

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

**CONSULTATION
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, and including 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 is the decision point for the development of the National Energy Customer Framework ("the national framework") – which is a national framework for regulating the sale and supply (i.e. retail and distribution) of electricity and natural gas to (energy¹) customers.

There is currently no commitment from Western Australia to apply the national framework for gas or electricity, nor from the Northern Territory to apply the national framework in respect of electricity.

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 or distributors. The term energy can be used interchangeably with "electricity and gas", both of which have the same meaning.

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

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

The issue of retail price regulation also remains a responsibility maintained by jurisdictions, 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 to the national framework is the final major stage of the energy market reforms agreed in the AEMA which is yet to occur, and regulatory authority for the sale and supply of energy to customers currently remains with jurisdictions.

The MCE, at its 13 December 2007 meeting, agreed to delay the introduction of the national retail (and related) legislation to the South Australian Parliament, as the lead legislature for the national energy legislation, until September 2009 in recognition of the complexity of the issues in creating the national framework. Included in the revised timetable accepted by MCE was that the work on the Retailer of Last Resort (ROLR) scheme should be advanced so that the arrangements for a national ROLR scheme can be introduced with the Laws and Rules for the national framework.

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 addressing major issues for consideration in developing the Laws 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.

After the public release of each Working Paper, stakeholders were asked to comment through written submissions. AAR then prepared a composite paper encompassing all of the Working Papers and considering the issues raised by stakeholders.

Stakeholders were again invited to provide written submissions on the AAR Composite Paper. Following this consultation process, the RPWG developed a SCO policy response paper and table of recommendations for the national framework, which considers the recommendations made by AAR in their composite paper, and the views of stakeholders who responded to the public consultation processes.

On 13 June 2008, SCO released its policy response paper and table of recommendations on the national framework for consultation. These were developed as the basis for the drafting of Laws and Rules to implement the national framework, as provided for in the AEMA. A public information session and workshops were held on 29 June and 7 July, respectively, to discuss the policy paper and written submissions were also invited on the policy response paper and table of recommendations. The closing date for submissions was 28 July 2008.

Feedback received through this public consultation process will be used to inform the drafting of the Initial Exposure Draft of the Laws and Rules. It is anticipated that the Initial Exposure Draft will be presented to the MCE for consideration towards the end of 2008. Stakeholders will have the opportunity to make submissions on the Initial Exposure Draft prior to the finalisation of the legislation.

In order for Ministers to consider the national framework and the proposed release of the Initial Exposure Draft in late 2008, a Decision Regulation Impact Statement (RIS) is required alongside the Initial Exposure Draft of the Laws and Rules. This Consultation RIS, along with the SCO policy response paper, table of recommendations and feedback received on each of these papers will form the basis of the Decision RIS.

IMPORTANT NOTE

The MCE SCO is aware that stakeholders have gone to considerable effort to respond in detail to the SCO policy paper and table of recommendations, and other consultation processes. For this reason, if stakeholders made a submission to the MCE SCO policy paper and table of recommendations that adequately addresses the issues in this Consultation RIS, they need not submit any further submissions as previous submissions will be considered.

Following consideration of the submissions on the Initial Exposure Draft, a Final Exposure Draft of the Laws and Rules is expected to be released for public consultation prior to the eventual 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 CONSULTATION REGULATION IMPACT STATEMENT

The Consultation RIS aims to cover off on the major policy areas that are to be transferred to the national framework and which are currently regulated by the States and Territories. The national framework is mainly concerned with regulating those entities that are engaged in the sale and supply of energy to small customers (all residential and small, non-industrial, business customers). Therefore, the package applies to the activities of distributors, retailers and customers².

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

- Retailer-customer relationship;
- Distributor interactions with customers and retailers;
- Business authorisation regime; and
- Enforcement and the statutory objective.

Further consultation has been undertaken in developing the details of the policy package.

The scope of the Consultation RIS will not extend to metering and customer transfer. Responsibility for developing these procedures in a national framework rests with the National Electricity Market Management Company (NEMMCO). Rule change processes for NEMMCO are comprehensive and involve extensive 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 Unless otherwise stated, the terms 'retailer' and 'distributor' is a reference to both gas and electricity retailers, and gas and electricity distributors.

3. STATEMENT OF PROBLEM

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

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 on 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. This largely reflects historical precedent, whereby electricity and gas utilities were publicly owned, with state-based monopolies providing services in each jurisdiction⁵.

As the energy market reform process has evolved, retailers are no longer restricted to operating in a single jurisdiction. This is due to the introduction of retail contestability, which has given retailers the opportunity to enter into other jurisdictional markets and compete with the traditional incumbents of that market. For example, as retailers increasingly operate across a number of jurisdictions in the National Electricity Market (NEM), 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 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 burden is also a factor in other areas of a retailer's operations such as their obligations in relation to hardship regimes, marketing conduct, terms and conditions of standard and market retail contracts, business entry requirements, or information reporting requirements of jurisdictional regulators. Currently these requirements vary across jurisdictions.

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 Productivity Commission: Review of Australia's Consumer Policy Framework p. 93

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 for more detail. Available at the website www.mce.gov.au

The Parer Review⁷ 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 \$10m per annum to the operating costs, and depreciation of establishment costs, of a retailer entering a new state market.

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."⁸

This is a significant problem for the energy market, as regulatory inconsistency across jurisdictions imposes additional compliance costs on retailers and distributors without any corresponding benefits to customers. These market inefficiencies are passed through to energy customers in the form of less competitive energy pricing. 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 privatised, 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.

Self-regulation is not considered an appropriate option for this industry as there is strong public interest involved. The nature of the industry means that any detriment incurred is likely to be of high risk and high impact. This relates in particular to the provision of energy to small customers, which is an essential service that impacts on the wellbeing and livelihood of individuals. 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.

RETAILER-CUSTOMER RELATIONSHIP

This policy area explores how to regulate the relationship between retailers and customers. In particular, issues surrounding the rights, obligations and responsibilities of each party need to be explored, as well as the options available for regulating these responsibilities. Broadly, the issues that enter into retailer-customer relationships are:

- The obligation to offer supply to a customer, including which retailer should have the responsibility for the obligation to offer supply, and conversely which customers should benefit from the obligation to offer supply;
- Whether to include a hardship regime for customers in financial difficulty; and
- To what extent generic consumer protections can be applied to marketing conduct by retailers, market contracts and standing offer contracts. In addition,

⁷ Council of Australian Governments: Towards a Truly National and Efficient Energy Market (the Parer Review), 2002

⁸ Council of Australian Governments: Towards a Truly National and Efficient Energy Market (the Parer Review), 2002, pp 75-76.

where industry specific regulation is applied, to what extent this should be applied⁹.

DISTRIBUTOR INTERACTION WITH CUSTOMERS AND RETAILERS

Policy in this area seeks to allocate rights and responsibilities between customers, retailers and distributors by means of different contractual models, such as linear, triangular and 'hybrid'. The contractual models propose various arrangements for regulating the provision of distribution and retail services to retail customers, and the mutual obligations between customers, retailers and distributors. These models also regulate the relationship between retailers and distributors, to clearly identify which party has responsibility for the provision of certain services, and to determine the extent to which each party assumes liability and responsibility for the provision of these services.

This policy option may consider non-contractual means for regulating these relationships, such as through direct obligations set out in the Laws and Rules.

BUSINESS AUTHORISATION

Business authorisation schemes (or licences) are in place in all jurisdictions and act as a means of maintaining stability in the energy market by restricting entry to those entities that have demonstrated the ability to meet their obligations to customers and the wholesale market(s), and the capacity to undertake the functions that are required of them as a retailer or distributor.

