2	Option 3	Option 4
Option	Residential customers only benefit from the obligation to offer supply	All customers consuming at or under a threshold amount benefit from the obligation to offer supply	All residential customers and energy customers consuming at or under a threshold amount benefit from the obligation to offer supply.	Standard contracts offered to all residential customers and non-residential customers up to a threshold. Market contracts are offered to other customers below a second threshold.

Option 1: *Retailers would only be obligated to offer to supply energy to residential customers, where energy is supplied primarily for residential purposes.*

Under this policy option, retailers would be obligated to offer supply to residential energy customers only, whereby energy customers would be classified primarily according to what the primary purpose of the energy supply is for. For example, a small business operating from residential premises may qualify to benefit from the obligation to offer supply, if the primary purpose for supply is for residential use.

Impacts on stakeholders

This policy option primarily impacts energy customers and retailers. Retailers are impacted by efficiency gains through only having to supply energy to customers for whom it is an essential service. By contrast, non-residential energy customers may be impacted where contestable and competitive energy

markets have not yet developed and may experience difficulty in accessing energy supply on reasonable terms, conditions and price.

Retailers	Retailers are positively impacted under this model, as retailers would only be required to offer supply (and on regulated tariffs if applicable) for energy customers for whom energy is an essential service and not a business input. Ultimately this reduces retailers' compliance burden, as it reduces the scope of the obligation to offer supply compared that the scope of the obligation that currently applies.
Distributors	Distributors are minimally impacted by this option as connection and energisation services to energy customers are required, irrespective of which retailer is designated to offer supply to the energy customer.
Energy Consumers	Non-residential energy customers are impacted by this policy option. Where an energy customer requires energy for a business input, they may be adversely impacted by this policy option as it denies them the benefit of receiving the obligation to offer supply, and also the option of receiving it on a regulated tariff, where applicable. This is especially a concern in energy retail markets where competition is less mature and for regional and remote customers.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Benefits and costs

The costs and benefits of this model primarily fall on energy customers and retailers. While broader economic gains can be made under this model, this is at the potential cost of disenfranchising some energy customers from securing energy supply on reasonable terms, conditions and price.

Benefits	
Economic efficiency	<p>Providing the benefit of the obligation to residential customers only recognises that energy is an essential service, but for customers outside this classification, it is a business input, and should therefore be priced accordingly rather than through regulated price mechanisms.</p> <p>This policy option allows for greater economic efficiency to be introduced into retail markets. An obligation to offer supply to residential customers only allows retailers to structure tariffs for business customers according to cost-reflective supply, and to subsequently ensure businesses make investment decisions according to an efficient allocation of resources (i.e. the actual cost of obtaining the necessary supply of energy at a chosen location).</p>
Competitive energy pricing	<p>Under this policy option retailers may choose to adopt a tariff structure that better reflects the cost of supply to residential customers whose consumption profiles may vary significantly from non-residential energy customers. Given that 79.31% of all energy customers are residential customers⁵⁰, such a measure may be conducive to allowing greater product diversity and competition for residential customers (subject to continuing jurisdictional price regulation).</p> <p>Similarly the consumption profile of different classes of non-residential customers can vary significantly, even for those that consume relatively</p>

⁵⁰ Source: esaa, Company Annual Reports, Electricity Gas Australia 2006

	small amounts of energy. Not imposing the obligation to offer for non-residential customer also allows retailers greater ability to offer competitive terms and conditions (including price) of supply to non-residential customers.
Market design	Limiting the obligation to offer supply to residential customers only is of benefit to retail energy market design. Retailers may choose to limit their operations to segments of the market, according to their business structure or economic imperative. While residential customers account for 79.31% of energy customers, their combined consumption is not reflective of (i.e. well below) this market share. This allows retailers greater flexibility in developing competitive and cost-reflective supply arrangements for non-residential customers who may be smaller in number but account for proportionately more of the energy sold by retailers and are likely to have diverse consumption patterns and needs.
Costs	
Market information and transaction costs	Some small businesses may incur additional costs. Small businesses would be required to negotiate market contracts with energy suppliers. These organisations do not necessarily have the resources to negotiate with suppliers over the terms and conditions of supply. This would require additional search costs for small organisations that may not outweigh the benefits of excluding them from the benefit of the obligation to offer supply.
Market power	Non-residential energy customers may become disenfranchised under this policy option, especially those operating in energy retail markets where full retail contestability (FRC) is not yet introduced, competition is not mature, or few retailers operate in the area. This cost is recognised by the AEMC, which observes that that some small business customers share many of the characteristics of residential customers ⁵¹ . Some businesses and other non-residential organisations have similar characteristics to residential customers in terms of their ability to negotiate, the costs of negotiation, the need for deemed supply arrangements and their vulnerability to inappropriate marketing.
Regional development	The absence of an obligation to offer supply to non-residential customers may limit access (both initial and ongoing) by small businesses to affordable energy supplies, particularly in regional and remote locations, potentially limiting regional development.

Option 2: Retailers would be obligated to supply energy to customers according to a consumption threshold (which is typically set at a consumption level per annum).

Under this option, retailers would be obligated to offer supply to all energy customers whose consumption (over a defined period of time) is at or below a threshold. This would not require classifying customers into residential and non-residential categories.

The difficulty with such a model is setting a consumption threshold that includes mostly residential customers and adequately captures non-residential energy customers considered to be vulnerable, or without sufficient market power, to negotiate a market contract.

⁵¹ AEMC Final Second Report on Retail Energy Competition in Victoria, page 5

Impacts on stakeholders

This policy option impacts retailers and energy customers. The impact on retailers is felt through having to supply energy to small to medium sized enterprises on regulated terms and conditions (including a standard or regulated price). This impacts retailers by not being able to efficiently allocate resources and therefore not efficiently recovering the costs of supplying business.

The impact on customers will vary across classes. Small business energy customers are impacted by this option as they are afforded consumer protections unavailable to them under Option 1. These consumer protection measures include receiving the benefit of the obligation to offer supply by retailers at a regulated price, where applicable. By contrast, very large residential customers may lose the benefit of the obligation and various customer classes cross-subsidise others due to limited flexibility for retailers to set different terms and conditions of supply for different customers.

Retailers	Retailers would be impacted in a number of ways by this policy option. While it offers regulatory simplicity, it also captures non-residential customers for whom energy is not an essential service but is a business input. Retailers would be required to offer supply to these customers on a regulated or standard tariff. This limited flexibility is likely to increase cross-subsidisation between customer classes and may prevent retailers offering competitive supply arrangements to larger customers that do not have the benefit of the obligation.
Distributors	Distributors are minimally impacted by this option as connection and energisation services to energy customers are required, irrespective of which retailer is designated to offer supply to the energy customer.
Energy Consumers	<p>The most substantial impact of this model is its capacity to capture some non-residential customers such as small businesses⁵². These customers may face very similar circumstances to residential customers in relation to their energy supply arrangements. In addition, a (very) small number of residential customers may consume above the threshold level of consumption which would exclude them from the consumer protections offered under the national framework to defined small customers.</p> <p>Large customers may also be impacted if inefficient pricing leads to cross-subsidisation between customer classes.</p>
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules which includes applying a threshold, noting the efficiencies of scale that result from the transfer to a single national regulator with a nationally consistent threshold.

Benefits and costs

The harmonisation of thresholds across jurisdictions should allow retailers operating across jurisdictions to realise efficiency gains. However, as retailers

⁵² Based on South Australian prices, customers that consume around 100MWh per annum of electricity would incur a yearly bill of roughly \$14,500 - \$16,000. If the customer were to access energy supply on regulated prices then a business that consumes up to 160MWh per annum of electricity would incur an energy bill of roughly \$24,000 - \$26,000 per annum. Based on regulated electricity prices, and market contract prices available from retailers websites.

would be required to offer supply on regulated tariffs to non-residential customers too, the capacity to recover the true cost of supply is reduced.

Benefits	
Regulatory simplicity	This policy option offers regulatory simplicity in the national framework. AAR noted that the application of a consumption threshold as a proxy provides a high degree of consistency, certainty and transparency ⁵³ . For this reason, where an obligation to offer supply includes non-residential customers, defining these customers according to a consumption threshold provides a degree of regulatory certainty for retailers where it is consistently applied in all jurisdictions.
Market power	In retail markets where competition is less mature, business energy consumers may have less bargaining power with energy suppliers in negotiating market contracts, or may also be vulnerable to inappropriate marketing. This policy option captures those customers who under Option 1 are disenfranchised from consumer protection measures, and who share similar characteristics to residential customers.
Regional development	The inclusion of an obligation to offer supply to non-residential customers may assist small businesses in obtaining and maintaining affordable energy supplies, particularly in regional and remote locations, potentially assisting regional development.
Information asymmetries	As noted under Option 1, some businesses share similar characteristics to residential customers, and may not have the resources to search out and locate the most appropriate energy supplier, or assess the terms and conditions of supply. A consumption threshold is likely to capture many these customers.
Costs	
Economic efficiency	<p>For business, energy forms a regular business input and therefore, should reflect the cost of supply and be negotiated between the customer and supplier like any other business input. Where businesses with varying consumption patterns and needs are able to access energy on regulated or standard tariffs, this is at the cost of allocative dynamics as businesses may be able to produce and sell products below the true cost of supply and for which retailers (or their other customers) are asked to assume part of this cost.</p> <p>Further the imposition of a consumption threshold has an element of arbitrariness and, if set to try and capture all small businesses that have similar characteristics as residential customers, is at the risk of being over-inclusive in that some customers falling under the threshold will not meet the description of vulnerability that might otherwise have applied⁵⁴.</p>
Compliance	This model imposes additional costs on energy businesses in that it requires retailers (and distributors, to the extent they are required to classify customers) to apply a criterion for determining whether a customer falls above or below the relevant threshold during the initial billing cycle.
Competition effects	Another cost of this model relates more broadly to competition effects in retail markets, and the flow-on effect this would have on energy prices for customers. Were the obligation to offer supply to be based solely on a consumption threshold, retailer's contracts need to accommodate residential <u>and</u> non-residential customers. This may be at the cost of competitive pricing and innovation for all customer classes customers, as retailer's tariff structure may need to be based on larger and more diverse consumption profiles to reflect the cost of supply. This is likely to increase the degree of cross-subsidisation between customer classes.

⁵³ AAR Working Paper no. 1, page. 20

⁵⁴ AAR Working Paper no. 1, page 20

Option 3: Designated retailers would be obliged to offer supply to all residential customers (irrespective of their level of consumption) and non-residential customers consuming up to a specified consumption level.

Option 2 attempted to capture non-residential energy customers that face similar situations in negotiating supply as residential customers, and would therefore benefit from the obligation to offer supply and other consumer protections in the national framework.

However, in attempting to offer some additional protections to smaller and more vulnerable non-residential customers in Option 2, it does so at the cost of less efficient pricing across potentially all customer classes (including residential). Option 3 ensures that all residential customers, irrespective of their consumption levels, benefit from the obligation to offer supply and the associated benefits of other consumer protections. This option also seeks to better target the benefit of the obligation to business customers that are more likely to demonstrate similar characteristics (in terms of vulnerability and access to information) to residential customers. This reflects the essential service nature of energy supply.

Impacts on stakeholders

The impacts of this policy option are similar to Option 2, except that all residential customers benefit from the obligation to offer supply and other associated protections irrespective of their consumption threshold.

Retailers	The impacts of this policy option are similar to Option 2, except that retailers would be required to offer supply to residential customers irrespective of their consumption threshold.
Distributors	The impacts of this policy option are similar to Option 2. Distributors are obligated to provide connection services on request from a retailer.
Energy Consumers	The impacts of this model are similar to Option 2, but include all residential customers under the protection of the consumer framework irrespective of whether they consumer above the consumption threshold.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Benefits and costs

The benefits and costs of this policy option are very similar to Option 2. One key difference is that all residential customers are included irrespective of their consumption.

See the discussion of the Benefits and Costs under Option 2 above.

In addition, the fact that the consumption threshold only applies to non-residential customers may allow a more “accurate” threshold to be set to

ensure it targets those non-residential customers that may be considered to share many of the characteristics of residential customers. This should reduce the incidence of inefficient pricing across the market, although the degree to which it is reduced may be limited.

Option 4: *Designated retailers would be obliged to offer supply on a standard contract to all residential customers and all non-residential customers consuming below a threshold amount, and offer supply on a market contract to non-residential customers consuming up to a specified consumption level.*

Option 3 captured residential customers, irrespective of their consumption, in the obligation to offer supply, as well as non-residential energy customers according to a consumption threshold. In response to the concerns of many retailers, the risk with Option 3 was that it over-compensated in capturing non-residential customers who may be vulnerable and face the same issues as residential customers in seeking and negotiating energy supply on reasonable terms and conditions.

Option 4, which was not identified in the Consultation RIS, goes one step further in addressing these issues, by offering a two-tier threshold in determining which customers may benefit from the obligation to offer supply, and especially on a standard contract (including published prices, which may be regulated), for which the consumer protections are non-negotiable and therefore more comprehensive than a market contract.

Under this model, all residential customers, irrespective of their consumption, will benefit from the obligation to offer supply on a standard contract. Also to benefit from the obligation on a standard retail contract are non-residential customers consuming energy up to a particular threshold amount that has initially been targeted at 40MWh per annum for electricity and 400 gigajoules (GJ) per annum for gas. This threshold is designed to capture vulnerable non-residential customers who may experience similar issues to accessing supply on reasonable terms and conditions.

For non-residential customers consuming between the lower and upper threshold (initially targeted at 40-100MWh per annum of electricity and 400GJ-1TJ per annum of gas), these energy consumers will benefit from the obligation to offer supply but on a market contract. That is, retailers must offer supply to these customers but the terms and conditions of that supply are negotiable for retailers and energy customers.

Impacts on stakeholders

The impacts of this policy option positively benefit retailers and more vulnerable non-residential energy consumers. In particular, it seeks to balance the competing impacts on retailers and consumers.

Retailers	The obligation to offer supply on a standard contract is limited to residential customers and non-residential customers consuming under a threshold amount. This recognises, for retailers, that energy is a regular business input for most businesses, and therefore should be offered in a negotiable market contract for businesses whose energy consumption is above a specified threshold 40MWh per annum for electricity and 400GJ per annum of gas.
Distributors	The impacts of this policy option are similar to Options 2 and 3. Distributors are obligated to provide connection services on request from a retailer.
Energy Consumers	Energy customers consuming above the lower threshold 40MWh per annum of electricity and 400GJ per annum of gas are most impacted under this option. While retailers will be obligated to offer supply, it will be on market terms and conditions, and non-standard or non-regulated prices. This option also seeks to target the benefit of the obligation to business customers that may demonstrate similar characteristics (in terms of vulnerability and access to information) to residential customers.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the economies of scale that result from the transfer to a single national regulator.

Benefits and costs

The benefits of this policy option combine the benefits of Options 1, 2 and 3 except that in the process they may introduce some regulatory complexity for retailers and non-residential customers.

Benefits	
Economic efficiency	<p>This policy option allows for increased economic efficiency in retail markets. An obligation to offer supply to residential and business customers and those consuming below a threshold amount 40MWh per annum of electricity and 400GJ per annum of gas allows retailers to structure tariffs for market contracts according to cost-reflective supply, and to subsequently make investment decisions according to an efficient allocation of resources.</p> <p>Limiting the obligation to offer supply on a standard retail contract to residential customers and non-residential customers with reference to a (lower) threshold recognises that while energy is an essential service, for business customers it is a business input, and should therefore be priced accordingly and not through regulated or standard price mechanisms. This is particularly the case for businesses consuming larger quantities of energy who are less likely to display characteristics of vulnerability.</p>
Competitive energy pricing	Under this policy option retailers may choose to adopt a tariff structure that better reflects the cost of supply to customers whose consumption, for the most part, is reasonably low. This model may allow greater product diversity in the area of market contracts above the 40MWh and 400GJ threshold where under Option 3 retailers were required to offer supply on a standard contract with non-negotiable terms and conditions.
Market design	Limiting the obligation to offer supply to residential customers and energy customers with respect to a lower consumption threshold is of benefit to retail energy market design. Retailers may choose to limit their operations to segments of the market, according to their business structure or economic imperative.

	This option recognises that smaller non-residential customers may require some additional protection in negotiating their energy supply arrangements, but that the requirement for these protections in relation to the terms and conditions of supply and right to supply, respectively, diminish as the consumption of the customer increases.
Regional development	The inclusion of an obligation to offer supply to non-residential customers may assist small businesses in obtaining and maintaining affordable energy supplies, particularly in regional and remote locations, potentially assisting regional development.
Costs	
Market information and transaction costs	Some small businesses may incur additional costs under this policy option especially in reference to consumer protections measures. Small businesses consuming above the lower threshold 40MWh per annum will be required to negotiate market contracts with energy suppliers. Some of these organisations may have limited capacity or resources to negotiate with suppliers over the terms and conditions of supply. However, the extent to which this is the case for businesses consuming over this threshold amount for gas and electricity is not clear ⁵⁵ .
Market power	Some non-residential energy customers may become disenfranchised under this policy option, especially those operating in energy retail markets where FRC is not yet introduced, relatively immature or where lack of competition means that few retailers operate in the area. Some businesses and other non-residential organisations have similar characteristics to residential customers in terms of their ability to negotiate, the costs of negotiation, the need for deemed supply arrangements and their vulnerability to inappropriate marketing. However, the expectation is that the customers that experience these characteristics to the greater extent (similar to residential customers) would be captured by the obligation to offer supply on a either a standard or market contract.
Regulatory complexity	This option, while balancing the impacts on consumers and retailers, adds some regulatory complexity into the framework. While all retailers must offer a contract to all non-residential customers consuming under a threshold amount 100MWh per annum, whether this should be a market contract or standard contract requires further consideration by retailers on a case by case basis. However, the expectation is that where retailers have the opportunity to offer market contracts with negotiable terms and conditions to these customers, this will outweigh any additional regulatory complexity introduced by this model.

5.3.3 Consultation

Stakeholder views on the issue of small customer definition for the purposes of the obligation to offer supply varied significantly, and can essentially be divided into two categories – those that did, and those that did not, support the inclusion of non-residential customers in the obligation.

