Balancing act – Protecting Consumers in a viable retail energy market

A report for the Australian Energy Council

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Executive Summary

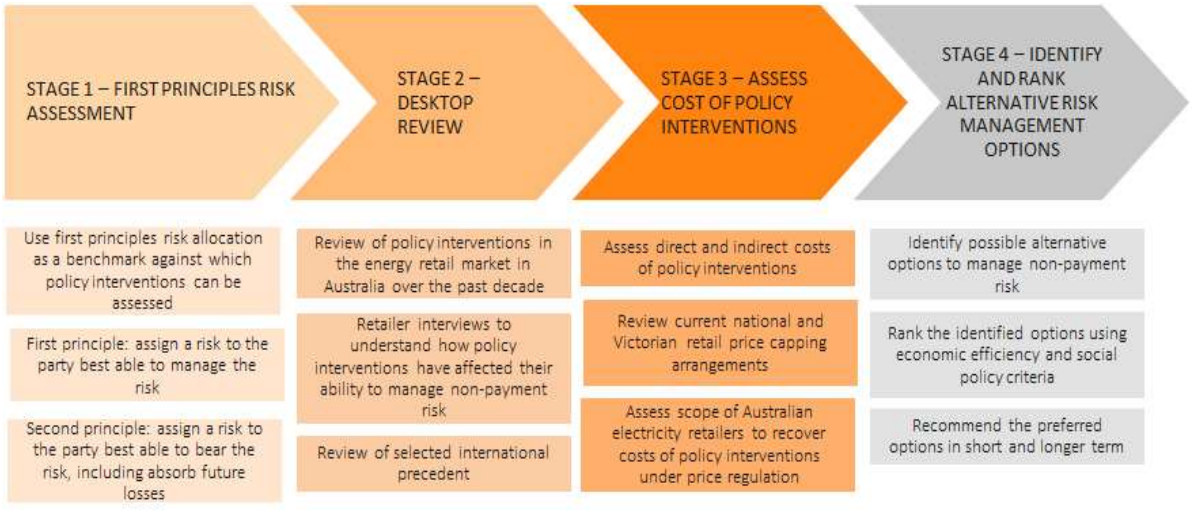
Given Australian Energy Council (AEC) concerns that changes to the national electricity regulatory framework have impeded the ability of retailers to adequately mitigate the risks due to customer non-payment, Synergies has been engaged by the AEC to develop a report that analyses the management of non-payment risk in the Australian National Electricity Market (NEM), including the recovery of its associated costs.

In preparing our report, we have considered the following matters:

- the extent to which the existing allocation of non-payment risks in the NEM reflects the original policy intent;
- whether notional bad debt levels are increasing across the NEM and the expected impacts of bad debt in future years;
- alternative approaches that might better balance non-payment risks between NEM participants, including having regard to international precedent; and
- possible approaches to ensure retailers can recover the costs of regulatory and policy interventions in the current price regulated retail electricity market.

Our assessment approach

We have adopted the following four stages for our review.



Our key findings from each of these stages is summarised briefly below:

First principles risk assessment

Maximising economic efficiency requires, among other things, that risks are allocated

efficiently. This requirement is underpinned by the following two principles:

- First principle: assign a risk to the party best able to **manage** the risk having regard to:
  - business systems
  - product/service designs
  - customer relationships and engagement.
- Second principle: assign a risk to the party best able to **bear** the risk, including possessing the financial capacity of the entity to absorb and recover from uncertain future losses.

A key focus of our analysis has been to assess how policy and regulatory interventions have affected risk allocation since the commencement of the NEM and introduction of the National Energy Consumer Framework (NECF).

To this end, the effects of regulatory and policy interventions in the past five years are most clearly seen from a 'clean sheet' perspective and the associated optimal risk sharing allocations. While the optimal environment is not necessarily achievable in the short term, particularly in the prevailing energy policy and market circumstances, there is value in defining an optimal environment to provide a relevant vantage point from which to inform:

- what is realistically achievable and indeed aspirational; and
- a strategy to move towards those outcomes over the short, medium and longer terms.

Capacity to manage non-payment risk

In general, we find that regulatory and policy interventions have diminished electricity retailers' capacity to manage non-payment risk (e.g. the Victorian Payment Difficulty Framework, AER Statement of Expectations of energy businesses) including due to:

- disconnection and the threat to disconnect now having greatly diminished usefulness; and
- engagement with customer in relation to their outstanding debt often being tokenistic and used to frustrate retailers' non-payment risk management.

Capacity to bear non-payment risk

In general, we find that regulatory and policy interventions have also diminished electricity retailers' capacity to bear non-payment risk primarily due to the introduction of regulated retail price caps in the form of the:

- Default Market Offer (DMO) under the national electricity regulatory framework;

and

- Victorian Default Offer (VDO) under the Victorian energy consumer regulatory framework.

Our overall assessment is that since 2010, in aggregate, the capacity of retailers to manage and bear risk in both the NEM and Victoria has been compromised relative to an optimal risk allocation and the one that was originally intended in the NEM.

Desktop review

Our desktop review has considered the nature of policy and regulatory interventions over the past decade in Australia, the cost of these interventions and comparable interventions internationally.

Increasing policy and regulatory interventions in Australia

Following an extended period of deregulation and policy harmonisation up to around 2012, industry observers and policy makers became concerned that the electricity retail market was not delivering good price or service outcomes for consumers.

Since around 2016, energy retailing has undergone a period of extensive re-regulation and increasing policy divergence across the NEM, which has addressed specific concerns of policy makers while eroding important elements of a competitive retail electricity market and the way non-payment risk can be managed.

While it is likely that some interventions have improved the performance of the least effective retailers in supporting customers in genuine need as regards to their accumulated outstanding debt, the interventions have not addressed, and some have exacerbated, problems with managing customers who do not wish to engage with their retailer.

Further, not all these customers will be genuinely vulnerable given there is no threshold of payment difficulty established to identify vulnerability or hardship. In other words, it is a self-assessment process for the customer with retailers having no right to query the customer's self-assessment.

In aggregate, we consider that the regulatory and policy interventions have negatively affected the ability of electricity retailers to both manage and bear non-payment risks. This adverse development has been exacerbated by the economic effect of the COVID-19 policy response as indicated in Figure 1.

Figure 1 Movement in Australian energy retailer bad debt since April 2020

Source: Synergies' analysis using AER data

Policy and regulatory intervention costs

Policy and regulatory interventions create both direct costs associated with implementation of a new regulatory requirement, as well as indirect costs associated with foregone opportunities.

The extent to which policy makers have adequately considered the costs of many interventions has varied. However, in general, we consider that inadequate attention has been paid to the direct and indirect costs of the interventions.

In terms of direct costs, interventions can impose on retailers:

- significant initial IT-related upgrade costs – which are especially large for first tier retailers;
- ongoing administrative compliance costs, which are cumulatively significant as each intervention incrementally builds on the previous one; and
- ongoing operational complexity and friction for retailers operating across the NEM given the increasing jurisdictional regulatory and policy divergences.

In our view, the original policy intent of a nationally consistent electricity retail regulatory framework in the NEM has been substantially undermined by the interventions that have occurred since 2012. This is most stark in relation to Victoria, which administers its own jurisdictional energy retail regulatory framework outside of the NEM framework.

In addition to the direct costs of the interventions, there have also been indirect (opportunity) costs associated with 'lost' business improvements that could otherwise be pursued potentially to the benefit of customers. More generally, the increase in interventions is likely to have created a greater focus by retailers on regulatory

compliance at the expense of their service offerings.

Looking to the future, we consider there is a need for economic regulators, rules and policy makers to interrogate the potential cost impacts of policy interventions more deeply through testing and consultation before implementation.

Policy interventions in overseas jurisdictions

Our review of overseas jurisdictions found that UK energy retailers also face challenges in recovering debts and managing non-payment risks with many similar restrictions on retailers regarding management of debts and disconnections. However, it appears that more tools and a somewhat better balance of the interests of consumers and retailers has been retained compared to the NEM.

In the UK, the combination of licence conditions and a voluntary industry commitment among the six largest energy retailers (the EnergyUK Safety Net) have made retailer-imposed disconnections exceedingly rare for vulnerable customers.

Prepayment meters (PPMs) are widely used in the UK, including on a non-voluntary basis where customers owe a debt if "safe and practicable", and regulatory measures provide further protection for PPM customers and a mechanism for indebted PPM customers to be able to transfer retailers, taking debts with them. Our review also found that PPMs are used across several countries in Europe and in New Zealand, along with security deposits for risk and debt management.

In the UK, in certain and limited circumstances, energy retailers can require a security deposit from a customer to the value of around 1 to 1.5 times quarterly consumption. In contrast, load limiting mechanisms are not currently permitted (based on a 2012 review of the state of technology and user acceptance).

In terms of retail price regulation applied by Ofgem, there are price caps per unit (kWh) for (1) PPM tariffs and (2) standard variable and default energy tariffs, which Ofgem re-calculates twice each year.

In terms of the COVID-19 response, there was an early increase in protections, including that retailers must:

- continuously monitor and support PPM customers who may be 'self-disconnecting';
- offer emergency and "friendly-hours" credit to all PPM customers; and
- apply updated 'ability to pay' principles – increasing support for customers struggling to pay their bills.

Given anticipated bad debts are rising to levels that are not covered by the retail price caps, Ofgem is considering an increase to the price caps to reflect higher bad debt costs.

Outside of the energy sector, in both the mobile phone and banking sectors, we found that consumers and their advocates often consider that their interests are better served by foregoing the provision of credit by their retail service provider.

Options to address non-payment risk management

We considered the following 12 potential options for retailers to better address the non-payment risks that they currently face:

- PPMs;
- Increase targeted government payments (for genuine hardship customers);
- Implement load limitation (for business customers only);
- Better load information provided to customers;
- Increase the retail price caps under the national and Victorian retail price regulation frameworks;
- Allow retailers to apply security deposits;
- Introduce a mechanism for non-payment risk to be shared between retailers and distributors;
- Increased scope to disconnect customers not making a genuine attempt to repay accumulated debt (compared to the restricted status quo);
- Require distributors to invoice customers directly for the network component of the electricity bill;
- Introduce government funded insurance for retailers' non-payment risk;
- Implement load limitation (for all customers); and
- Implement government insurance against retailer failure.

Assessment criteria

We then evaluated the options using economic efficiency and social policy criteria recognising that not all policy and regulatory interventions have been driven by efficiency considerations. The social policy criteria were identified individually in terms of acceptability to each of policy makers, energy consumers and retailers.

Reconciling the economic efficiency and social policy criteria required us to first apply a narrow economic efficiency assessment to identify preferred non-payment risk management tools, and second to factor in our perspective of the likely political,

consumer and retailer acceptability of the use of each tool to establish an overall ranking of tools.

Applying this two-stage approach also usefully provides a guide as to the short and longer term time frames for possible implementation of alternative enhanced non-payment risk management tools.

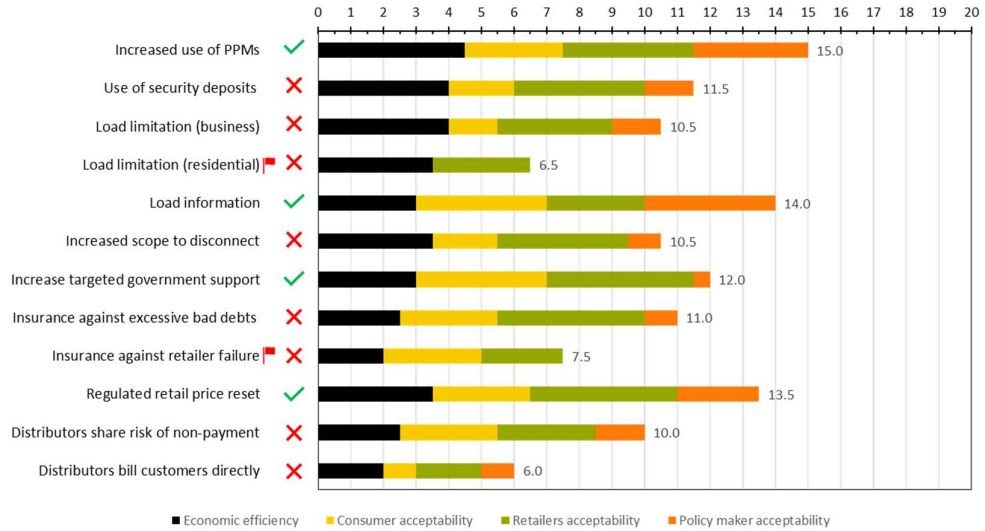
Preferred options

Having regard to our economic efficiency and social policy criteria, we concluded that the non-payment risk management options that would best address the current sub-optimal non-payment risk allocation facing Australian electricity retailers are:

- greater recognition of non-payment risks in regulated retail price resets (as well as broader intervention costs) and trialling load information approaches for vulnerable customers, both of which could be implemented in around a year; and
- increasing the use of prepayment meters, which would require regulatory changes and would take in the order of three years, but which may also require reforms to address up-front cost barriers for retailers to install smart meters.

Figure 2 presents our scores for each option when applying an equal weighting of the economic efficiency and social policy assessment criteria.

Figure 2 Option scores – all criteria (equal weights)



Note: The two options with red flags may not be workable in the short term, nor workable within the foreseeable future.
Data source: Synergies' analysis

Achieving greater recognition of regulatory intervention costs in regulated retail prices, while challenging, appears to be the most promising short-term option. This will likely require retailers to put greater effort into substantiating such costs to make it harder for regulators and rules makers to ignore them.