In the NEM, NEMMCO registers electricity entities operating in both the physical supply and/or financial markets. NEMMCO also registers network service providers (including distributors) in relation to a range of requirements including reliability and security of the power system and access regulation¹⁰.

In gas markets, distribution pipelines may be declared for the purpose of access regulation by the relevant Minister (on advice from the National Competition Council) or by schedule to the National Gas Law (NGL).

Therefore, the policy questions that arise are:

- What should be required of a distributor or retailer when entering the retail energy market;
- Should entry requirements apply to both distributors and retailers; and
- To what extent can current arrangements administered by NEMMCO be relied on in this area to avoid regulatory duplication?

⁹ While some generic regulation, such as the *Trade Practices Act 1974* and the Fair Trading Acts of each State and Territory provide some regulatory control over the activities of distributors and retailers, it does not have the capacity to deal effectively with industry-specific issues. As noted in the Productivity Commission's *Review of Australia's Consumer Policy Framework: Productivity Inquiry Report*, 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 purchase" (Productivity Commission Review, pp 81).

¹⁰ MCE SCO Policy Paper, p70.

ENFORCEMENT AND STATUTORY OBJECTIVE

The policy area of enforcement underpins the framework by encouraging compliance with the framework and providing remedies for non-compliance. The enforcement and compliance regime should consider a number of options available to remedy non-compliance, including an enforceable undertakings regime, information (i.e. reporting) obligations on retailers, and mechanisms for dispute resolution including court-based enforcement in lower and superior courts, as appropriate, and private enforcement remedies. As the various elements of the energy market reform program have been undertaken over time by separate work streams, there may be a need to consider whether and how this enforcement regime should apply to the various parts of the energy market supply chains, including in the context of third party access regulation of distribution networks.

Section 7 of the National Electricity Law (NEL) includes an express statement of the statutory objective in the following terms:

“The national objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to–

- (a) price, quality, safety, reliability and security of supply of electricity; and*
- (b) the reliability, safety and security of the national electricity system.*

An objective expressed in similar terms has been incorporated in section 233 of the new NGL.

In designing the national framework the question arises as to whether the existing statutory objective is appropriate and sufficient for the national framework.

4. OBJECTIVES

4.1 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.

4.2 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 to be explored in the Consultation RIS.

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, 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. STATEMENT OF OPTIONS

5.1 RETAILER-CUSTOMER RELATIONSHIP

The policy options proposed to govern the retailer-customer relationships are structured according to an over-arching policy decision of whether or not to transfer an obligation to offer supply in the national framework. A number of sub-policy questions arise where an obligation to offer supply is imposed.

The following table sets out a simple cost-benefit analysis of the obligation to offer supply.

	Impose an obligation		Do not impose an obligation	
	Cost	Benefit	Cost	Benefit
Retailers	Retailers operating costs may increase marginally, depending on the details of the obligation imposed (as a retailer would offer supply to a high proportion of customers)	May benefit retail market competition where all retail customers can access the market driving product innovation.	Competition and drive for product innovation reduced as retailers need only provide services to customers as a matter of choice.	Regulatory burden is reduced.
Customers	Increased regulatory obligations on retailers may lead to less competitive energy prices.	Relevant energy customers are assured of access to an essential service (which may be of particular significance to vulnerable customers or those in rural areas, for example).	Access to an essential service may be jeopardised.	Reduced regulatory obligations on retailers may lead to competitive pricing of energy products.
Distributors	Distributors' operating costs may increase marginally, depending on the details of the obligation imposed (distributors would continue to offer connection services to retailers' customers).	Potential for a wider customer base (depending on the details of the obligation imposed).	Could limit future expansion of the network and customer base.	Regulatory burden is reduced.
Regulators	Greater compliance monitoring requirements	Publication of clear market information will send clear signals to assist investment decisions for energy security and reliability.	Lack of clear market information can affect investment decisions.	Fewer compliance monitoring requirements, which should reduce the costs of compliance monitoring.

The following sub-policy issues help to shape the scope and purpose of the obligation to offer supply under a national customer framework:

1. Which retailer should be obligated to offer supply;
2. Which customers should benefit from the obligation to offer supply;
3. Which consumer protections should be adopted; and
4. Should a regime be introduced into the national framework to protect customers in financial hardship?

Whichever policy options are adopted for transfer to the national framework will invariably result in reduced compliance costs for retailers and distributors, as these entities would only need to comply with one set of regulatory obligations, instead of numerous jurisdictional requirements. The question that should be explored therefore is, which option is optimal in terms of transference to the national framework.

5.1.1 Obligation to offer supply

An obligation to offer supply places a requirement on specified retailers to offer to sell energy to a customer if that customer requests supply.

Currently all jurisdictions regulate the obligation to offer supply to small customers¹¹. For electricity, the requirement is expressly stated in all jurisdictions. The arrangements for gas differ across jurisdictions and are related to whether gas is considered an essential service for customers.

Jurisdictions generally impose this obligation to offer for the benefit of ‘small customers’ who are defined with reference to a consumption threshold. The consumption threshold for small customers varies across jurisdictions for electricity from 100 megawatt hours (MWh) per annum to 160MWh per annum and from 1 terajoule (TJ) per annum to 10TJ per annum for gas.

The rationale for imposing an obligation to offer supply is primarily for the benefit of small customers for whom energy is an essential service, as access to energy affects the health and well-being of individuals. It is also a protection for customers who may not be financially attractive to retailers (because of their location, consumption patterns or payment history, for example).

Parties affected by the obligation to offer supply are primarily retailers and energy customers. Distributors are implicitly affected by an auxiliary obligation to connect customers to the network in order for customers to receive supply.

Jurisdictional regulators already monitor compliance in this policy area, according to jurisdictional rules. Transferring this responsibility to a single national regulator should afford cost savings overall through reduced duplication and greater efficiencies of scale. This shift and overall likely reduction in costs is relevant throughout this RIS when considering the transition, from arrangements monitored and enforced by

¹¹ Some jurisdictions also regulate an obligation for large customers. For example in NSW, the obligation to offer supply applies to all customers, however only small customers may benefit from the obligation on a standing offer contract with regulated terms, conditions and prices, and in Queensland’s electricity market the obligation applies to all new connections (including large customer connections) and large non-market customers.

various jurisdictional regulators, to the national framework, monitored and enforced by a single national regulator.

Policy Option 1- Do not impose an obligation to offer supply

Not imposing an obligation to offer supply removes any obligation on retailers to supply electricity or gas to a customer who requests supply.

Impact Analysis

The need to impose an obligation to offer supply becomes less clear where markets are fully competitive and prices are not regulated. Arguably, a fully effective market would not exclude classes of customers on the basis that they are not attractive to any retailer. For example, in the retail market for 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 customers including those that would otherwise be considered a financial risk. However, full retail competition (FRC) has not commenced in all jurisdictions and taking steps to determine whether retail energy markets are fully effective and competitive is only a recent development in the economic reform process. At this stage, the Australian Energy Market Commission (AEMC) has finalised a review of the effectiveness of competition in Victoria and South Australia's retail energy markets.

Removing the obligation to offer supply, in the absence of fully effective retail markets, would likely have the greatest impact on small and less commercially attractive customers (which may include customers in rural and remote locations where the cost to supply is greater). These impacts would be considered to be of detriment to affected customers recognising the essential service nature of energy supplies. Under a reasonably competitive market, only a small number of customers may not be able to obtain a supply, but 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 public health implications.