⁵⁵ The expectation is that a business requiring a business input of a certain value would have the capacity to negotiate a market contract. A key detail of the regulatory framework under this option will be to determine the appropriate thresholds. For example, the types of businesses that consume up to 100MWh per annum of electricity, which may be considered an appropriate upper threshold, have annual electricity bills of around \$16,000 (depending on the state in which they reside). These types of businesses may include: medium sized restaurants that are opened long hours (such as a McDonalds outlet for example), service stations or a medium sized office.

Stakeholders in support of capturing non-residential customers outlined reasons similar to those outlined in Options 2 and 3. Kildonan Uniting Care, noted that rural and regional businesses in particular might depend on the obligation to offer supply to receive an offer on reasonable terms, conditions and price⁵⁶.

EWOV and the Energy and Water Ombudsman New South Wales (EWON) strongly supported the inclusion of non-residential customers in the obligation to offer supply. Their arguments centred on the tenet that not only should these businesses be able to access supply on reasonable prices, but should be able to access the associated consumer protections that are afforded to energy customers that benefit from the obligation to offer supply. EWOV noted that "the threshold is not only important for access to regulated prices. It is important for access to dispute resolution in jurisdictions where this is governed by a threshold. In EWOV's experience, it is just wrong to assume that customers with large usage are able to negotiate successfully and equally with energy retailers"⁵⁷.

EWON supported the argument for the including non-residential customers quoting the Utility Regulator's Forum: "Conversely, there are some very small business customers who consume large amounts of electricity (for example, fish and chip shop and delicatessen owners) who may not be any more sophisticated than some domestic customers and, in some areas, may have significant English-language and comprehension difficulties"⁵⁸.

Ergon Energy supported small non-residential customers benefiting from the obligation to offer supply. In its submission, Ergon Energy acknowledged that some small businesses experience similar challenges to those identified for residential customers. Ergon Energy supports all residential customers and business customers below a consumption threshold benefiting from the obligation to offer supply⁵⁹.

Stakeholders who support the exclusion of non-residential customers from the benefit of the obligation, argue that energy is a business input and should be treated as such and only be available to businesses on market terms, conditions and prices.

Retailers primarily opposed non-residential customers benefiting from the obligation to offer supply. The reasons for not including non-residential customers mainly related to energy not being an essential service for business as it is a business input.

Origin Energy and Australian Power and Gas stated that there was no need to include non-residential customers in the obligation to offer supply⁶⁰. TRUenergy

⁵⁶ Kildonan Uniting Care submission to the SCO Policy Paper, page 18.

⁵⁷ EWOV submission to the SCO Policy Paper, page 6

⁵⁸ EWON submission to the SCO Policy Paper, page 5

⁵⁹ Ergon Energy submission to Consultation RIS, page 5

⁶⁰ Origin Energy also raised the issue of including an obligation to offer supply for gas customers in general. This matter is dealt with in the section 5.3 that discusses adopting the obligation to offer supply in the national framework. See Origin Energy submission to SCO Policy Paper, page 2 and Australian Power and Gas submission to SCO Policy Paper, page 2.

elaborated further on this matter and, similar to other retailers, noted that "businesses, as part of their day-to-day operations, are required to negotiate with many entities, including, for example, suppliers, landlords, financial institutions, government authorities and employees, often involving complex contractual negotiations. The negotiation of energy contracts should not be regarded as any different to these other commercial negotiations. Indeed the complexity, financial impact and risk of an energy contract are likely to be substantially less than most other contracts the business will be required to enter"⁶¹.

Simply Energy, in its submission to the Consultation RIS noted that it would be prudent for the regulatory framework to allow for the progressive lifting of the obligation to offer supply for customers where energy is not an essential service (such as business customers and, in some regions, gas customers) or where competition is sufficiently advanced that customers no longer risk facing access to supply issues⁶².

Distributors did not explicitly oppose the inclusion of non-residential customers in the obligation to offer supply, but sought clarification on finer policy issues related to their role in classifying a premises as being either within or beyond any consumption thresholds. For this reason Ergon Energy noted that the classification of customers had implications beyond the national framework, in particular, market operating systems and procedures, guaranteed service levels and timeframes for service order initiation and completion. Ergon Energy noted that distributors would not possess the information that would be required to identify customer type, and that this identification issue rested with retailers who would need to record and maintain the classification of the customers at a premises as residential/non-residential in their customer information systems, for their own use⁶³.

⁶¹ TRUenergy submission to SCO Policy Paper, pages 2-3

⁶² Simply Energy submissions to Consultation RIS page 2.

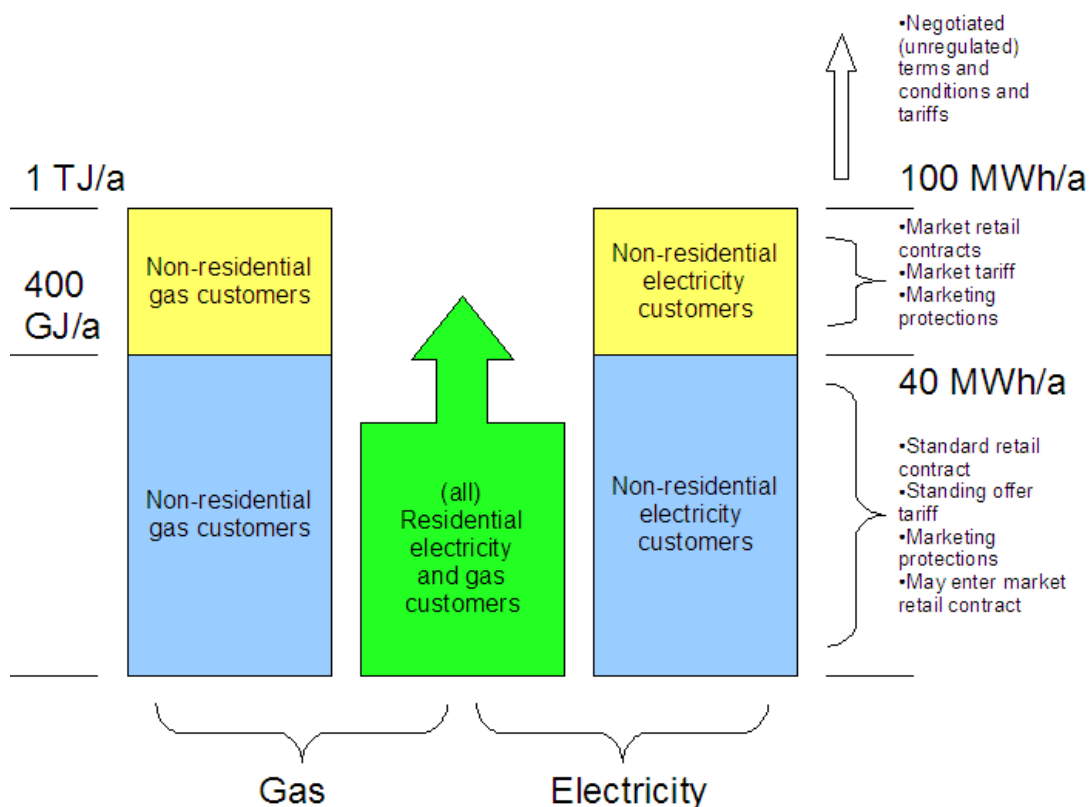
⁶³ Ergon Energy submission to SCO Policy Paper, page 7

5.3.4 Conclusion

The MCE SCO recommends the adoption of **Option 4** – a combination of standard and market contracts for defined customers and consumption thresholds – for reasons relating to maximising economic efficiency whilst maintaining an appropriate consumer protection focus.

MCE SCO recommends a small customer definition that attempts to balance competing views. The small customer definition, for the purpose of defining which energy customers receive the benefit of the obligation to offer supply, is proposed to be a 2-tier model. The following graphic demonstrates the workings of this model:

Graphic 1: Small customer definition for the purpose of receiving the obligation to offer supply and associated consumer protections in the national framework.



Retailers would be obligated to offer supply on a standing offer contract, and therefore a published (standard or regulated) price to all residential electricity and gas customers, all electricity customers consuming under 40MWh per annum, and all gas customers consuming under 400GJ per annum.

For energy customers consuming between 40-100MWh of electricity per annum and 400GJ to 1TJ of gas per annum, retailers will be obligated to offer supply to these customers however, supply will be offered on market contract terms, conditions and price. These customers will not be excluded from other small

customer protections in the framework relating to marketing conduct and other provisions.

The national framework would not regulate an obligation to offer supply for energy customers consuming above the second thresholds for gas and electricity (100MWh/a and 1TJ/a, respectively). These customers are considered by MCE SCO to have sufficient bargaining power in the retail market to be able to effectively negotiate a contract for terms, conditions and cost of supply.

In recommending an appropriate definition, the MCE SCO took into consideration the views of stakeholders, as the two primary competing views each had persuasive arguments. While energy should be treated as a business input for most businesses, and not as an essential service, it is critical to recognise the influence of current market conditions in Australia, and the state of retail contestability across jurisdictions.

The AEMC to date has only completed two reviews of retail competition in jurisdictions, Victoria and South Australia, with reviews for New South Wales and the Australian Capital Territory currently scheduled⁶⁴. Queensland introduced FRC in 2007, and Tasmania, Western Australia and the Northern Territory have yet to introduce FRC. Given the current national inconsistency of market developments and competition, it is difficult to assess whether a small business could confidently access supply on reasonable terms, conditions and price. This is especially the case in regional and remote areas where market competition is likely to lag in maturation compared to urban areas.

MCE SCO is satisfied that the small customer definition proposed for the national framework should adequately address the impacts on retailers and consumers. The national framework will contain provisions for the MCE to undertake a review of non-residential small customer's thresholds with a view to amending thresholds as retail markets develop and competition matures. This review assists in addressing the matters raised by Simply Energy in its submission to the Consultation RIS. As noted above, Simply Energy suggested that that it would be prudent for the regulatory framework to allow for the progressive lifting of the obligation to offer supply for customers where energy is not an essential service (such as business customers and, in some regions, gas customers) or where competition is sufficiently advanced that customers no longer risk facing access to supply issues⁶⁵.

MCE SCO notes that the policy issue in relation to consumption thresholds (as addressed in the MCE SCO Table of Recommendations) will allow the opportunity for the consumption threshold to be reviewed in a period of not more than five years. MCE SCO considers that this is sufficient time for under-developed retail energy markets to mature in time to reconsider the consumption threshold.

⁶⁴ Noting this schedule may be subject to revision.

⁶⁵ Simply Energy submission to the Consultation RIS, page 2

5.4 GENERIC VERSUS ENERGY-SPECIFIC REGULATION

The degree to which the regulation of standing offer contracts, market contracts and marketing conduct can rely on generic regulation or require industry-specific provisions is an important consideration for adoption in a national framework, especially where high-level objectives seek regulatory harmonisation in order to reduce the compliance burden.

Partly driving the need for energy-specific regulation in this area is the high level of public interest in the provision of energy services, and the detriment that may be suffered by individuals in the absence of adequate customer protection in relation to their supply of essential services. In this case, some energy-specific regulation may be warranted.

The PC *Review of Australia's Consumer Policy Framework: Productivity Commission Inquiry Report*, released in December 2007, concluded that industry-specific regulation can be an effective means of providing consumer protection where the risk of consumer detriment is high and/or the quality of the product or service is difficult to establish prior to purchase⁶⁶.

Regulating energy-specific matters may be considered necessary in order to achieve an effective consumer protection regime that could not otherwise be provided by generic provisions alone. For example, taking action after the event under generic law may not provide adequate consumer protection where:

- The risk of consumer detriment is relatively high and/or the detriment suffered if things go wrong is potentially significant or irremediable.
- The suitability and quality of services is hard to gauge before or even after purchase – the ostensible rationale for many other professional licensing regimes and 'objective' standards for technically complex products.

The policy options presented below seek to explore to what extent energy-specific regulation should be adopted in the national framework.

5.4.1 Problem

Section 3 outlines the Statement of Problem in relation to harmonisation of arrangements for the sale and supply of energy agreed in the AEMA.

The current framework for regulating consumer protection measures is jurisdictionally based. Retailers and distributors are required to comply with the Commonwealth *Trade Practices Act 1974* (TPA), the Fair Trading Acts (FTAs) of each jurisdiction and other jurisdictional regulations and codes (such as electricity and gas codes) relating to the retail of energy that are administered by jurisdictional regulators.

⁶⁶ Productivity Commission: Review of Australia's Consumer Protection Framework, page 25

The PC Review of Australia's Consumer Policy Framework noted that the current division of responsibility for the consumer framework between the Commonwealth and State and Territory Governments leads to variable outcomes for consumers, added costs for businesses and a lack of responsiveness in policy making. The PC recommended that the first step in addressing these inconsistencies would be to introduce a single generic consumer law applying across Australia, and based on consumer provisions in the TPA, modified to address gaps in its coverage and scope⁶⁷.

5.4.2 Options

	Option 1	Option 2	Option 3
Option	Only apply energy-specific where jurisdictional and national consumer protection laws are silent	Only apply where jurisdictional and national consumer protection laws are either silent or inconsistent	Apply comprehensive energy-specific regulation

Option 1: *Apply energy specific regulation where jurisdictional and national general consumer protection laws are silent*

This approach relies on generic provisions in the TPA and the FTAs of each jurisdiction to regulate marketing conduct, market contracts and standing offer contracts. Energy-specific regulation would be limited to only those areas where general consumer protection laws are silent. A prime example of this would be provisions relating to de-energisation of supply, which has a significant impact on energy consumers but which is not addressed in generic legislation.

Impacts on stakeholders

The impact of this policy option on stakeholders is minimal, as regulation will only take place in those areas that are silent on particular policy matters. However, the longer term impact of this policy option is a persistence in regulatory disharmony that has consequences for market efficiency and barriers to entry for new entrants.

Retailers	Retailers will be required to comply with various jurisdictional regulations, including jurisdictional consumer protection regulations. Layering of regulatory obligations impacts on the operating costs of retailers and prevents economies of scale (i.e. requiring different IT systems to be developed).
Distributors	Regulatory inconsistency is problematic for distributors that are currently subject to nationally consistent access requirements under the NEL and NGL. Like retailers, layering of regulatory obligations impacts on the operating costs of distributors and prevents economies of scale.
Energy Consumers	Energy customers are impacted by multiple regulatory requirements where jurisdictional consumer protection laws are inadequate in addressing energy customer issues such as de-energisation of supply. Consumers face confusion in understanding what recourse they may have if their rights are infringed with various regulatory bodies potentially having a role.

⁶⁷ http://www.pc.gov.au/__data/assets/pdf_file/0006/79170/consumer1.pdf

	The compliance burden on retailers and distributors also indirectly impacts energy customers through market inefficiencies and less competitive energy pricing.
Regulators	The cost to jurisdictional and national regulators is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules.

Benefits and Costs

Moving to this policy option has minimal overall benefits in terms of market efficiency, and minimising the compliance burden. Where the majority of regulation is maintained by jurisdictions, giving rise to scope for inconsistency, the compliance cost to retail market participants is cumulative. The compliance burden contributes to market inefficiencies that are passed onto consumers in the form of less competitive energy pricing.

Benefits	
Compliance burden	This policy option partially minimises the compliance burden by ensuring that energy-specific regulation is not imposed where generic regulation already applies, introducing a minimal amount of regulation. Energy specific regulation would only occur in those areas where neither the TPA nor jurisdictional FTAs provide for an energy-specific matter. It does however still require retail energy market participants to comply with numerous other inconsistent jurisdictional regulations.
Costs	
Regulatory inconsistency	This option does not meet the AEMA objective of achieving a nationally consistent framework. Further, it does little to harmonise the regulatory arrangements between gas and electricity as different generic laws apply across jurisdictions.
Emerging areas that require regulation	The nature of energy as an essential service and the relatively recent emergence of consumer choice for energy providers suggest that general consumer protection laws are likely to be inadequate across the wide area of regulation under consideration. The absence of regulation in this area relating to consumer choice is an area that jurisdictions may choose to regulate in the future; adopting it in the framework at this opportunity will reduce regulatory inconsistency in the future.
Compliance costs	Compliance burden still remains an issue under this policy option, as it does not harmonise regulatory requirements. Retail energy market participants are only afforded regulatory harmony in areas where new regulation is required.

Option 2: Apply energy-specific regulation both where general consumer protection laws are silent and where national and jurisdictional laws are inconsistent

This option relies on national and jurisdictional consumer protection laws to provide a consistent national approach in dealing with consumer protection. Energy-specific regulation is applied where general laws are inconsistent between the jurisdictions and where such laws are silent but the nature of energy as an essential service calls for specific treatment.

An example of an additional matter for regulation that would be brought into the energy-specific regime under this approach is the cooling-off period applied to entry into market contracts.

Impacts on stakeholders

This policy option impacts on stakeholders positively through reducing compliance burden by harmonising regulatory obligations across jurisdictions. Under Option 1, retailers, for example, will generally be required to comply with the same types of consumer protection laws across jurisdictions. But under Option 2, the specific details of these will be harmonised across jurisdictions where they were once inconsistent.

Retailers	Regulatory consistency will deliver lower compliance costs, and regulatory certainty for retailers, especially those who operate across numerous jurisdictions. Regulatory consistency should reduce the operating costs for retailers, which in the long-term enables retailers to deliver competitive energy prices and allows competitive headroom to attract other entrants into the market. Reducing regulatory obligations will impact on retailers by allowing for economies of scale through major IT infrastructure that is required to operate nationally.
Distributors	Regulatory consistency will deliver lower compliance costs for distributors, and regulatory certainty. In the long-term, this will deliver lower operating costs for distributors. This will compliment other nationally consistent requirements under the NEL and NGL, especially in relation to access arrangements.
Energy Consumers	Energy customers are impacted by the development of competition that is derived from retailer and distributor efficiency gains operating under a national framework. Given that differences between existing jurisdictional frameworks are not significant, it is not expected customers would experience material changes in their rights and protections.
Regulators	The cost to jurisdictional and national regulators is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules.

Benefits and costs

This policy option seeks to harmonise regulatory obligations, and in doing so reduce the compliance burden upon retail energy market participants. The benefits of this policy option are numerous; where the compliance burden is reduced this contributes to efficiently functioning markets, competitive energy pricing and reduced barriers to entry.