There are several other options we identified that are likely to be unsuitable to pursue in the short term but may have greater potential in the medium to long term, including:

- non-voluntary load limitation;
- increased scope to disconnect (compared to the status quo); and
- use of security deposits.

However, these options will fundamentally depend on a more favourable political environment than what currently exists for retailers/generators.

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1 Introduction

The unrelenting drift towards greater risk being borne by retailers in the National Electricity Market (NEM) includes a shifting allocation of risk between energy service providers and their customers in relation to non-payment risks, which has seen retailers assume a quasi-social policy role, a situation further exacerbated by the COVID-19 pandemic. Additional risk is being transferred to retailers while the previously accepted credit management tools used by retailers are now banned or strictly limited. All NEM jurisdictions are now also subject to retail price regulation.

The treatment of bad debts is a litmus test for the efficacy of the national electricity regulatory regime in delivering for the long-term interests of consumers. The challenges presented by current conditions mean that securing desirable change will take time and likely be achieved with incremental steps – a sense of these steps in the context of a long-term strategy will be crucial in influencing policy and rules makers about future evolution of the regulatory framework.

1.1 Project objectives

The purpose of this report is to analyse the following issues identified by the Australian Energy Council (AEC) as being of most importance to the non-payment risk management issue:

- better understand the impact of continuing market interventions on retail businesses, particularly those concerned with retail pricing and customer protection);
- identify if the estimated level of bad debt, or delayed payment, is increasing across the NEM;
- ascertain if the original market design intent that retailers should bear all non-payment risk in the NEM remains economically efficient;
- review international approaches to sharing non-payment risks, and their effect on retail competition and network costs;
- consider alternative mechanisms that might provide retailers with greater confidence that they will be able to make reasonable returns in future years, without decreasing the incentives on retailers to effectively manage customer payments; and
- identify approaches to ensure retailers have a reasonable opportunity to recover the capital costs of implementing market interventions, in a price regulated environment.

Our report is structured as follows:

- Chapter 2 summarises our project approach.

- Chapter 3 discusses a first principles approach to non-payment risk allocation.
- Chapter 4 identifies and assesses the effect of Australian energy market interventions made by policy and rules makers and economic regulators over the past decade.
- Chapter 5 discusses implementation costs associated with these Australian energy market interventions.
- Chapter 6 summarises the key findings from our international review of non-payment risk management.
- Chapter 7 identifies several options that could be used to address non-payment risk and provides a qualitative ranking of these options based on applying economic efficiency and social policy criteria.
- Chapter 8 makes recommendations regarding the highest ranked non-payment risk options in a political and broader energy market context.
- Appendix A presents further details on policy interventions in the Australian electricity retail market over the past decade.
- Appendix B presents our analysis and ranking of options to manage non-payment risk based on application of our stakeholder acceptability criteria.

2 Our Approach

Our approach to preparing this report has been based on the following steps:

- Identify a first principles approach to the allocation of non-payment risk in the NEM to use as a reference point against which market interventions affecting the allocation of this risk can be assessed.
- Undertake desktop reviews of:
  - market interventions made by policy makers and economic regulators in the energy retail market in Australia over the past decade; and
  - market interventions in overseas jurisdictions, which focussed on the UK energy market given its similarities to and frequent influence on Australian energy regulatory framework design.
- Assess the implementation costs of policy and regulatory interventions in the Australian electricity retail market, including interviews with a broad cross-section of energy retailers currently operating in the NEM to better understand how the interventions have affected their costs and ability to manage non-payment risk;
  - this includes the scope for Australian electricity retailers to recover the costs of interventions given current price capping arrangements applied at the national and Victorian levels.
- Having regard to Australian energy market interventions over the past decade, identify possible alternative options to manage non-payment risk and rank these options having regard to the National Energy Retail Objective (NERO) and broader social policy, consumer and retail acceptability criteria.

Each of these steps is discussed in turn below.

2.1 Role of first principles risk allocation review

We have examined how the Australian energy retail regulatory framework could be framed, if we were to start again, to achieve the National Energy Retail Objective (NERO) as follows:

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

The national electricity regulatory framework has changed considerably since its inception, with many small and large modifications made to the national market rules, as well as to jurisdictional frameworks. Many of these changes have been technical fixes conceived and designed in a manner consistent with the original intent of the

framework. However, many other changes have rested on important assumptions, principles or objectives that differ from those which prevailed when the framework was first established. The resulting compromises that are now embedded in the current framework are most clearly seen from a "clean sheet" perspective and the associated optimal risk sharing allocations.

While recognising that the optimal risk allocation is not necessarily achievable now, particularly in the prevailing policy and market circumstances, there is value in defining an optimal environment to provide a relevant vantage point from which to inform:

- what is realistically achievable and indeed aspirational; and
- a strategy to move towards those outcomes over the short, medium and longer terms.

Our first principles review has been underpinned by applying the following two risk assignment principles to assess the overarching effect of the regulatory interventions and how far they have resulted in a divergence from the optimal risk allocation:

- assign risks to the party best able to manage those risks (i.e. which party best possesses the means to manage non-payment risks?);
- assign risks to the party best able to bear those risks (i.e. which party possesses the financial capacity to absorb and recover from uncertain future losses arising from the occurrence of non-payments?)

2.2 Scope of our desktop review

Our research has two limbs:

- a detailed review of policy and regulatory interventions in the NEM since 2010 that have impacted most significantly on energy retailers; and
- a scan of international precedent regarding non-payment risk management and what this might mean in an Australian energy context.

In relation to international experience, we have focussed on the UK energy market given its regulatory interventions have followed a broadly similar path, including stronger customer protections and the re-imposition of retail price regulation. However, there appears to be a somewhat better balancing of the allocation of non-payment risk between retailers and consumers than is currently the case in Australia.

We have also drawn from experiences in the mobile phone and banking sectors for approaches to managing non-payment risk. For example, we find that in both the mobile phone and banking sectors, consumers consider that their interests are better served by foregoing the provision of credit by their retail service provider. In other words,

avoiding debt accumulation is better than managing the reduction and clearance of accumulated debt.

2.3 Retailer interviews

We have consulted with seven energy retailers currently operating in the NEM to seek their views on the impact of current market interventions on their cost structures and ability to adopt various non-payment risk management approaches. The retailers we interviewed represented a good cross section of what are often referred to as Tier 1, Tier 2 and Tier 3 retailers (see Box 1).

Box 1 Retailer classifications

The terms Tier 1, Tier 2 and Tier 3 are frequently used in Australia to differentiate between energy retailers, however, none of these terms appear in the energy rules. We define these terms by reference to AEMC[1] and Thwaites Review usages as follows:

- a Tier 1 retailer is an energy retailer provider that has more than 10% of the market share in a network region. The highest profile Tier 1 retailers are AGL, Origin Energy and Energy Australia, while Aurora (Tas), Ergon (regional Qld) and Evo Energy (ACT) also meet this definition in their respective service areas.;
- The AEMC defines all other retailers as Tier 2 retailers, but the Independent Review into The Electricity and Gas Retail Markets in Victoria (the 'Thwaites review') applied the term only to non-Tier 1 retailers who increased their market share to at least 100,000 customers (in Victoria) and who own some generation assets[2];
- The Thwaites review defined retailers with fewer than 100,000 customers and little or no energy generation capacity as Tier 3 retailers.

Data source: AEMC and Thwaites Review

Before the interviews, we shared a list of questions grouped under the following key themes:

- Business model of retailers.
- Strategy and tools used by retailers for managing non-payment risk.
- Current trends in customer debt level.
- Identification of which policy and regulatory interventions have had the biggest effect on costs and/or capability to manage non-payment risk.
- Issues arising from imposition of the policy and regulatory interventions:

1 AEMC, final report, 2019 Retail Energy Competition Review, 28 June 2019, p. 38

2 Thwaites J, Mulder T and Faulkner P (2017) Independent Review into The Electricity and Gas Retail Markets in Victoria, August, page 4

  - Effect on ability to manage non-payment risks
  - Costs borne by retailers to meet social policy objectives
  - Impact of retail price regulation on retailers' ability to recover the costs associated with the interventions
  - Opportunity costs, including on customer engagement and product innovation
  - Effect on profitability and viability
- Possible alternative non-payment risk management tools.

2.4 Assessment of implementation costs

The regulatory interventions in the NEM over the past decade have imposed various operating and capital costs on energy retailers including:

- human resource cost (e.g. training staff, engaging people to implement regulatory changes);
- costs of changes to IT systems, websites, energy bill formats;
- ongoing regulatory compliance costs, which are exacerbated by jurisdictional differences.

Our interviews with retailers indicated that the implementation costs imposed by each regulatory intervention depends on the nature of the intervention and the type of retailer and can vary widely.

2.5 Assessment of alternative non-payment risk management options

We have identified several alternative tools that might provide energy retailers with increased confidence that they will be able to manage non-payment risk into the future based on the following sources:

- our review of regulatory and commercial practice and developments in Australia and overseas;
- our consideration of the limitations imposed under the National Electricity Consumer Framework (NECF) and the Victorian energy consumer protection framework;
- suggestions from retailers that we interviewed; and
- other suggestions made by the AEC.

The range of alternative mechanisms considered include greater use of pre-payment meters, load limitation applied to business consumers, sharing of non-payment risk with energy distribution networks and targeted government transfers.

We assess these alternatives having regard to the NERO, which is an efficiency-based assessment that considers the long term interests of energy consumers. This is the standard that all rule changes under the NECF should satisfy.

Whilst posited in terms of an efficiency-based test, it is capable of being interpreted as incorporating distributional aspects with respect to the impact on specific classes of customers. This is reflected in the tendency for some policy and regulatory interventions over the past decade to have not rigorously applied a purely efficiency-based test. Rather, there have been several significant regulatory interventions (e.g. the AER's binding Customer Hardship Policy Guideline and Statement of Expectations for energy businesses, and the Victorian Payment Difficulty Framework) that have been driven by policy concerns associated with disengaged and/or vulnerable electricity customers, including affordability and hardship. Accordingly, there is a focus in our analysis on the classes of customers most likely to exercise the minds of policy makers when considering reform options.

When considering alternative non-payment risk management tools, this stratification of the energy consumer cohort makes it hard to determine whether the long term interests of consumers taken as a whole are satisfied or not. This is particularly the case when several non-payment risk management tools (and past policy and regulatory interventions) have distributional rather than efficiency implications. In other words, an intervention may not satisfy the economic efficiency criterion interpreted narrowly but would satisfy a criterion based on achieving a social policy objective for a specific class of customers.

Reconciling the economic efficiency and social policy considerations has required us to:

- first, apply a narrow economic efficiency assessment to identify preferred non-payment risk management tools; and
- second, to factor in our perspective of the likely political, consumer and retailer acceptability of the use of each tool to establish an overall ranking of tools.

Applying this two stage approach also usefully provides a guide as to the short, medium and long term time frame for possible implementation of alternative non-payment risk management tools.

3 First principles risk assessment

Key points

- When operating effectively, markets provide mechanisms and incentives that enhance economic efficiency over time.
- Maximising economic efficiency requires, among other things, that risks are allocated efficiently, which means that they are allocated to the party possessing the comparative advantage in both assuming risk and managing that risk at the lowest cost.
- Risk allocation was defined in the development of the National Energy Customer Frame (NECF). The design principle for the functions of retailers and their relationship to distributors was also previously strongly informed by a 2005 independent report which largely focused on retailer responsibility of assuming risk.
- Long-term interests of consumers is central to the development and application of the national energy regulatory frameworks. However, the concept of consumer vulnerability has become increasingly important in energy policy evaluation and consequential changes made to the regulatory frameworks.
- Non-payment risk in the NEM has been allocated to retailers and retailer liabilities have increased through the required provision of credit.

3.1 What do we want from markets?

The central concern of good economic policy is minimising the constraints imposed by resource scarcity on fulfilling desires, which in turn is achieved by maximising economic efficiency. This is what allows economic systems to improve welfare by satisfying more needs and wants with limited resources. When operating effectively, markets provide mechanisms and incentives that enhance economic efficiency over time.

Economic efficiency is often described in terms of the following three types of efficiency:

- **Allocative efficiency**: Satisfying as many wants as possible with finite resources by allocating resources to their highest value uses. Markets achieve this primarily through the price mechanism.
- **Productive efficiency**: Making more outputs with the same quantity of inputs – efficiently deploying resources. Markets achieve this through the incentive to maximise profit by reducing the costs of production.
- **Dynamic efficiency**: Innovating to alleviate the constraints of scarcity over time, including through creating new products and services– whether these are satisfying

new wants (for products or services that did not previously exist), or existing wants that are satisfied in novel ways (such as when a product is replaced with a service).