The benefits of removing an obligation to offer supply need to be further established. While only a small percentage of customers may be affected by the removal of the obligation, the detriment suffered may be serious enough to warrant its continued application¹². Not imposing this obligation on retailers may be of minimal benefit, as retailers would consider a very high proportion of energy customers to be financially attractive, and would offer supply regardless of any regulatory obligation to do so.

Policy Option 2- Impose an obligation to offer supply

Imposing an obligation to offer supply would require designated retailers to provide energy services to those customers who request it.

¹² 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.

Impact Analysis

The rationale for imposing an obligation to offer supply relates to-

- *Essentiality* - The essential nature of energy supply in relation to health, safety and well-being. This measure aims to protect customers from the potential detriment they may suffer if denied access to a supply of energy. In particular it seeks to make certain that supply is available to vulnerable and less commercially attractive customers.
- *Affordability* - Jurisdictions impose an obligation to offer supply on a regulated tariff as 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.
- *Economic development* - 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.
- *Market failure* - This applies in circumstances where customers do not have sufficient choice of, or information available on, products in order to effectively participate in the market¹³.

The absence of an obligation to offer supply may lead to detriment for a particular class of customers where retailers with market power may choose to exclude customers that are considered less commercially attractive, such as customers in rural and remote areas or those experiencing financial hardship. For these reasons, and until competition is deemed to be effective in all retail markets, there is a strong argument to continue to impose an obligation to offer supply.

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's *Review of Australia's Consumer Policy Framework* to "meet the needs of those who, as consumers, are most vulnerable, or at greatest disadvantage"¹⁴.

A statutorily imposed obligation to offer supply is a simple regulatory measure to reduce the risk of customers not getting a supply of energy. 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. This policy issue is addressed in the next section.

The costs of transferring this obligation to a national framework are considered to be negligible as jurisdictions already impose this function on retailers.

Obligation to offer supply policy options table

Policy Option 1	Policy Option 2
No imposition of an obligation to offer supply.	Imposition of an obligation to offer supply.

¹³ MCE SCO Policy Paper, p. 17

¹⁴ Productivity Commission: Review of Australia's Consumer Policy Framework p 12.

TARGET QUESTIONS

Feedback is sought on the following issues:

- **To what extent would customers be affected by removing the obligation to offer supply?**
- **Are there reasonable marginal gains to retailers that would be realised if the obligation to offer was removed?**
- **How will the impacts of an obligation to offer supply differ between gas and electricity for retailers?**

5.1.2 Designating retailers in the event that an obligation to offer supply is imposed

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 would need to take into account:

- The potential of a fully contestable national retail market in future;
- How best to 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.

In all jurisdictions, the retailer with the obligation is designated through a jurisdictional instrument and, other than in Queensland's electricity sector, 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 points¹⁵. 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).

Retailers and customers are primarily affected by this policy option. The cost to jurisdictional and national regulators is marginal as regulators already monitor for compliance in this policy area, but according to jurisdictionally based rules.

Policy Option 1- Local Area Retailer

The LAR model imposes an obligation to offer supply on retailers as designated by jurisdictional instruments. The supply remit of a LAR can be specified according to a number of parameters including a geographical area or a particular class of premise or customer¹⁶.

¹⁵ In Queensland the Local Area Retailer has the obligation to supply customers at new connection points.

¹⁶ MCE SCO Policy Paper, p.12

Impact Analysis

Customers benefit from this policy as it provides ease of identification of the designated retailer by customers. In the short term this eases the need to search for a suitable retailer, and customers may readily take supply. There is minimal disruption to the customer in this process. Further in a competitive market, with a demonstrably 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 are less likely to remember who the LAR is.

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 will 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 advantage¹⁷.

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.

Policy Option 2- **Financially Responsible Retailer (FRR) Model**

The FRR model imposes an obligation to offer supply on retailers who are the financially responsible retailer¹⁸ for that 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 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 network.

Impact Analysis

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 the customer later vacates the premises. It does not give an automatic advantage to a retailer simply on the basis of an historical and geographical circumstance and so reduces barriers to entry¹⁹.

¹⁷ MCE SCO Policy Paper, p. 20

¹⁸ The financially responsible retailer in electricity markets is generally referred to as the Financially Responsible Market Participant.

¹⁹ MCE SCO Policy Paper, p. 21

A further benefit of this model is that it accommodates 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 market²⁰ and does not rely on jurisdictional instruments that can affect the behaviour of retailers operating in jurisdictions by creating effective barriers to entry for other retailers. Also, as this model does not rely on jurisdictional instruments it can provide a nationally consistent approach to designating retailers.

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:

- 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.

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 fairly²¹."

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.

The FRR model, however, requires elaboration to account for circumstances where no FRR exists for premises (e.g. new premises). In this case, a LAR may be designated for new connections.

Compliance costs for retailers operating in several LAR areas would be reduced if this were to be adopted in the national framework, as retailers would only need to comply with one regulatory requirement in relation to identifying the retailer with the obligation to offer supply.

Policy Option 3- All Retailers

This model imposes an obligation to offer supply on all retailers operating in the national retail energy markets.

Impact Analysis

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

²⁰ Allens Arthur Robinson: Consultation Paper on the National Framework Distribution and Retail Regulation, p. 9

²¹ AEMC Second Report on Retail Energy Competition in Victoria p. 32.

considered more equitable to place the obligation to offer supply equally on all retailers.

However, 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 classes²². For example, it may be impractical 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 patterns²³.

In addition, 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 quantities of energy²⁴.

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

The compliance costs for retailers may be reduced if this were to be adopted in the national framework, as retailers would only need to comply with one set of regulatory requirements in relation to identifying the host retailer with the obligation to offer supply (in this case ALL retailers), although retailers may face costs in having a suitable range of default supply arrangements to apply to the broad range of customers they may be obliged to supply.

Designated retailers and where the obligation to offer supply operates policy options table

Policy Option 1	Policy Option 2	Policy Option 3
Local Area Retailer	Financially Responsible Market Participant	All Retailers

TARGET QUESTIONS

Feedback is sought on the following issues:

- **How each option facilitates (or impedes) competition?**
- **The costs and benefits of each option to retailers?**
- **The workability of each option for retailers and regulators?**

²² MCE SCO Policy Paper, p. 21

²³ 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.

²⁴ MCE SCO Policy Paper, p. 21

5.1.3 Where an obligation to offer supply is imposed, which customers benefit from that obligation?

All jurisdictions currently delineate which customers may receive the benefit of the obligation to offer supply. 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 in a competitive market.

Jurisdictions currently define the type of customer to benefit from the obligation to offer supply by reference a consumption threshold²⁵. Designated retailers are obliged to offer supply to those who consume at or below the defined consumption threshold. Retailers are not required to offer supply to customers whose consumption exceeds that threshold²⁶.

Table 5.1.3

The following table sets out the current jurisdictional arrangements²⁷.

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 terms (including price)
Victoria	160*	5	*As of 1 January 2008, regulated prices only apply to residential small customers (small business 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	

Harmonisation of small customer thresholds would deliver systems efficiencies for retailers. However, the overall cost for jurisdictional and national regulators of

²⁵ The electricity consumption thresholds set by jurisdictions currently varies from 100 megawatt hours (MWh) per annum to 160MWh per annum, although in NSW the obligation to offer applies to all customers (with customers below 160MWh entitled to supply at the regulated price. The gas consumption thresholds giving rise to the benefit of the obligation also varies across jurisdictions from 10 terajoules (TJ) to 1TJ per annum. In Queensland there is also an obligation to offer supply to certain large electricity customers.

²⁶ Including large customers in the benefit of the obligation would over-estimate the need to impose an obligation to offer supply. Large industrial customers are able to exert significant market power, and for this reason are better placed to negotiate specialised terms, conditions and price for energy supply.

