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Review of Governance Arrangements for Australian Energy Markets  
Energy Division  
Department of Industry and Science  
GPO Box 9839  
Canberra ACT 2601

Dear Secretariat

**Submission to Review of Governance Arrangements for Australian Energy Markets  
Issues Paper**

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to provide input the Review of Governance Arrangements for Australian Energy Markets Issues Paper (the **Issues Paper**).

Consumer Action is an independent, not-for-profit, consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for vulnerable and disadvantaged consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

Consumer Action has significant experience in dealing with energy market institutions and processes. This experience includes:

- participating in various reviews of the effectiveness of retail competition pursuant to the Australian Energy Market Agreement (**AEMA**);
- participating in the development of various energy regulatory frameworks, including the rules for network pricing, the National Energy Customer Framework (**NECF**) and review of enforcement regimes;
- providing consumer input into Victorian electricity distribution pricing reviews by the Australian Energy Regulator (**AER**), including advocating for benchmarking frameworks which have more recently been adopted;
- seeking to intervene in applications for merits review of distribution pricing determinations;
- initiating (with the Consumer Utilities Advocacy Centre) the first retail rule change application to the Australian Energy Market Commission (**AEMC**).

Consumer Action also sits on the AER's Customer Consultative Group and regularly participates in the AEMC Consumer Priorities Forum. We have also participated in stakeholder forums initiated by the COAG Energy Council.

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This submission provides comment on the following areas relevant to the Issues Paper:

- the need for consumer confidence in institutions in a transforming energy market;
- the need to revise the COAG Energy Council approach;
- the provision of interpretative guidance for the National Energy Objective; and
- the creation of a single effective rule maker and regulator.

We have included recommendations throughout the submission, and compiled these into the box below.

### **Recommendations**

1. That the Review focus on the way in which energy market institutions can best support a transforming energy market so that it promotes the interests of consumers.
2. That COAG EC:  
develop clear policy statements on various aspects of market reform, that re-assert COAG EC role as the policy maker;  
develop a transparent process which establishes the terms of reference for parties undertaking reviews on its behalf; and  
continue direct engagement with a broad range of consumer representatives at COAG EC meetings.
3. That COAG EC update the AEMA to:  
ensure it can accommodate the evolving market and technologies;  
ensure it progresses policy from *introducing* competition to *improving* competition; and  
recognises and accommodates the likely emergence of a second class of energy consumer based on entrenched disadvantage
4. That COAG EC adopt a 'best practice' rather than 'lowest common denominator' approach to policy development.
5. That COAG EC issue guidance to institutions operating under the NEO that ensure particular regard is given to social and environmental considerations as part of the long-term interests of consumers.
6. Consideration should be given to folding the responsibilities of the AEMC into that of the AER, so that there is one body responsible for regulating retail energy markets and promoting the long-term interests of energy consumers.
7. That at least one member of the governance body of a single rule maker/regulator be expanded, have strong consumer expertise and an understanding of consumer protection, behaviour and decision-making.
8. For the COAG EC to assess the funding model of the AER to include an industry levy as part or whole of its funding source.

### **1. Consumer confidence in institutions in a transforming energy market**

The nature, make-up and decision-making of energy market institutions has implications for whether the energy market promotes the long-term interests of consumers. Consumers are affected by the decisions of the market's governance bodies, as these decisions in turn influence product and service offers, costs incurred by consumers, and market practices. Good outcomes for consumers rely on governance bodies that have a strong understanding of the circumstances and experiences of consumers. Consumers also expect that institutions are efficient, accountable, well-resourced and have a clear focus.

As noted by the Issues Paper, new technologies and competition are playing a more dominant role in the market, increasing the role of consumer choice. Further, consumers are no longer solely the

end point of a long vertical supply chain. More advanced metering and network tariff reform are unlocking innovation and greater competition in products and services on both the supply and demand sides of the market. Our experience is that in rapidly changing markets, businesses will be experimenting with new business models and marketing strategies in an uncertain regulatory environment. Regulators and market institutions thus have a choice: to sit on their hands and see what happens, or play a role in shaping the market by sending early messages that particular types of conduct will not be tolerated. Consumer Action expects energy market institutions to foster innovation but also 'set the tone' of the market so that poor consumer outcomes are avoided.