Benefits	
Regulatory harmony	This policy option promotes regulatory harmony for retailers and distributors operating across jurisdictions. Where jurisdictional laws are consistent, additional regulation will not be applied. Given the regulation would only be introduced in areas where there is regulatory inconsistency, or where jurisdictional or national regulations remain silent on the matter, it meets the AEMA objectives by providing regulatory consistency, certainty and harmonisation across both gas and electricity markets.

Barriers to entry	As noted elsewhere, the Parer Review observed that jurisdictional inconsistency in relation to regulatory obligations introduced significant costs and barriers to entry for retailers and distributors operating across numerous jurisdictions.
Competitive energy pricing	Regulatory consistency and reduced barriers to entry will deliver reductions in the long-term operating costs of retailers and distributors. The cost savings made through reduced compliance costs will be passed on to consumers in the form of competitive energy pricing. Customers would also benefit in the long-term through greater choice of energy retailer and competitive pricing as more retailers enter the market.
Market efficiency	Regulatory harmony, reduced barriers to entry and competitive energy pricing will allow the retail energy markets to operate more efficiently across jurisdictions. The longer term benefit of this is the efficient allocation of resources and clear price signals for investment, which will deliver energy security and reliability in a cost-effective manner.
Costs	
Transition cost	There may be a minor transition cost relating to those areas of regulation that are currently inconsistent (or not covered).

Option 3: *Apply comprehensive energy-specific regulation including in areas where there may be a nationally consistent approach, or where generic consumer protections are adequate.*

Impacts on stakeholders

This policy option has significant impacts on stakeholders, especially retailers and distributors, where they may be required to comply with jurisdictional obligations under generic consumer protection legislation, as well as those obligations set out in the national framework. The total effect of this is an accumulation of the compliance burden on energy business, which impacts on operating costs, and therefore resource allocation and competitive pricing. In addition, customers and energy suppliers may face confusion in understanding which obligations apply or take precedence.

Jurisdictional and national regulators are impacted by this policy option, and will not achieve the economies of scale available under the other available policy options.

Retailers	This policy option burdens retailers by regulating in areas where there may already be a nationally consistent approach in place. For example, even where jurisdictional requirements are consistent and sufficient; this option endorses further regulation thus requiring retailers to comply with both national and jurisdictional requirements. The long-term impact of this policy option is that it introduces compliance burden for retailers, which will result in increased operating costs.
Distributors	The impact on distributors of this policy option is similar to retailers.
Energy Consumers	As with previous options, the impact on energy customers is derived from the compliance costs imposed on retailers and distributors. Under this policy option, retailers and distributors are subject to increased compliance burden that translates to increased operating costs. The increased costs correspond to lowered competition and less competitive energy pricing. Depending on the details of the regulatory obligations under this model, energy customers may benefit from increased consumer protections.

	However, the extent to which consumer protections are duplicated, and do not necessarily deepen the breadth of consumer protections, is questionable under this model and may create confusion.
Regulators	This policy option would introduce increased compliance burden for regulators and result in duplication by regulators under generic and energy-specific regulation.

Benefits and costs

The costs of this policy option are significant, especially in comparison to the benefits. While comprehensive legislation may encourage a culture of compliance for retail market participants, the overall cost of comprehensive energy-specific legislation in addition to generic regulation results in compliance costs that impact on retailers, and energy customers.

Benefits	
Regulatory harmony	This policy option introduces regulatory harmony for retail energy market participants, including distributors, in relation to those requirements which are national.
Compliance and transparency with the national framework	As noted in AAR Working Paper 1, this approach potentially produces additional benefits by encouraging industry compliance and enhancing consumer understanding. Arguably, it also promotes the objectives of simplicity and transparency as it enables the energy-specific requirements to be set out in a single document that comprehensively describes retailer and consumer rights and responsibilities ⁶⁸ , provided these obligations are consistent and/or compatible with generic law requirements.
Costs	
Compliance burden	This policy may impose costs on retailers and distributors as it duplicates regulatory functions already in place by jurisdictions. As noted in the discussion of the impacts on retailers and distributors, these energy markets participants will be required to comply with multiple regulatory obligations – under a national framework and according to generic requirements which may differ across jurisdictions. These regulations would most likely operate to produce a similar outcome in relation to consumer protection measures. Further, it does not meet the high-level objectives of the AEMA which aims to reduce overlap between energy-specific and generic regulation, and minimise compliance costs.
Energy pricing	The increase in operating costs caused by accumulative compliance burden will be passed onto energy customers into the form of higher energy prices.
Allocation of resources	Where retailers and distributors are required to comply with numerous regulations, that largely replicate each other, they are forced to allocate their resources in an inefficient manner. Where one set of regulatory requirements would have sufficed in delivering similar protections to energy customers, retailers and distributors are instead required to devote resources to operating and complying with various and multiple regulations. This results in retailers and distributors allocating their resources in an inefficient manner and ultimately increasing prices for customers.
Market design	Duplication of some elements of existing jurisdictional generic consumer protection regulation through the national framework may cause confusion for energy customers and businesses regarding which protections apply and whether one takes precedence over the other. Resolving this confusion is likely to increase costs for retailers and reduce customer participation in the market.

⁶⁸ Allens Arthur Robinson Working Paper Number 1 page 34

5.4.3 Consultation

This policy issue raised minimal debate in stakeholder submissions. The majority of feedback on this issue was received in relation to specific market contract and marketing issues in the MCE SCO Table of Recommendations.

Of the feedback received, retailers and distributors were specifically concerned with the regulation of *marketing conduct*. Energy Australia noted that marketing activities are already sufficiently regulated by general consumer protection laws at both national and jurisdictional levels. Further it noted that the vast majority of marketing issues raised by consumers are adequately covered by general consumer protection and other laws⁶⁹.

Origin Energy did not consider specific regulation governing energy contract marketing as necessary and noted that marketing conduct can by implication influence the terms of any contractual arrangement for a wide range of goods and services⁷⁰.

Ergon Energy, a non-competing electricity retailer not engaged specifically in recruiting customers, asked that MCE SCO clearly define the term "marketing" to ensure that it did not impinge on establishing or confirming a supply relationship.

In response to the Consultation RIS's target questions, Ergon Energy noted that in relation to regulatory certainty, transparency and clarity, that Option 2 best met these objectives⁷¹.

Australian Power and Gas supported an approach to regulating market contracts where there is reliance on current existing jurisdictional consumer protection laws, and that energy-specific regulation should only be considered where there is evidence or threat of market failure and where there is jurisdictional inconsistency in existing consumer law⁷². In relation to marketing conduct, Australian Power and Gas offered similar comment, that the MCE SCO should avoid unnecessary duplication of existing consumer law in regulations⁷³.

Kildonan supported both approaches, but noted in relation to small customer marketing that the process of achieving a nationally consistent fair trading scheme is only now beginning⁷⁴.

⁶⁹ Energy Australia submission to the SCO Policy Response, page 18

⁷⁰ Origin Energy submission to the SCO Policy Response, page 14

⁷¹ Ergon Energy submission to Consultation RIS, page 6

⁷² Australian Power and Gas submission to the SCO Policy Response page 10

⁷³ Australian Power and Gas submission to the SCO Policy Response page 14

⁷⁴ Kildonan Uniting Care submission to SCO Policy Paper, page 30

5.4.4 Conclusion

The MCE SCO recommends the adoption of Option 2 – only applying energy-specific regulation where laws are either silent or inconsistent – for reasons relating to economic efficiency and future considerations relating to the PC’s recommendations.

The rationale for MCE SCO's recommendation has taken into account the views of the PC Review of Australia's Consumer Protection Framework which is likely to impact on the national framework.

For this reason Option 2 is recommended for regulating the content of marketing contracts and marketing conduct. This approach will accommodate any changes to the consumer protection framework where these are harmonised nationally.

While some stakeholders argued that current jurisdictional consumer protection laws were sufficient in protecting consumers, the policy approach proposed was to harmonise those current regulations by adopting them in the national framework, and where necessary include other energy-specific regulations. Therefore, the majority of consumer protection measures that are adopted in the national framework reflect those arrangements that already exist in jurisdictional legislation, and the relatively minor differences are expected to be harmonised.

A decision not to harmonise consumer protection requirements in the national framework would have been a short-lived outcome, as the current imperative, based on the PC's recommendation is to harmonise these requirements at least in relation to generic consumer protection provisions. Adopting a nationally consistent approach is consistent with these recommendations without unnecessarily creating additional regulation in areas where consistent regulation already exists.

While some stakeholders had reservations relating to the adoption of energy-specific regulation, the MCE SCO has considered that this is a necessary measure given the evolution of changes to the retail market, and that in an environment of increasing consumer choice and market competition, market activities will become more sophisticated and an appropriate regulatory response should be in place to protect energy consumers.

This approach also avoids the possibility that where the national framework does not accommodate for energy-specific regulations, jurisdictions may need to regulate these matters in other available policy spaces, thus contributing to persistent regulatory inconsistencies across jurisdictions that will impact on retailers and other market participants.

5.5 HARDSHIP REGIMES

A hardship regime places obligations on retailers to identify and assist financially vulnerable energy customers in meeting their energy payments. The PC Review of Australia's Consumer Policy Framework defines a disadvantaged customer as one who has ongoing attributes or circumstances, such as poor education and low income, which cause a continuing susceptibility to detriment⁷⁵.

5.5.1 Problem

Section 3 outlines the Statement of Problem in relation to harmonisation of arrangements for the sale and supply of energy agreed in the AEMA.

Hardship policies have been developed as part of jurisdictional energy regimes to avoid disadvantaged customers being de-energised for non-payment. Currently a nationally consistent approach for hardship regimes is not in place⁷⁶. Each jurisdiction sets out the regulatory requirements of its own hardship regime which is administered by its independent energy regulator. The regulatory obligation placed on retailers differs across jurisdictions and varies in content from a requirement to offer instalment plans to offering programs such as energy audits to assist customers in financial hardship.

The degree to which jurisdictions regulate and monitor hardship varies across jurisdictions. Given the degree of variation of hardship regimes and monitoring this issue will require resolution in the national framework.

5.5.2 Options

	Option 1	Option 2
Option	Adopt a hardship regime	Do not adopt a hardship regime

Option 1: *Adopting a hardship regime to require retailers to provide arrangements for residential customers experiencing financial hardship.*

Where retailers are required to provide financial hardship arrangements under the national framework, the framework could include matters such as⁷⁷:

- flexible payment options for payment of energy bills;
- processes for early response by both retailers and residential customers to energy bill payment difficulties;

⁷⁵ Productivity Commission: Review of Australia's Consumer Protection Policy Framework, page 293

⁷⁶ The following policy area is relevant to the obligation to offer supply – where an obligation to offer supply is imposed on retailers, retailers must offer supply to energy customers that may pose some financial risk. A hardship regime seeks to balance the risks faced by retailers (financially risky customers) and energy customers (potential disconnection of supply of an essential service).

⁷⁷ MCE SCO Policy Paper, page50

- processes for identifying appropriate programs (including the retailers own) to manage future energy consumption and costs (i.e. energy audits); and
- processes for identifying appropriate government concession programs and financial counselling services to assist in hardship mitigation and notifying customers experiencing hardship of their existence.

The potential for de-energisation to exacerbate ongoing financial difficulties⁷⁸ and have a severe impact on the health and well-being of affected customers, compared to the impact of these obligations on retailers, have been the drivers for regulating in this space.

Impacts on stakeholders

Retailers and energy customers are primarily impacted by this policy option. Energy customers, especially vulnerable customers, benefit from this policy option as it helps these customers avoid de-energisation – re-energisation cycles and maintain access to an essential service. It is difficult to determine the extent to which retailers are negatively impacted by this policy option, as it does provide retailers with some cost saving measures, such as allowing them to avoid de-energising energy customers who do not pay, and facilitating some recovery of debts. Further, the harmonisation of hardship regimes across jurisdictions will benefit retailers allowing for economies of scale.

Retailers	Retailers are impacted by a hardship regime by maintaining a financial relationship with vulnerable and financially stressed energy customers. This improves debt recovery for retailers, and militates against de-energisation – re-energisation cycles.
Distributors	Distributors are minimally impacted by this policy option. Where a designated retailer is obligated to offer supply to a customer, distributors must provide connection services irrespective of the financial position of the energy customer. Further, retailers generally bear the financial risk of non-payment of network charges by customers.
Energy Consumers	Energy customers, particularly vulnerable and disadvantaged customers, are impacted by this policy option. Where a customer is experiencing payment difficulties, either on a temporary or more permanent basis, the customer is able to avoid potential de-energisation by entering into a payment plan with retailers or accessing other forms of support. For vulnerable energy customers, this is critical to maintaining supply of an essential service such as energy.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area – according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

⁷⁸ Defining financial hardship is a difficult task to undertake, recognising the differences between customers who, for whatever reason, are unable, as opposed to unwilling), to meet their accumulated energy bill payments, on a transitory or long-term basis.

Benefits and costs

The benefits of this policy option relate to harmonising hardship policies across jurisdictions and the economies of scale that retailers can achieve in areas such as training and IT systems and processes.

While it is recognised that there are some costs to retailers under this model, hardship regimes only capture a small minority of energy customers, and allow retailers a means of recouping monies owed from these customers.

Benefits	
Complementarity with other policies in the national framework	<p>This policy option extends and complements other initiatives in the national framework aimed at minimising the likelihood that vulnerable and financially disadvantaged customers will be prevented access to energy supplies.</p> <p>Where an obligation to offer supply in the national framework is adopted, designated retailers are obligated to offer supply to energy customers without regard for their financial position. A hardship regime offers retailers and customers the means to resolve each of their conflicting priorities – maintaining energy supply for residential customers and recovery of payment by retailers.</p>
Protection for vulnerable energy customers	<p>By allowing energy customers to enter into payment plans with retailers and accessing other available forms of assistance, vulnerable and disadvantaged energy customers are assured continued access to energy supply.</p> <p>Energy customers experiencing financial hardship gain a number of protective mechanisms to ensure that de-energisation is a last resort for retailers in the event of non-payment by customers. This policy option aims to minimise the chances that hardship customers will be further disadvantaged as a result of de-energisation of their essential energy supplies⁷⁹.</p>
Retailer operating costs	<p>By allowing retailers to enter into payment plans with energy customers in financial hardship, energy retailers are able to avoid costly de-energisation – re-energisation cycles, which is especially the case where the energy retailer is the retailer with the obligation to offer supply.</p> <p>Retailers are able to maintain a financial relationship with energy customers and are better placed under this policy option to be recompensed for energy supply and services provided to energy customers in financial hardship.</p>
Costs	
Economic inefficiency	<p>The major costs to retailers are the prolonged recovery of payments from energy customers and increased interaction between retailers' staff and customers in financial hardship. Further to the delayed recovery of payments by customers, retailers must also implement additional operating systems and training for staff to accommodate this policy option.</p> <p>The cost to retailers of this policy option may be inferred through the incidence of customers de-energised due to non-payment. In Victoria the percentage of customers de-energised for non-payment of bills in 2006-</p>

⁷⁹ According to the Essential Services Commission of Victoria less than 30% of disconnected residential and small customer's exhibit signs of financial hardship. The number of those customers experiencing financial hardship is not available. However, approximately 5% of Victorian customers are on instalment plans.

	07 was higher than in 2005-06 but remained well below 1%, and below most other states ⁸⁰ . For New South Wales, the de-energisation rate due to non-payment for residential customers for 2006-07 was 0.7% ⁸¹ .
Perverse incentives	It is recognised that imposing a hardship regime on retailers may create perverse incentives for customers who are otherwise capable of paying their energy bills on time to delay payment until de-energisation is imminent. This could significantly add to the costs of a hardship regime. To avoid creating perverse incentives, a hardship regime would need to be carefully tailored to ensure these incentives do not exist or are minimised – in particular, care needs to be taken to distinguish those customers who <u>cannot</u> pay from those who <u>will not</u> pay.

Option 2: Retailers will not be required to implement a hardship regime to accommodate for residential customers experiencing financial hardship

This policy option will not require the adoption of an energy-specific consumer hardship regime in the national framework.

Impacts on stakeholders

This policy option impacts greatest on energy customers, especially vulnerable energy customers who are experiencing either temporary or more permanent financial hardship. These energy customers, without a hardship regime, may be prevented from maintaining access to an essential service. Further, where a hardship regime is not adopted in the national framework, these types of customers may enter in to a costly de-energisation – re-energisation cycle.

Retailers are not immediately impacted by the absence of a hardship regime, but where an obligation to offer supply exists, may enter into costly de-energisation – re-energisation cycles with vulnerable energy customers. Further, the absence of a hardship regime may impact on the capacity for retailers to recoup monies owed by energy customers.

Retailers	Retailers would be minimally impacted by not adopting a hardship regime in the national framework. However, the extent to which they would adopt their own suite of measures aimed at assisting customers in financial hardship remains an issue. Retailers may find it beneficial to choose to adopt a hardship regime irrespective of regulatory obligations in place.
Distributors	Distributors are minimally impacted by this policy option. Where a designated retailer is obligated to offer supply to a customer, distributors must provide connection services irrespective of the financial position of the energy customer. Further, retailers generally bear the financial risk of non-payment of network charges by customers.

⁸⁰ Essential Services Commission of Victoria: 2006-07 Energy Retail Performance – Consumer Snapshot, page 2(ii)

⁸¹ Independent Pricing and Regulatory Tribunal: NSW Electricity Information Paper No 1/2008, for the period 1 July 2002 to 30 June 2007, page 17

Energy Consumers	Energy customers, especially those who are experiencing financial hardship or are vulnerable, will be severely impacted by not adopting a hardship policy in the national framework. These customers may be disenfranchised from an essential service which may result in severe detriment to their well-being.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Benefits and costs

The cost of not adopting a hardship regime in the national framework mainly relate to the health and well-being of energy customers who may be denied access to an essential service such as energy. These costs are substantial when considering what detriment can be suffered by these customers.

The benefits of this option are mainly accumulated to retailers that will have lower operating costs as they would not be required to invest in IT systems, and training and be able to recoup owed payments promptly (although retailers may experience lower rates of success in doing so).

However, given the segment of the market that would require the assistance of a hardship regime, this may be of minimal impact on the operating costs of retailers. Additionally, if a hardship regime is not adopted in the national framework, jurisdictions may choose to regulate or include a suite of hardship measures in other regulatory areas, allowing inconsistencies to persist.