²⁷ MCE SCO Policy Paper, p. 23

harmonisation in this policy area is not likely to be material as regulators already monitor for compliance in this area, but according to jurisdictionally based rules.

Policy Option 1- Residential customers only

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

Impact Analysis

This policy option primarily benefits retailers and residential customers. Imposing on retailers an obligation to offer supply to residential customers only may be a driver for competitive pricing. Retailers may choose to adopt a tariff structure that better reflects the true cost of supply to residential customers, whose consumption profiles may vary significantly from non-residential energy customers. Given that 79.31% of customers are residential customers²⁸, such a measure may be conducive to allowing greater product diversity and competition for residential customers (subject to continuing jurisdictional price regulation).

The major cost to energy customers of this model is that it potentially disenfranchises small non-residential customers in under-developed retail markets and, more generally, less commercially attractive non-residential customers. The AEMC has observed that some small business customers share many of the characteristics of residential customers²⁹. 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.

Compliance costs for retailers would be reduced if this were to be adopted in the national framework, as retailers would only need to comply with one set of regulatory requirements to identify which customers benefit from the obligation to offer supply and would not be exposed to any risks associated with the obligation to offer supply to non-residential customers.

Policy Option 2- Small customers defined by a consumption threshold

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

Impact Analysis

Obligating retailers to offer supply to customers beyond the residential classification, and according to consumption thresholds is currently the practice in all jurisdictions. Some non-residential 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.

²⁸ Source: esaa, Company Annual Reports, Electricity Gas Australia 2006

²⁹ AEMC Final Report on Retail Energy Competition in Victoria, pg. 5

The major benefit of this model is its capacity to capture non-residential customers such as small businesses³⁰. For example, the types of businesses that a consumption threshold of up to 160 MWh or 1 TJ per annum is likely to capture includes businesses such as petrol stations, bakeries, panel shops, small dairies and medium sized restaurants that are open long hours and have a large output component such as a deep fryer or other large kitchen appliances that are constantly operating, or those that rely on gas as a key business input³¹.

Further benefits of this model relate to regulatory ease of execution. AAR noted in Working Paper No. 1 that the use of consumption thresholds as a proxy provides a high degree of consistency, certainty and transparency, potentially at the risk of being overly inclusive in that some small customers falling under the threshold will not meet the description of vulnerability that might otherwise have applied³². 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.

Where contestable markets are not yet developed, and especially in relation to regional areas, including non-residential customers by way of a consumption threshold may support ongoing economic development.

However, this model does impose costs on businesses in that it requires retailers (and distributors, to the extent that are required to classify customers) to establish or apply a criterion for determining whether a customer falls above or below the relevant threshold during the initial billing cycle. Such a measure may work to complicate retailer's billing arrangements, however it is difficult at this stage to determine to what extent this would outweigh the benefit of having a nationally consistent definition for small customer.

It should be noted that, as retailers and distributors are already required to determine the classification of customers, this is not a new cost imposed by the proposed national framework. In addition, any harmonisation of thresholds across jurisdictions should allow retailers operating across jurisdictions to realise efficiency gains.

The other costs of this model relate more broadly to competition effects in retail markets, and the flow-on effect this will have on energy prices for customers. Were the obligation to offer supply is based solely on a consumption threshold, retailers' contracts would need to accommodate residential and non-residential customers. This could deliver less competitive pricing and innovation as retailers' tariff structures may be based on significantly different consumption profiles.

Another difficulty with implementing this policy option is in determining what the appropriate consumption threshold should be, although existing consumption thresholds in jurisdictions could be used to guide policy development.

³⁰ 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.

³¹ Information based on discussion with retail business

³² Allens Arthur Robinson Working Paper Number 1, p. 20

Compliance costs for retailers would be reduced if this were to be adopted in the national framework, as retailers would only need to comply with one regulatory requirement in relation to identifying which customers benefit from the obligation to offer supply.

Policy Option 3- Residential customers, and business customers below a consumption threshold

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.

Impact Analysis

The major benefit of this model is that it moderates between policy options 1 and 2 to include in the obligation those non-residential customers who may have very similar characteristics to residential customers in relation to negotiating their energy supply arrangements.

Including non-residential customers up to a consumption threshold recognises that some small businesses face similar disadvantages to those faced by residential customers in relation to market power and access. This policy option aims to make certain that these customers are not unduly disadvantaged when seeking supply of energy.

It also recognises that energy is an essential service for all residential customers, regardless of consumption levels whereas policy option 2 would exclude some residential customers from benefiting from the obligation to offer of supply.

Compliance costs for retailers would be reduced if this were to be adopted in the national framework, as retailers would only need to comply with one set of regulatory requirements in relation to identifying which customers benefit from the obligation to offer supply.

Customers that benefit from the obligation to offer supply policy options table

Policy Option 1	Policy Option 2	Policy Option 3
Residential customers only	All small customers defined by a consumption threshold	All residential customer and small business customers defined by a consumption threshold

TARGET QUESTIONS

Feedback is sought on the following issues:

- **The costs to retailers of moving from a consumption threshold to a residential/non-residential split.**
- **The degree to which small businesses face similar circumstances to households.**

5.1.4 Industry-specific versus generic 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 in the development of the national framework. As noted earlier, due to the high level of public interest in the provision of energy services, and the detriment that may be suffered in the absence of adequate customer protection in relation to their supply of essential services, some industry-specific regulation may be required.

The Productivity Commission's *Review of Australia's Consumer Policy Framework: Productivity Commission Inquiry Report*, first released in December 2007, states 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 purchase³³.

The intent of energy-specific regulation is to provide more effective and certain consumer protection than the generic provisions could provide alone. In particular, 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 therefore propose to what extent industry-specific regulation should be applied to in these areas.

The current framework requires retailers and distributors to comply with the Commonwealth *Trade Practices Act* (TPA), the Fair Trading Acts (FTAs) of each jurisdiction and other jurisdictional regulations and codes relating to the retail distribution of energy that is administered by jurisdictional regulators.

The cost to jurisdictional and national regulators is marginal as regulators already monitor for compliance in this policy area although this is currently undertaken in accordance with jurisdictionally based regulatory requirements.

Policy 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 FTAs to regulate marketing conduct, marketing 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 disconnection of supply, which has a significant impact on energy consumers but which is not addressed in generic legislation.

³³ Productivity Commission: Review of Australia's Consumer Protection Framework, p. 25

Impact Analysis

The benefit of this policy option is that it introduces a minimal amount of regulation. Regulation would only occur in those areas where neither the TPA nor jurisdictional FTAs provide for an energy-specific matter.

The cost of this policy relates to regulatory inconsistency and lack of harmonisation. While this policy option meets the AEMA objectives of lowering the cost and complexity of regulation, it does not achieve a nationally consistent framework. Further, it does not harmonise the regulatory arrangements between gas and electricity as different generic laws apply across jurisdictions.

In addition, 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 compliance costs for retailers and distributors would be marginally affected under this policy option as retailers and distributors would still be required to respond to different generic regulatory obligations across jurisdictions. Compliance costs will be reduced in those areas where there is a nationally consistent approach to generic consumer protections, and as a result of the nationally-consistent energy-specific regulation.

Policy 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 where these provide a consistent national approach in dealing with the relevant subject matter. Energy-specific regulation is applied where general consumer protection 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.

The main 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 the entry into market contracts.

Impact Analysis

The major benefit of this policy is that it introduces regulatory harmony and consistency, which meets AEMA objectives. In doing so, it does not broaden energy-specific regulation where generic consumer protections exist.