A recent example is Tesla's release of a low-cost household battery systems that may lead to households exiting the grid in the next two or three years.<sup>1</sup> Battery storage is widely acknowledged to be 'the next big thing' in energy market innovation. AGL has also announced its battery storage products will be launched in 2015.<sup>2</sup> AGL has not, however, disclosed its price as it will be customer-specific and may be bundled with retail energy contracts or offered through a leasing arrangement.<sup>3</sup> Such innovation is exciting, and will likely benefit many consumers. However, this innovation also increases complexity for consumers—through multiple relationships and contracting arrangements, and much more complex financing arrangements. It will be imperative for energy market institutions to be cognisant of this complexity and take steps to minimise risks of consumer detriment.

A complicating factor for energy market institutions in a transforming energy market is that consumer trust and confidence in the market is currently extremely low. A recent consumer sentiment survey by CHOICE found that only 9% of consumers trust their energy provider.<sup>4</sup> Accenture also recently found that, on average, consumers interact with their energy provider only 12 minutes per year and that 70% of those interactions are negative.<sup>5</sup> At the same time, there is evidence that retail margins in Victoria—the most 'competitive' jurisdiction—are higher than in other jurisdictions.<sup>6</sup> It is apparent that the benefits of competition are not flowing to consumers: there are both higher prices and low levels of trust, inhibiting consumer engagement. This raises questions about the effectiveness of energy market institutions in promoting the long-term interests of consumers.

The coming years of transformation will put a lot of pressure on energy market institutions. In particular, there has been little effort to date in explaining the impact of network tariff reform. Moving from a usage charge to an 'impact on the network' approach to charging may be economically efficient. However, there are many customers who have invested in order to reduce their power bill (for example, through solar PV or energy efficiency). These groups will be outraged when they find that prices may increase due to removal of an existing hidden subsidy. We expect this will further impact consumer confidence and trust in the market and regulatory institutions.

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<sup>1</sup> RenewEconomy, 1 May 2015. *Tesla launches home, business and utility battery storage range.*

<http://reneweconomy.com.au/2015/tesla-launches-home-business-and-utility-battery-storage-range-74034>

<sup>2</sup> AGL, 1 May 2015. *AGL is first major retailer to launch battery storage.* <http://www.agl.com.au/about-agl/media-centre/article-list/2015/may/agl-is-first-major-retailer-to-launch-battery-storage>

<sup>3</sup> RenewEconomy, 1 May 2015. *AGL fast-tracks home energy storage option with 6kWh battery.*

<http://reneweconomy.com.au/2015/agl-fast-tracks-home-energy-storage-option-with-6kwh-battery-40348>

<sup>4</sup> Choice (2014). *Pulse Check, National Findings 2014.* Available at:

<https://www.documentcloud.org/documents/1263550-choice-pulse-check-national-findings-2014.html>

<sup>5</sup> Accenture (2014). *The Balance of Power: Why Australian utilities need to defend, delight and disrupt.*

[http://www.accenture.com/SiteCollectionDocuments/Local\\_Australia/PDF/Accenture-Why-Australian-Utilities-Need-to-Defend-Delight-and-Disrupt.pdf](http://www.accenture.com/SiteCollectionDocuments/Local_Australia/PDF/Accenture-Why-Australian-Utilities-Need-to-Defend-Delight-and-Disrupt.pdf)

<sup>6</sup> AEMC (2014). 2014 Retail Competition Review, Final Report.

<http://www.aemc.gov.au/getattachment/3fccbed6-ebf8-4edb-86c9-71ff22eced08/Final-report.aspx>

This Review provides an opportunity to consider how best to reform institutional arrangements so that market has the capacity to foster good outcomes for consumers. Central to this will be institutions that understand consumers and are focused on rebuilding their trust and confidence. Without this, there is a risk that 'energy productivity' reforms will be undermined as consumers opt to not engage with the products and services which are intended to increase the efficiency of asset use and drive prices for all consumers down.

**Recommendation 1:**

That the Review focus on the way in which energy market institutions can best support a transforming energy market so that it promotes the interests of consumers.

## 2. The COAG Energy Council approach

### 2.1 The COAG Energy Council's role as the policy-maker

The role of COAG Energy Council (and its predecessors<sup>7</sup>) (the **COAG EC**) is outlined in the AEMA. It was specifically established to provide "*national oversight and coordination of energy policy development to provide national leadership to that consideration of broader convergence issues and environmental impacts are effectively integrated into energy sector decision-making*".