Benefits	
Efficient allocation of resources	Without any hardship obligations placed on retailers, retailers will be able to allocate resources efficiently. Retailers will not be required to undertake specific training for staff and develop IT resources to accommodate a hardship regime.
Costs	
Regulatory inconsistency	Where retailers are not obliged to implement a hardship regime, jurisdictions may continue to regulate for this policy perpetuating regulatory inconsistency for retailers operating across numerous jurisdictions and increase barriers to entry.
Insecurity of supply/disenfranchisement of energy customers	A significant cost of not adopting a hardship regime in the national framework is that customers requiring assistance in managing payment for their energy supplies may be unable to find assistance, or the provision of assistance will fall principally to welfare agencies with less direct contact with customers and limited time and resources with which to assist customers who are experiencing difficulty in paying their bills due to financial hardship.
Consumer detriment	The costs to energy customers of not including a hardship regime in the national framework may be significant. If hardship arrangements don't exist, energy customers who are unable to afford their energy supply face a greater risk of de-energisation from this essential service.
Unregulated hardship regimes	Retailers may find it beneficial to implement their own hardship regimes in order to secure compensation of payments, or to avoid de-energisation – re-energisation cycles where the obligation to offer supplies is adopted in the national framework. Where retailers maintain their own hardship regimes, the degree to which they properly serve consumers is unaccounted for.

5.5.3 Consultation

The feedback from stakeholders on the issue of a hardship regime in the national framework did not present argument for significant changes to the policy settled upon in the MCE SCO Policy Paper⁸².

Ergon Energy noted that failure to provide hardship programs, either through mandated legislation or initiated by the retailer, can have a significant adverse impact on this portion of the customer base⁸³.

Of the feedback received on the proposed hardship regime, consumer advocacy groups generally sought for tighter compliance for hardship regimes, such as requiring retailers to seek AER approval for their hardship regime. The Tasmanian Council of Social Service (TasCOSS) and Queensland Council of Social Service (QCOSS), whilst recognising that under current jurisdictional requirements most retailers would have already received jurisdictional approval for their hardship regimes, considered that retailer's hardship regimes should be approved by the AER⁸⁴.

The Kildonan Uniting Care submission noted that a requirement akin to best practice principles placed in the Law would ensure that the hardship regimes required of retailers would effectively and efficiently meet customer needs under such a program⁸⁵.

Other issues of concern to consumer advocacy groups related to the manner in which retailers were required to identify customers experiencing financial hardship. In particular the EWOV and the Essential Services Commission of Victoria (ESCV) noted that best practice should allow customers to identify themselves as being in financial hardship, and not solely rely on the imperative of retailers to identify that customers were in hardship⁸⁶. The principle of self-identification would allow this customer protection to be more broadly available.

Ergon Energy noted that on the issue of self-identification that "hardship customers" should be characterised as those customers "who are willing but unable to pay their bill within existing credit guidelines without affecting the customers' ability to meet basic living needs (such as rent and food)"⁸⁷.

Retailers were generally supportive of the adoption of a hardship regime in the national framework as these provisions are already required of retailers at the jurisdictional level. TRUenergy noted that the obligation placed on a retailer for the early identification of a hardship customer was misrepresenting the role of a retailer, as retailers cannot be expected to know whether a customer is

⁸² Set out in the MCE SCO Policy Paper, page 50

⁸³ Ergon Energy submission to Consultation RIS, page 7

⁸⁴ TasCOSS submission to SCO Policy Response page 4

⁸⁵ Kildonan Uniting Care submission to SCO Policy Response, page 32

⁸⁶ Essential Services Commission of Victoria submission to SCO Policy Response page 18 and Energy and Water Ombudsman of Victoria submission to SCO Policy Response page 17

⁸⁷ Ergon Energy submission to Consultation RIS, page 7

experiencing payment difficulty in the absence of advice from that customer, or a third-party on the customer's behalf⁸⁸. It should be noted that identification of financial difficulty by the retailer varies from self-identification of being a hardship customer, as the latter would automatically qualify a customer for the hardship program offered by the retailer.

Ergon Energy noted in its response to the Consultation RIS that the materiality of the costs incurred by the retailer in implementing hardship arrangements will be largely dependent on how prescriptive the regulatory framework is and the scope afforded to the retailer to tailor its program to individual customer needs. Costs are also dependent on a retailer's customers profile – how diverse is the geographical spread of their customer base (urban, rural and isolated/remote)⁸⁹.

TRUenergy suggested that the AER should be required to consult with stakeholders in developing the any guidelines that would require retailers to report on hardship indicators⁹⁰.

Ergon Energy noted that a distinction should be made between those customers who were in financial hardship on a permanent basis, and those who could seek resolution to financial difficulties through extensions of time to pay, instalment plans or any such other measures⁹¹.

The MCE SCO Table of Recommendations has made such a distinction and notes that, in relation to small customers who are not identified as hardship customers but who experience payment difficulties from time to time, the retailer may be obligated to provide payment options⁹².

5.5.4 Conclusion

The MCE SCO recommends the adoption of Option 1 – the adoption of a hardship regime – for reasons relating to the consumer protections and national consistency where retailers may proceed to implement hardship regimes.

The MCE SCO Policy Paper and Consultation RIS outlined the preferred option for the adoption of a hardship regime in the national framework. The rationale for the adoption of a hardship regime in the national framework are outlined in the benefits and costs under Option 1 above and in the longer term will prevent jurisdictions, or retailers from adopting an alternative and possibly inconsistent approach to the issue of customers in financial hardship.

The MCE SCO recommends that all retailers must have in place a Customer Hardship Policy that outlines their policies and process to assist residential

⁸⁸ TRUenergy submission to SCO Policy Response, page 6

⁸⁹ Ergon Energy submission to the Consultation RIS, page 6

⁹⁰ TRUenergy submission to SCO Policy Response, page 6

⁹¹ Ergon Energy submission to SCO Policy Response, page 10

⁹² MCE SCO Table of Recommendations, Recommendation 1.20A

customers in financial hardship and that such policies should be available on their website.

A retailer's Customer Hardship Program will be required to have the explicit aim of assisting hardship customers in managing their current and future payment obligations. It must also outline a range of programs which retailers can draw on to assist hardship customers. To ensure retailer compliance with these obligations, the AER will be required to monitor compliance with the requirements and to develop and report on a range of hardship indicators.

In responding to the concerns of consumer advocates that the AER should approve the hardship regimes in place by customers, the express requirement that a retailer must publish their hardship program, guidance as to its contents and historical precedents and practices amongst retailers provide significant incentives to ensure that retailers offer a reasonable regime to energy customers in hardship. The MCE SCO is aware that while the benefits of a hardship regime in the national framework are numerous, and that retailers are amenable to such regimes, the imperative for stricter oversight of the development of these regimes, by way of AER approval may be unnecessary. Retailers will be required to report on hardship indicators, which the AER must in turn report to the MCE. The MCE SCO considers this to be sufficient incentive for the hardship regimes to be effective in targeting those customers who would benefit from it.

On the issue of self-identification, the national framework will be sufficiently flexible to allow energy customers to self-identify; otherwise the obligation placed on retailers to identify which customers are experiencing financial hardship would become significantly more onerous, and also be impracticable for energy customers where they wish to identify as being in financial hardship but are unable to.

The SCO believes that adopting a national approach to customer hardship will enable effective management of the costs to retailers where they participate in more than one jurisdiction.

6. DISTRIBUTOR INTERACTION WITH CUSTOMERS AND RETAILERS

Policy options available for the distributor interaction with customers and retailers are structured according to the models currently in operation across jurisdictions.

Generally, retailers are responsible for the sale of energy, and distributors for the physical delivery of energy, to customers. Contracts between retailers, distributors and customers govern the relationship between the parties for the sale and supply of energy services to customers.

In relation to distributors, a contract governs the provision of distribution services to customers (both physical and operational) and determines the extent to which distributors interact with, and are responsible directly to, customers for the provision of distribution services.

The contractual model adopted in the national framework should seek to balance each market participant's capacity to deliver on responsibilities without unduly complicating end-use customers' ability to seek energy supply and distribution services. This is a matter to be addressed in the detailed content of the specific contracts and regulatory obligations between distributors, retailers and customers.

For clarification, a liability regime refers to the way in which responsibilities and obligations are divided amongst distributors, retailers and energy customers. Therefore, where a contractual model is modified, this also modifies the liability regime by way of introducing or removing obligations through on parties.

6.1 PROBLEM

Section 3 outlines the Statement of Problem in relation to harmonisation of arrangements for the sale and supply of energy agreed in the AEMA.

Currently each jurisdiction has in place different obligations for regulating the relationship between distributors and retailers, and distributors and customers (which may include some interaction between retailers and customers in relation to the provision of distribution services to customers).

AAR's Working Paper No. 2⁹³ broadly sets out the various types of contractual models currently used by jurisdictions as a basis for providing options for the national framework. The three models of triangular, linear and modified linear (or 'hybrid') are each applied (with variation) in jurisdictions:

- Queensland and South Australia (for electricity) have adopted forms of the triangular model;

⁹³ Allens Arthur Robinson Working Paper Number 2, page 29

- Western Australia, Tasmania,⁹⁴ Queensland and South Australia (for gas) and the Northern Territory effectively adopt linear models; and
- New South Wales (for electricity), Victoria and the Australian Capital Territory adopt forms of a modified linear model.

The models described below are theoretical concepts and may be open to adaptation when applied in practice.

The objective of regulating at a national level is to provide common regulatory arrangements for the electricity and natural gas sectors. Another aspiration of this regulatory approach is to improve the transparency of regulatory arrangements and as a result provide an appropriate level of certainty. Furthermore it is hoped by taking a national approach to this issue, the overlap between energy specific and generic regulation will be reduced and ultimately the regulatory compliance burden and associated costs will be minimised.

6.2 Options

	Option 1	Option 2	Option 3
Options	Triangular model	Linear model	Tripartite ⁹⁵ contractual model

Option 1: Triangular model

Under the triangular model both distributors and retailers coordinate the provision of energy services to customers, so that each has a direct relationship with customers relating to those aspects of the sale and supply of energy over which each party has control. AAR Working Paper Number 2⁹⁶ outlines the contractual interplay of this model to include:

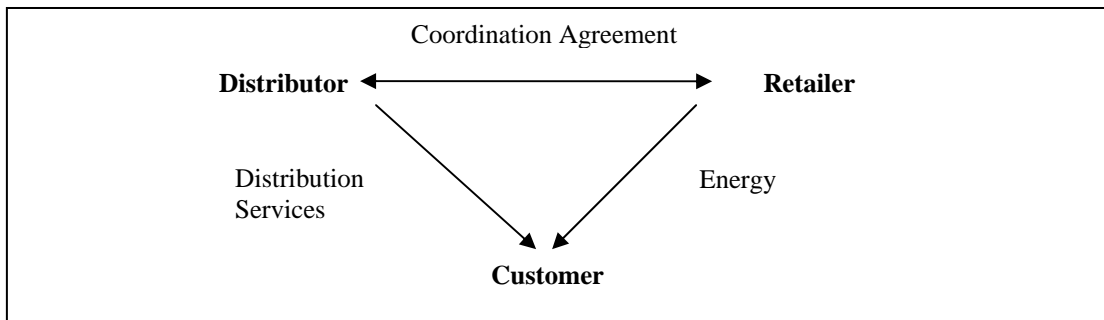
- A contract between the distributor and the customer pursuant to which the distributor provides distribution services to the customer;
- A contract between the retailer and the customer pursuant to which the retailer sells energy to the customer; and
- An agreement between the distributor and the retailer to coordinate the provision of services to the customer and to allow the customer to make payment to a single service provider. The retailer collects network service charges from the customer on behalf of the distributor and requests distribution services (such as energisation) from the distributor on behalf of the customer.

⁹⁴ Tasmania is currently considering transitioning to the tripartite contractual model as outlined in the National Energy Customer Framework.

⁹⁵ This model is similar but not identical to the “hybrid” contractual model considered by AAR in Working Paper No. 2 and discussed in the Consultation RIS

⁹⁶ Allens Arthur Robinson Working Paper Number 2, page 27

Triangular Contractual Model:



Impacts on stakeholders

Retailers	Retailers assume financial risks associated with distribution services, although they are not directly responsible for the provision of distribution services to customers. Retailers are impacted by assuming financial liability beyond the scope of the services that they provide.
Distributors	This contractual model places distributors in a direct contractual relationship with customers regarding the provision of energy distribution services that include operational safety and reliability of energy supply.
Energy Consumers	This relationship signals a clear contractual relationship for customers and their individual relationship with each of their service providers: distributors and retailers. The services offered by these service providers are streamlined for the benefit of energy customers while preserving the rights and responsibilities of each party.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Benefits and costs

The primary benefit of this model is the allocation of responsibilities between energy customers and their service providers. Under this model retailers concentrate on their core business of selling energy to customers including increasing market share by use of competitive activities such as marketing.

Distributors are responsible to energy customers for ensuring that their energy is delivered to them in the appropriate way.

Each service provider has a direct responsibility to their mutual energy customer. This ensures that customers have access to both retailers and distributors depending on what type of issue they may have.

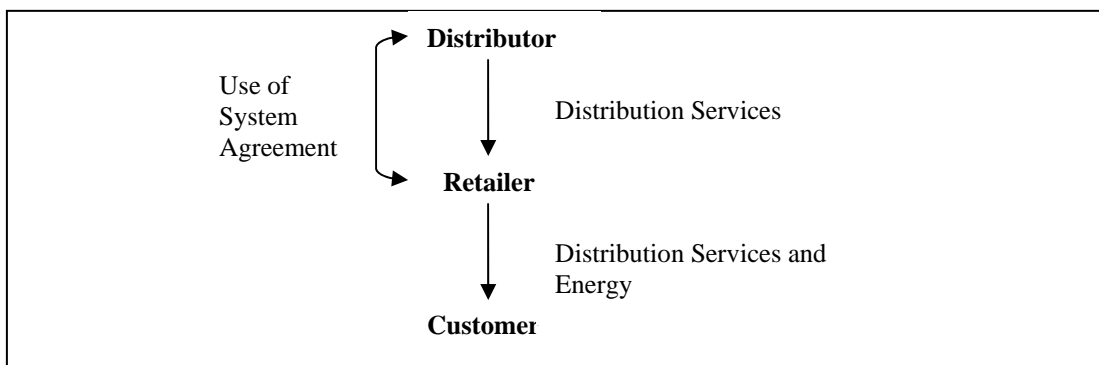
Benefits	
Energy customers	Retailers and distributors must coordinate with each other for the provisions of the financial and physical aspects of energy supply to their mutual energy customers. Retailers and distributors are obligated contractually to provide energy services including selling and supplying to energy customers.
Clear	This model provides clear contractual rights and obligations for all parties.

contractual rights for all parties	The contracts put in place mutual rights and obligations for each party, breaches of which may be remedied under contract law. For example, if the distributor defaults in its supply of energy to a customer, the customer can seek damages under their contract.
Defining the relationship between retailers and distributors	The responsibilities of retailers and distributors to customers can be easily captured within the terms and conditions of the coordination agreement between these two parties. For distribution services – distributors are contractually responsible for the physical and operational supply of energy, while retailers are responsible for the payment of distribution services to the distributor on behalf of their energy customers.
Costs	
Allocation of liabilities	<p>Under the triangular model retailers assume the financial risk for the provision of distribution services. Retailers are the responsible agents for the collection of payment for the provision of distribution services to customers and are liable to pay the distributor distribution fees and charges irrespective of whether the customer has paid the retailer for such services.</p> <p>The extent to which retailers assume customer credit risk, as part of their responsibility for collecting network charges on behalf of distributors, is a matter of detail that requires clarification in the detail of the contracts between retailers and distributors.</p>

Option 2: Linear model

Under this model, retailers purchase conveyance services from distributors and then sell a bundled product to customers. Customers receive energy that is delivered by distributors on behalf of retailers, and do not have a contractual relationship with their distributor.

Linear Contractual Model:



Impacts on stakeholders

Retailers	Under the linear model retailers purchase distribution services from distributors to allow them to sell their energy to their customers. Retailers are therefore responsible to energy customers for a bundled service including the sale and supply of energy to their premises. Retailers are seen by their energy customers as being responsible for the physical supply of energy which they have no control over as this is the distributor's responsibility. Energy customers may seek damages from retailers for problems with the physical supply under this model (then requiring retailers to recover from distributors).
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Distributors	The linear model removes distributors from entering into a contractual relationship with energy customers and therefore reduces their responsibilities to energy customers. Further, distributors' compliance costs are reduced under this contractual model due to limited direct interaction with customers.
Energy Consumers	<p>Energy customers' protections may be limited or complicated under this model as the relationship with its energy providers is limited to retailers only, despite distributors having control over the physical supply of energy through the distribution network to the customers' premises. Retailers can only control the sale of energy to customers and not the physical and operational aspects.</p> <p>Energy customers do not have direct access to their distributors under the linear model which may result in a reduced quality of service for non-regulated areas. For example, a customer requiring a unique connection service cannot go directly to the distributor but rather work through a third party being the retailer.</p>
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Benefits and costs

Benefits	
Distributor liabilities reduced	Distributors are not required to enter into a contractual relationship with energy customers under this model. The overall effect is that distributor liabilities and compliance costs are reduced under this model which may lead to efficiency gains, although the extent of these may be immaterial as the distributor will still be liable to the customer's retailer.
Efficiency in delivery of services to end-use customers	The retailer purchases, from the distributor, the provision of physical distribution services, the cost of which then is then passed onto energy customers.
Retailers can price financial risk	<p>The significant difference between the linear and the triangular model is that retailers "purchase" distribution services from the distributor, pay for them and then pass on the costs to the end-use customer rather than acting as a billing agent for the distributor and accepting the distributor's credit risk.</p> <p>In effect, under the linear model the risk assumed by retailers under the triangular model is formalised as retailers are actually purchasing a service for which they pay the distributor.</p>
Costs	
Uncertainty in liabilities regime	The risk of this model is the indistinct liability regime, especially in relation to the rights and obligations of distributors to energy customers. Costs may fall on retailers to the extent that they are seen by energy customers as being responsible for both the sale and supply of energy. Energy customers may incorrectly infer a liability upon retailers in relation to matters outside their control, such as the quality, safety and reliability of energy supply.
Costs to energy customers and retailers in the liability regime	Under this model, distributors are not directly liable to customers for the provision, safety and reliability of supply as no direct contract exists between these two parties (although the distributor has obligations under the Law in relation to the operation and maintenance of its supply network).