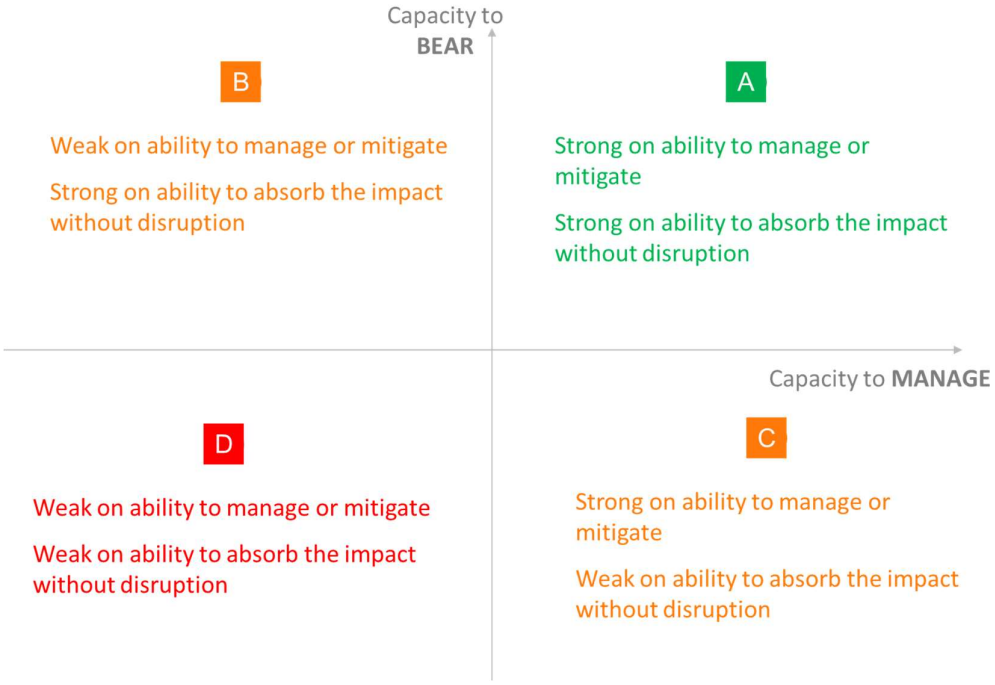
3.2 Economic efficiency and risk allocation

Maximising economic efficiency requires, among other things, that risks are allocated efficiently, which means that they are allocated to the party possessing the comparative advantage in assuming that risk. This party may be the entity best able to understand a risk, control the likelihood of the risk occurring, or best able to minimise the impact of the risk should it eventuate. The connection with economic efficiency flows from the fact that if the party responsible for managing the risk also bears the consequences of the risk being realised, it will face incentives to better manage the risk.

Many residual risks remain even after mitigation measures are applied, while some risks may not be possible to mitigate at all. When considering how these risks should be allocated, the party best able to manage them at lowest cost may be the party best able to bear (in the sense of absorb) the negative consequences of the adverse outcome eventuating.

Figure 3 represents the two main dimensions of efficient risk allocation, conceptually. For any given set of risks, the most efficient allocation will be found in the top right quadrant, furthest along the capacity to bear risk and capacity to manage risk axes, at A. Conversely, the least efficient allocation will be found in the bottom left quadrant, at D. Intermediate risk allocations could involve accepting a lower capacity to manage risks (B) or accepting increased risks of disruption if the risk eventuates (D).

Figure 3 Risk allocation schematic



Data source: Synergies' analysis

In Figure 3, risk allocation A is likely to be preferred to D, however the comparison between B and C is less obvious as the choice between them will involve trade-offs.

Where we anticipate catastrophic consequences from an entity buckling under the burden created by a risk eventuating, allocation B may be superior. For example, governments provide deposit insurance to banks because of concerns that a run on a specific bank can lead to a systematic banking failure. It is understood and accepted that the cost of this intervention is a lessening of incentives on banks to manage risks they are better placed than the insurer to manage.

In the case of a retail electricity market, it may be better to emphasise the effective management of risks (risk allocation C) since this will tend to make all parties better off, most of the time and the risk of systemic consequences appears limited[3].

[3] For instance, the retailer of last resort framework allows for an orderly step-in process in the event of a single retailer's failure.

3.3 Original risk allocation in national electricity and gas markets

3.3.1 The national and jurisdictional regulatory frameworks

The National Energy Customer Framework (NECF) is the suite of regulatory instruments that regulate the sale and supply of electricity and gas to retail customers in adopting states and territories of Australia. It principally comprises the National Energy Retail Law (NERL) and the National Energy Retail Rules (NERR). Among other things, the NERR sets out model terms and conditions for standard retail contracts and minimum terms for market retail contracts for supply of energy to customers.[4] Responsibilities for monitoring and enforcing the NECF are vested in the Australian Energy Regulator (AER).

The NECF commenced in the Australian Capital Territory and Tasmania on 1 July 2012, followed by South Australia on 1 February 2013, New South Wales on 1 July 2013 and Queensland on 1 July 2015. However, each jurisdiction, to varying degrees, applies departures ('derogations') from specific provisions of the NECF.

Victoria never adopted the NECF – opting instead to continue to regulate its retail energy markets under the Victorian Energy Retail Code and the supervision of the Essential Services Commission of Victoria (ESCV). The Victorian framework covers many of the same matters dealt with in the NECF, but the rules it specifies are to varying degrees different to those provided for in the NECF.

3.3.2 Principles guiding the development of the NECF

Introduction of the NECF was the last major task associated with the competition policy reforms flagged in the Parer review of the early 2000s.[5] The process to harmonise state-based consumer protections was undertaken progressively alongside the removal of retail price regulation in most markets. The NECF aimed to provide the energy-specific consumer protections necessary to ensure consumers had access to retail electricity and gas services and to minimise the complexity for consumers when negotiating their energy market contracts.[6]

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[4] Ministerial Council of Energy Standing Committee of Officials (2008), A National Framework for Regulating Electricity and Gas (Energy) Distribution and Retail Services to Customers, Policy Response Paper, July, p. v

[5] Parer, W, Breslin, P, Sims, R and Agostini, D, Towards a truly national and efficient energy market, Council of Australian Governments, December 2002, p. 86.

[6] South Australian Parliament, House of Assembly, National Energy Retail Law (South Australia) Bill, Second Reading speech, Hansard 27 October 2010.p. 1748.

In 2006, the then Ministerial Council on Energy committed to the transfer of national distribution network and retail regulatory functions to the AEMC in the form of a rule maker and the AER in terms of an economic regulator administering the rules.

The design principles for identifying the functions of retailers and their relationship to distributors was strongly informed by a 2005 report prepared by NERA Economic Consulting and Gilbert + Tobin titled *Public Consultation on a National Framework for Energy Distribution and Retail Regulation*. This report articulated design recommendations – most of which were generally accepted at the time – including a range of recommendations relating to the assignment of risks to parties in the market.

Table 1 Design recommendations of the NERA and Gilbert + Tobin Report

Risk	Allocation	Reasoning
Non-payment risks	The retailer should be the financially responsible party for consumption of energy and other services (such as network services) consumed at a connection point[7] and should be responsible for the collection and non-payment of network charges[8].	The retailer has the direct relationship with the customer and should have strategies for managing non-payment risks. Implicit, though unstated, in the vesting of this risk was the understanding that retailers would have enforceable property rights in respect of customer debts.
Wholesale price risk	This risk should be managed by retailers and, even in the event of a retailer's failure, customers should be shielded from wholesale price risk[9].	Retailers have tools and expertise relevant to managing price volatility whereas retail customers lack these tools and require (or strongly prefer) relatively stable and predictable energy prices.
Non-payment risk in case of retailer failure	Where a retailer steps in to supply the customers of a failed retailer, its liabilities in respect of the failed retailer's connection points should be limited to the receipts from the failed retailer's customers. In cases where these receipts are insufficient to cover the amounts owed by the retailer, the market operator has first call, with distributors and generators (or gas suppliers) next in line[10].	The incoming retailer has no special ability to manage the mismatch between the failed retailer's receipts and its liabilities, thus the most efficient allocation is to assign the risk to parties with a greater capacity to bear.
Technical network and equipment risks	This risk should be borne by customers and distributors pursuant to a direct contractual relationship.	The distributor has the greatest capacity to mitigate the risks associated with the construction, operation and maintenance of their respective assets and should be accountable to the customer for doing so[11]..

Source: NERA and Gilbert + Tobin (2005)

7 NERA and Gilbert + Tobin (2005) page 54

8 NERA and Gilbert + Tobin (2005) page 70

9 NERA and Gilbert + Tobin (2005) page 88

10 NERA and Gilbert + Tobin (2005) page 90

11 NERA and Gilbert + Tobin (2005) page 45

3.4 Approach to protecting long term interests of energy consumers

A proper understanding of the origins of the energy market requires that we consider how the designers conceived of risk sharing between market participants and customers, including from an efficiency and customer protection perspective. Several core concepts bear highlighting.

3.4.1 The long-term interests of consumers

The goal of advancing the long-term interests of consumers is central to the development and evolution of the national regulatory frameworks for electricity and gas.[12] The concepts embedded within the explicit objectives of these two frameworks were, above all else, economic concepts, with particular meanings to the people proposing them, as we set out here.

First, the concept of the "interests of consumers" was understood by the designers to refer to the collective or aggregate interests of all consumers. In other words, the goal was to enhance welfare in aggregate and the question of how benefits were distributed was considered to sit largely outside the domain of the rules.

Second, advancing "long-term interests", in the context of retail and generation markets, meant for economists that the rules would attract firms to invest and compete over long time horizons. They contemplated lengthy cycles during which prices might rise or fall depending on the available resources and level of competition at any given time. Since market participants would be subject to the self-correcting feedback mechanism of a workably competitive market, over the long-term, the system was expected to provide customers with efficient prices and fit-for-purpose products. Consequently, these economists were less concerned about the level of market prices at any particular point in time, than with the long-run incentives that the framework would establish for market participants to supply services demanded by energy consumers.

Finally, customers themselves, the designers assumed, would be actively involved in advancing the "long-term interests of consumers" – it was assumed that customers would be engaged in making their decisions regarding choice of retailer with certain customer protections incorporated into the framework (discussed further in the next section). Importantly, it was assumed that customers would be responsible for informing themselves of their options and then exercising judgement and choice to reward retailers

[12] See National Gas Objective (s23 NGL) and National Electricity Objective (s7 NEL).

with good offers and punish those whose offerings were too expensive, complicated or inconvenient.

3.4.2 Framework to provide basic regulatory protections, jurisdictions to fund social policy

The designers anticipated that customers, in particular small customers, should have the benefit of various restrictions on energy suppliers to make transacting easier and fairer, such as having standard terms and conditions approved by a regulator, but emphasised that[13]:

> "The scope of regulation should be sufficient to ensure small end-customers are treated "fairly" but should not be so wide or prescriptive as to impose regulatory costs which exceed the benefits."

Beyond these limited interventions to support fair interactions, the designers saw limited scope for additional interventions under the national framework to advance particular social policy goals. For instance, while they explicitly contemplated the continuation of jurisdictional Customer Service Obligations (CSO), for the most vulnerable customers[14], they assumed the jurisdictions would fund them. This was consistent with their view that achieving specific distributional outcomes was not within the purview of the energy regulations they were designing.

The AEMC has subsequently recognised the potential trade-off between efficiency and distribution concerns driven by government policy objectives as follows:[15]

> This means that governments may have potentially multiple and conflicting objectives to manage, which results in trade-offs being made between different objectives on behalf of consumers. Therefore, the achievement of such policy objectives is typically associated with a subjective value judgement that typically differs, depending on a particular view, and may potentially have broad societal impacts; rather than a more narrow, objective assessment based on technical engineering, economic or financial considerations such as those relevant to energy objectives.

[13] NERA and Gilbert + Tobin (2005) page 46.

[14] NERA and Gilbert + Tobin (2005) page 51.

[15] AEMC (2019), Applying the Energy Market Objectives, July, p 10

3.4.3 National consistency

The original design of the national energy market contemplated harmonisation of the requirements imposed on market participants across the NEM. The goal was to establish a national market in which participants, once established in one region, would be able to transfer their knowledge, systems and resources to compete in all regions. In this way, regulatory harmonisation was expected to reduce the barriers to competition, reduce compliance costs for market participants and drive better consumer outcomes. The development of the NECF was the product of this policy aspiration.

Due to the political sensitivities surrounding regulatory harmonisation in a federal system, the NERR (like the National Electricity Rules and National Gas Rules) were drafted to explicitly allow jurisdictions to adopt specific rules in place of specific national provisions – that is to derogate from the common rules. The intention was this mechanism would be used sparingly, to realise as much of the benefit from harmonisation as possible.

All participating jurisdictions have specified various derogations which have, to varying degrees, eroded some of the benefits of the NECF, although the degree of divergence is very modest by comparison with the regulatory divergence observed between NECF jurisdictions and Victoria. The latter problem was emphasised by the ACCC in its Retail Electricity Pricing Inquiry—Final Report, which estimated that the annual cost of the divergence was around $4 per customer per year[16].

3.4.4 Different types of customers

Policy makers should (and often do) recognise that there are different types of customers and that the strategies for advancing the welfare of customers might differ across them. The primary distinction acknowledged in jurisdictional policies tends to concern whether customers face financial disadvantage or other social disadvantages that may make them particularly susceptible to being unable to pay for their energy services on time, or at all. Such customers are sometimes referred to as vulnerable customers.

A second distinction can be made between customers who are actively engaged with the retail market and those who are not. Engagement may take the form of reading retailer communications, paying bills on time, comparing prices, switching suppliers and considering alternative supply options or products. For customers facing payment difficulties, engagement may involve contacting the retailer to advise of issues and to request assistance. The concept of customer engagement is recognised or implied in the

[16] ACCC (2018) Retail Electricity Pricing Inquiry—Final Report, June, page 227.

design of many of the customer protections established under the NERR and under Victoria's corresponding regulatory framework.