It is unclear, however, what direction the COAG EC are taking to deliver to these goals, and as the head of energy market governance institutions, this creates a lack of clarity of governance across the entire market.

Further, we consider that this lack of clarity and transparency has meant that its role in determining policy outcomes has defaulted to the AEMC. The AEMC are regularly conducting major market reviews, such as the Power of Choice or Reviews of Effective Competition, with these forming the basis of key energy market policy with significant outcomes for consumers. Where the COAG EC actively seek policy input from the AEMC, we perceive the terms of reference<sup>8</sup> of those reviews are limited to the point that they prevent the AEMC from fully investigating aspects of the market, the result being that the COAG EC, is not basing its policy decisions on sound evidence-based policy.

The AEMC's role as rule-maker also enables it to develop pseudo policy outcomes, for it is essentially considering issues of policy and determining aspects of market outcomes. We refer to the implications of this in our experience in section 3.1 below.

This lack of effective policy direction is creating disconnected policy processes with, for example, COAG EC, its Energy Market Working Group (**EMWG**), the AEMC, the AER and state governments undertaking related processes at various and even overlapping times. We consider the example of Victoria's roll out of smart meters at the time of the National Smart Metering Program to be a process where failure to establish clear policy priorities upfront, or even earlier on in the process, in collaboration with Victoria, led to duplications, convergences and variations in energy market policy

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<sup>7</sup> For the purposes of this submission, reference to COAG EC, will be assumed to also include reference to SCER and MCE, unless otherwise indicated.

<sup>8</sup> COAG EC, Terms of Reference, Australian Energy Market Commission (AEMC) Reporting on the state of retail energy market competition across the national electricity market

which has contributed to a resource intensive, and inefficient process. Across Australia, in particular in Victoria, many households have a smart meter that is operational, however the discussion in relation to smart meters, i.e. functionality, contestability, access to data is ongoing. Policy determined at the commencement of these market reforms that clearly stated, for example desired consumer outcomes, could have facilitated a more streamlined and harmonised approach to the process. The consequence of this has been that COAG EC has not set the direction of reform, but rather has assumed a role monitoring the technical details of reform as it is rolled out.

Recent efforts of COAG EC to be more consultative with energy market stakeholders are very welcome. Consumer Action has attended stakeholder meetings directly with Ministers ahead of COAG EC meetings, which provide opportunity for input and debate on current energy market issues. We strongly support these efforts, and encourage COAG EC to continue to engage a range of consumer representatives in this manner.

**Recommendation 2:**

That COAG EC:

- develop clear policy statements on various aspects of market reform, that re-assert COAG EC role as the policy maker;
- develop a transparent process which establishes the terms of reference for parties undertaking reviews on its behalf; and
- continue direct engagement with a broad range of consumer representatives at COAG EC meetings.

## 2.2 The Australian Energy Market Agreement

The AEMA needs to undergo revision to ensure its focus in Section 14 *'The National Framework for Distribution and Retail'* remains relevant to the current and emerging market.

As highlighted in our introductory comments, the very recent announcement of affordable household battery storage is likely to interrupt existing market arrangements in Australia earlier than previously anticipated. As such, the AEMA, and any review of the AEMA, will need to include an assessment of the whether the functions of the AEMC and the AER (or any market institutional arrangements subsequent to the outcome of this Review), are able to sufficiently accommodate a) this particular change in technology and its implications for the Australian market and b) the likelihood of additional, significant changes impacting on the Australian market.

Further, the AEMA's focus on Retail Price Regulation (CI 14.10 to 14.20) needs revision as it is no longer relevant to the majority of markets within the NEM, for where competition hasn't been declared effective, there is now a focus on priming that market for competition.

In an effort to update the AEMA to reflect the maturing of these markets, we consider that the focus of this section needs to be on how to *improve* competition in those markets.

In doing so there is a significant need to understand the demand side more fully. There is an assumption in the market that consumers want, need or can manage 'greater control' over how their electricity is delivered and consumed which fails to acknowledge the heterogeneity of energy consumers across Australia. Specifically, demographic and socio-economic factors, the market

reach of traditional industry players *as well as* new participants, climate, fuel mix (e.g. access to gas, rooftop solar, solar hot water), household arrangements, such as embedded or exempt networks, and even housing stock and appliance mix all vary considerably, so there is no 'one size fits all'.