	<p>The absence of a contractual relationship between distributors and energy customers may result in added complexity to the resolution of supply issues. For example, if a customer suffers any loss arising from the distributor's failure to supply they would seek compensation directly from the retailer, yet it is the distributor that is best placed to address any physical supply issue and ultimately the retailer would seek to recover the cost of meeting any such customer claims from the distributor.</p>
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Option 3: *Tripartite contractual model*

Whilst the linear and triangular contract models are theoretically ‘pure’ in that they start from a set of principles for determining which parties deliver which services, it is possible to introduce a contractual model without such a basis, defining the services provided by the parties as needed to effect policy goals which are external to the contractual model itself.

A tripartite contractual model introduces a contractual relationship between distributors and energy customers for the provision of some services in the form of a deemed contractual relationship.

The tripartite contractual model is not unlike the triangular model where retailers and distributors enter into a contractual arrangement for the provision of energy services to energy customers. However, the deemed contractual relationship between distributors and energy customers defines a narrower set of services to be provided to shared customers.

Like the linear model, retailers provide a bundled service of energy and distribution services to energy customers, however distributors are directly responsible for the provision of these services to energy customers under the deemed contractual relationship.

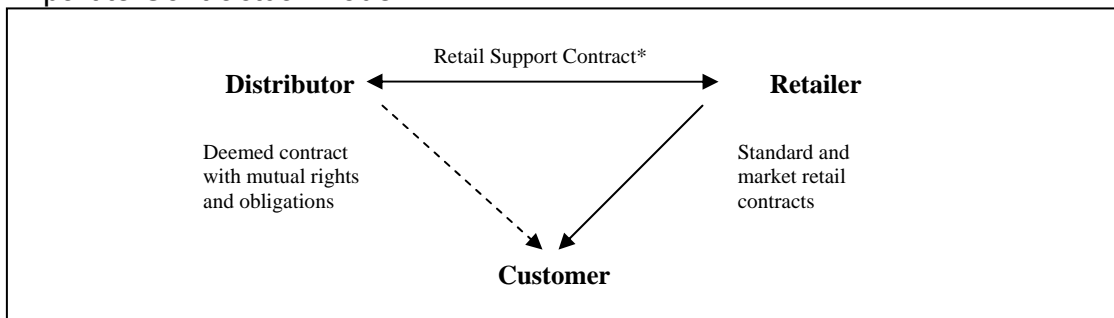
The rationale for introducing such a contractual model is the need to accommodate differing arrangements for economic regulation of the principal functions of the gas and electricity distribution businesses, and the need to introduce a liability management regime to rationalise the complex system of liabilities and immunities for loss, damage and non-delivery of services which are necessary to manage a disaggregated energy market. Because several of the issues in this space concern the relationship between customers and distributors, a tripartite model provides the most direct and flexible arrangement by which these issues can be addressed in a contractual sense.

As distributors provide few actual services directly to the retailers, apart from metering data in many cases, and the bulk of services (particularly delivery of energy, connection, emergency management) to customers, it can be argued that the retailer’s offering is ‘bundled’ in name only, but it allows for the continuation of arrangements where retailers must purchase regulated transportation services from distributors in order to trade.

Placing direct obligations on distributors via deemed contracts should also provide greater clarity in relation to possible claims by customers against distributors for failure to meet the specified supply requirements and allows all

parties to seek contractual remedies for breaches directly from the party responsible, where necessary and appropriate.

Tripartite Contractual Model:



* Supports provision of retail and distribution services to common customers and supplements additional services to energy customers on behalf of retailers not covered by access arrangements

Impacts on stakeholders

Retailers	The introduction of a deemed contractual relationship between distributors and energy customers has a tangible impact on retailers where the proportion of liability assumed by retailers for the physical provision of energy supply is limited. Where energy customers seek redress for detriment caused by the supply of energy to premises, retailers are removed from liability (where appropriate). In terms of the financial risk assumed by retailers, this remains unchanged from the options above.
Distributors	Distributors are directly impacted by the introduction of a deemed contractual relationship whereby they have direct responsibility to customers for aspects of the physical supply of energy to customers' premises. Option 2 excluded distributors from this regime, other than to the extent that distributors have obligations under the Law in relation to the operation and maintenance of its supply network. Under this model distributors have defined rights and obligations to energy customers.
Energy Consumers	This model does not change the services provided to energy customers by retailers and distributors. At the same time, while the deemed contractual model places rights and responsibilities on distributors for the supply of energy to a premises, it also places complementary rights and obligations on energy customers in receiving energy supply services from distributors.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Benefits and costs

Benefits	
Consistency with economic regulation	Under both the gas and electricity regulatory frameworks, retailers are system 'users' for the purpose of purchasing the energy transfer services of distributors (on behalf of their customers). The tripartite model allows this role of retailers to be acknowledged while keeping a meaningful division of services to end-use customers.
Liability regime	This model redresses the absence of a contractual relationship between distributors and energy customers under the linear model by ensuring

	<p>distributors are directly responsible for matters relating to the physical supply of energy to customers' premises. Retailers are subject to a more appropriate division of rights and responsibilities to energy customers, while still charging a bundled tariff service to energy customers.</p> <p>Retailers maintain a clear contractual relationship with energy customers where energy customers are liable for the payment of distribution services to retailers. Retailers assume the financial risk similar to the triangular model but now have a clear service provided to them from distributors.</p>
Costs	
Ambiguity regarding deemed contractual relationship	<p>The tripartite contractual model creates a deemed contractual relationship between distributors and energy customers in the form of a deemed contractual relationship which is enlivened by the distributor's supply of energy to the premises, which may be at the request of a retailer to connect the energy customer's premises.</p> <p>Uncertainty enters into this tripartite contractual relationship when the retailer purchases distribution services from the distributor and on-sells it to energy customers – there may be confusion for energy customers regarding the contractual rights and obligations between the customer and distributor under the deemed contract arrangement.</p>

6.3 Consultation

Feedback received from stakeholders on the MCE SCO Policy Paper in relation to the contractual model was mainly from gas distributors whose interaction with retailers is largely governed by existing access arrangements⁹⁷ and distributors have almost no direct interaction with customers.

As reflected in submissions received, electricity distributors were less concerned (than gas distributors) on the adoption of the contractual relationship between distributors and energy customers in the national framework as a more "triangular" model already applies in electricity.

Gas distributors raised concern with the contractual arrangements and, consequently the liability arrangements between distributors and both retailers and small customers. Some gas distributors also favoured direct obligations in the Law and Rules to govern the relationship, rather than a tripartite contractual relationship.

The APA Group argued that the current arrangements between gas distributors and retailers, largely reflecting the linear model with limited interaction with energy customers, should be adequate in addressing the obligations and rights of distributors and customers, as mediated through retailers.

⁹⁷ For gas the distributor-retailer relationship has been largely governed by national access arrangements, which are based on a 'negotiate/arbitrate' model, underpinned by an AER-approved access arrangement. Access arrangements for gas distributors have not traditionally sought to provide the supply of services directly to retail customers and have relied on a 'linear' supply arrangement that views retailers as the 'users' of the gas distribution network (i.e. closer to policy option 2 such that retailers provide a bundled service to energy customers).

APA Group noted that no rationale existed for amending this lineal relationship by requiring deemed contract between distributors and customers. Any obligation between the distributor and customer should be managed through legislation and regulation as well as customer contracts with retailers and retailer contracts with distributors⁹⁸.

Jemena argued that while the adoption of a national framework has a consumer protection focus this should not necessitate moving away from the linear contractual model currently in place between gas distributors and retailers. Jemena argue that the 'hybrid' contractual model may be inherently confusing to customers and offer them no direct benefits. As an alternative Jemena have maintained that mandatory distributor/retailer/customer interactions would best be dealt with by direct obligations set out in the Law and Rules rather than be artificially imposed via 'deemed' contracts⁹⁹.

Multinet and United Energy Distribution (UED), on the issue of the contractual relationship between distributors and energy customers, noted that the AER, as regulator, can effectively negotiate on the behalf of small energy customers and that energy customers would not value individual liability rights offered under a deemed contract as much as effective enforcement of minimum network service standards under a Rules-based mechanism¹⁰⁰.

SP AusNet highlighted the need for flexibility in contractual relationships such that default deemed contracts could be negotiated as part of a price review process¹⁰¹.

Multinet and UED also noted that where the SCO still wished to pursue a liability regime between distributors and small customers, that the following guiding principles should be considered by SCO:

- Distributors should not be forced to accept liability to the extent that it would create uninsurable risks or excessive insurance costs;
- Evidence of a material degree of negligence should be established before any assignment of liability to a distributor; and
- Indemnities between parties must reflect their particular areas of control¹⁰².

Ergon Energy, a Queensland based retailer familiar with the triangular model, noted that moving from the existing triangular model will cause many of the benefits of customer understanding to be lost. In particular, they noted that this would occur in moving from the triangular model to a linear or 'hybrid' model.

Feedback received on the contractual relationship between distributors and retailers was again mainly from gas distributors whose relationship, in the case of covered pipelines, with retailers is already usually subject to regulation by the AER under access arrangements.

⁹⁸ APA submission to MCE SCO Policy Paper, page 2

⁹⁹ Jemena submission to Consultation RIS, page 2

¹⁰⁰ Multinet and UED submission to MCE SCO Policy Paper, pages 17- 18

¹⁰¹ SP Aus Net submission to MCE SCO Policy Paper, pages 26- 27

¹⁰² Multinet and UED submission to MCE SCO Policy Paper, page 18. See also Jemena submission.

The APA Group did not support the introduction of a contract between retailers and distributors under the new national framework as such a relationship already exists under the access arrangements that effectively already deal with matters between retailers and distributors and the move towards an additional contractual relationship between these two entities would create another contractual layer. The APA Group submitted that this new contractual relationship creates an unnecessary regulatory imposition with its attendant inefficiencies and complexity. Further, a Retail Support Contract (RSC) (between retailers and distributors) creates the potential for inconsistency and confusion with access arrangements in particular¹⁰³. Where additional matters require regulation, APA argued that these are best addressed via the current contractual relationship between distributors and retailers under access arrangements.

Multinet and UED were of a similar opinion to the APA Group and noted that access regulation provides a complete and efficient mechanism to govern distributor-retailer contractual relationships. Multinet and UED argued that the responsibility of retailers is to ensure that energy gets delivered to their customers' connections in the way customers want it – that is, retailers should provide a full and complete service. Multinet and UED asserted that the value of a retailer in providing a service becomes questionable if it does not provide a bundled service and declines to fully manage the relationship with the distributor¹⁰⁴.

Multinet and UED argued that while the standardisation of the contractual model across the two sectors of electricity and gas may reduce retailer costs, the impact on energy customer prices can be expected to be minimal. A significant element of the cost reduction (for retailers) is simply transferring costs to distributors, which balances out the benefits of retailer cost reduction flowing from a consistent approach across jurisdictional boundaries¹⁰⁵. Similarly, ActewAGL in their submission to the Consultation RIS argued that the standardisation of a contractual model across the two different energy sectors would result in a net increase in regulation for retailing businesses¹⁰⁶.

SP AusNet (involved in both electricity and gas distribution) was of contrary opinion to the APA Group, Multinet and UED and supported the standardisation of the contractual model across two sectors and viewed it as an appropriate measure. In particular, SP AusNet supported the model terms and conditions in a deemed contractual relationship between distributors and customers, as well as the capacity for retailers and distributors to enter into a contract either within the scope of the model terms and conditions, or negotiated separately and with the approval of the AER.

In terms of the costs to retailers moving from the triangular to the linear or 'hybrid' linear model, these are significant according to Ergon Energy, and

¹⁰³ APA Group submission to MCE SCO Policy Paper, pages 1-2

¹⁰⁴ Multinet and UED submission to the MCE SCO Policy Paper, pages 15-16

¹⁰⁵ Multinet and UED submission to the MCE SCO Policy Paper, pages 16-17

¹⁰⁶ ActewAGL submission to MCE SCO Consultation RIS page 1

mainly due to the liability/risks regime of the linear-type models as previously discussed, especially in the provision of a bundled service to energy customers¹⁰⁷.

Integral Energy, in its submission to the Consultation RIS, noted that the contractual model used to describe arrangements in New South Wales does not accurately reflect the contractual arrangements that apply. The detail and form of the contractual model were not for consideration in the Consultation RIS, and therefore the high-level models would not accurately capture all aspects of the arrangements in place.

Integral Energy also raised concerns around the definition of "distribution services" in the contractual model, and how this would interact with "distribution services" as defined in other legislation such as the National Electricity Rules (NER). Integral Energy emphasised the importance of the definition of "distribution services" in the National Energy Customer Framework being identical to the current definition of "distribution services" in the NER to reduce any uncertainty and overlap and to improve uniformity of regulation.¹⁰⁸

6.4 Conclusion

The MCE SCO recommends the adoption of Option 3 – the tripartite contractual model – for reasons relating to the appropriate allocation of liabilities and clear contractual responsibilities between retailers, distributors and energy customers.

In developing the contractual model to be adopted in the national framework, the SCO has considered the types of models in operation in jurisdictions and the whether these models appropriately meet the high-level AEMA objectives while still having regard for the impact on stakeholders. While the contractual model's tangible economic impacts are less obvious than other policy matters under consideration in the Decision RIS, their impact on the compliance costs of business and potential for inappropriate allocation of responsibility must be carefully considered by the SCO.

The models available to SCO for adoption in the national framework each present liability regimes where the liabilities are transferred at the cost or benefit of the three parties. For example, where distributors benefit by not being included in a deemed contractual relationship, this is at the cost of retailers who may assume liability to customers in relation to faulty supply, for example, and prevents customers from seeking redress from the party in control of the service (as applicable). Where distributors have direct liability to customers, distributors may incur extra costs, but this can be expected to benefit energy customers and retailers.

¹⁰⁷ Ergon Energy submission to Consultation RIS, page 7

¹⁰⁸ Integral Energy submission to Consultation RIS page 6

Therefore the sensitivities for the SCO are in developing a contractual framework that accurately captures the appropriate responsibilities and obligations of each party. At the high-level the SCO is recommending Option 3 based on the tripartite contractual arrangements, which might also be characterised as a 'hybrid' model.

The appeal of Option 1 is that it offers a streamlined service to customers on behalf of retailers and distributors, such as retailers and distributors coordinating in the provision of connection services and timeframes. For this reason the SCO is recommending a RSC be included in the national framework that will govern the relationship between retailers and distributors. The SCO will, where appropriate, model the terms of the RSC based on best practice examples from jurisdictional agreements already in place¹⁰⁹.

The reason for not fully adopting all high-level aspects of Option 1 lie in the liabilities that retailers must assume under this model. As noted, retailers act as a collection point, essentially, for the recovery of distribution charges on behalf of distributors. However, Option 2 ameliorated these concerns by positing retailers in a contractual relationship such that they are able to purchase from distributors the provision of energy services to on-sell to energy customers; importantly retailers buy and sell distributors services, and do not act as a collection point.

It is this aspect of the linear model that appeals to the SCO in terms of appropriately dividing liabilities and obligations on each of the parties. For this reason, while a RSC will govern the relationship between retailers and distributors, retailers will be able to charge a bundled tariff to customers.

Under Option 3 however, where distributors provide customer distribution services to an energy customer of behalf of a retailer they will enter into a deemed contractual relationship with that energy customer. The deemed contractual relationship should clearly signal to market participants and customers the relationship in place between distributors and energy customers. Further, while distributors will have certain obligations to energy customers, the SCO is of the opinion that energy customers must also fulfil particular obligations to distributors in relation to physical energy supply, such as ensuring safe access to energy equipment on the customer's premises.

The SCO has taken into consideration the concerns of gas distributors in developing the RSC, including the interaction with access arrangements. Given that:

- in many cases, contractual relationships already exist between distributors and retailers in relation to energy supply; and
- in the gas context particularly, the gas access regime will continue such that the AER approves the terms and conditions of access,

the SCO is proposing that only essential minimum obligations should be deemed to apply as a RSC by way of the Laws and Rules.

¹⁰⁹ MCE SCO Policy Paper, page 67

In line with matters raised in ENA's submission to the Consultation RIS¹¹⁰, the MCE SCO is committed to working with industry-based groups to ensure the workability of this governance framework for RSCs.

In short, the SCO recommends Option 3 based on a tripartite contractual model with the following contractual relationships:

- A RSC between retailers and distributors with model terms and conditions; and
- A deemed contractual relationship between distributors and energy customers with model terms and conditions placed in the Rules.

In response to Integral Energy's concern regarding the definition of "distribution services", the implementation of the contractual relationship will separately define those services which are provided to customers and retailers for the purposes of the national customer framework.

¹¹⁰ ENA submission to Consultation RIS, page 2

7.0 BUSINESS AUTHORISATION

A business authorisation regime acts as a gatekeeper mechanism to limit entry into the market to those participants that have demonstrated the financial and organisational capacity to comply with their regulatory obligations. As such, the regime aims to minimise the likelihood of disruption and uncertainty in the retail market by facilitating orderly entry to the market, providing ongoing stability as participants are capable of operating in the market and limiting disruption caused by retailer failure.

Electricity and gas retailers provide services to retail customers and participate in national energy markets where their conduct can have immediate financial and social impacts on a range of other industry participants and customers. AAR Working Paper No. 3 presented working options on the criteria for authorising entry into the retail energy market, and considered which entities should be subject to these criteria (retailers and/or distributors)¹¹¹.

7.1 ENTRY CRITERIA FOR RETAILERS AND/OR DISTRIBUTORS

The AAR Working Paper No. 3 listed the entry criteria applied by jurisdictions in granting a licence (not all these criteria currently apply in all jurisdictions):

- Financial viability – whether the entity is able to finance the activities to be performed under the Laws and Rules.
- Technical capacity – whether the entity has the technical capacity to carry out its obligations under the Laws and Rules.
- Fit and proper person test – whether the applicant has not previously been disqualified from being a director under the *Corporations Act 2001*, and other relevant considerations.