From these two distinctions a simple classification matrix emerges, which offers a useful way of thinking about the challenges for retailers and policy makers in ensuring that aggregate societal welfare is maximised, while basic standards of fairness and access are met – refer Table below.

Table 2 Customer engagement and vulnerability – types of customer

		Engagement	
		Engaged customers	**Disengaged customers**
Vulnerability	**Non-vulnerable customers**	Customers with adequate means to pay, tend to pay on time and who are inclined to monitor their supply options. • May test the market from time to time for better deals or more suitable products. • Engagement may strengthen further if economic conditions tighten.	Customers with adequate means to pay, but who tend to satisfice and/or may forget to pay on time. • Price regulation has limited the costs of remaining disengaged. • Restrictions on penalties have limited the costs to customers of late payment. • May switch to becoming engaged if economic conditions tighten.
	Vulnerable customers	Customers with limited means or other disadvantages who maintain communication with retailers, take up payment plans, make payments etc. • Subject to extensive regulatory framework to ensure consistency of treatment and fairness. • Retailers must have systems to manage these customers and make provision for the associated costs. • Likely to be many additional customers in this group if unemployment rises significantly in 2021.	Customers with limited means or other disadvantages who stop making payments, do not communicate or respond to communications but continue to take supply. • Disconnecting these customers can be difficult and expensive. • Limited incentive for these customers to genuinely engage. • Likely to be many additional customers in this group if unemployment rises significantly.

If economic conditions worsen in Australia and unemployment increases in 2021, we expect to see more customers become vulnerable. It may also be the case that economic uncertainty will cause some customers to become more engaged with their retail electricity and gas options.

We return to this distinction between engaged and disengaged customers later in section 4 of our report.

3.5 Non-payment risk

3.5.1 The role of credit in energy retailing

Energy retailers face a risk of not being paid for the services they supply to the extent that they incur liabilities to supply the services in advance of receiving payment for the

services. That is, the risk arises from the fact that, by default, they supply customers on credit.

While the provision of credit by suppliers is common in many industries, Synergies understands that the practice arose in the electricity and gas sectors for practical reasons. Suppliers had to wait for a meter reading before the quantity of service being supplied was accurately known. To keep costs down, manual meter readings for residential and smaller business customers traditionally occurs in NEM jurisdictions four times a year for small customers, with the result that suppliers by default would extend up to 3 to 4 months' credit to each customer.[17]

Retailers would avoid most or all of the risk of non-payment if they could supply energy without extending credit and instead took payment in advance of delivery. Systems and products for prepayment of energy services do exist and include:

- PPMs, which require the customer to put credit on the meter in order for electricity or gas to continue to flow into the connection point. The meters are encoded to cut off supply automatically when the credit added by the customer runs out, subject to specific rules regarding when and how supply may be cut off.
- Prepay products, which require the customer to pay in advance based on a forward-looking estimate of consumption. These products lack the immediate connection between the account remaining in credit and the continuation of supply observed with a PPM.
- Security deposits, where the customer puts down a deposit sufficient to cover the maximum value of services they are likely to draw between bills and the retailer can then apply some or all of the deposit to recoup any portion of the bill left unpaid.

The NECF and Victoria's regulatory framework (principally the *Victorian Energy Retail Code* and the *Electricity Industry Act 2000* and *Gas Industry Act 2001*) both impose various obligations on when and how retailers can extend and manage credit to their customers.

3.5.2 The toolbox for managing non-payment risks

The tools available to energy retailers for managing the risk of non-payments can be grouped according to when they are deployed in a four stage process for managing credit risks[18].

[17] These customers have basic accumulation meters rather than interval meters that can be read remotely through communications links.

[18] This process and most of the tools are common to many sectors, although several of the specific actions are particular to certain types of networks. In listing tools here, Synergies is not asserting that they are available to be used by Australian energy retailers, since some may be restricted by law. Rather, we are summarising the main potential tools.

Stage 1: Customer identification and acquisition

At this stage, the retailer seeks to assess an individual customer's creditworthiness and payment habits in order to assess the risk of non-payment. This can inform decisions on whether to offer to supply, or what types of products to offer, or promote to the customer.

Stage 2: Manage customers to reduce likelihood of non-payment

Here, the retailer aims to ensure that the customer continues to pay its bills in a timely way. Part of the strategy may involve monitoring the customer's behaviour to identify risk factors that may point to an increased likelihood of non-payment. Strategies to manage customers at this stage may be targeted (e.g. a response to monitoring), or broadly applied and include providing financial incentives (positive and negative) for timely payment and promoting products that reduce non-payment risks.

Stage 3: Manage non-payments

Here, the retailer seeks to get the customer back on track and, just as importantly, prevent potentially bad debts from growing too large. Some of the tools are similar to those that apply during Step 2 but may be more assertively applied. Some of the tools are only used for customers in arrears, such as agreeing on a payment plan and sending a disconnection warning letter.

Stage 4: Exit strategy

If Stage 3 fails, the retailer seeks to end its supply arrangement with the customer through disconnection. The retailer may or must do various things at this stage to close out the account, such as recognising the loss on its books and/or selling the debt. It may also follow through on representations made to the customer during Stage 3 regarding credit listing.

Table 3 shows the stages and lists the tools that may be available at each stage.

Table 3 Risk management tools organised by customer engagement stages

Customer engagement stage	Risk management tool
Customer identification and acquisition	• Evaluate customer risk profiles using credit checks, customer payment history data etc. • Apply risk-based pricing or product targeting.
Reduce likelihood of non-payment	• Enable multi-channel communications/ reminders (sms, emails etc) • Minimise billing errors (self-meter reads) • Minimise bill shock (advance notice of price changes) • Reward early payment • Penalise late payment • Encourage lower risk payment methods, such as:

Customer engagement stage	Risk management tool
	– direct debit – PPMs – load limitation • Require paperless billing • Identify high-risk customers early and offer them tailored programs (e.g. program for low-income households) • Monitor customers for signs of energy hardship or delinquency • Customer education • Energy efficiency programs
Manage non-payments	• Adopt multi-channel communications (sms, email, phone call, field visits) • Encourage customers to pay (payment matching, appliance swapping) • Agree to payment plans • Incentivise pre-payment meters for customers with increasing debts • Encourage customers to seek government support (concession) • Adopt differentiated collection strategies with bias toward customer experience • Adapt collections levers (e.g. scripts, offers, objection handling) to the needs of different customer segments • Disconnection warning notice
Exit strategy	• Disconnect • Write-offs • Sell debt to third parties • Default credit listing of customer

Note: the use of some tools may be limited by law in Australian jurisdictions.
Source: Synergies analysis based on literature review and retailers' interviews

In a workably competitive market, different retailers could be expected to implement each tool differently and with different degrees of success. However, it is interesting to note that in our interviews with retailers, Synergies was repeatedly advised of the efficacy of a disconnection warning notice as the best means of securing a customer's attention and getting them to engage with their unpaid energy bills. This is consistent with a large body of research in behavioural economics suggesting that energy consumers (indeed, people in general) respond better to more immediate and salient signals[19].

[19] See, for instance a review by the Electricity Policy Research Group; Pollitt M and Shaorshadze I (2011) The Role of Behavioural Economics in Energy and Climate Policy, EPRG Working Paper 1130, December.

4 Review of Australian retail energy market interventions

Key points

- Following an extended period of deregulation and policy harmonisation in the first decade of the 2000s, industry observers and policy makers increasingly became concerned that the market was not delivering good outcomes for energy consumers.
- Energy retailing has since undergone a period of extensive re-regulation and policy divergence which has addressed many specific concerns of policy makers, while eroding important elements of competitive retail markets in the NEM.
- The extent to which policy makers have adequately considered the costs of many interventions has varied.
- The impact of interventions undertaken since 2016 has increased the importance of other pre-existing restrictions or constraints that exist, to varying degrees, in each jurisdiction.
- It is likely that some of the interventions have improved the performance of the least effective retailers in supporting customers, including vulnerable customers, to pay their bills.
- However, the interventions have not addressed, and some have exacerbated, problems with managing vulnerable or non-paying customers who do not engage.
- In aggregate, the interventions have negatively affected the ability of retailers to both manage and bear non-payment risks.

4.1 Background

Starting in the mid-1990s, the Australian Government began to progressively introduce competition in energy retailing. Initially, retailers were subject to various forms of price supervision at the jurisdictional level – before this oversight was progressively wound back between around 2009 and 2016.[20] Policy makers had expected that competition between retailers and the behaviour of engaged customers would create an effective discipline on retail prices.

However, concerns about rising energy prices and the margins being earned by retailers, led some to question whether the market was delivering for consumers. A 2017 Grattan Institute analysis of ABS data found that, in real terms, electricity prices in the NEM's

[20] Victoria deregulated energy retail market price in 2009, South Australia in 2012, New South Wales in 2014 and Queensland in 2016.

mainland capitals increased by around 50 per cent between 2006 and the introduction of the carbon price in July 2012.[21] The Grattan Institute stated that the wide range of tariffs arising from competition created barriers to customers to get the best price. For example, surveys for the AEMC indicated that one-in-20 Victorian households did not know they had a choice in retailer or plan.[22] Many Australians, including some of the most vulnerable, the Grattan Institute claimed, were paying more than they needed to.

In late 2016, the Victorian Government called an independent review into the electricity and gas retail markets in Victoria – the "Thwaites Review".[23] The review was prompted by concerns that Victoria's energy market was not delivering anticipated benefits to consumers. Completed in August 2017, the review found that Victorian households were paying much higher prices than official estimates of the cost of supply. It also found that the retail charge – the component of the total bill that covers the retailer's costs and profits from selling energy – was a major contributor to energy prices in Victoria at the time of the review. The review panel recommended the re-introduction of retail price regulation in Victoria and a range of new obligations and oversight mechanisms for retailers[24].

In March 2017, the Commonwealth Treasurer directed the ACCC to hold an inquiry into the supply of retail electricity and the competitiveness of retail electricity prices.[25] The ACCC's final report released in June 2018 found that the standing offer was no longer working as it was intended and instead was resulting in financial harm to consumers.[26] The ACCC recommended that, in non-price regulated jurisdictions, the standing offer and standard retail contract should be abolished and replaced with a default offer.[27] It also recommended a wide range of other interventions to constrain or supervise retailer practices.

Many of the regulatory interventions since 2017 have their origins in the recommendations of the ACCC and Thwaites reviews.

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21 Grattan Institute (2017) Price Shock: Is the retail electricity market failing customer?

22 Grattan Institute (2017) Price Shock: Is the retail electricity market failing customer?

23 Thwaites J, Mulder T and Faulkner P (2017) Independent Review into The Electricity and Gas Retail Markets in Victoria, August.

24 Other recommendations included: abolish standing offers; better price marketing and clearer contracts for customers; smart metering; protection for vulnerable customers; and increased regulatory oversight.

25 ACCC (2018) Retail Electricity Pricing Inquiry – Final Report: Restoring electricity affordability and Australia's competitive advantage.

26 The ACCC noted that standing offers, which were originally intended as a default protection for consumers who were not engaged in the market, were being set much higher than expected by retailers in order to use a high priced benchmark from which the discounts advertised for their market offers were calculated.

27 AER Final Determination - Default Market Offer Prices - April 2019.pdf

4.2 Interventions we have considered

The scope of our review was to identify relevant market interventions in the energy retail market in Australia with a focus on:

- "major" interventions made in the NEM since 2010; and
- interventions related to, or which have effect upon:
  - the risk of non-payment and delayed payment of energy supply by end-customers; and
  - retailers' ability to recover costs of supplying energy, including the costs of interventions.

Broadly, the two types of interventions reviewed were those that have increased retailer costs (e.g. cost of managing hardship customer, exposure to bad debts and retailers' system costs such as IT upgrades) and those that have limited a retailer's ability to pass the associated cost through to customers (e.g. Victorian Default Offer and Default Market Offer). Both types of interventions can have implications for retailer viability and competition.