Further, while it must be recognised that there are increasingly more "prosumers" in the market who can and want to take control of their energy profile, it is essential that policy makers, and their policy instruments reflect the reality that many consumers merely want energy to be available, and have little interest or capability/capacity to "engage" with new complexity. If everyone is expected to "engage", we risk creating a second class of consumer, who does not participate in the emerging market, and ultimately is likely to pay more as a result.

We reference a recent report commentating on Australian society by CEDA and ACIL ALLEN<sup>9</sup>, which documents the growing number of consumers who are experiencing entrenched disadvantage to be 4-6% of the Australian population. COAG EC's policy and the direction of the AEMA need to consider this.

**Recommendation 3:**

That COAG EC update the AEMA to:

- ensure it can accommodate the evolving market and technologies;
- ensure it progresses policy from *introducing* competition to *improving* competition; and
- recognises and accommodates the likely emergence of a second class of energy consumer based on entrenched disadvantage.

2.3 Adopting a best-practice approach

We are concerned that the COAG EC pursues energy market reform with a 'lowest common denominator approach'. We appreciate the complex nature of jurisdictional differences in the development of national policy, however it is essential it adequately acknowledges the varying levels of market maturity with the goal of enabling market outcomes that meet the needs of the most mature market, not the least mature. We note that the way in which issues of jurisdictional difference are impacting key policy, to the detriment of Australian energy consumers overall.

We consider this approach to be a 'lowest common denominator' approach based on an attempt to seek consensus, and this is leaving consumers in some markets exposed to poor market outcomes.

This was evidenced in the development of the National Energy Customer Framework, where Victoria clearly held, in the most part, a standard of consumer protections that well exceeded those in other jurisdictions. Instead of adopting those protections as the baseline for consumer protections in the NECF which could be considered 'best practice', the process was modelled on those consumer protections of less mature markets with significantly lower standards of consumer protection.

The outcome of this process has been a framework that, while it advanced the protections of consumers in some jurisdictions, did not meet the needs of Victorian consumers at its completion—because it proposed a diminution of current protections.

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<sup>9</sup> CEDA, Addressing entrenched disadvantage in Australia, April 2015

Importantly, while Victoria has not signed on to the NECF for reasons that are not entirely transparent, the previous Victorian government did initiate a process whereby our existing Energy Retail Code was harmonised with the National Energy Retail Rules. While Victoria has retained some key consumer protections in legislation, this harmonisation has resulted in an overall reduction in consumer protections in Victoria, at a time when Victoria's market reaches a level of complexity unparalleled in any other NEM jurisdiction.

The development of smart meter consumer protections is another example of a lowest common denominator approach. In Victoria, the development of consumer protections was underway to meet the rollout of smart meters in Victoria. In parallel, but with significant delay, consumer protections were then developed as an addendum to the National Smart Meter Program, and then added to the National Energy Retail Rules via the AEMC's rule making function. While in their development the national protections referenced Victorian protections, it did not use Victorian protections as a baseline of protections, despite Victoria being the key jurisdiction with smart meters rolled out and in operation.

The outcome has been highly inefficient processes that have failed to produce any benefit for those participating jurisdictions with more mature markets, and ultimately poor outcomes for consumers within those markets.

**Recommendation 4:**

That COAG EC adopt a 'best practice' rather than 'lowest common denominator' approach to policy development.

## 2. Interpreting the National Energy Objective

The National Electricity Objective (**NEO**) and subsequently the National Gas Objective and the National Energy Retail Objective, is the guiding instruction for the NEM and its institutional bodies, the AER, AEMO and the AEMC.

We are concerned that the market has lost sight of its end use (consumers) and its obligations to supply energy to Australians. In a market where competition has resulted in complex offers and high prices, or where households are being disconnected from energy at record rates<sup>10</sup>, yet energy companies continue to make record profits<sup>11</sup>, this indicates market failures.

The long term interests of consumers can not accurately be represented in a market that places shareholder and business interests over and above those of its end users. A renewed focus is necessary to determine how the "the market is optimised" to ensure end users are able to actively and fairly participate in energy markets, in particular in the emerging market with its range of new technologies and services.