National registration requirements already exist in relation to retailers and distributors. For electricity, the NEL and NER prohibit a person from owning, controlling or operating a distribution system that forms part of the interconnected transmission and distribution system, and from purchasing electricity directly from the market, unless that person is a Registered Participant or is exempt from the registration requirement¹¹². To become a Registered Participant, that person must register with NEMMCO¹¹³.

The NEMMCO registration process includes the following criteria:

- Evidence of legal status;
- Regulatory compliance with jurisdictional instruments;
- Financial viability; and
- Organisational capability.

¹¹¹ Existing National Electricity Law and National Gas Law registration requirements will still apply to electricity and gas retailers and distributors. The scope of this package will not extend to distributor technical and safety business authorisations, which under the AEMA remain the responsibility of the States and Territories. However, it is worth noting that the Australian Government is currently investigating the scope for harmonising distributor technical and safety standards in another workstream of the Energy Market Reform Working Group, which may impact on the authorisation of distribution businesses as it relates to these matters.

¹¹² See Chapter 2 of the NER.

¹¹³ Allens Arthur Robison Working Paper No. 3 page21

For gas, registration processes for retailers and distributors have been administered at jurisdictional level by a number of market operator entities¹¹⁴. These entities included the Victorian Energy Networks Corporation (Victoria and Queensland), the Retail Energy Market Company (South Australia and Western Australia) and the Gas Market Company (New South Wales and the Australian Capital Territory). In Tasmania, gas distribution and retail licences are issued by the Director of Gas under the *Gas Act 2000* (TAS), pursuant to section 21.

It is envisaged that, in order to minimise regulatory obligations and complexity, AEMO registration requirements under the NEL and NGL, will not be duplicated in a national business authorisation regime in the national framework, although the national business authorisation regime may consider matters such as financial viability. In addition, as provided in the AEMA, a national business authorisation regime would not consider matters of technical capability or safety.

7.1.1 Entities that must meet the market entry requirements

	Option 1	Option 2	Option 3	Option 4
Options	No national framework entry requirements	National entry requirements for electricity and gas retailers only	National entry requirements for electricity and gas retailers and for gas distributors	National entry requirements for all retailers and all distributors

Option 1: No entry requirements in the national framework

Under the first policy option there would be no entry requirements for retailers and distributors wishing to supply or sell energy to customers, other than the existing registration requirements set out in the NEL/NGL, and the requirements of market operators (if any).

Impact Analysis

Retailers	This option would reduce regulatory obligations (and associated market entry costs) faced by retailers in the short-term.
Distributors	As certain functions are maintained by the jurisdictions through the AEMA, distributors would be minimally impacted by the exclusion of entry requirements in the national framework. For distributors the scope of any retailer authorisation would be material, particularly in relation to ensuring sufficient credit support and ongoing payment of charges after a retailer starts operating.
Energy Consumers	Energy consumers are impacted by the authorisations regime to the extent that the authorisation regime adequately assess whether retailers and/or distributors have the capacity to enter the energy market and meet

¹¹⁴ With the commencement of the Australian Energy Market Operator (AEMO) from 1 July 2009 registration in both gas and electricity markets will be managed by AEMO.

	technical, safety, operational and prudential requirements or the delivery of energy supply and services.
Regulators	If there is an absence of national arrangements there will be no material change from existing costs and no opportunity to take advantage of economies of scale associated with the transfer to a national regulator.

Costs and Benefits

Benefits	
Compliance burden	The compliance burden imposed on retailers is reduced under this option, the longer term impact being that operating costs of these firms is reduced, which contributes to competitive pricing in retail markets.
Reduction in barriers to entry	Foremost, this option reduces the barriers to entry for retail firms wishing to enter the retail energy market. Increased number of retailers operating in the retail energy market leads to competition that is of benefit to consumers. Distribution services are monopoly services, partly regulated by jurisdictions, and do not therefore benefit from reduced barriers to entry conditions.
Costs	
Retailer failure	This policy option introduces significant risk into the energy market by not adequately vetting market participants for their prudential requirements for supplying energy services to customers. This may result in retailer failure which would adversely impact energy customers and other market participants.
Under-emphasis of authorisation regimes	This option under-emphasises the significance of a business authorisation scheme in limiting entry to those entities that have demonstrated the financial, organisational and technical capacity to meet their obligations under the Laws and Rules to provide essential energy services.
Inconsistency across energy sectors for distributors	Distribution firms in the electricity and gas sectors would be faced with greater uncertainty dealing with entities that have not undergone any form of entry requirement. In the absence of an authorisation regime they may be put at greater financial risk which could jeopardise the security of the market.

Option 2: Entry requirements for retailers only

The second policy option would limit business authorisation requirements under the national framework to retailers. Retailers would be subject to entry requirements in relation to their organisational capacity, financial viability, regulatory compliance and suitability (i.e. a “fit and proper persons” test), in addition to the entry requirements of market operators where it can be demonstrated there is a need.

States and Territories would continue to be responsible for distribution business authorisation. Therefore the costs and benefits to distributors are similar to Option 1.

Essentially under this model, the Australian Energy Regulator replaces the jurisdictional regulators who currently administer authorisations regimes for retailers, harmonising the regime across jurisdictions.

Impact Analysis

Retailers	This option harmonises authorisation requirements across jurisdictions, replaces multiple licensing processes, and as a result, reduces compliance costs for retailers operating across more than one jurisdiction.
Distributors	Distributors benefit from this option as it continues to provide a safeguard that retailers have the financial capacity to recompense them for the network services provided such as energisations, de-energisations, meter reads and network maintenance ¹¹⁵ , and the organisational capacity to undertake necessary market transactions with distributors. Regulatory inconsistency would persist across jurisdictions where jurisdictions maintain responsibility for distributor licensing requirements (as provided for under the AEMA).
Energy Consumers	Customers benefit from this policy option as it limits the potential for retailer failure events which adversely affect customers, and also ensures that retailers have the capacity at time of entry to the market to properly meet their obligations to customers and distributors.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Costs and Benefits

Benefits	
Regulatory certainty and consistency	Harmonising the authorisation regime for retailers increases regulatory certainty and consistency for retailers operating across numerous jurisdictions. Consistency and certainty in this approach contributes positively to the regulatory environment that retailers must operate in and meets the high-level objectives of the AEMA.
Lower compliance costs for retailers	A single authorisations regime is likely to provide lower compliance costs on an ongoing basis for retailers through the need to only report to a single regulator against the requirements of a single regime.
Lowering barriers to entry	The most immediate benefit to retailers of a single retailer authorisation regime is that it lowers barriers to entry for energy retailers seeking to operate in multiple jurisdictions, as only a single, national authorisation would be required.
Market signals	This option benefits other market participants, such as generators and distributors, by making certain that retailing firms, when entering into markets, are able to meet their financial obligations and have the organisation capacity to undertake market transactions.
Distributor authorisation	Electricity distributors are already subject to numerous processes in national frameworks in order to operate and supply energy in national energy markets. Likewise, gas distributors are also subject to jurisdictional authorisations regimes which are often linked to technical and safety standards. An authorisation regime risks duplicating those functions already in place under national and jurisdictional legislation with little or no clear benefit.
Costs	
Regulatory inconsistency for distributors	Where distributors are not included in the business authorisation regime, regulatory inconsistency may persist across jurisdictions, and across energy sectors. This will continue to add to the compliance costs of these monopoly services, while retailers benefit from harmonised requirements.

¹¹⁵ Although this may also be addressed through other elements of the national framework such as any distributor-retailer contract that may be developed to support the supply and sale of energy to customers.

Option 3: National entry requirement for retailers and for gas distributors

The third option would see retailers and gas distributors subject to entry tests, comparable to existing jurisdictional requirements, in relation to matters such as organisational capacity, financial viability, regulatory compliance capability and suitability (i.e. the ‘fit and proper person’ test). The entry requirements may relate to established requirements under the NGR or NER that are already administered by NEMMCO, and gas market operators.

Jurisdictions currently maintain responsibility for licensing gas distributors as NEMMCO only authorises business entry into electricity markets. There are some requirements for gas distributors to register with the market operator; however, the obligations are generally less onerous than those in electricity markets.

Under Annexure 2 of the AEMA, jurisdictions maintain responsibility for the distributor technical and safety aspects of business authorisations – licensing and authorisation schemes that require demonstration of technical capability.

This policy option is similar to Option 2, but introduces a business authorisation regime for gas distributors, which is not provided for under current access arrangements. In contrast to the electricity market where NEMMCO registers network service providers for the purposes of access regulation, the requirement for gas distributors to have an approved access arrangement is based on a ‘coverage’ decision.

Impact Analysis

Retailers	This option harmonises authorisation requirements across jurisdictions, and reduces compliance costs for retailers operating across more than one jurisdiction. Compared to the current status quo, barriers to entry into retail markets are reduced for retailers.
Distributors	Distributors benefit from this option as it continues to provide a safeguard that retailers have the financial capacity to recompense them for the network services provided such as connection and energisation services, meter reads and network maintenance ¹¹⁶ and the organisational capacity to undertake the necessary market transactions. Gas distributors, particularly those operating in more than one jurisdiction, would benefit from reduced compliance costs where divergent jurisdictional requirements are harmonised under a national framework.
Energy Consumers	Customers benefit from this policy option as it limits the potential for retailer failure events which adversely affect customers, and also ensures that retailers and gas distributors have the capacity to properly meet their obligations to customers and distributors at time of entry to the market.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

¹¹⁶ Although this may also be addressed through other elements of the national framework such as any distributor-retailer contract that may be developed to support the supply and sale of energy to customers.

Costs and Benefits

The costs and benefits of this option for retailers reflect those discussed under Option 2 above. The following discussion therefore focuses on the impact of a national authorisation regime for gas distributors.

Benefits	
Regulatory consistency for market participants	This option introduces regulatory consistency into the authorisation regime as gas distributors are regulated for jurisdictionally (there are some requirements for gas distributors to register with the market operator; however, the obligations are largely less onerous than those in electricity markets).
Certainty and stability in energy markets	A national business authorisation for distributors may provide a further element of certainty and stability in national energy markets, by ensuring distributors are able to meet their obligations, which would benefit all participants. However, these benefits are not as material as for retailer authorisations as distributors are infrastructure businesses which do not enter and exit energy markets in the same way as retailers (due to their monopoly position).
Costs	
Risk of regulatory duplication	While seeking to minimise regulatory inconsistency, the risk remains that including gas distributors in a national authorisation regime may duplicate some requirements under gas access arrangements and those functions relating to technical and safety standards that remain a jurisdictional responsibility. This option is best considered once the Australian Energy Market Operator (AEMO) has commenced and in the context of other reforms currently underway in gas markets (such as the Gas Short Term Trading Market) ¹¹⁷ .
Increased compliance costs for gas distributors	Gas distributors may face increased compliance costs under this option, depending on the scope of the national business authorisation (i.e. the extent to which the national arrangements replace authorisation requirements administered by jurisdictional regulators and do not replicate any technical and safety requirements). Gas distributors are subject to national access regulation, including AER-approved gas access arrangements. A business authorisation would be additional to these requirements.

Option 4: National entry requirement for retailers and distributors

Under the fourth option, all retailers and distributors would be subject to entry tests in relation to organisational capacity, financial viability and suitability.

The entry requirements may relate to already established requirements under the NER and NGR, including those administered by market operators. However, whilst seeking to minimise duplication, potential exists to include additional entry requirements where it can be demonstrated that there is a need.

¹¹⁷ Work is currently being undertaken in another MCE workstream to harmonise safety and technical standards. Also, work is currently being undertaken by the Workplace Relations Ministerial Council to harmonise occupational, health and safety (OHS) laws. Ministers have committed to a single national OHS Act by 2011.

The scope of the entry requirements for distributors may be less than those for retailers, recognising existing entry requirements for distributors under the NER or NGR and the functions that remain the responsibility of the States and Territories under the AEMA.

Impact Analysis

Retailers	This option harmonises authorisation requirements across jurisdictions and reduces compliance costs for retailers operating across more than one jurisdiction. Barriers to entry into retail markets are reduced for retailers.
Distributors	Electricity and gas distributors may be adversely impacted under this option, depending on the way in which an authorisations regime interacts with other national and jurisdictional requirements for these firms. The risk to these firms is that their compliance costs will increase under this option.
Energy Consumers	Customers benefit from this policy option as it limits the potential for retailer failure events which adversely affect customers, and also ensures that retailers and distributors have the capacity to properly meet their obligations to customers and other market participants at time of entry to the market.
Regulators	The cost to jurisdictional and national regulators of harmonisation in this policy area is considered marginal as regulators already monitor for compliance in this area according to jurisdictional rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Costs and Benefits

Benefits	
Regulatory harmony and consistency	This option would introduce regulatory harmony and consistency into the business authorisation regime, for both retailers and distributors. Harmonisation requirements could also be standardised across the two energy types to deliver greater efficiency gains; however the extent to which this is suitable across gas and electricity distributors is uncertain.
Costs	
Increase in regulatory compliance	<p>Licensing regimes for gas and electricity distributors are also currently maintained by jurisdictions, and are used for other functions which will remain jurisdictional responsibilities in accordance with Annexure 2 of the AEMA (such as technical and safety capabilities). As jurisdictions may retain licensing for these functions subsequent to the national framework's introduction, the introduction of a national distributor authorisation may increase the regulatory burden and cost for distributors.</p> <p>This option introduces significant risk of duplicating regulatory requirements already in place in jurisdictions and nationally through the NGR and NER which regulate third party access to the networks.</p> <p>At this stage of the Energy Market Reform process, including reforms occurring in gas markets such as the Gas Short Term Trading Market and AEMO, it may be imprudent to include a comprehensive authorisation model where the legislation is not yet settled. The likely risk is that licensing and registration requirements would be duplicated, adding to compliance costs for distributors.</p>

7.1.2 Consultation

Feedback received on this policy issue, for both the MCE SCO Policy Response Paper and the Consultation RIS was limited. In general, neither retailers nor distributors raised concerns with the proposed authorisation regime (for retailers only).

The following comments are largely taken from feedback received through submissions to the MCE SCO Policy Paper¹¹⁸.

Stakeholders generally endorsed the conclusion that the national framework should include entry requirements in the form proposed for retailers only.

EnergyAustralia commented that a sufficient case had not been made to subject electricity distributors to an additional layer of regulatory obligation through the national framework and that regulatory objectives are already adequately addressed through a number of other mechanisms.

EnergyAustralia also noted that the absence of national registration requirements for distributors in the gas sector does not justify an additional registration requirement for distributors in electricity and that the case for the role of a national registration being established through the AER to 'satisfy broader regulatory objectives' has not been made.

EnergyAustralia was of the view that electricity distributors should not be subject to duplicate registration regimes. If there is a national business authorisation regime, then there should be a clear framework for jurisdictional obligations to be imposed under the national authorisation regime. EnergyAustralia also noted that the responsibility for national business authorisation for electricity distribution rests more appropriately with NEMMCO, rather than the creation of a dual authorisation with the AER¹¹⁹.

Other issues relating to distribution authorisations raised by the submissions were:

- Whether the role proposed for market operators in relation to distributor business authorisation was appropriate;
- A concern to avoid duplication between the roles of the AER, jurisdictions and market operators (and to clarify the process and sequencing of registration and authorisation processes); and
- The need to address the position of inset networks and other exempt arrangements, and to ensure they are appropriately regulated.

¹¹⁸ MCE SCO Policy Paper, pages 72- 73

¹¹⁹ Energy Australia submission to MCE SCO Policy Paper pages 20-21

7.1.3 Conclusion

The MCE SCO recommends the adoption of Option 2 – an authorisation regime for retailers only – in the national framework for reasons relating to avoiding duplication of regulatory functions that already adequately account for distributor authorisations.

The SCO recommends the adoption of an authorisations regime in the national framework for retailers only. As noted in submissions received on this issue, the SCO has similar concerns to distributors that there is some risk in adopting a distribution authorisations regime at this point, where reforms to the gas sector are not yet settled, as the SCO noted in its Policy Response Paper¹²⁰.

If, at some future point, jurisdictional distribution licences are no longer required, and the reforms to the gas sector are more settled, then a national authorisation framework for all participants in national energy markets may be appropriate.

The SCO further noted in its Policy Response Paper¹²¹ that if a distributor authorisation framework were introduced, it would need to be limited to entry requirements for distributors that are specifically tailored to whether or not a distributor is capable of meeting its obligations in relation to the performance of its functions to supply energy to retail customers.

However, distributors who have responsibilities in relation to retailers and consumers will have those obligations imposed directly through the national Law and Rules in the national framework.

Thus, it does not seem necessary to introduce an authorisation scheme at this time.

The SCO considers that these existing regimes provide sufficient safeguards to guarantee a capability for providing efficient delivery of distribution services to customers. In particular, the distributors who will have responsibilities under the new national framework for retail energy supply are primarily those distributors who are currently subject to full access regulation in the national regimes. These distributors are already required to meet stringent entry and ongoing requirements (by NEMMCO, the AER and jurisdictional regulators) and an additional national authorisation regime would not appear to add any value.

Further a national distributor authorisation in addition to the existing licences would increase the regulatory burden without any demonstrable benefit at this point in time. In the absence of a compelling policy rationale for a further national authorisation for distributors, the argument of duplication is a persuasive one, and was raised by network businesses in submissions to the AAR Composite Paper.

¹²⁰ MCE SCO Policy Response Paper, page 70

¹²¹ MCE SCO Policy Response Paper, pages 73- 74

The continuation of jurisdictional distribution licences means that the situation in distribution is not the same as it is in retail. Submissions that addressed this issue indicated that whatever framework is relied upon, it should not introduce duplication in relation to licences/authorisations.

8.0 ENFORCEMENT AND STATUTORY OBJECTIVE

Policy options proposed in relation to enforcement and the statutory objective need to be considered differently to the remainder of the Decision RIS. This is because:

- Nationally consistent enforcement and compliance mechanisms already exist under the NEL and NGL for those matters that are currently regulated at the national level; and
- The NEL and NGL already contain statutory objectives.

The tools available to jurisdictional regulators in relation to compliance monitoring of retailers and distributors may need to be brought into a national framework as the current compliance regime under the NEL and NGL may not adequately reflect the tools needed for enforcement and monitoring of these businesses under the national framework.