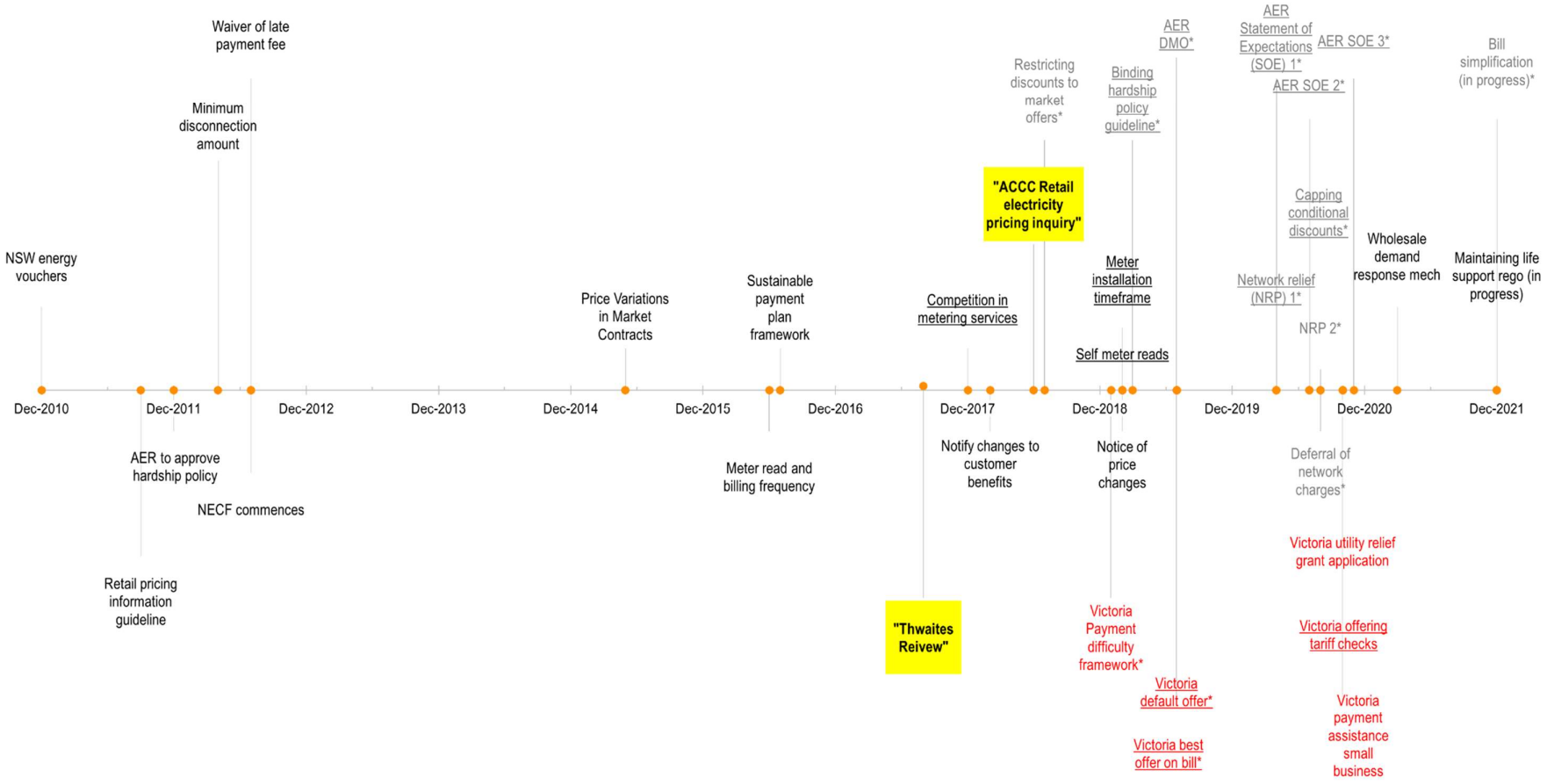
4.3 Our review of the interventions

4.3.1 Timeline of interventions

Figure 4 provides a timeline of the interventions that have been introduced since 2010. Broadly speaking, it highlights three time periods:

- From 2010 to 2012 there were some interventions introduced that were designed to help customers through provision of better information, as well as the introduction of the NECF.
- Between 2012 to 2017, there was less activity across the jurisdictions in terms of reforms and interventions.
- Post 2017 an obvious proliferation of interventions can be observed, particularly triggered by the ACCC Inquiry and the Thwaites Review, with the latter's recommended interventions in Victoria (highlighted in red in the timeline).

Figure 4 Proliferations of interventions, particularly after 2017



Note: "*" indicates interventions highlighted by retailers in interviews as having particularly significant impacts on costs or revenues.
Source: Synergies.

4.3.2 Summary of interventions

The interventions we reviewed are summarised in Table 4. Additional information on each intervention is provided in Appendix A.

Table 4 Summary of market interventions with implications for retailers in the NEM (2010 – 2020)

Ref	Intervention	Type	Decision factors	Implementation costs	Consumer focus	Support or limit retailer capacity to manage risk
1	Retail pricing information guideline	Marketing behaviour	Customer interest, retailer interest (not being too prescriptive), market impact (economic efficiency, competition)	High	All	Support
2	Customer hardship policy binding guideline and approval	Customer hardship	Focus on customer interest	High	Vulnerable	Support
3	Minimum disconnection amount	Customer hardship	Customer interest and retailer interest (minimum amount helpful in identifying customers experiencing possible payment difficulties)	Medium	Vulnerable	Support
4	NECF commences	All aspects of customer protection	Policy objective of harmonising consumer protections across all jurisdictions to support greater competition and lower compliance costs.	Low	All	Various, however, national consistency supported retailer cost efficiency
5	Waiver of late payment fee	Customer hardship	Focus on customer interest	Medium	Vulnerable	Limit
6	Retailer price variations in market retail contracts	Marketing behaviour	Customer interest, competition in retail energy markets, implementation costs	Low	All	Support
7	Meter read and billing frequency	Billing and account management	Efficient use of energy services, enhancing consumer experience, implementation costs on retailers or metering data providers	Low	All	Support
8	AER Sustainable Payment Plans Framework	Customer hardship	Benefits to customers and retailers (customers likely to make their agreed payment plan)	Low	Vulnerable	Support
9	NSW Energy Accounts Payment Assistance Scheme	Customer hardship	Focus on customer interest	Low	Vulnerable	Support
10	Competition in metering services	Other	Allow a contestable service to be market supplied, support opportunities for innovation, avoid a mass rollout and consumer opposition	Low	All	Limit[(a)]
11	Victorian Payment Difficulty Framework	Customer hardship	Customer interest, cost to retailers	High	Vulnerable	Limit
12	Advance notice of price changes	Billing and account management	Customer focus, impact on competition in market, retailers' costs versus customer benefits	Low	All	Support

Ref	Intervention	Type	Decision factors	Implementation costs	Consumer focus	Support or limit retailer capacity to manage risk
13	Preventing discounts on inflated energy rates	Marketing behaviour	Information provision to facilitate consumer choices, costs on market participants, and tariff and service innovation in the future	Low	All	Support
14	Notification of changes to customer benefits	Billing and account management	Customer focus, impact on competition in market, implementation costs against customer benefits	Low	All	Support
15	Meter installation timeframes	Other	Customer focus; benefits to consumers vs additional regulatory burden on retailers	High	All	Support
16	Self-meter reads	Other	Balance between enhancing customer protections and maintaining flexibility for retailers to design their own approach to using self-reads	Low	All	Support
17	AER Default Market Offer (DMO)	Retail price controls	Consumer interest, costs incurred in electricity supply chain	High	All	Limit
18	Victorian Default Offer (VDO)	Retail price controls	Consumer interest, costs incurred in electricity supply chain	High	All	Limit[(b)]
19	Best offer on bills (Victoria)	Marketing behaviour	Customer focus	High	All	Support
20	Reducing customer's switching time (retail)	Other	Customer impact; consumer choice; transparency and certainty of market processes; regulatory and administrative burden	Low	All	Support
21	AER Statement of Expectations (SOE) 1	Customer hardship	Customer protection; impact on costs/risks for energy businesses	Medium	Vulnerable customers	Limit
22	Network relief package (NRP) 1	Customer hardship	Focus on customer interest	Medium	Vulnerable customers	Support
23	AER SOE 2	Customer hardship	Customer protection; impact on costs/risks for energy businesses	Medium	Vulnerable customers	Limit
24	Capping conditional discounts	Marketing behaviour	Impact on competition, risk allocation, administrative and implementation costs	Medium	All customers	Support
25	AEMC deferral of network charges rule	Customer hardship	Industry viability and financial resilience, risk allocation, and implementation costs relative to the benefits	Low	Vulnerable customers	Support
26	NRP 2	Customer hardship	Customer interest	Medium	Vulnerable customers	Support
27	Utility relief grant application (Victoria)	Customer hardship	Customers experiencing payment difficulties	Low	Vulnerable customers	Support
28	Offering tariff checks (Victoria)	Marketing behaviour	Customer interest	Medium	Vulnerable customers	Support
29	Payment assistance small business (Victoria)	Customer hardship	Customers experiencing payment difficulties	Medium	Vulnerable customers	Support

Ref	Intervention	Type	Decision factors	Implementation costs	Consumer focus	Support or limit retailer capacity to manage risk
30	AER SOE 3	Customer hardship	Customer protection; impact on costs/risks for energy businesses	Medium	Vulnerable customers	Limit
31	Wholesale demand response mechanism	Wholesale market	Wholesale market access and competition, retailer impact and costs,	Medium	Sophisticated customers	Neutral
32	5-minute settlement	Wholesale market	Prices; generation and demand response flexibility; management of price risk exposure; efficient risk allocation; supply and demand side competition; regulatory and administrative burden	High	All customers	Neutral
33	Bill simplification rule change (in progress)	Marketing behaviour	Transparency of information; consumer engagement, choice, and participation; regulatory and administrative burden	High	All customers	Support
34	Maintaining life support customer registration when switching (in progress)	Customer hardship	Ensuring that benefits of proposed solution outweigh costs	Low	Vulnerable customers	Neutral

(a) For reasons discussed later, we regard metering competition as having limited the circumstances in which it makes financial sense for retailers to use smart meters as tools to manage credit risks associated with higher risk customers.

(b) We note that the ESCV in setting the 2021 VDO included an additional temporary allowance of $6 per customer for bad debts to account for the effect of the coronavirus pandemic on retailers' costs, which may go some way to mitigating the effect of the price cap during a period of elevated non-payment risk.

Note: Those interventions highlighted in grey were time bound and ended in 2020. The interventions highlighted in blue are time bound and will end in early 2021.

4.3.3 Key findings

The following are key findings of our review of the 34 interventions and our interviews with retailers:

- Largely, the focus (and associated key factors) considered in the decision-making process was customer welfare and impact. Secondly, the impact on retailers, particularly the impact of implementation costs, was also considered. It was found that the AEMC decision making process included consideration of the balance between customer benefits and retailer costs.
- Just over half of the interventions focused on vulnerable customers specifically, with the remainder aimed at all customer types.
- Around a third of interventions were identified as having high implementation costs for retailers. These included customer hardship, market behaviour and retail price control interventions that largely deal with managing and bearing the risk of non-payment.
- Only eight of the interventions were/are time limited – three concluded this year (June and October 2020) and five are expected to conclude in early 2021. These interventions are focused on customer hardship.
- Most interventions aim to support retailers' capacity to manage/bear risk rather than limit it. Where interventions were found to limit retailers' capacity to manage/bear risk, these were largely focused on avoiding customer disconnections and delaying debt recovery, in turn increasing non-payment risk.

4.4 Retail electricity price regulation

The re-introduction of retail electricity price regulation in NSW, South East Queensland, South Australia,[28] and Victoria[29] were landmark interventions during the period in question and warrant separate discussion.

Prior to developing these pricing frameworks, national and Victorian policy makers raised the concern that the market outcomes were giving rise to some prices being significantly higher than the cost of supply[30] and very significant "price dispersion".[31]

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[28] Under the *Competition and Consumer (Industry Code – Electricity Retail) Regulations 2019*.

[29] Under Order of the Governor in Council made under section 13 of the *Electricity Industry Act 2000* and published in the Victorian Government Gazette No. S 208 on Thursday 30 May 2019.

[30] Thwaites J, Mulder T and Faulkner P (2017) Independent Review into The Electricity and Gas Retail Markets in Victoria, August, 18.

[31] ACCC (2018) Retail Electricity Pricing Inquiry—Final Report, page 257.

Notwithstanding substantial similarities in their findings as to how the retail markets were functioning in various NEM jurisdictions, policy makers in Victoria formed a different view to the ACCC as to the type of policy intervention required.

NSW, South East Queensland and South Australia

From the perspective of the ACCC, a key problem was that disengaged customers on standing offers were unwittingly paying a large premium given standing offers were much higher than other market offers.[32,33] To this end, it recommended (and the Australian Government and the AER ultimately implemented) retail price regulation designed to establish a reference price in the form of a retail price cap that would limit the size of pricing premia imposed on disengaged customers, while allowing retailers to continue to compete through market offers below the capped price. The ACCC stated its intent as follows:[34]

> "The default offer should not exist to be the lowest price, or close to the lowest price in the market. Its purpose is to act as a fallback position for the disengaged or for those that require its additional protections. Ideally, it should only be utilised by a small number of consumers. It must be set above the price for competitive market offers to avoid incentivising consumer disengagement."

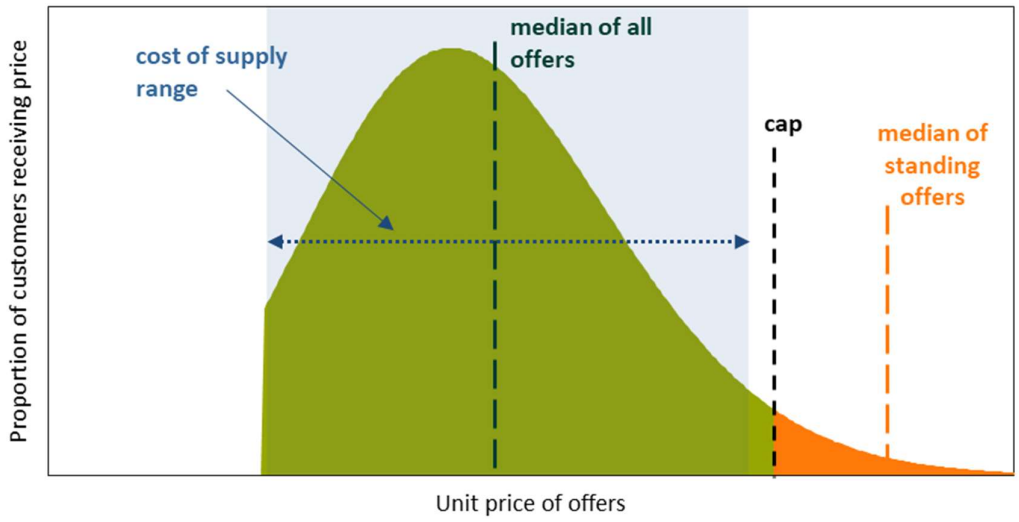
Figure 5 illustrates the logic underpinning the design of the DMO, which emerged from the ACCC's initial advice. In a contestable retail market, some level of price dispersion is likely to emerge, resulting in a skewed distribution around some median value. Assuming the market is workably competitive, the median price paid by customers should sit somewhere within a range of retailer costs to supply (noting that the cost to supply varies between retailers and between customers). The price cap (i.e. the level of the DMO) sets a ceiling on price offers for disengaged customers, thus any customers previously receiving a price in the righthand tail (orange) of the distribution, would henceforth receive the DMO.