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<sup>10</sup> Essential Services Commission, Energy Retailers Comparative Performance Report , December 2014  
<http://www.esc.vic.gov.au/getattachment/0fdace1d-e672-46bc-8b9b-b432340b2d34/Energy-retailers-comparative-performance-report-Cu.pdf>

<sup>11</sup> AGL Half Yearly Report to Stakeholders, March 2015.  
[http://www.agl.com.au/~/\\_/media/AGL/About%20AGL/Documents/Investor%20Centre/2015/150319\\_HalfYearly\\_Shareholders.pdf](http://www.agl.com.au/~/_/media/AGL/About%20AGL/Documents/Investor%20Centre/2015/150319_HalfYearly_Shareholders.pdf)

We are particularly concerned that the current drafting of the NEO is too narrow to sufficiently consider consumer outcomes in the development of policy, regulations and market practices beyond its economic role. This is supported by the second reading speech at the introduction of the legislation which highlights that *"the market objective is an economic concept"* and *"The long term interest of consumers of electricity requires the economic welfare of consumers, over the long term, to be maximised."*<sup>12</sup>

Beyond this, it is unclear how different institutions are to adequately consider consumer interests in their operations. In some areas, we are concerned that these bodies are not effectively interpreting the objective to ensure that the long (and subsequently short) term interests of consumers are considered. All too often, we find that market structures prioritise energy businesses over consumers.

This was demonstrated in the outcome of our retail rule change that sought fixed prices for fixed-term contracts. This rule would have increased transparency for consumers, encouraging consumers to be more confident to make effective choices. Instead, the AEMC decision resulted in increased information for consumers, without any framework to determine whether this increased information facilitated effective decision-making by consumers.

Further, we refer to the AEMC 2014 Retail Competition Review which uncovered high retail margins in Victoria. In a fully contestable market with retail price deregulation, consumers would expect that competition is delivering efficient prices yet this may not be so. Little has been done to address this issue for consumers.

We agree that the overriding objective of the energy market should be to promote the long-term interest of consumers. However, it is critical that in the face of rapid development in the energy market, which is providing lots of new opportunity for consumers, that the governance arrangements are adequately positioned to ensure consumer interests are prioritised.

We consider that further interpretative guidance around the NEO could benefit energy market institutions. Guidance could include:

- better linkage to the AEMA objectives,<sup>13</sup> which are broader than the NEO, particularly as they provide further direction in relation to desired consumer outcomes, such as consumer participation.
- the provision of facilitating objectives. Victoria's Essential Services Commission's (ESC) objective requires it to *"promote the long term interests of Victorian consumers"*, which in turn is supported by eight facilitating objectives, including consideration of information asymmetries and the costs and benefits of regulation for consumers (including low-income and vulnerable consumers);

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<sup>12</sup> Wednesday 9 February 2005 The Hon. J.D. Hill, for the Hon. P.F. CONLON (Minister for Energy), obtained leave and introduced a bill for an act to amend the National Electricity (South Australia) Act 1996

<sup>13</sup> Clause 2.1(b) of AEMA includes (iv) enhance the participation of energy users in the markets including through demand side management and the further introduction of retail competition, to increase the value of energy services to households and businesses; (v) further increase the penetration of natural gas, to lower energy costs and improve energy services, particularly to regional Australia, and reduce greenhouse emissions; and (vi) address greenhouse emissions from the energy sector, in light of the concerns about climate change and the need for a stable long-term framework for investment in energy supplies".



- the issuance of guidance. We note with interest the way in which objectives are administered in the United Kingdom (UK). The UK authority's principal objective is to "*protect the interests of consumers existing and future, wherever appropriate by promoting effective competition*". Additional guidance however is provided to the authority in terms of how it must carry out its duties, for example, "*it must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, and residing in rural areas*". The Secretary of State can also issue "guidance towards the attainment of any social or environmental policies".<sup>14</sup> Similar sorts of guidance could be included in the statements of expectations that the Government provides to the AER and the AEMC.

**Recommendation 5:**

That COAG EC issue binding guidance to institutions operating under the NEO that ensure particular regard is given to social and environmental considerations as part of the long-term interests of consumers.

### **3. A single and effective rule maker and regulator**

#### 3.1 Problems with a separate rule-maker

There are a number of reasons to suggest that the existing institutional structure, particularly the division between the AEMC as rule-maker and market reviewer and the AER as market regulator, creates problems for addressing consumer issues.