8.1 ENHANCEMENTS TO THE ENFORCEMENT AND COMPLIANCE REGIME

The AAR Supplementary Working Paper addressed the issue of a national enforcement and a compliance regime for retailers and distributors in the national framework and how this might interact with current regimes in the NEL, NGL and TPA.

Recent amendments to the NGL include a general enforcement regime and some expanded powers for the AER in relation to monitoring and compliance. Changes to the NGL were intended to replicate the current arrangements under the NEL and to harmonise this regime across electricity and gas sectors. Further harmonisation and enhancements to the enforcement and compliance regime form part of the RPWG workstream.

The NEL and NGL currently provide for a general enforcement and compliance regime. The existing compliance and enforcement frameworks for the energy sector under the Laws/Rules are broadly similar. These current frameworks consist of:

- An obligation for the AER to monitor compliance with the Law, Regulations and Rules and investigate breaches;
- An ability for the AER to issue guidelines on its enforcement strategy;
- AER information gathering powers (search warrants for breaches, a general power to obtain existing information from any person and regulatory information instruments in respect of network service providers and their related service providers);
- The ability for the AER to seek a range of remedies in Supreme Courts and the Federal Court to enforce the obligations in the regime (e.g. injunctions and declarations);
- Civil penalties;
- The ability of the AER to serve an infringement notice which, if paid, would avoid Court proceedings;

- An access dispute framework allowing the enforcement of regulated access terms and conditions;
- A dispute resolution framework for disputes between registered participants in the NEM;
- The AER as the sole enforcer of obligations, so there is a general prohibition on any party taking civil legal action to enforce obligations under the Law, Regulation or Rules, subject to limited exceptions; and
- A very limited number of criminal penalties (e.g. obstructing a witness in an access dispute)¹²².

8.1.1 Options

The following table sets out two possible policy options available for the enforcement and compliance regime in the national framework.

Options	Option 1 No change to existing enforcement and compliance regime	Option 2 Enhancements to the enforcement and compliance regime
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Option 1: No change to existing enforcement and compliance regime

This policy option maintains the current arrangements in relation to enforcement and compliance regime. The AER will continue to enforce the NEL, NGL and Rules in accordance with the existing enforcement and compliance regimes provided for under these Acts.

Impact Analysis

Retailers	Maintaining the current compliance regime in the national framework may reduce compliance costs for retailers. However, not introducing changes to the enforcement regime, such as enforceable undertakings may increase operating costs for retailers in the longer term where alternative and cheaper enforcement options are not available for use by the regulator to remedy breaches.
Distributors	The impact on distributors is similar to retailers. Not amending the compliance regime in the national framework will reduce compliance costs for distributors. Similarly, not introducing changes to the enforcement regime, such as enforceable undertakings may increase operating costs for distributors in the longer term where alternative and cheaper enforcement options are not available for use by the regulator to remedy breaches.
Energy Consumers	Energy customers will have insufficient options available to them to remedy any detriment suffered through retailers or distributors not operating in accordance with the Law and Rules.
Regulators	The costs to jurisdictional and national regulators is marginal as regulators already perform these functions, but according to different rules. As noted above, the national regulator should benefit from efficiencies of scale, particularly in its performance monitoring role.

¹²² MCE SCO Policy Response Paper pages 90- 91

Costs and Benefits

Benefits	
Reduction in compliance costs for retailers and distributors	Operating costs for retailers and distributors are unchanged under this option. The AER already has powers under the NEL and NGL to investigate breaches, information gathering powers as well as enforcement powers. The compliance cost may be reduced for retailers (in particular) if the new national framework contains a more limited compliance and enforcement regime than contained in previous jurisdictional regimes.
Limited unmeritorious behaviour	Not extending the enforcement regime to include private enforcement action may prevent trivial or unmeritorious actions from being commenced under the provisions of the enforcement regime. Where private enforcement action is possible energy market participants may be subject to increasing legal claims that have little merit.
Costs	
Adherence to national framework	Not including enhancements in the national framework may in the longer term contribute to non-compliance with the Law and Rules, especially where enforcement and compliance measures under the NEL and NGL are not suitable to the business activities of retailers and distributors interaction with small energy customers.
Insufficient enforcement and compliance regime for retailers and distributors	The current regulatory arrangements under the NEL and NGL are designed for energy businesses participating in the wholesale supply markets and do not take into account the different forms of compliance and enforcement that are appropriate for regulating the sale and supply of energy to retail customers.
Use of Lower Courts	Not enhancing the enforcement regime to include the use of lower courts (where they have appropriate jurisdiction) may lead to less timely and more costly resolution of minor matters and disputes. This option would restrict court proceedings to more costly options in the Supreme and Federal Courts.

Option 2: Enhancements to the enforcement and compliance regime

Retail market compliance and enforcement is based on ensuring a suitable degree of compliance in a market which supplies essential services to millions of customers – including small customers. This may require:

- The collection of information on the degree of compliance by businesses;
- The collection of information on the degree of competition in the market to inform the regulator (the AER) as to what extent consumer interests are best served by competitive pressures or regulatory oversight; and/or
- A flexible hierarchy of enforcement tools to reflect the relative materiality and seriousness of types of compliance issues in the retail sector (which may be also appropriate for the energy sector more broadly).

Currently, the compliance provisions in the NEL and NGL may be unsuitable for the collection of information relating to retailer and distributor activities in the provision of energy supply to small customers. The information gathering provisions in the NEL and NGL were designed primarily for the benefit of energy market participants who have little, if any, interaction with small energy customers (aside from broader technical and safety provisions).

The introduction of the national framework may require a different focus in its enforcement and compliance regime, to recognise that small energy customers are also participants in this particular sector of the energy market. Therefore, an enforcement regime that restricts court action to the Supreme and Federal Courts may be considered unsuitable and too costly for some energy market participants and relative to the matter being considered.

The additional measures to the enforcement and compliance regime are set out below:

Additional administrative measures – enforceable undertakings

This policy option is modelled on provisions similar to the TPA.

This option enables the AER to accept (but not compel) enforceable undertakings by a retailer or distributor. This provides an alternative way for the AER to achieve regulatory compliance without the involvement of the courts. Enforceable undertakings may benefit regulators (as well as retailers and distributors) as they are relatively simple to execute, can be implemented in a timely manner and include mutually agreed terms and conditions.

Private enforcement action

Private enforcement action allows private parties the opportunity to take action against regulated entities that have breached the Law or Rules. In this manner, private enforcement action may act to complement the actions taken by the regulator, or where the regulator has insufficient public interest to take action in response to a breach.

Access to lower courts in remedying breaches of the Law and Rules

Extending court-based enforcement action to the lower courts, where the action is consistent with the general jurisdiction of the court, will provide a means of resolving matters in a less costly and timelier manner. The availability of lower courts means that the relative cost to parties of participating in proceedings is reduced. This may assist in efficiency by allowing minor matters to be heard in the lower courts while more serious and complex matters continue to be reserved for the superior courts.

Compliance reporting system

The AER's existing role in relation to monitoring and reporting on matters of compliance and performance should be expanded to suit the transfer of retail regulation to the national framework. The AER should be required to monitor and report on a range of retail market activities and the performance of retailers and distributors against relevant obligations and service measures. Powers for the AER to collect the necessary information to prepare such reports should also be provided.

This policy option includes extending enhancements of the enforcement and compliance regime to other registered energy market participants under existing national regulatory requirements.

Impact Analysis

Retailers	In terms of compliance, retailers will not be significantly impacted as jurisdictional economic regulators already require retailers to provide significant information regarding compliance with jurisdictional regimes, and especially in relation to small energy customers ¹²³ . Proposed enhancements to the enforcement regime do not necessarily increase costs to retailers, as enforcement will only be available to regulators where breaches of the Law and Rules are incurred.
Distributors	The impact on distributors is similar to retailers – the proposed enhancements to the enforcement regime do not necessarily increase costs to distributors, as enforcement will only be available to regulators where breaches of the Law and Rules are incurred.
Energy Consumers	Enhancements to the enforcement and compliance regime will underpin the operation of the framework and engender greater certainty to energy consumers that energy Law and Rules will be enforced.
Regulators	The transfer of the Laws and Rules to a national framework will mean that the AER takes on responsibility for functions that were previously held by the jurisdictions. The AER already assumes functions for enforcement and compliance provisions under the NEL and NGL and should be able to take advantage of efficiencies of scale in consolidating its enforcement activities and replacing the roles of the various jurisdictional regulators.
Other market participants	Where the enhanced enforcement regime amends the enforcement options available for breaches by other market participants, the impact on those participants is not expected to be material. There will be no change to their substantive rights and obligations and all market participants can be expected to benefit from lower costs due to greater flexibility in the type of enforcement action undertaken.

Costs and Benefits

Benefits	
Variety of options in remedying breaches	Introducing enhancements to the enforcement regime will provide a greater range of options for addressing non-compliance with the Law and Rules. This is critical in maximising the likelihood that industry participants will adhere to the Law and Rules, providing a greater certainty to participants and energy consumers that the energy laws will be enforced and encouraging a culture of compliance within the sector.
Reduction in costly court action	Including other registered market participants in the enhanced enforcement regime may benefit both regulators and these entities in the long-term. Providing for all registered market participants to use enforceable undertakings, for example, may prevent costly court action to remedy non-compliance of the current national energy Laws and Rules and the national framework.
Market information	Enhancing the compliance regime to allow the AER to gather comprehensive information in relation to retail and distributor businesses' interactions with small energy customers in particular will provide the retail market, and regulators, with clarity of information regarding the market conditions. For example, such information may include de-energisations, energy customers in hardship regimes. This information is especially important to regulators in assessing how well the framework is operating in delivering an essential service to energy customers, and to what extent retailers and distributors are meeting their obligations to these customers – providing for more appropriate and targeted enforcement action.

¹²³ Subject to compliance and enforcement undertaken by jurisdictions in relation to those matters which, under the AEMA, are retained by the States and Territories and do not form part of the national framework.

Energy customer franchise	Allowing private enforcement action will ensure energy market participants are able to effectively participate in the energy market and will not always have to rely upon the regulator to proceed with action where there has been an incident of non-compliance with the Law or Rules.
Efficiency in dispute resolution-inclusion of the lower courts	Including the lower courts as a means of addressing minor matters offers a timely and less costly avenue for dispute resolution. Where private enforcement action is introduced into the enforcement regime, the use of the lower courts is necessary to complement this measure – otherwise private enforcement matters would be required to pass through more costly and time-consuming court proceedings such as the Supreme and Federal Courts.
Efficient resolution of non-compliance	Enforceable undertakings can be used to assist compliance by businesses and to make sure that a compliance culture is sustained within the business when the undertaking expires ¹²⁴ . Regulators consider enforceable undertakings to be an effective means of taking action against non-compliant entities for the reason that entities have the opportunity to rectify their non-compliant behaviour before court action is taken. The flexibility of terms that can be included in enforceable undertakings should also mean these are attractive to industry participants over other, more rigid, enforcement options.
Costs	
Risk of unmeritorious, litigious and strategic behaviour	The risk of introducing private enforcement action, especially in conjunction with the use of lower courts, is it may create perverse incentives whereby unmeritorious court proceedings may be more frequent in nature, due to the lower costs of pursuing court action. The combination of both the use of the lower courts and private enforcement action may lower the barriers to proceeding with legal action, resulting in an overall increase in legal action.
Uncertainty in enforcement regime	The combination of private enforcement action and the use of the lower courts may introduce instability and uncertainty into the enforcements regime. The role of the AER in enforcing the national framework may be undermined whereby private enforcement action can by-pass the AER and its authority in this area.
Duplication in enforcement measures	The contractual model may be considered adequate in underpinning the national framework as the main stakeholders – retailers, energy customers and distributors – are each in a contractual relationship with the other. The contracts define the rights and obligations of each party and can be enforced through contractual actions and remedies. To then attempt to further underpin the enforcement regime with additional enhancements may introduce unnecessary measures, especially in relation to the lower courts and private enforcement.

8.2 CHANGES TO THE EXISTING STATUTORY OBJECTIVE

The statutory objective of the Law provides direction and clarity where the Law or Rules require interpretation, especially in relation to decision or Rule-making functions. Therefore, amending the statutory objective gives new precedent to the issues that bodies such as the AER and AEMC must consider in their determinations.

The rationale for altering the statutory objective of the NEL and NGL is to accommodate the consumer aspect of the national framework. The statutory objective as it currently operates considers the Law and Rules was designed in

¹²⁴ MCE SCO Policy Paper, page 92

the context of market participants who have limited interaction with small energy customers and therefore is underlined by primarily economic imperatives.

The statutory objective as it currently stands is to promote efficient investment in, and efficient operation and use of, energy services for the long-term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy.

8.2.1 Options

	Option 1	Option 2	Option 3
Options	No change to existing statutory objective	Change to the existing statutory objective	No change to objective but clear guidance in the law regarding the role of customer hardship provisions

Due to the minimal impacts identified below, it is not considered possible to specify the costs and benefits of these options in any detail.

Option 1: Do not change statutory objective

Under this option there would be no change to the statutory objective that currently exists in national energy market legislation.

Impact Analysis

Retailers	This would have minimal impact on retailers, as the regular interpretation of the Law and Rules would apply.
Distributors	This would have minimal impact on distributors, as the regular interpretation of the Law and Rules would apply.
Energy Consumers	Energy customers may be impacted by leaving the statutory objective unchanged as social objectives would be limited in scope for consideration by Rule and decision making bodies.
Regulators	Regulators would be minimally impacted – the functions and responsibilities of this entity would remain unchanged.

Option 2: Change statutory objective

This option considers a change to the statutory objective for the national framework that moves away from the statutory objective that currently exists under the NEL and NGL. The objective could be amended or supplemented to include a customer protection focus.

Impact Analysis

Retailers	This would have minimal impact on retailers, as the regular interpretation of the Law and Rules would apply. Retailers are only impacted to the extent that the statutory objective is required in relation to court proceedings or Rule changes.
Distributors	This would have minimal impact on distributors, as the regular interpretation of the Law and Rules would apply. Distributors are only impacted to the extent that the statutory objective is required in relation to court proceedings or Rule changes.
Energy Consumers	Energy customers are impacted by amending the statutory objective whereby Rule and decision making bodies must consider in greater weight consumer and social policy objectives.
Regulators	Regulators would be minimally impacted – the functions and responsibilities of this entity would remain unchanged. However, an amendment to the objective may create confusion or competing priorities for regulators and Rule-makers under the national framework, reducing certainty for all participants.

Option 3: No change to statutory objective but legislative guidance for hardship

This option was not considered in the consultation RIS, however it reflects the divergence of views expressed by stakeholders in response to AAR’s papers, the SCO Policy Response and the Consultation RIS. Under this option, the existing statutory objectives under the NEL and NGL would not be amended. However, it is recognised that in the key area of customer hardship, which is being introduced in to the national energy regime for the first time with the new national framework, a statutory objective which focuses on economic efficiency may create perverse outcomes.

Thus, in order to balance the benefits of the single objective, which appropriately applies to both the existing NEL/NGL frameworks and the new national regime generally, with a regime that provides specific protection for retail customers experiencing financial hardship, a third option has been considered. Under this option, specific legislative guidance would be provided in relation to the customer hardship provisions, to ensure the policy intent for including a customer hardship regime is not removed over time through the application of a statutory objective which focuses on economic efficiency for the long-term interests of customers.

Impact Analysis

Retailers	This would have minimal impact on retailers, as the regular interpretation of the Law and Rules would apply and customer hardship policies would retain their intended focus over time.
Distributors	This would have minimal impact on distributors, as the regular interpretation of the Law and Rules would apply and only retailers are required to implement customer hardship policies.
Energy Consumers	Energy customers are impacted by amending the statutory objective whereby Rule and decision making bodies must consider the particular role of customer hardship arrangements.
Regulators	Regulators would be minimally impacted – the functions and responsibilities of this entity would remain unchanged but clearer guidance as to the role of hardship policies would be provided.

8.2.2 Consultation

Submissions received on enhancements to the enforcement and compliance regime mainly considered issues relating to the use of lower courts, especially in combination with private enforcement action, and increased powers for the regulator, the AER, with respect to information gathering provisions.

Information gathering powers

Information gathering powers relate to the compliance regime, as it allows the regulator to seek information from firms to determine whether there has been a breach of the Law or Rules. It differs from a regular compliance regime which has a set of information requirements that firms must comply with to provide information to the regulator.

Increasing information powers, according to some submissions, was not sufficiently backed by evidence suggesting that the powers available to the AER as they currently are under the NEL and NGL are inadequate. ENA noted that "at this stage, this extension has not yet been supported by evidence of an experienced deficiency in current information gathering powers which were, following significant industry concern and controversy, enshrined in national energy laws"¹²⁵.

On this issue of the rationale for increasing information gathering powers, stakeholders including Ergon Energy¹²⁶, Grid Australia¹²⁷ and Jemena¹²⁸ were concerned that increased powers would be used by the regulator as part of its regular compliance regime, and not for specific cases relating to breaches of the Law and Rules. This is especially the case where section 28 of the NEL, and similar provisions in the NGL, already provide the AER with sufficient powers to operate a compliance and enforcement regime.

Compliance regime for distributors and retailers

Irrespective of any increased information gathering powers, stakeholder submissions were accommodating to the requirement for a compliance regime. Stakeholders argued that the AER's approach to the regime should be cognisant of the costs to retailers and distributors of complying with a compliance regime, especially where any breaches of the Law or Rules were immaterial.

Citipower and Powercor noted that "reporting obligations should not remove discretion as to how the regulated entity will most efficiently manage their own compliance processes and risks...Any such scheme must place a degree of reliance on the efficacy of the existing penalties and not introduce a compliance reporting regime that is unduly onerous and costly for business"¹²⁹.

¹²⁵ ENA submission to MCE SCO Policy Response Paper, page 6

¹²⁶ Ergon Energy submission to MCE SCO Policy Response Paper, page 62

¹²⁷ Grid Australia submission to MCE SCO Policy Response Paper, page 4

¹²⁸ Jemena submission to MCE SCO Policy Response Paper, page 23

¹²⁹ Citipower and Powercor submission to MCE SCO Policy Response Paper

Ergon Energy similarly commented that: "A requirement for the identification and reporting of immaterial or non-systemic breaches may become administratively onerous and costly for both participants and the AER"¹³⁰. AGL put forward the same argument in relation to immaterial breaches, noting that the requirement on retailers should be limited to situations of material systemic breaches and that the scope of an audit should also reflect the significance of the obligations being audited¹³¹.