[32] ACCC (2018) Retail Electricity Pricing Inquiry—Final Report, page 249.

[33] We note that standing offers had trended rapidly upwards because they had become integral to the calculation of discounts – as required by regulation.

[34] ACCC (2018) Retail Electricity Pricing Inquiry—Final Report, page 249.

Figure 5 Schematic of effect of price cap in the retail market



Data source: Synergies analysis

The DMO (cap) is intended to be set below the hypothetical median of standing offers and (potentially) above the range of retailer costs to supply. In this way, it retains important incentives for retailers to compete and for customers to remain engaged in the market.

The methodology used to calculate the initial DMO relies on the AER sampling observed market offers and standing offers, which would also reflect retailer costs. Subsequent DMOs are based on adjusting the initial DMO to reflect forecast changes in wholesale, environmental and network costs. Retail costs are the residual costs which are adjusted according to changes in the Australian Consumer Price Index (CPI). There is also scope for the AER to account for step changes in retailer costs where it considers additional adjustments to be appropriate.

Victoria

The approach recommended by the Thwaites Review and implemented by the Victorian Government and the ESCV differed in subtle but important ways to the DMO. The Thwaites Review recommended the introduction of a regulated Basic Service Offer that would:[35]

[35] Thwaites J, Mulder T and Faulkner P (2017) Independent Review into The Electricity and Gas Retail Markets in Victoria, August, 18, page 55.

> "be available to all consumers and would represent a reasonable price of energy in the market. It would provide an option for consumers who just want affordable energy without the fuss."

The Terms of Reference provided to the ESCV by the Victorian Government to establish the VDO methodology and the Order in Council which subsequently codified the price determination framework required that the VDO price(s) must "not include an allowance for headroom". [36,37]

By constraining the VDO methodology in this way, the Victorian Government largely precluded the price cap from operating in the manner that the ACCC had recommended. Meeting these requirements is likely to result in a price much closer to the median of market offers shown in Figure 5. At this level, the price is prone to substantially reduce the incentive for retailers to compete for customers and reduce the incentive for customers to seek out better offers. In effect, the VDO seeks to replace the outcome of competitive processes with a regulated outcome.

Further, as the framework implies that a bottom-up cost methodology must be used to set the VDO, only those cost components explicitly included in the ESCV's calculation are recognised in the regulated price. Hence, if the ESCV is either precluded from recognising specific cost components, or if it judges certain types of retailer costs to be illegitimate or unnecessary costs, then legitimate retailer incurred costs may be omitted from the calculation of the VDO. In this way, the ESCV may be determining not only the price of the default service, but also, implicitly, the optimal service parameters.[38]

4.5 Other constraints

While our brief was focussed on the implications of new regulatory interventions since 2010, several other constraints deserve mention here, since they appear to have continuing relevance for how retailers respond to the interventions above.

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[36] Scott, Robin MP (2018) Retail Market Review: Terms of Reference for the Essential Services Commission, 14 December, included as Appendix A to ESCV (2019) Victorian Default Offer to apply from 1 July 2019, Advice to Victorian Government, 3 May.

[37] Order of the Governor in Council made under section 13 of the *Electricity Industry Act 2000* and published in the Victorian Government Gazette No. S 208 on Thursday 30 May 2019, see clause 12(10).

[38] For instance, retailers may ordinarily offer different levels of customer service, whereas if a VDO cost component is determined based on the lowest level of service, the result is effectively to drive retailers to focus on minimising customer service costs.

4.5.1 Legal prohibitions on PPMs

It is a standard retail licence condition for all electricity and gas retailers in Victoria that they must not implement a PPM scheme without the prior approval of the ESCV[39].

Similarly, retailers in NECF jurisdictions can use PPMs, provided the jurisdictions expressly permits this. Queensland, Tasmania and South Australia have all provided these permissions, though not NSW. Thus, retailers are also not permitted to use PPMs in NSW.

4.5.2 Legal prohibition on load limitation products

The ESCV expressly prohibits the provision of what it calls "supply capacity control products" to a residential customer for any credit management purpose.[40] Such a product might, for example, involve temporarily disconnecting a customer for exceeding a usage limit. This prohibition was introduced around 2010, in the context of a range of concerns regarding how smart meters might be used by retailers and distributors.[41]

The National Energy Retail Law provides that the Rules (NERR) may provide for the use of interval meters and smart meters and other related technologies, including devices designed to enable direct load control and the ability of a retailer or distributor to undertake supply capacity control. To our knowledge, the current version of the NERR does not enact restrictions or rules bearing on the use of load limitation.[42]

4.5.3 Cost barriers

The AEMC's metering contestability reform has facilitated customer/retailer-led roll out of smart meters which has meant that, outside Victoria, smart meters have only been deployed on a case-by-case basis where the retailer or customer is willing to fund each meter individually.[43]

This competitive roll out model has implications for the potential risk mitigation options that remain permissible for electricity retailers in those jurisdictions – specifically PPMs,

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39 Clause 10.1 in electricity retail licences and clause 11.1 in gas retail licences.

40 ESCV (2020) Energy Retail Code, section 93.

41 ESCV (2010) Regulatory Review Smart Meters Draft Decision, September.

42 https://www.legislation.sa.gov.au/LZ/C/A/NATIONAL%20ENERGY%20RETAIL%20LAW%20(SOUTH%20AUSTRALIA)%20ACT%202011/CURRENT/2011.6.AUTH.PDF (section 237, Division 2); https://www.aemc.gov.au/sites/default/files/2020-08/NERR%20v24%20full.pdf

43 Under the national electricity regulatory framework, a smart meter must be installed at all new network connection premises.

prepayment plans and load limitation products. By removing the scope for socialising the cost of smart meters in cases where retailers face higher risks of non-payment, the market-led approach to smart meter deployment has likely limited their use in these circumstances.

Where a retailer is both permitted and inclined to offer a PPM, a prepaid plan or a load limitation product as a means of reducing the risk of non-payment for certain customers, there must already be a suitable meter installed at the premises or the retailer must pay for the installation of one. In a competitive roll out model, it is likely that in most cases where a PPM is appropriate to manage credit risk, a new installation will be required, costing in the order of $600.[44] However, where the customer in question is already in arrears or is at risk of becoming so, the customer will be poorly placed to pay for a new meter and it is easy to imagine that a retailer may be reluctant to self-fund the installation of the meter.

In such cases, PPMs may not be a very useful solution if the upfront costs are similar to the value of the customer's accumulated debt that a retailer is trying to manage. However, where retailers deploy a more active solution like PPMs that provide clearer and better incentives to customers with a higher risk of non-payment from the start of the customer-retailer relationship, we think there could be some positive externality that all retailers benefit from (i.e. if retailer A manages this customer better, then it is less likely to have that customer then 'churn' and become a similar problem for another retailer). This positive externality might then be considered as a basis for socialising the cost of smart meters for a small subset of high-risk customers (i.e. recovered from some form of common pool of funds).

However, we are doubtful that such a socialisation option would gain strong policy or economic regulator support in the short to medium term. Rather, we think that any such prepayment-related metering costs, expressed as a cost per customer, should be recognised under the DMO and VDO arrangements.[45] In practice, we envisage that retailers would be able to make a stronger case for cost recognition if prepayment arrangements were adopted by the industry as a legitimate non-payment risk management mechanism in a forward-looking sense.

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[44] Canstar Blue (2020) "How to get a smart meter", https://www.canstarblue.com.au/electricity/how-to-get-a-smart-meter/.

[45] We are aware from our retailer interviews that full recognition of metering costs under the DMO has been problematic.

4.5.4 Opt-out rights and the cost of meters

In those jurisdictions which do permit the use of PPMs, the NERR imposes a range of restrictions and obligations on retailers which discourage retailers from deploying PPMs they fund themselves, most notably:

- Customers switched to a PPM must be granted an automatic three-month trial period. The retailer must swap the customer back to a standard service if requested within that period at no charge.
- Customer self-disconnections must be monitored and if there are three or more in three months, the retailer must actively offer to switch the customer back to a standard product at no charge.
- Where the customer switches to another retailer, the outgoing retailer must, if requested by the incoming retailer, remove the PPM.[46]

4.5.5 Perception problems

PPMs have had an image problem in Australia. Since 2000, PPMs have continued to be used widely in Tasmania and deployed successfully in remote communities – particularly indigenous communities – in Western Australia, Northern Territory, South Australia and Queensland.

Nonetheless, consumer advocacy groups in Western Australia,[47] South Australia,[48] and Victoria[4950] have all opposed their use at various times between 2000 and 2010. Tracing the origins of this opposition is beyond the scope of this report. The point noted here is simply that negative perceptions surrounding PPMs may have contributed to deterring retailers from using them, even where legally permitted. These perceptions may also have contributed to the adoption in the NERR of rules constraining their use in significant ways.

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46 While this rule should create limited issues in the case of smart meters, the cost to install, then remove and write-off traditional PPMs may have been a significant impediment in the past.

47 WACOSS [DN: example – reference submissions from 2006/7]

48 SACOSS [DN: example – reference submissions from 2006/7]

49 St Vincent de Paul (2004) Customer Protections and Smart Meters Issues for Victoria.

50 Energy Action Group (2003) Second Class Customers: Pre-Payment Meters, the Fuel Poor and Discrimination

4.6 Implications

4.6.1 Implications for competition

Net retailer margins across the NEM have decreased on average from $93 to $66 per customer between 2017-18 to 2018-19.[51] In November 2019, the ACCC found that retail margins as a proportion of overall costs tended to be higher in Victoria and NSW, and lower in South Australia and South East Queensland. The ACCC's analysis found that Victoria and NSW had some of the highest retail margins (as a percentage of revenue) in the world at rates of around 13 per cent and 11 per cent respectively in 2016–17. However, the ACCC noted that reported retail margins as a percentage of revenue had fallen since that time to 6 per cent in Victoria and 5 per cent in NSW.[52]

We were unsurprised that several of the retailers we spoke to indicated that the reduction in retailer margins has had a chilling effect on their investment in pursuing new customers. This view was expressed primarily by Tier 2 and Tier 3 retailers, who advised that they were largely concerned with reducing costs and were not considering changes to their service offerings or campaigns to compete for new business.

The retailers we spoke to did not express fears for their immediate viability, but their responses point to concerns that policy makers should nonetheless take seriously. If retailers are focussed largely on subsisting rather than pursuing growth by actively competing to win customers, the market as a whole faces several downside risks. This is because:

- competition drives suppliers to consider alternatives to existing practices and products, which in turn drives economic efficiency;
- competition provides an important driver for customer engagement – because insurgent suppliers raise the salience of energy services among consumers, prompting them to compare prices and terms; and
- in an environment where margins remain low for too long, retailer failures become more likely and/or retailer exit and market concentration can quickly develop.

4.6.2 Implications of regulatory divergence

In the interviews, retailers highlighted increased compliance costs as a key concern for them. Retailers consider jurisdictional differences exacerbate the compliance costs, with Victorian derogations singled out as creating a separate set of obligations.

[51] AEMC (2020). 2020 retail energy competition review – Final report, 30 June, p.44.

[52] ACCC (2019). Inquiry into the National Electricity Market, 29 November, p.5.

With respect to jurisdictional differences, retailers noted differences in how concession frameworks are implemented across States. For example, there are different rebate amounts and concession amounts, and there are differences in how concessions are calculated (e.g. Victoria uses age-discount system).

Generally overlapping jurisdictional obligations with different implementation rules compromise retailers' ability to innovate, affect their willingness to invest in providing enhanced customer service, and their incentive to compete. Rather, retailers considered that jurisdictional interventions and state derogations were forcing them to focus on compliance issues rather than on meeting customers' requirements.

4.6.3 Different customers – different outcomes and prescriptions

The outcomes of regulatory interventions will be different for different customers. Well-targeted interventions to improve the operation of the retail market, for instance by reducing the transaction costs of price comparison and price discovery, have tended to benefit engaged customers (and may have encouraged more customers to become engaged). Some social policy interventions, such as the minimum disconnection amount[53] requirement for disconnecting the service is likely to have led to a more consistent experience for vulnerable customers across different retailers and may have positively affected the rate at which some customers accumulate debts.

Figure 6 summarises the implications for the four different groups of interventions we reviewed.