We recently partnered with the Consumer Utilities Advocacy Centre to initiate the first rule change under the NERR. For over 18 months the rule change project was a key activity for our centres, meaning that we diverted effort away from other work. Following the rule change, we conclude that it is a resource-intensive and timely mechanism which is unlikely to promote the interests of consumers.

We will shortly publish a report an evaluation of this project, which further identifies our concerns. In it, we suggest that there needs to be a much more flexible rule change process. The evaluation also makes comment on:

- the way evidence is considered, particularly concerns that in practice the evidence-burden sits with the rule-change applicant rather than the decision-maker;
- the limited information gathering powers of the AEMC; and
- the AEMC's reliance on traditional economic theory and 'rational choice' over more evidence-based understanding of consumer behaviour.

Our report also makes particular comment on the institutional structure of the AEMC.

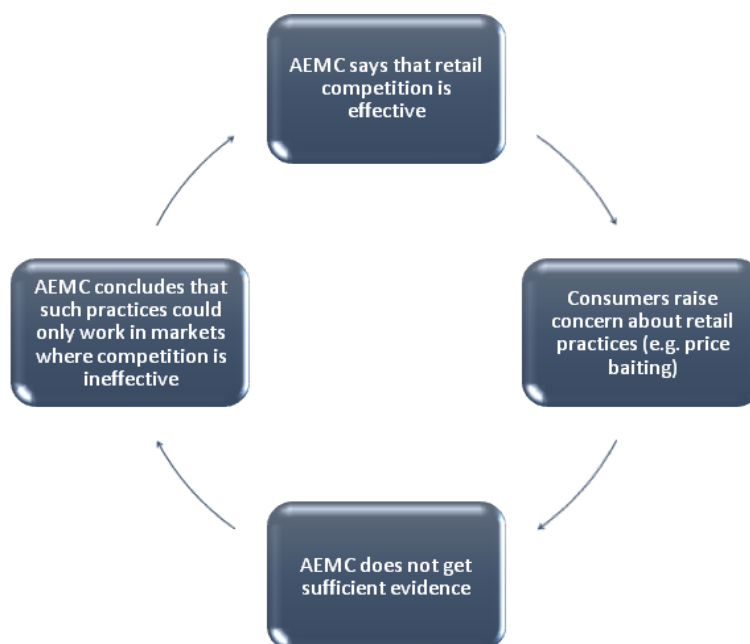
Firstly, it is arguably problematic that the same agency that undertakes effectiveness of competition reviews also assesses retail market rule change proposals. When the AEMC finds that a retail market is first displaying effective competition it becomes difficult for the AEMC to later take the view that competition in the market can be ineffective.

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<sup>14</sup> <https://www.ofgem.gov.uk/ofgem-publications/74203/file37517.pdf>

For example, in relation to the issue of potential price-baiting practices in our retail rule change, the AEMC argued<sup>15</sup> that price-baiting could not be a problem because price-baiting can only occur in markets where competition is ineffective. However, the AEMC's review into effectiveness of competition in 2014 found that competition was effective.<sup>16</sup> Such a finding perhaps inhibits the AEMC from making any rule change which argues that competition is ineffective or could be made more effective.

The following chart explains this conundrum.



Secondly, the AEMC lacks accountability measures that apply to other regulators and market institutions. Unlike regulatory determinations of the AER, determinations of the AEMC are not subject to merits review. Merits review allows a person affected by a decision to have that decision reviewed by a separate decision-maker. The review considers the merits of the initial decision and decides whether or not a correct and preferable decision should be made. It has become quite common for determinations of the AER to be challenged and overturned via merits review.

Decisions of the AEMC are subject to judicial review. Judicial review is far narrower form of review compared to merits review, considering only the lawfulness of the decision-making not the substantive decision. It considers matters such as whether the decision-maker took into account all relevant information, excluded irrelevant matters, and reached a conclusion that, on the weight of the evidence, is reasonable in the circumstances.

There is some uncertainty with the appropriate law around this, given it is not clear that an AEMC determination is an 'administrative decision' or a 'legislative decision'. Given a new rule will have a general rather than specific application (i.e. apply to all retailers), it is likely that it is legislative in character. As such, the *Administrative Decisions (Judicial Review) Act 1977* (the AD(JR) Act) will

<sup>15</sup> It did not inquire as to whether these practices were occurring due to 'insufficient information gathering powers'.