TRUenergy argued for balance by the AER in developing a compliance regime, requiring that the AER should explicitly be required to consider the costs to retailers, and robustly validate consumer benefits, when evaluating what represents appropriate systems and procedures¹³².

EnergyAustralia argued that incorporating a compliance regime into the national framework should be consistent with existing jurisdictionally-based compliance regimes operating for distributors and that overlaps between the NEL and the NGL should be avoided.

Lower courts and private enforcement

The inclusion of both lower courts and private enforcement action into the enforcement regime concerned retailers and distributors. The consequences of combining these two enforcement measures were considered to potentially have a significant impact, especially by introducing risk and uncertainty into energy market frameworks, and possibly undermining the role of the regulator as an appropriate mediator of breaches of the Law and Rules.

ENA believed that allowing private enforcement may undermine the role of the regulator which should be considered the enforcement body for the Law and Rules. ENA argued that a clear, consistent and predictable enforcement framework was required to allow least cost management of legal risks for energy market participants. Combined with the use of the lower courts, the potential for court-based interpretations of key enforcement provisions may multiply, and subsequently foster significant changes in the general enforcement framework applying in the national framework.

SP Ausnet noted that the practicality of operating a distribution network that involves dealing with mass numbers of customers inevitably means that equality of service is not possible without a disproportionate increase in resources or capabilities on their behalf; the regulator is best placed to balance the costs and risks of this situation. With the introduction of private enforcement, the likelihood for distribution firms is that a revaluation of the costs and risks to providing distribution services would be required. SP Ausnet does not support this change to the enforcement regime, particularly where this might involve lower courts to hear cases¹³³.

¹³⁰ Ergon Energy submission to MCE SCO Policy Response Paper, page 61

¹³¹ AGL submission to MCE SCO Policy Response Paper, page 8

¹³² TRUenergy submission to MCE SCO Policy Response Paper, page 7

¹³³ SP Ausnet submission to MCE SCO Policy Response Paper, pages 64- 65

TRUenergy argued that the regulator has sufficient enforcement powers available to it for breaches of the Law or Rules, and that to further include the lower courts as an enforcement tool is inappropriate. Court-based remedies should only be available under circumstances of systemic breaches where remedial action has not been taken; the observation that jurisdictional industry ombudsman schemes have not required taking court-based action is evidence of this. Further, allowing proceedings to be heard in lower courts potentially lowers the threshold for breaches for which breaches will result in court action, and increases the likelihood that court action will be taken¹³⁴.

Distribution firms were united in their view that the inclusion of private enforcement action and lower courts risks making the pursuit of unmeritorious and trivial actions for broader strategic purposes more common. Further, the costs and incentives around enforcement action may evolve to create a far more litigious energy market regime¹³⁵.

Statutory Objective

The issue of changing the statutory objective to reflect the inclusion of energy consumer's participation in energy markets raised some concern, especially in relation to it changing precedent in the interpretation of the Law and Rules in decision and Rule-making processes.

TRUenergy argued that there should be no weakening of the economic regulation role of the AEMC by introducing non-economic objectives. In accordance with the recommendations made in the MCE SCO Policy Response Paper, TRUenergy agree that environmental and social objectives are best dealt with in other legislative instruments and policies¹³⁶.

GridAustralia supports the continued use of economic objectives to underpin Rule changes and other discretionary decisions required by the AER. Legal and regulatory frameworks should protect the interests of consumers, and that the proliferation of multi-layered and potentially conflicting new objectives elements or sub-objectives is to be avoided¹³⁷.

AGL considered that the transfer of consumer protections to a national framework would be adequately covered by the current statutory objectives as outlined in the NEL and NGL.

The Australian Council of Social Service (ACOSS) strongly supported a facilitating objective that ensures all consumers benefit from competition and the regulatory framework. ACOSS considers that the current ESCV objective clearly and adequately captures consumer protection issues in relation to the provision of essential services: "to protect the long-term interests of Victorian consumers with regard to the price, quality and reliability of essential services"¹³⁸.

¹³⁴ TRUenergy submission to MCE SCO Policy Response Paper, page 8

¹³⁵ ENA, Jemena, Multinet and United Energy, and Grid Australia submissions to MCE SCO Policy Response Paper

¹³⁶ TRUenergy submission to the MCE SCO Policy Response Paper, page 9

¹³⁷ GridAustralia submission to the MCE SCO Policy Response Paper, page 5

¹³⁸ ACOSS submission to the MCE SCO Policy Response Paper

8.3 Conclusion

Enforcement and compliance regime

The SCO recommends Option 2 – enhancing the enforcement and compliance regime in order to:

- encourage a culture of compliance with the national framework;
- boost consumer confidence that energy market participants are adhering to the framework; and
- provide the regulator with a suite of appropriate tools to follow through with its enforcement and compliance regime.

Enforceable undertakings

The SCO considers that enforceable undertakings are procedurally simple, and provide for cooperation between the entity and regulator in addressing non-compliant behaviour. Enforceable undertakings also provide flexibility in the remedy adopted and thus allow tailoring of the remedy to the circumstances of the non-compliant action¹³⁹.

Compliance Reporting Systems

The SCO considers that a compliance reporting system is a relatively simple, effective and efficient means of encouraging and ensuring compliance to the national framework by regulated entities. The compliance reporting system will be modelled on existing jurisdictional reporting requirements.

Private enforcement

The SCO recognises that the regulator plays a central role in balancing the interests of energy market participants, including public interest criterion, in developing its enforcement regime. This is particularly recognised by the current absence of private enforcement mechanisms under the NEL and the NGL.

Where private enforcement is included in the national framework, the regulator will no longer have a monopoly role in balancing the interests of energy market participants with public interests considerations. The SCO recognises that where the regulator contributed certainty and predictability to the regime, private enforcement may work to add an element of uncertainty into the regime.

However, with the inclusion of RSCs, of which some obligations will be placed in the Rules, the SCO recognises that in some circumstances it may be appropriate to allow private parties to enforce the Law and Rules, particularly where mutual obligations have been breached.

The SCO recognises that private enforcement action on behalf of public interest litigants should not be driven in this enforcement space. In particular, retailer-customer obligations are best dealt with through current jurisdictionally-based ombudsman schemes.

¹³⁹ MCE SCO Policy Response Paper, page 93

Use of lower courts

While consumer groups supported the inclusion of the lower courts in the national framework, retailers and distribution businesses opposed their inclusion. Rather, they viewed that in combination with private enforcement action use of the lower courts would change the incentives regime to encourage litigious and unmeritorious behaviour.

However, the SCO is of the opinion that including the lower courts will be an important addition to the operation of the energy market, especially by lowering the cost of court action. This is specially the case to facilitate efficiency in hearing cases that are of a minor nature, where more serious and complex matters are heard in either the Federal or Supreme Courts.

This is in accordance with the Productivity Commission's finding that the costs of hearing cases in District and Supreme Courts is 10 to 21 times higher (respectively) than hearing cases in lower courts¹⁴⁰.

The MCE SCO recommends that where matters are of a more complex nature, that the lower courts should be precluded from hearing these matters. Such matters, not to be heard in the lower courts, would relate to issues of injunctions, implementation of compliance programs and judicial review. The MCE SCO believes that, rather than increase the number of court actions, this will ensure actions are commenced in a court of appropriate jurisdiction, which will ensure a more cost-effective resolution of matters.

Statutory Objective

The SCO recommends Option 3 – no change to the statutory objective but legislative guidance in relation to hardship policies – for the purpose of allowing Rule-making and regulatory bodies to balanced the objectives of protecting consumers and minimising the cost and burden of regulation.

Statutory Objective

The MCE SCO Policy Response Paper¹⁴¹ considered carefully the issue of whether to amend the statutory objective. In particular it noted the findings of Mr. Roger Beale AO, who carried out a review of the operation of the *Essential Services Commission Act 2001* (ESC Act). In that review Mr Beale considered the operation of section 8 of the ESC Act providing the objectives of the ESCV.

Currently the objective of the ESCV is to “protect the long term interests of Victorian consumers with regard to price, quality and reliability of essential services”. Facilitative objectives require the ESCV to ensure that:

- Regulatory decision making has regard to the environment, health and safety and social legislation applying to the regulated industry; and
- Users and consumers, including low income and vulnerable consumers, benefits from the gains from competition and efficiency.

¹⁴⁰ Productivity Commission 2007 Review of Australia' Consumer Policy Framework, page 149.

¹⁴¹ The MCE SCO Policy Response Paper, pages 105- 107

Mr Beale recommended that the objective to which the ESCV must have regard in carrying out its functions should be harmonised with the national gas objective and the national electricity objective. He considered that the ESCV should be guided by one objective whose terms should reflect the national gas and electricity objectives and the current reference to social and environmental objectives in the ESC Act should be removed.

Mr Beale was of the view that social and environmental objectives were best pursued by governments for which they had the means of influencing in other regulatory spaces. In particular, Mr Beale noted that governments, and not unelected bodies, should be appropriately positioned to make sensitive environmental and social decisions.

The SCO's position on this issue is that the statutory objective should not be amended to explicitly pursue social and environmental objectives by the regulatory and Rule-making bodies. Not amending the statutory objective will drive the best outcome, giving to the Rule-making body, when exercising its rule making function, appropriately balanced guidance between the objectives of protection consumers and minimising the cost and burden of regulation.

This view is also consistent with the Mr Beale's recommendations in relation to the ESCV. In particular, the SCO agrees with Mr Beale that the most appropriate bodies to protect the interests of consumers are governments. The interests of consumers will necessarily be protected by various SCO recommendations on the structure of the new national framework. Examples of this include recommendations for an obligation to offer supply, the existence of deemed contracts and a hardship regime in the Law.

While the SCO believes that the implementation of a national hardship regime is consistent with the existing statutory objectives, for the avoidance of doubt specific guidance will be provided in the Law to ensure the hardship regime is correctly interpreted by Rule-making bodies and the AEMC, the AER and the Courts.

9.0 TRANSITIONAL ARRANGEMENTS

The following implementation and transition approach is consistent with that outlined in the MCE SCO Policy Response Paper: *A National Framework for Regulating Electricity and Gas (Energy) Distribution and Retail Services to Customers* pages 108 -110.

The overarching objective of the SCO will be to ensure a clear and smooth transition from the existing jurisdictional retail supply arrangements to a single new national regulatory regime for retail supply of energy in accordance with the AEMA.

The SCO considers it crucial that the transition to the new national retail arrangements does not cause confusion or disturbance in the retail supply of energy to end-use consumers of energy. In addition, the SCO is mindful that distributors and retailers participating in national energy markets have substantial investments in those markets and that it is important to have clarity and certainty about the implementation of the new regime. The SCO places a high priority on minimising regulatory risk arising from the change processes.

The SCO will therefore seek to manage the implementation and the transition to new national framework as efficiently and effectively as possible. The shift from six jurisdictional retail supply regimes for both electricity and gas to a single national regime is a major regulatory transition. The SCO proposes to approach this transition with a consultative approach at each stage of the development of Laws and Rules and their implementation.

9.1 TRANSITIONING TO A NATIONAL REGIME

The SCO will develop a comprehensive transition regime to manage matters that include:

- Jurisdictionally retained matters: some matters will remain in their entirety within jurisdictional controls and be completely separate from the national framework. These types of matters include rules and codes governing technical safety functions.
- Joint jurisdictional and national customer framework matter: some matters may remain under jurisdictional schemes but must be legally linked, recognised or referred to in the national framework. These matters include the state-based ombudsman schemes which are to be the dispute resolution bodies for small customers in each State and Territory for the national framework.
- Jurisdictionally controlled but transitioned matters: some matters will initially remain under jurisdictional control, but will require transitional mechanisms that are designed to enable the national framework to be adopted as and when each jurisdiction formally chooses to do so.
- Transitional matters: there will be a very substantial set of transitional rules needed to manage a smooth transition for retailers, distributors, customers and other industry participants from the current jurisdictionally based laws, rules codes and contracts to the new national framework Law, Rules and contracts.

Examples of specific transitional arrangements

The SCO considers that the implementation of the national framework will require specific transitional provisions. It is not practicable at this early stage to comprehensively identify all of the matters that may require transitional support.

However, for the purpose of indicating that SCO will give careful consideration to the managing of the transition to the new national customer's framework, the following are provided by way of example.

Managing jurisdictional price regulation

As previously noted, the AEMA sets out the agreed basis for implementation of the national framework. The national framework will not include a regime for price regulation. However, because under the AEMA jurisdictions retain control over the price regulation within their own jurisdiction (and the decision as to whether or not to phase out price regulation), the national framework will need to provide for a number of key matters in this area:

- The new statutory obligation to offer supply in the national framework will be capable of operating independently of whether price regulation continues in any jurisdiction.
- To facilitate the orderly transfer to nationally consistent (non-price) terms and conditions of standard retail supply arrangements, the transitional regime must enable relevant jurisdictional regulators to carry out any future reviews of regulated tariffs based on the national standard retail contract terms and conditions of supply, rather than on the previous, jurisdictionally-regulated standard terms and conditions.
- Where jurisdictions elect to do so, this would enable the transfer of customers on jurisdictional standard retail contracts to national standard retail contracts under the national framework, even where a jurisdiction retains price regulation.
- Subject to jurisdictional agreement, jurisdictional regulators should also be able to apply the national threshold that defines which customers receive the benefit of the obligation to offer supply, noting that the threshold should not change through the price path period. Those jurisdictions continuing with price regulation might (for example) elect to adopt the national threshold applying at the time of the price reset, which would achieve a further shift toward harmonisation ahead of any phase-out of price regulation.
- The national framework will not interfere with jurisdictional arrangements relating to the obligation to offer supply as it exists in each jurisdiction while a jurisdiction elects to maintain retail price regulation.
- Similarly, the designation of the retailer with the obligation to offer supply at a regulated price will remain under the control of the jurisdictional Minister unless or until that Minister decides otherwise.

Existing distribution determinations and access arrangements

Regulatory arrangements that operate over extended time periods are a characteristic of national electricity and gas access regulation. Electricity distribution determinations controlling the prices that may be charged by distributors for distribution services generally operate for five-year periods. Gas access arrangements setting out the services and applicable reference tariff offerings are required to include dates for review of those arrangements, and also generally operate on at least a five-year term.

This means that implementing national regulatory arrangements for retail supply must have close regard to those existing arrangements. On the other hand, because determinations and access arrangements must be robust to changes that occur during the regulatory period, those arrangements often have a built-in flexibility that permits new developments to be accommodated.

The SCO will actively manage the implementation of the national framework so that it can operate consistently with existing regulatory determinations and arrangements. Where there are changes that are necessary for the new national customer framework that may have an impact on existing regulatory determinations or access arrangements, these matters will be identified and appropriately addressed on a case-by-case basis, if necessary, at the time when the new national framework is being implemented.

Existing customer supply contracts

SCO's policy approach is that the transition to the national framework must not disturb supply to end-use customers or create contractual problems or discontinuities for retailers, distributors or customers.

If a standard retail contract under jurisdictional arrangements is to be transferred to the national framework, this will occur with transitional support, and retailers will be required to adopt the national standard retail contracts over a clear time frame and inform customers accordingly.

For existing, jurisdictionally-based negotiated or market retail contracts – these may continue until they terminate under the terms of the particular contract. Retailers would consequently be required to comply with the national framework requirements when negotiating new market retail contracts.

In summary, SCO will invite and consider submissions regarding the need for savings and transitional rules at each stage of the draft Laws and Rules. Interested parties will be able to provide information on matters of general application to ensure a smooth transition, as well as specific issues for individual industry participants as necessary.

At this stage of the policy development process, it is difficult to gauge the exact timing for the full implementation of the National Energy Customer Framework. The national Law and Rules to implement the new national framework is expected to be released as a Second (Final) Exposure Draft in the second half

of 2009. However, the timing for jurisdictions to apply the national framework is unknown at this time, and is at the discretion of the jurisdictions.

Jurisdictions will consult with stakeholders in their state or territory on specific implementation and transitional arrangements as it relates to the adoption of the national framework¹⁴².

¹⁴² Each jurisdiction will be required to undertake processes in order to amend their legislation and licenses to adopt the national framework. This will involve jurisdictions consulting with regulators, such as the AER and their independent economic regulators, national retailers operating within their jurisdiction and other retail energy market participants on how the national framework will operate within their jurisdiction.

10. SUMMARY OF RECOMMENDATIONS

Policy	Preferred option
5.1 Obligation to offer supply	
Do not impose obligation to offer supply	
Impose obligation to offer supply	✓
5.2 Designated Retailer	
Local Area Retailer	
Financially Responsible Retailer	✓
All retailers	
5.3 Energy customers to benefit from the obligation	
Residential customers only benefit from the obligation to offer supply	
All customers consuming at or under a threshold amount benefit from the obligation to offer supply	
All residential customers and energy customers consuming at or under a threshold amount benefit from the obligation to offer supply	
Standard contracts offered to all residential customers and non-residential customers to a threshold. Market contracts are offered to other customers below a second threshold	✓
5.4 Generic versus energy-specific regulation	
Energy-specific regulation where jurisdictional and national general consumer protection laws are silent	
Energy-specific regulation both where general consumer protection laws are silent and where national and jurisdictional laws are inconsistent	✓
Comprehensive energy-specific regulation	
5.5 Hardship regimes	
Implement hardship regime for energy customers	✓
Do not implement hardship regime for energy customers	
6. Distributor interaction with customers and retailers	
Triangular model	
Linear model	
Tripartite model	✓
7. Business Authorisation	
No entry requirements in the national framework	
Entry requirements for retailers only	✓
National Entry requirements for retailers and for gas distributors	
National entry requirements for retailers and distributors	
8.1 Enforcement regime	
No change to existing enforcement and compliance regime	
Enhancements to the enforcement and compliance regime	✓
8.2 Statutory Objective	
No change to existing statutory objective	
Change to the existing statutory objective	
No change to objective but clear guidance in the law regarding the role of customer hardship provisions	✓