The harmonisation and greater consistency in the regulatory framework should reduce barriers to entry caused by former differences. The benefit for energy retailers will be further reductions in their long term production costs, as they can now enter other jurisdictions (where FRC has been introduced) on the same market terms. Customers

would also benefit in the long-term through greater choice of energy retailer and competitive energy pricing.

Policy Option 3 – Apply comprehensive energy-specific regulation

This policy option involves developing comprehensive energy-specific regulation including in areas where there may be a nationally consistent approach, or where generic consumer protections are adequate.

Impact Analysis

The major benefit of this model, in particular for retailers, is that it introduces regulatory certainty and harmony into the national framework. As noted in AAR Working Paper No. 1, this approach potentially produces additional benefits by encouraging industry compliance and enhancing consumer understanding³⁴. 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.

However, this policy may impose costs on retailers as it duplicates regulatory functions already in place. 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.

Industry-specific versus generic regulation policy options table

Policy Option 1	Policy Option 2	Policy Option 3
Apply energy specific regulation where jurisdictional and national general consumer protection laws are silent	Apply energy specific regulation both where general consumer protection laws are silent and where national and jurisdictional laws are inconsistent	Apply comprehensive energy specific regulation.

TARGET QUESTIONS

Feedback is sought on which option better meets the following objectives:

- **Regulatory certainty/transparency.**
- **Clarity.**
- **The ease with which retailers/customers can understand their rights and obligations.**

5.1.5 Regimes to deal with consumer hardship in the energy retail market

A hardship regime places obligations on retailers to identify and assist financially vulnerable energy customers in meeting their energy payments. The Productivity Commission's *Review of Australia's Consumer Policy Framework* defines a

³⁴ Allens Arthur Robinson Working Paper Number 1 p. 34

disadvantaged customer as one who has ongoing attributes or circumstances, such as poor education and low income, which cause a continuing susceptibility to detriment³⁵.

Hardship policies have been developed as part of jurisdictional energy regimes to avoid disadvantaged customers being disconnected for non-payment. The potential for disconnection to exacerbate ongoing financial difficulties³⁶ and have a severe impact on those customers, compared to the impact of these debts on retailers, have been the drivers for regulating in this space. Hardship policies also assist retailers in avoiding customer default.

Currently a nationally consistent approach for hardship regimes is not in place³⁷. Each jurisdiction sets out the regulatory requirements of its own hardship regime through 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 a range of measures such as offering energy audits to assist customers in financial hardship.

The cost to jurisdictional and national regulators of harmonisation this policy area is considered marginal as regulators already monitor for compliance in this area but according to jurisdictionally based rules, noting the efficiencies of scale that result from the transfer to a single national regulator.

Policy Option 1 – Implementing hardship regimes for residential energy customers

Imposing an obligation on retailers to provide arrangements for residential customers experiencing financial hardship could require retailers to provide some or all of the following options³⁸:

- Flexible payment options for payment of energy bills;
- Processes for early response by both retailers and residential customers to energy bill payment difficulties; 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.

Impact Analysis

The major benefit of introducing a financial hardship regime in the national framework is that it extends and complements other initiatives aimed at minimising the likelihood that vulnerable and disadvantaged customers are disconnected from energy supply. Relevant energy customers gain a number of protective mechanisms

³⁵ Productivity Commission: Review of Australia's Consumer Protection Policy Framework, p. 293

³⁶ Defining financial hardship is a difficult task to undertake, recognising the differences between customers who, for whatever reason, are unable to meet their accumulated energy bill payments, whether this is a transitory or long-term situation

³⁷ The following policy area is tangible 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. In order to balance the risks faced by retailers (financially risky customers) and energy customers (potential disconnection of supply), a hardship regime bridges these two concerns.

³⁸ MCE SCO Policy Paper, p.50

to ensure that disconnection 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 disconnection of essential energy supplies.

Retailers may benefit from hardship regimes by maintaining a financial relationship with customers, thereby improving debt recovery, and mitigating against disconnection-connection cycles.

The cost to retailers of this policy option may be inferred through the incidence of customers disconnected due to non-payment. In Victoria the percentage of customers disconnected for non-payment of bills in 2006-07 was higher than in 2005-06 but remained well below 1%, and below most other states³⁹. For New South Wales, the disconnection rate due to non-payment for residential customers for 2006-07 was 0.7%⁴⁰.

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 plans⁴¹. The availability of this sort of data is dependent on the reporting requirements of each jurisdiction, and also to what extent retailers are prepared to publicly release this commercially sensitive information.

Other costs to retailers relate to prolonging the recovery of payment from energy customers. It is recognised that by imposing these obligations on retailers, perverse incentives could be created for customers who are otherwise capable of paying their energy bills on time to delay payment until disconnection is imminent. This could significantly add to the costs of a hardship regime. As such, the requirements of a hardship regime would need to be carefully examined to ensure these incentives do not exist or are minimised – in particular, care needs to be taken to distinguish those customers who cannot pay from those who will not pay.

If hardship obligations are included in the national framework, a number of options are available in terms of how these obligations can be implemented. Options include placing direct obligations in the Laws and Rules, including requirements in minimum contract terms and conditions, or placing the obligations as a condition of business authorisation and entry into the retail market.

Compliance costs for retailers would be reduced if this policy option were to be adopted in the national framework, as retailers would only need to comply with one set of regulatory requirement in relation to identifying and responding to customers who are in financial hardship.

³⁹ Essential Services Commission of Victoria: 2006-07 Energy Retail Performance – Consumer Snapshot, p. 2(ii)

⁴⁰ Independent Pricing and Regulatory Tribunal: NSW Electricity Information Paper No 1/2008, for the period 1 July 2002 to 30 June 2007, p. 17

⁴¹ Energy Retail Businesses Comparative Performance Report 2007.

Policy Option 2 – Not implementing hardship regimes for energy customers

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

Impact Analysis

Relying on jurisdictional instruments, where they exist, to guide retailers to implement a hardship regime is contrary to the directives set out in the AEMA which focuses on the harmonisation of retailer (and distributor) regulations.

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 will be unable to find assistance, or the provision of assistance will fall principally to welfare agencies with less direct contact with customers and less time and resources with which to manage customers who are falling behind on their bills.

The costs to energy customers of not transferring a hardship regime to the national framework are significant. Energy customers who are unable to access the provisions of a hardship regime to maintain energy supply may face significant detriment including the loss of basic services such as lighting, heating and cooking and for which there may be personal and public health implications.

The compliance cost for retailers initially appears to be reduced under this option, compared to policy option 1. However, as noted already, some (if not all) retailers may choose to implement a hardship regime in the absence of an explicit requirement to do so, in order to avoid costly disconnection-reconnection cycles with hardship customers.

Regimes to deal with consumer hardship in the energy retail market policy options table

Policy Option 1	Policy Option 2
Imposing a requirement for a hardship regime on energy retailers.	Not imposing a requirement for a hardship regime.

TARGET QUESTIONS

Feedback is sought on the following issues:

- **The cost to retailers of implementing hardship arrangements.**
- **The demand from customers for a hardship regime, and the implications of the absence of such a regime.**
- **The regulatory arrangements through which a hardship regime should be imposed.**

5.2 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 and which may be considered for transfer to a national framework.

Whichever policy option is adopted it will invariably result in lowered compliance costs for retailers and distributors, as entities need only comply with one set of regulatory obligations instead of numerous jurisdictional requirements.

The cost to jurisdictional and national regulators is marginal as regulators already monitor for compliance in this policy area, albeit according to different rules, with economies of scale likely from the move to a single national regulator.