<sup>16</sup> AEMC, 2014, *2014 Retail Competition Review*, available <http://www.aemc.gov.au/Markets-Reviews-Advice/2014-Retail-Competition-Review>

also not apply and any judicial review must be via the common law. The AD(JR) Act improves access to judicial review compared to the common law, by removing technical requirements such as issuing a prerogative writs, making review for error of law simpler, and expanding remedies available. The technicality and cost involved in a common law judicial review is likely to make it out of reach for many consumer organisations.

In the absence of any explicit failure by the AEMC to follow the relevant statutory process or to take into account submissions received (as opposed to simply not giving them adequate weight), the AEMC's rule change decisions are unlikely to be judicially reviewable due to the broad powers conferred upon it which include making a more preferable rule or no rule at all if it considers that doing so would better serve the long-term interests of consumers.

Finally, we consider there to be evidence that separating the regulator from the rule maker is constraining the ability of the AER to effectively regulate for optimal consumer outcomes. There is the potential that some rules limit the capability of the AER to regulate or address particular market failures, or forces them to deal with the issue in a costly manner. In relation to our rule change application, the AER will now be required to monitor compliance with energy retailer's obligation to inform customers about the potential of price changes. This additional role is likely to be costly for the AER (i.e. it will have to audit and/or shadow shop), and will limit its ability to provide information for consumers entering into contracts simple and accessible (i.e. there will be another lot of information to be provided, diminishing the impact of consumer messaging).

### 3.2 Criticisms of AER potentially misplaced

The energy market institutional arrangements have facilitated a lack of focus on consumer interests and subsequently decisions resulting in over-investments and/or excessive profits by network businesses.

When the institutions were established, it was thought that there should be separation between rule-making and rule implementation or enforcement. This separation is said to result in independent decision-makers with clear accountabilities and objectives. It was also said that this separation reduced the prospect of conflict between the functions. In reality, it appears the conflict has reduced the capacity of the AER to act independently in the public interest—it is constrained by rules set by a different institution.

It is interesting to note that the AER has received the lion's share of criticism about the first set of national distribution price determinations. In particular, a number of State Ministers have sought to reform the AER by advocating for it to be 'structurally separate' from the Australian Competition and Consumer Commission (**ACCC**). This criticism is misplaced. As noted above, the AER has previously been limited by the rules it was to administer and a lack of resources. The success of appeals by businesses suggests that the AER did endeavour to limit businesses' revenue, but many of its decisions were wound back due to unfavourable rules.

The Harper Review on Competition Policy has also recommended that the AER be rolled into a new Access and Pricing Regulator, and be separate from the ACCC. The evidence supporting such a change is weak, and there is much consumer benefit from economic regulation working in tandem with consumer and competition regulation.

In consumer protection, the ACCC has taken a keen interest in the energy market—most recently through court action against EnergyAustralia (and their telemarketer, Bright Choice Australia) in relation to poor telemarketing conduct. Its investigation was coordinated with the AER, which has also instituted court action against this business relating to the bypassing of explicit informed consent laws to sign-up customers. Similarly, the ACCC’s ‘discounts off what’ court actions against AGL and Origin (relating to the use of unclear discounts as a marketing tool) support AER goals around effective retail energy markets—clear marketing is essential to build consumer trust in a complex market. This action also resulted in a Federal Court finding that AGL misled its customers.

There are significant other benefits in maintaining a coordinated regulator responsible for competition, consumer protection and economic regulation in the energy sector. These functions are inextricably linked and are based on an economic understanding that fair and effective markets are in the long-term interests of consumers. Maintaining the AER-ACCC relationship also ensures skills are shared between these institutions, and that the broad focus of the ACCC contributes to it being less likely that the AER becomes captured by the industry it regulates—a significant risk for industry-specific regulators.