[53] See Appendix A.3

Figure 6 Implications of interventions for different customers and suggested focus areas

		Engagement	
		Engaged customers	Disengaged customers
Vulnerability	Non-vulnerable customers	1. This group remain well-served by the market. Warrant light handed regulatory approach. • Some regulation may have reduced transaction costs, improves competition; • Large but diffuse losses as a result of reduced economic efficiency and increased cost transfers. • Incentives to engage with the market have likely diminished; • Some regulation may be inhibiting competition; • Critical to retain / regain scope for retailers to innovate, offer choice and good alignment of incentives.	2. Remain adequately served by the market and warrant light handed regulatory approach. • Price regulation has limited the costs of remaining disengaged; • Rely on competition to drive further improvements to customer engagement. • Critical to retain / regain scope for retailers to innovate and offer choice.
	Vulnerable customers	3. This group has been strongly protected and good outcomes are more consistent. Boundary issues and incentives warrant attention. • A high baseline of retailer obligation maintains consistency of outcome – e.g maintain high level of engagement. • Important to retain / regain scope for retailers to innovate, offer choice and good alignment of incentives. • Options for reducing credit and increasing the emphasis on prepayment should be actively expanded.	4. This group has been strongly protected and faces undesirable incentives. Warrants clearer incentives or government funding. • Requirements for retailers to frequently solicit engagement were appropriate. • Policy makers should ensure either: – Path to disconnection or non-discretionary prepayment is not unduly protracted or expensive; – Continued service is funded as Community Service Obligations.

Data source: Synergies analysis

Group 1 – Engaged and non- vulnerable customers

We expect that a large majority of customers in this group were always well-served by the market and continue to be relatively well-served. We think it likely that some of the interventions will have reduced transaction costs (particularly information costs) and thereby improved competition. However, we think that the benefits arising from those changes for this group will have been relatively modest. This will be the group that has borne the largest share of the significant but diffuse losses that we would expect to have resulted from reduced economic efficiency and increased cost transfers to support expanded social policy objectives. In future, the incentives for this group to remain engaged with the market have likely diminished slightly, both as a consequence of lower price dispersion and due to the reduced incentives and/or scope for retailers to innovate.

The priority for policy makers in respect of these customers in future should be to retain and preferably expand the scope for retailers to innovate, offer choice and provide a good alignment of incentives. The single most important element of this will be ensuring that price regulation does not drive out retail competition. Further, options to relax some of the restrictions on particular technologies and practices should be explored where

opportunities to reduce costs or improve service are identified and the risks to customers are acceptable.

Group 2 – Disengaged and non-vulnerable customers

This group is adequately served by the market and past concerns regarding price dispersion (which arguably affected this group most) have been largely addressed by price regulation.

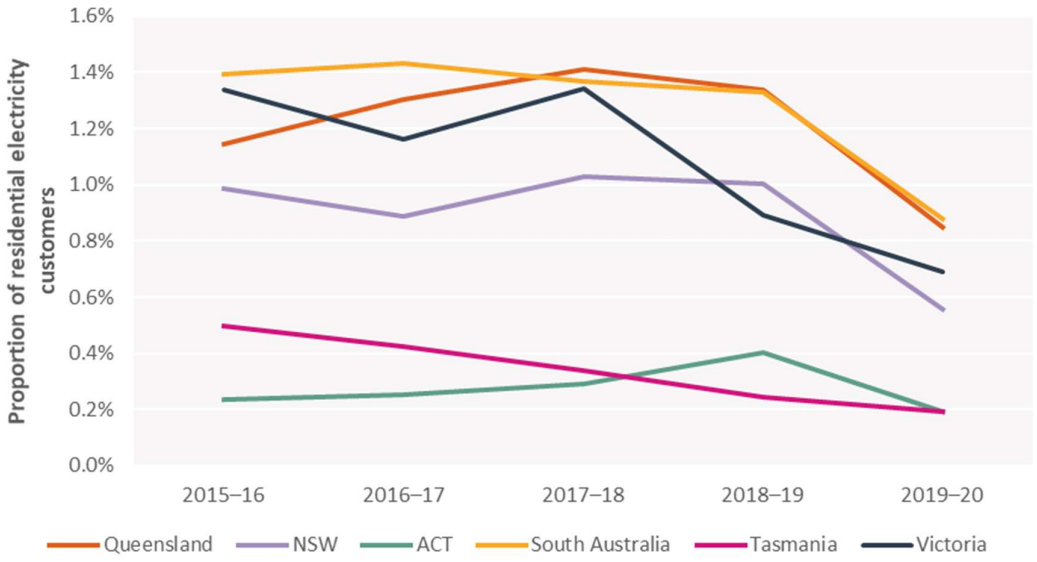
The policy focus for these customers should be the same as for Group 1. That is, emphasising balanced price regulation that prioritises competition and recognises that a certain level of disengagement merely reflects transaction costs and will necessarily result in some price dispersion. Again, opportunities to relax restrictions, subject to appropriate consideration of risks and benefits should be considered.

Group 3 – Engaged and vulnerable customers

This group has been strongly protected by the various interventions and outcomes are likely to have been more consistent across retailers. The high standards imposed through regulation on things such as retailer communication and engagement are expected to have improved the experience of some disadvantaged customers who are trying to pay their way.

Since 2015, residential electricity disconnections (as a percentage of customers) have fallen in all NEM states. As illustrated in Figure 7, the greatest improvements were observed in New South Wales, Victoria, South Australia, and Tasmania, where disconnection rates fell by more than a third. We consider that this benefit should be regarded as primarily accruing to vulnerable customers, but we offer no view as whether engaged or disengaged vulnerable customers have been more strongly affected.

Figure 7 Residential electricity disconnections as a percentage of customers



Data source: AER (2020) Annual retail markets report 2019–20, ESC (2020) Victorian energy market report, 2019-20

Expanded measures to encourage engagement does not guarantee that a vulnerable customer would succeed in paying their energy bills and clearing existing debts. Data from the AER showed that of the 75,000 customers who exited a hardship program in 2018-19, only 32 per cent did so because they had successfully exited the program and were able to return to a normal billing cycle.[54] Nearly 60 per cent of exits were due to the customer being excluded from the program primarily for failing to pay (75 to 80 per cent of exits) or being uncontactable (4 to 6 per cent of exits).[55] It is not possible to discern from the statistics the extent to which failure to pay arose due to these customers simply being unable to make payments or due to these customers disengaging.

We consider that retailers are probably too restricted in their ability to innovate, offer choice and improve the alignment of incentives for this group and that further restrictions would be very problematic. In particular, we consider that retailers should be supported to experiment with prepayment or load limitation options. Policy makers should also consider options to address the up-front cost barriers associated with smart meters for the high-risk customers.

[54] AER (2020) Annual retail markets report 2019–20, page 88. Note, AER statistics exclude Victoria.

[55] AER (2020) Annual retail markets report 2019–20, pages 88-89.

Group 4 – Disengaged and vulnerable customers

This group has also been strongly protected by some of the policies considered here, but we are concerned that some of the protections are too onerous to expect retailers to bear, other than as short-term and temporary measures. Nonetheless, the obligations on retailers to frequently and actively monitor the customer and try to engage them with payment plans, payment assistance or other support are proportionate and may have made a meaningful difference for a small proportion of customers in this group.

Policies towards this group need to be rethought as Australia gradually emerges from the COVID health crisis in 2021. In particular, a coherent statement of objectives with respect to this group is needed. On the one hand, governments may view access to an equal level of energy service as a fundamental right even where customers are unwilling or unable to pay for the service. If this is the case, a market provision model ultimately breaks down, because the customer has no reason to try to pay for supply. If the policy objective is to ensure equal and unqualified access to an energy service, then governments must fund the cost of supplying this group as a formal customer service obligation.

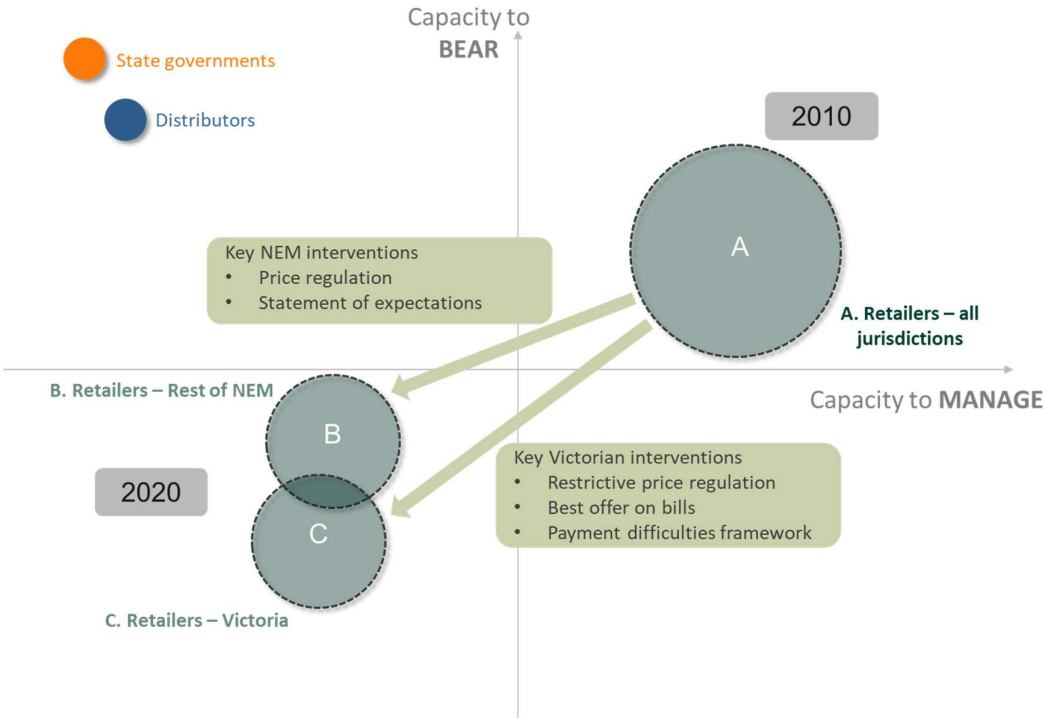
We note that even Centrelink requires benefit recipients to maintain reasonably active engagement by reading communications and providing timely and accurate information on matters bearing on their eligibility. That is, the Australian Government does not consider itself duty bound to provide benefits to parties that do not engage with the relevant agency.

Alternatively, governments may view the right of access to energy services as a qualified right. This may mean that the right only exists to the extent that a customer must make all reasonable efforts to pay their costs of supply, or face disconnection. Or it may mean that any customer has a right to receive some level of service, albeit a lower level of service in the case of a customer who is vulnerable but disengaged. These two interpretations suggest different ultimate outcomes for vulnerable customers that consistently disengage – either they should lose access to energy service(s) for a time or they should expect to experience some reduction in the quality or convenience of the service they receive.

4.6.4 Erosion of efficiency in the allocation of risk

Taken as a whole, the regulatory interventions since 2010 have adversely affected the capacity of retailers to both manage and bear non-payment risk. Our view of the relative positions of retailers then as compared to now, in both Victoria and the rest of the NEM jurisdictions is illustrated conceptually in Figure 8.

Figure 8 Outcomes of interventions for efficiency of risk allocation



Source: Synergies analysis

In 2010, retailers are shown at "A" in the top right quadrant, denoting good capacity to both manage and bear risks. We have assumed the regulatory framework in 2010 is broadly reflective of the intent of policy makers and therefore provides a baseline to identify differences in the current framework. Retailers could manage non-payment risks by using many of the tools previously noted in this report. Capacity to bear risks was likely assisted by a reasonably benign operating environment. While retail price regulation remained in place in most states, regulators were mindful of the goal of encouraging competition and phasing out price regulation, so relatively generous allowances for retail margin within the standing offer were common. Further, many retailers chose to forego this level of margin to compete for customers.

Sphere "A" covers a wide area, reflecting our expectation that in 2010, differences between retailers on these dimensions would have been relatively large. We would expect retailers then to differ significantly both in terms of endogenous characteristics (i.e. some large, some small, some sophisticated, some less so) and in terms of exogenous characteristics – most notably the jurisdictional regulations to which they were subject.

In 2020, retailers are shown in two positions in the bottom left quadrant, with Victorian retailers shown at Sphere "C" and retailers elsewhere in the NEM shown in a slightly more favourable position at Sphere "B". In both cases, tough restrictions on disconnections and chasing non-payment have significantly diminished retailer capacity to manage non-payment risks with Victoria having somewhat tighter restrictions.

Further, in both cases, the reintroduction of price regulation has reduced retailer capacity to bear the risk of non-payment, noting that prices have been set relatively low, especially in Victoria. The smaller areas occupied by Spheres "B" and "C" compared to "A" reflect the reduced diversity in the exogenous environments of retailers due to the harmonisation of regulations across most of the NECF jurisdictions.

The impact of this reduction in the efficiency of the risk allocation cannot be readily observed. Under normal economic conditions it will take the form of incrementally higher retailer costs and average retail offers. The economic downturn caused by the COVID pandemic clearly does not represent normal trading conditions. However, the fiscal stimulus provided by the Australian Government (and customers' ability to access their superannuation) appears to have been highly effective in masking the impact of unemployment on the underlying capacity of customers to pay their electricity bills.[56] However, customer debt levels are likely to become an emergent problem once government support is wound back.

4.7 Conclusion

Our research indicates that there has been a proliferation of interventions in the Australian electricity retail market since 2016. In the context of our risk allocation principles discussed in Section 3, the cumulative effect of the policy and regulatory interventions has been to reduce the ability of retailers to manage non-payment risk, by constraining or removing access to risk management tools, as well as to bear this risk because of the introduction of retail price regulation (the Victorian Default Offer (VDO) and national Default Market Offer (DMO)).