5.2.1 Contractual model for distribution services to retailers and customers

In general terms, 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 the market participant's capacity to deliver on responsibilities without unduly complicating end-use customers' ability to seek energy supply and related distribution services. This is a matter to be addressed in the detailed content of the specific contracts between distributors, retailers and customers.

AAR's Working Paper No. 2⁴² 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 variations) in jurisdictions:

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

Policy Option 1- Triangular model

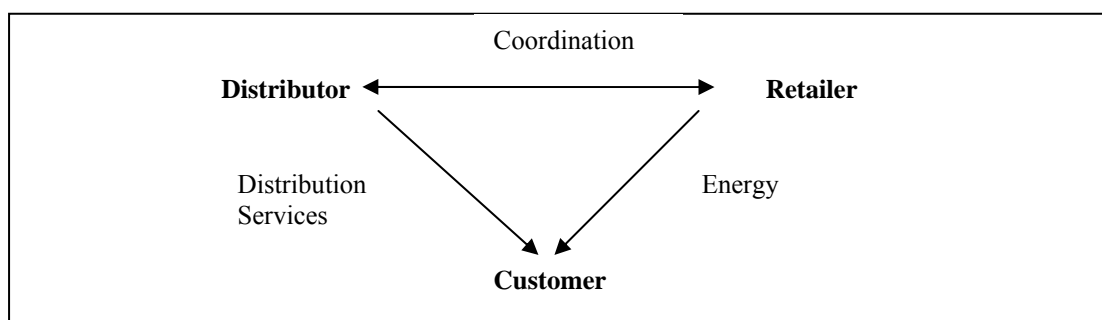
The primary characteristic of the triangular model is that both distributors and retailers coordinate the provision of energy services to customers, so that each has a direct relationship with customers relating to those aspects of the sale and supply of

⁴² Allens Arthur Robinson Working Paper Number 2, p. 29

energy over which each party has control. AAR Working Paper No. 1⁴³ 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, so the customer can effectively deal with a single service provider. In particular, the retailer collects network service charges from the customer on behalf of the distributor.

Triangular Contractual Model:



Impact Analysis

The major benefit to energy customers under this model is that it streamlines the processes for customers seeking energy supply and distribution, while at the same time placing obligations on each party in relation to that aspect of the sale and supply of energy controlled by the party.

Of further benefit to retailers, distributors and customers is that this model provides a clear contractual relationship amongst all parties. Contracts put in place mutual rights and obligations for each party, breaches of which may be remedied under the law of contracts. Under this model, if the distributor defaults in its supply of energy to a customer, the customer can seek financial redress.

Specifically between distributors and retailers, the benefits of this model are that the responsibilities of each party are clearly defined: the retailer is responsible for the financial aspects of distribution services; and the distributor is responsible for the operational functions such as reliability and safety of energy supply. The responsibilities and obligations of distributors and retailers to the customer can be reasonably captured within a coordination agreement between retailers and distributors.

The cost to retailers of this model is that (as is currently the case) retailers assume the financial credit risk of customers, as retailers are liable to pay for distribution services even in the event of non-payment by customers receiving those services. However, 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.

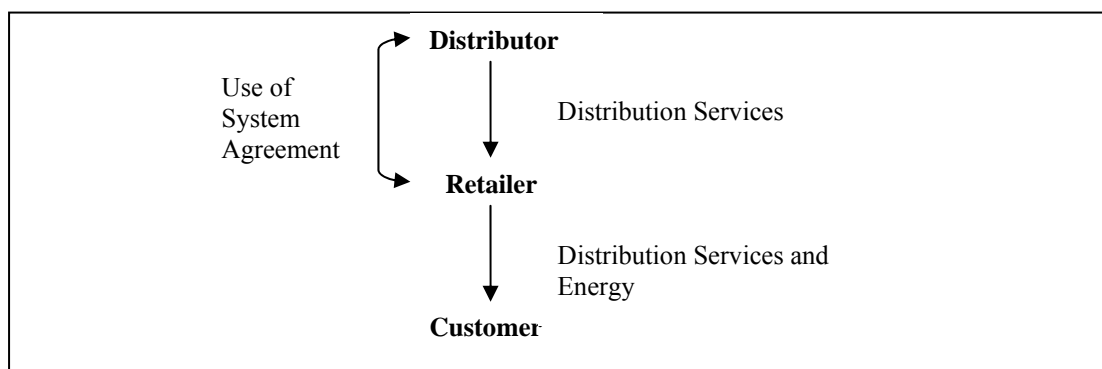
⁴³ Allens Arthur Robinson Working Paper Number 2, p. 27

Compliance costs for retailers would be reduced if this were adopted in the national framework, as retailers, distributors and customers would only need to comply with one set of regulatory requirements to identify the responsibilities and obligations of each party.

Policy Option 2- **Linear model**

Under this model, retailers purchase services from distributors and then sell a bundled product to customers. Customers receive both energy and distribution services from retailers and do not have a contractual relationship with their distributor.

Linear Contractual Model:



Impact Analysis

Distributors benefit from this model as they are not required to have a direct relationship with the end-use customer. There are no contractual obligations between the customer and distributor as the retailer provides both energy and distribution services to the customer by way of an on-sold (bundled) product.

Costs to the customer under this model are that the distributor does not have any direct obligations to the customer (although the distributor has obligations under the Law in relation to the operation and maintenance of its supply network) which may add 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.

There is also a potential cost to retailers, to the extent that they are seen, by the customer, as being responsible for both the sale and supply of energy, thus inferring a liability in relation to matters outside their control such as quality, safety and reliability

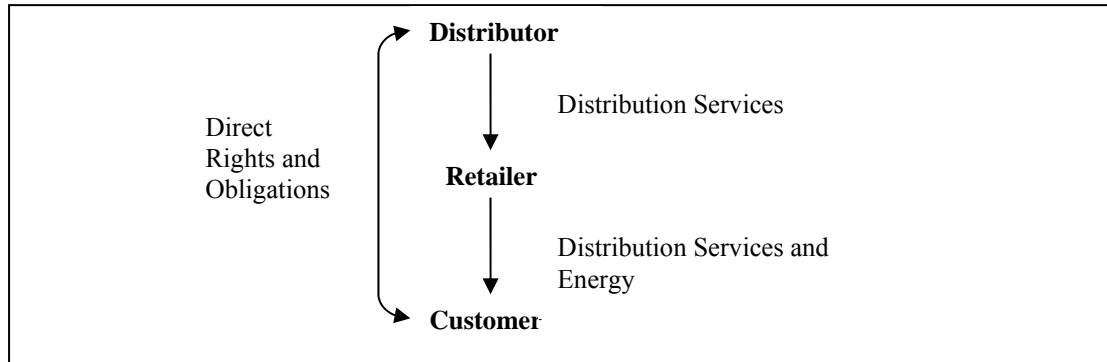
Compliance costs for retailers and distributors would be reduced if this were to be adopted in the national framework, as these entities would only need to comply with one set of regulatory arrangements in relation to identifying the responsibilities and obligations of each party. However there is a degree of complexity, which would have

an associated cost, in relation to the resolution of issues relating to the physical aspects of a customer's supply.

Policy Option 3- Modified linear (or 'hybrid') model

The modified linear model introduces a limited contractual relationship between distributors and customers. Distribution services are provided to retailers, and retailers provide a bundled service of energy and distribution services to customers.

Modified Linear Model:



Impact Analysis

The benefit of this model to distributors and retailers is that it attempts to redress the financial risks of policy option 1, while also attempting to retain its clear contractual benefits. However this model may adversely affect the rights and obligations of customers, as these may remain unresolved at this level. The benefits to retailers and distributors, and costs to customers are not clear until the policy is 'drilled down' to reveal the exact nature and content of the contractual relationship.