Rather than focusing on the AER, we submit that there is a greater need to consider the structure of the AEMC and whether a separate rule-maker promotes the long-term interests of consumers. As noted above, the AEMC were strong proponents of restricting the AER in its ability to regulate the network businesses through providing detailed prescription in the rules. More recently, the AEMC has released its rule change on network tariff arrangements.<sup>17</sup> Unlike the economic regulation rule change which regulated the total amount of revenue businesses could recover, the network tariff rule change regulates how this revenue is collected from consumers. The main driver of this rule change was to reduce cross-subsidies in the way networks charge: those that create a burden on the system (i.e. those with high air-conditioner use) should pay for that burden. However, it is instructive to note that the AEMC’s final decision leaves significant discretion to the network businesses in setting tariffs—while each network tariff must be based on long-run marginal cost, network businesses will have flexibility about how they measure long run marginal cost. While we welcomed the requirement on network businesses to consider the impact on consumers of changes in network prices and develop price structures that are able to be understood by consumers, the level of flexibility will necessarily limit the AER’s role in relation to network tariffs.

There may be merit in considering whether it is necessary to have structural separation between the energy market rule-maker and regulator. It seems to us that the public and political pressure to deliver consumer outcomes is placed on the AER as regulator, rather than the AEMC as rule-maker. Should there be one institution that makes and administers the rules, the accountability would be with that body rather than be diluted between two different organisations.

**Recommendation 6 :**

Consideration should be given to folding the responsibilities of the AEMC into that of the AER, so that there is one body responsible for regulating retail energy markets and promoting the long-term interests of energy consumers.

<sup>17</sup> Australian Energy Market Competition (2014). *Rule Determination: National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014*. Accessed at: <http://www.aemc.gov.au/getattachment/de5cc69f-e850-48e0-9277-b3db79dd25c8/Final-determination.aspx>

### 3.3 Consumer representation

Given the importance of energy market institutions' decision-making for energy consumers, we submit that there should be specific consumer interest expertise at the decision-making level. While the institutions have improved in the way that they consult with consumers, both the AEMC and the AER fall short compared to other regulators in including consumer interest expertise on their governing bodies.

The legislation establishing the Australian Competition and Consumer Commission states that at least one member of the Commission must be a person who has knowledge of, or experience in, consumer protection.<sup>18</sup> By practice, this person has been in the position of Deputy Chair. More recently, it has become practice for the Deputy Chair of the Australian Securitise & Investments Commission to be someone with experience in consumer protection.

It essential that to ensure that demand side interests are adequately represented in the operations of the single rule maker/regulator, that the COAG EC initiate an expansion of the number of board members from three to five, and that a member with strong consumer expertise and an understanding of consumer protection, behaviour and decision-making is appointed. This was recently recommended by the Senate Standing Committee on Environment and Communications.<sup>19</sup>

#### **Recommendation 7:**

That at least one member of the governance body of a single rule maker/regulator be expanded, have strong consumer expertise and an understanding of consumer protection, behaviour and decision-making.

### 3.4 Funding

It is axiomatic that funding limitations can impact the ability of regulators to adequately fulfil their functions. In recent years, efficiency dividends made have resulted in reduced resources for most government bodies, including regulators like the AER. We understand staff numbers have reduced.

Consumers need adequately resourced regulators to protect their interests and to ensure they can benefit from genuinely competitive markets and market regulation. Reduced funding may limit the ability of regulators to sufficiently to monitor compliance and initiate enforcement measures where necessary. In relation to AER's network regulation function, it could negatively impact network decisions, resulting in higher costs flowing to consumers. It must be acknowledged that the AER is already at a resource disadvantage when compared to the teams of regulatory staff inside regulated businesses.

There is an opportunity to assess the funding model of the AER to include an industry levy as part or whole of its funding source, as is reflected in the current arrangements for AEMO, and the newly appointed Energy Consumer Australia. Increased funding certainty for the AER will contribute to more stable market outcomes for consumers, and mean that consumers aren't disadvantaged due to Federal budget cycles.

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<sup>18</sup> Ref section 7(4) Competition & Consumer Act 2010

<sup>19</sup> Recommendation 14, Interim Report, Inquiry into Performance of Electricity Networks

**Recommendation 8:**

For the COAG EC to assess the funding model of the AER to include an industry levy as part or whole of its funding source.

Thank you for the opportunity to comment on the Issues Paper. Please contact Janine Rayner on 03 8554 6943 if you have any questions.

Yours sincerely

**CONSUMER ACTION LAW CENTRE**

A handwritten signature in black ink that reads "Gerard Brody". The signature is written in a cursive, flowing style.

**Gerard Brody**

Chief Executive Officer