The cost to customers is the (potentially) less clear nature of their contractual relationships with distributors and retailers. In this model distributors and retailers enter into a contractual relationship whereby distributors provide distribution services to customers which the retailer then sells as a bundled service to the customer. A deemed contractual relationship between the distributor and customer exists in relation to the physical supply of energy to the premises.

As the retailer purchases distribution services from the distributor and on-sells them to the customer, there may be confusion regarding the contractual rights and obligations between the customer and distributor under the deemed contract arrangement. It may therefore be unclear under this proposed model how a customer could seek personal compensation in case of a breach under the deemed contract.

This model does not change the services provided to customers by retailers under the linear model (a bundled service of energy and distribution services) however, it changes the emphasis of liability in the provision of distribution services, with regulatory instruments placing direct obligations on distributors, in relation to physical and operational supply issues, for example. By contrast, the triangular model places these obligations on distributors under contracts between distributors and customers.

However, 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 'bundled' service is deprived of much of its meaning under this model.

Compliance costs for retailers and distributors would be reduced if this were to be adopted in the national framework, as these entities would only need to comply with one set of regulatory arrangements in relation to identifying the responsibilities and obligations of each party. 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, where necessary and appropriate.

Contractual model for distribution services policy options table

Policy Option 1	Policy Option 2	Policy Option 3
Theoretical triangular model	Theoretical linear model	Theoretical modified linear model

TARGET QUESTIONS

Feedback is sought on the following issues:

- **The costs of moving from one form of contractual model to another (given the variety of existing jurisdictional arrangements).**
- **The practicality of harmonising the arrangements for electricity and gas.**

5.3 BUSINESS AUTHORISATION

Policy options proposed for a business authorisation regime are structured according to which entities should be subject to registration requirements in order to participate in retail markets and in the supply of energy services to customers.

Whichever policy option is adopted for transfer to the national framework will invariably result in lowered compliance costs for retailers and distributors, as entities need only comply with one set of regulatory obligations instead of numerous jurisdictional requirements. The question, therefore, that should be explored is which option is expected to provide the most efficient outcome.

The cost to jurisdictional and national regulators is marginal as regulators already monitor and perform these functions albeit according to different rules. Once again, cost savings should be realised with the national regulator able to take advantage of efficiencies of scale.

5.3.1 Business authorisation regimes

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)⁴⁴.

5.3.2 Entry criteria for retailers and/or distributors

The following is taken from AAR Working Paper No. 3 and lists 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.

⁴⁴ 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.

National registration requirements already exist in relation to retailers and distributors. For electricity, the NEL and National Electricity Rules (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 requirement⁴⁵. To become a Registered Participant, that person must register with NEMMCO⁴⁶.

The NEMMCO registration process includes the following criteria:

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

For gas, registration processes for retailers and distributors are administered at jurisdictional level by a number of market operator entities. These entities include 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).

It is envisaged that, in order to minimise regulatory obligations and complexity, market operator registration requirements will not be duplicated in the business authorisation regime, although the national business authorisation regime may consider similar 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.

5.3.3 Entities that must meet the market entry requirements

Policy Option 1 – No entry requirements in the national framework

There would be no entry requirements for retailers and distributors wishing to supply or sell energy to customers in national, other than existing registration requirements set out in the NEL/NGL or the requirements of market operators.

Impact Analysis

This option may reduce regulatory obligations (and associated market entry costs) faced by retailers and distributors in the short-term, but it 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.

This policy option has a significant risk associated with the potential for retailer failure, which would significantly and adversely affect other retailers and businesses. This may lead to a need for enhancement of customer protection measures and schemes such as ROLR arrangements.

⁴⁵ See Chapter 2 of the National Electricity Rules.

⁴⁶ Allens Arthur Robinson Working Paper No. 3 p.21

If this role is retained by jurisdictional regulators (in the 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. By contrast, if jurisdictional regulators no longer perform this role, the costs to regulators may reduce in the short-term. However, regulators may face greater monitoring and compliance costs associated with a greater risk of retailers being unable to meet their obligations and possibly higher incidence of retailer failure.

Policy Option 2 – Entry requirements for retailers only

This policy option would limit business authorisation requirements to retailers. Retailers would be subject to entry requirements in relation to organisational capacity, financial viability, regulatory compliance and fit and proper persons, 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.

Impact Analysis

This policy option introduces regulatory certainty and consistency into the national framework for retailers in line with the objectives of the AEMA.

The immediate benefit to retailers 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. Retailers should also benefit from lower costs associated with only needing to satisfy single authorisation criteria. Unless the entry criteria for the national authorisation were significantly more onerous than the jurisdictional arrangements they would replace, relative to the benefits of an authorisation regime, the costs may be considered to be negligible.

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 connections, disconnections, meter reads and network maintenance⁴⁷.

Customers benefit from this policy option as it continues to limit the potential for retailer failure events which adversely affect customers, and also ensures that retailers have the capacity to properly meet their obligations to customers at time of entry to the market.

This policy option benefits other market participants, such as generators, by making certain that an entity is not permitted to enter the market unless it can meet its financial obligations. It facilitates certainty and stability in energy markets.

Under this option, the compliance costs for distributors would remain unaffected.

⁴⁷ 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.

Policy Option 3- National entry requirement for retailers and for gas distributors

Retailers and gas distributors would be 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 National Gas Rules (NGR) or NER that are already administered by NEMMCO, and gas 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.

This policy option is similar to policy option 2, but introduces a business authorisation regime for gas distributors, which is not provided for under current access arrangements⁴⁸.

Impact Analysis

This policy option meets some of the high-level objectives of the AEMA by introducing an element of regulatory consistency into the national framework. Jurisdictions currently maintain responsibility for licensing gas distributors as NEMMCO only authorises business entry into electricity markets, while gas market operators do not currently administer market entry requirements 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). Gas distributors are subject to national access regulation and must have in place AER approved gas access arrangements. A business authorisation would be additional to these requirements.

Where any new authorisation requirements are included for gas distributors, this will increase costs to distributors both in the short-term, to comply with the requirements, and the longer-term, to comply with any associated reporting and compliance arrangements. Regulators would also face similar costs in administering the authorisation and ongoing monitoring of authorised distributors.

The costs and benefits for retailers are the same as those set out under option 2 above.

In addition, 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.

⁴⁸ In contrast to the electricity market where NEMMCO registers network service providers for the purposes of access regulation, the requirement to have an approved access arrangement is based on a ‘coverage’ decision.

Policy Option 4- National entry requirement for retailers and distributors

All retailers and distributors would be subject to entry tests in relation to organisational capacity, financial viability, regulatory compliance 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.

The scope of the entry requirements for distributors may be less than those for retailers, recognising existing entry requirements for distributors under the NGR or NER.

Impact Analysis

This policy option is similar to policy option 3, but introduces a business authorisation regime for electricity distributors.

This policy option may increase compliance costs for gas and electricity distributors, as electricity distributors must already register with NEMMCO, both gas and electricity distributors may be subject to access regulation by the AER. 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. 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.

While this policy option provides for greater national consistency and increased harmonisation between electricity and gas, it also may also introduce some regulatory overlap and increases regulatory compliance costs for distributors.

The costs and benefits for retailers are the same as those set out under options 2 and 3 above.

Business Authorisation policy options table

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

TARGET QUESTIONS

Feedback is sought on the following issues:

- **Which entities should national entry requirements apply to?**
- **What are the risks of not authorising retailers/distributors in the national framework?**
- **What are the costs to distributors of introducing a national authorisation that would be additional to existing authorisations by the AER or market operators?**

5.4 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 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.

However, the tools currently 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 monitoring retail and distribution businesses under the national framework.

Whichever policy option is adopted for transfer to the national framework, compliance costs for market participants are not expected to increase as participants must comply with the obligations under a national framework regardless. In addition, compliance costs are expected to be lower for businesses under the national framework as they will only be required to comply with a single national set of requirements and report to a single national regulator⁴⁹.

Jurisdictional regulators currently monitor compliance in this policy area, according to jurisdictional rules. Transferring this responsibility to a single national regulator should afford efficiencies overall through reduced duplication and greater efficiencies of scale.

Enforcement regimes will only come into effect where there has been a breach of the Laws or Rules.

5.4.1 Enhancements to the enforcement and compliance regime

The AAR Supplementary Working Paper addressed policy issues relating to a national enforcement and compliance regime for distributors and retailers and how this may 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. Further harmonisation and enhancements to the enforcement and compliance regime form part of the RPWG workstream.

The NGL and NEL currently provide for a general enforcement and compliance regime. Amongst other actions, the regime provides for the following:

- Obligations for the AER to monitor compliance provided for under the NEL and NGL, including information gathering powers;

⁴⁹ 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.

- Dispute resolution frameworks for both registered NEM participants and entities operating under Access Arrangements;
- The ability for the AER to seek remedies to breaches through the Supreme and Federal Courts; and
- The ability for the AER to serve infringement notices, issue guidelines on enforcement, civil penalties, and limited criminal penalties.

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

Policy Option 1 – No change to existing enforcement and compliance regime

This policy option requires no change to existing enforcement and compliance regimes. The AER will continue to enforce the NEL, NGL and Rules in accordance with the existing enforcement and compliance regimes provided for under the NEL and NGL.

Impact Analysis

Leaving the enforcement and compliance regimes unchanged will not impose any immediate costs or benefits on retailers and distributors. The costs of not enhancing the enforcement regime to accommodate the transfer of responsibilities under the national framework relate to the longer-term stability and competitiveness of energy markets, and in particular making certain that retailers and distributors comply with the national customer framework and maintain the capacity to continually do so.

The current regulatory arrangements under the NGL and NEL 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. Including additional enforcement mechanisms such as enforceable undertakings, for example, may help to limit the use of courts to remedy breaches or acts of non-compliance with the Laws and Rules.

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 as to what extent consumer interests are best served by competitive pressures or regulatory oversight; and
- A flexible hierarchy of enforcement tools to reflect the relative materiality and seriousness of types of compliance issues in the retail sector.

The compliance costs for retailers and distributors would not be affected, as these entities would be required under any framework (national or jurisdictional) to comply with regulatory obligations.

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.

Policy Option 2- **Enhancements to the enforcement and compliance regime**

This policy option provides for including further enforcement and compliance measures to be available to the regulatory body and the public such as:

- Additional administrative measures;
- Access to lower courts to remedy breaches of the Laws and Rules;
- Private enforcement action; and
- Including a statutory objective similar to the NGL and NEL.

Impact Analysis

The enhancements available to the enforcement regime do not increase the regulatory obligations placed on entities – they are still obliged to comply with the regulations regardless of what enforcement actions regulators or private parties can take. These enhancements introduce other options available to the regulator (and private parties) to pursue breaches of the Laws and Rules.

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 NGL and NEL 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.

The key benefit of introducing enhancements to the enforcement regime is that it provides 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 regulations, 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.

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

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 under consideration.

Additional administrative measures

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

Including enhancements to the choice of administrative measures available may reduce business (retailers and distributor) compliance costs, depending on the type of measures introduced. For example, 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 expires⁵⁰. 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.

This option enables the AER to accept (but not compel) an enforceable undertaking 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 and can be implemented in a timely manner.

Private enforcement action

Private enforcement action primarily benefits energy customers and regulators. 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.

However, private enforcement action may create perverse incentives for opportunistic, frivolous or unnecessary action by private parties. This may add to the operating costs of retailers and distributors.

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

This policy option is of benefit to energy customers, retailers and distributors. Where remedy is sought for a breach of the Law or Rules, where the remedies sought are within the jurisdiction of lower courts, actions taken in lower courts provide a less costly solution to actions in superior courts.

Extending court-based enforcement action to the lower courts 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.

Enhancements to the enforcement and compliance regime will not increase compliance costs to retailers or distributors. These entities must comply with regulatory obligations regardless of enhancements to enforcement and compliance. These enhancements are designed to encourage compliance, and provide appropriate remedies for non-compliance where it does not occur

Enforcement Mechanisms policy options table

<p>Policy Option 1 No change to existing enforcement and compliance regime</p>	<p>Policy Option 2 Enhancements to the enforcement and compliance regime</p>
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⁵⁰ MCE SCO Policy Paper, p. 92

TARGET QUESTIONS

Feedback is sought on the following issues:

- **Whether and how the introduction of the enhanced enforcement options increase compliance costs on business.**
- **The effectiveness of the national regime without the enhancements (and the impacts on customers).**

Statutory Objective

Adoption of the existing NEL/NGL statutory objective for the national framework should provide clarity and meaning to guide the activities and decisions of the AER and AEMC's in relation to the national framework. This would benefit all market participants including regulators, energy customers, retailers and distributors. A statutory objective will not add to business compliance costs.

Statutory Objective policy options table

Policy Option 1 No change to existing statutory objective	Policy Option 2 Change to the existing statutory objective
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TARGET QUESTIONS

Feedback is sought on whether the existing statutory objective in the NEL and NGL (see part 3 above) is sufficient and adequate for the national framework.

6. IMPLEMENTATION AND REVIEW

6.1 SCO GENERAL POLICY APPROACH

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 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.

SCO considers that it is 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, 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. SCO places a high priority on minimising regulatory risk arising from the change processes.

SCO will therefore seek to manage the implementation and the transition to new national customer 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. SCO proposes to approach this transition with a consultative approach at each stage of the development of Laws and Rules and their implementation.

6.2 TRANSITIONING TO A NATIONAL REGIME

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 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

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 5 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 5-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.

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.

For existing, jurisdictionally-based negotiated or market retail contracts – these would continue until they terminate under the terms of the particular contract. Only then would retailers 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 lead legislature for AEMA reforms, the South Australian Parliament, is expected to consider the national energy customer framework in September 2009. However, the timing for other 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 framework⁵¹.

⁵¹ 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.

7. CONCLUSION

Proposed Regulatory Framework

Based on AAR Working Papers, AAR Composite Paper, all available at the MCE website (www.mce.gov.au) the following are proposed for adoption in a new national framework.

Policy	Preferred option	Undecided
5.1.1 Obligation to offer		
Impose obligation to offer supply	✓	
Do not impose obligation to offer supply		
5.1.2 Designated Retailer		
Local Area Retailer		
Financially Responsible Retailer	✓	
All retailers		
5.1.3 Energy customers to benefit from the obligation		
Residential		
Small customers defined by a consumption threshold		
Residential customers, and business customers below a consumption threshold	✓	
5.1.4 Industry specific versus generic 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		
5.1.5 Hardship regimes		
Implement hardship regime for energy customers	✓	
Do not implement hardship regime for energy customers		
5.2 Distributor interaction with customers and retailers⁵²		✓
Triangular model		
Linear model		
Modified linear (or 'hybrid') model		
5.3 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		
5.4 Enforcement and Statutory Objective		
No change to existing enforcement and compliance regime		
Enhancements to the enforcement and compliance regime	✓	

⁵² Please see the MCE SCO Policy paper for more detail on the Retail Support Contract model proposed for adoption in the national customer framework.