Further, we also think the potential for customer non-payments to increase further in 2021 is high based on the assumption that the Australian Government will significantly reduce the income support measures it introduced in response to COVID-19. This will place further financial pressure on incumbent retailers given the constraints on both the management of this risk and recovery of the associated costs of it.

[56] AER, Annual retail markets report 2019-20, November 2020. The report notes that the energy debt levels of both residential and small business customers increased sharply from the onset of the pandemic (i.e. between March and June 2020) but stabilised since then due to various support measures (p. 11).

5 Implementation costs of interventions

Key points

- The interventions reviewed by Synergies in Section 4 have imposed considerable implementation costs on retailers, particularly over the past five years.
- Regulatory recognition of these costs has been patchy:
  - Consideration of implementation costs by economic regulators and rule makers prior to imposing interventions has generally been broad and qualitative;
  - Retail price regulation decisions for the DMO have not explicitly accounted for retailer implementation costs, while the most recent VDO decision has granted a small additional cost allowance for the implementation of the 5 minute settlement rule change and a temporary allowance relating to the effect of the coronavirus pandemic on bad debt costs.
- We consider three options to improve the recognition and valuation of implementation costs in retail price determinations, and conclude that the two options worth serious consideration are:
  - to encourage or require the economic regulator and rule maker to publish information on implementation costs; and
  - to require the economic regulator and rule maker to obtain implementation costs from an independent cost estimator, which can then be published in its regulatory decision.

5.1 Features and extent of imposed costs

Regulatory interventions impose a range of operating and/or capital costs on retailers including:

- human resource cost (e.g. training staff, engaging people to implement regulatory changes);
- up-front cost of changes to IT systems, website, bill design and structure;
- ongoing compliance costs, which are exacerbated by jurisdictional differences in customer protection frameworks (e.g. there are differences in concessions frameworks across States).

There is also the opportunity cost of implementing regulatory interventions and complying with them, because responding to regulatory requirements affects retailers'

ability to devote adequate resources to improve customer experience or engage in product innovation or improve operational efficiency.

5.1.1 Retailers views on costs

The implementation costs imposed by each regulatory intervention depend on the nature of the intervention and the type of retailer.

Table 5 summarises implementation costs for some of the major interventions noted in our interviews with retailers. For instance, from the retailer interviews we understood that:

- for some smaller retailers the costs of 5-minute settlement were not significant whereas for larger retailers the cost was in the tens of millions of dollars;
- the cost of implementing Victorian interventions (e.g. 'best offer on bill' requirement and the Payment Difficulty Framework) had a significant up-front and ongoing cost impact on all retailers; and
- the cumulative costs of interventions are substantial (e.g. in hundreds of millions of dollars for large retailers).

Table 5 Indicative implementation costs of interventions

Intervention	Large retailers (Tier 1)	Tier 2 retailers
5-minute settlement	$10-50 million	Ranging from not significant to significant (under $1 million)
Victoria Payment Difficulty Framework	Significant (under $50 million)	Significant
Victoria 'best offer on bill' requirement	Significant (under $50 million)	Ranging from $250K to a few million dollars
Wholesale demand management response	No comment	Not significant / not assessed
Cumulative cost (over past five years)	Substantial (about $150 million)	Substantial

Source: Retailer interviews

In addition to the cost of interventions, there are also the costs of bad debt and debt collection faced by retailers. For example, the ACCC's 2018 Inquiry notes that the cost of bad debt and debt collection is significant at 22% of the cost to serve. The ACCC estimated the annual costs to be about $20 per customer per annum in the NEM.[57] The NEM serves an estimated 10 million customers indicating an overall annual cost associated with bad debt of $200 million.[58]

[57] ACCC, Retail Electricity pricing inquiry – final report, p. 225.

[58] https://www.aemo.com.au/-/media/files/electricity/nem/national-electricity-market-fact-sheet.pdf).

The ACCC acknowledged that the cost of bad debt is a key concern for retailers and that changes in the level of bad and doubtful debts are a key contributor to increases or reductions in retailers' costs to serve. The ACCC considered that it was therefore critical efforts are made to reduce the extent of bad debt costs in the interests of overall affordability.

5.2 Regulatory recognition of these costs

5.2.1 Consideration of costs prior to rule making or policy interventions

When assessing the case for a new rule or policy intervention, rules and policy makers have generally considered implementation costs to retailers only qualitatively with benefits similarly qualitatively assessed. In other words, robust cost benefit analysis is rarely undertaken.

For example, the AEMC considers impact on retailers qualitatively, with 'regulatory and administrative burden' as one of four factors of the assessment framework to determine if the rule is likely to contribute to the achievement of the NEO and NERO. For example, in its final determination for advance notice of price changes, the AEMC noted "the costs for a price change notice across all jurisdictions would not be insignificant at the current time" however "the rule has been designed to keep the costs of implementation as low as possible".[59]

In its final determination for estimated meter reads, the AEMC noted "the rule is not prescriptive in the processes to be adopted by retailers to comply with the draft rule, which should reduce the implementation costs".[60] In other decisions, the AEMC considered while there would be costs to retailers, these costs are outweighed by benefits to consumers. The AEMC also notes that in its assessment framework that it "considers the benefits of the final rule versus the implementation costs that would likely pass through to consumers in a workably competitive market."

The ESCV consulted with stakeholders on the development of its new Payment Difficulty Framework and a key criticism received was that the framework was "too rigid and very costly".[61] As a result, the ESCV revised its approach and changed its proposed implementation to a consolidated implementation plan to reduce costs.

[59] AEMC (2018) Rule Determination National Energy Retail Amendment (Advance Notice of Price Changes) Rule.

[60] AEMC (2018) Rule Determination National Electricity Amendment (Estimated Meter Reads) Rule 2018.

[61] ESC (2017) Payment difficulty framework – Final decision, 10 October 2017. Available at: https://www.esc.vic.gov.au/sites/default/files/documents/payment-difficulty-framework-final-decision-20171009.pdf

Further, the ESCV commissioned two independent assessments on the likely impact on retailers. While cost impacts to retailers were recognised, it was noted that some portion of the cost impacts experienced by retailers would ultimately be borne by customers as retailers pass a portion of these costs through to their customers in the form of higher electricity charges. However, in practice, this will clearly be a function of whether the costs are reflected in the VDO or not, which is the ESCV's responsibility.

In the AER's Statement of Expectations of energy businesses, it is recognised that "many retailers are providing additional assistance to customers who are in financial stress and encouraging them to get that help".[62] Further, the AER notes that it is expected "retailers should waive disconnection, reconnection and/or contract break fees for small businesses that have ceased operation, along with daily supply charges to retailers, during any period of disconnection until at least 31 March 2021".

5.2.2 Consideration of costs in regulatory retail price determinations

AER's DMO

The AER sets the DMO using a top-down benchmarked approach based on observed market offers.

For DMO-1 (2019-20), the AER set a DMO for each distribution zone at the mid-point (50th percentile) of the range between the median market offer and median standing offer, based on generally available offers in October 2018.

Retail cost plus a retail profit margin are the residual cost components of the AER's DMO after deducting wholesale electricity costs, network costs and environmental costs. Since DMO-1 reflected available market and standing offers in October 2018, the retail cost and margin component inherent in those offers would generally reflect the costs and risks retailers expected at that time.

However, regulatory interventions have proliferated in the past few years, which have imposed additional unanticipated costs on retailers. Among the post October 2018 interventions are:

- Advance notice of price change (the AEMC acknowledged this rule change may create additional costs for retailers).[63]
- AER's customer hardship policy guideline that would require retailers to modify their systems and processes to comply with this binding instrument.

[62] AER (2020) Statement of Expectations of energy businesses: Protecting customers and the market during COVID-19.

[63] See Appendix A.11

- AER's Statement of Expectations of energy businesses that imposes additional implementation costs on retailers (e.g. increased compliance costs, increased call centre costs, corporate overheads), as well as the additional costs and risks associated with the temporary moratorium on debt collection and disconnection.
- 5-minutes settlement rule change (the AEMC acknowledged the implementation process is expected to be extensive, because all existing IT systems, metering infrastructure and financial contracts have been designed with reference to the existing 30-minute settlement requirement. The ESCV has recognised the additional cost imposed on retailers and included an allowance in its 2020 VDO determination).[64]
- The electricity bill simplification rule change, which is currently under consideration by the AEMC. If implemented, such a change would require changes to retailer billing systems, which will impose further costs on retailers.

The DMO-2 (2020-21) adjusts DMO-1 to reflect forecast changes in wholesale, environmental and network costs. However, rather than reflecting any additional costs, the residual cost component (retail costs plus a retail profit margin) is adjusted by the change in the Australian Consumer Price Index (CPI).

The AER considered that its approach to estimating residual costs has the benefit of maintaining the residual cost component of the DMO price at current levels in real terms. Absent any significant changes to retail costs, this approach will produce a forecast of the residual costs for 2020-21 that is consistent with the criteria under the DMO policy objectives. In the case where retail costs are materially impacted by exogenous factors, such as new regulatory obligations, there is scope to apply step changes to the residual cost component.[65] AER also sees merit in introducing a re-opener provision in the regulations governing the DMO to account for uncertainty over future costs at the time of a DMO determination.[66]

However, the AER in setting DMO-2 did not recognise any new regulatory interventions in 2019/20 that in its view materially increased retailer costs and should be reflected in the 2020/21 DMO. In doing so, the AER noted a paucity of information and uncertainty about the impacts of COVID-19. Given the ESCV's recent decision to

[64] See Appendix A.28

[65] The AER's proposed step change assessment framework is designed to pass through any exogenous, material change to retail costs not reflected in the DMO 1 price. The criteria for step change framework are: there is an exogenous change in a retailer operating environment that is mandatory and would be incurred by an efficient and prudent retailer within the DMO determination period; the change(s) will lead to a material overall change in the retail costs of an efficient and prudent retailer; and the change in retail costs is not compensated in AER's forecast of other cost elements.

[66] AER - Default Market Offer - Price determination 2020-21 Final Determination - 30 April 2020, p. 22

provide an additional COVID-related allowance in VDO, we expect retailers to be able to provide information to the AER to seek to re-open or apply a step change in the next DMO determination to account for the additional debt costs imposed by the economic consequences of COVID-19.

ESCV's VDO

Unlike the AER's DMO, the ESCV applies a 'ground up' cost-based approach to determining the VDO comprising:

- wholesale electricity costs – including hedging costs and network losses for electricity;
- network costs – which are directly taken from tariffs approved by the AER;
- environmental costs – including national renewable energy schemes and the Victorian Energy Upgrades program;
- retail operating costs – including modest costs of customer acquisition and retention;
- other costs – such as licence fees and AEMO fees; and
- retail operating margin – which is applied to all underlying costs.

As noted previously, the VDO framework includes a requirement that regulated price levels must not include "headroom".[67] This increases the importance of ensuring that the regulated price reflects all relevant costs, estimated to a level sufficient to cover a wide range of retailer scales.

The ESCV's allowance for retail operating cost is based on a benchmark from a regulatory decision made by the Independent Competition and Regulatory Commission (ICRC) in 2017 (adjusted for inflation since 2017). Relevantly, the ICRC benchmark is itself derived from IPART, which undertook a comprehensive review of retail operating costs in 2013.

In addition to this benchmark, the ESCV includes an estimate of $10 per customer to account for Victorian-specific costs, recognising the impacts of regulatory changes with the introduction of the Payment Difficulty Framework and the analysis of Victorian-

[67] Order in Council made under section 13 of the *Electricity Industry Act 2000* and published in the Victorian Government Gazette No. S 208 on Thursday 30 May 2019. Clause 12(10) of the order, headroom means an allowance that does not reflect an efficient cost borne by firms operating in the market.

specific costs in the ACCC's 2018 inquiry report.[68] This additional amount has been included in the VDO since it started in July 2019.

The 2021 VDO (to apply for 2021 calendar year), included an additional allowance of:[69]

- $6 for costs relating to the effect of the coronavirus pandemic on bad debt levels, which the ESCV states is a temporary allowance and will be removed at a future review, noting this reflects an adjustment for forecast increases in bad debt costs; and
- $0.21 for costs associated with introducing the five-minute settlement rule, which represents the additional forecast operating costs of this rule change that is due to commence in October 2021. The ESCV acknowledged it is a new national regulatory obligation, which will lead to some additional costs for retailers. This represents a significant change in the ESCV's position as previously it had rejected accounting for such costs on grounds that they will also apply across the whole market, rather than applying specifically to Victoria.[70]

The ESCV's decision regarding five minute settlement costs may indicate it is now more receptive to the need to account for the additional costs and risks to retailers of regulatory interventions. This presents an opportunity to identify interventions that impose costs on retailers and are not accounted for in the VDO cost stack, including:

- Victorian 'best offer on bill' requirement;
- Victorian utility relief grant application;
- requiring retailers to conduct a tariff check for all residential customers; and
- the Victorian Payment Difficulty Framework (the $10 allowance noted above accounts for additional ongoing costs of implementing the framework but it does not account for the increased likelihood of bad debt, as the ESCV rejected retailers' view that the framework would likely increase the quantum of bad debt).[71]

The $6 allowance is estimated in an environment of government support measures that have masked the true effect of the pandemic on bad debt levels. As government support

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68 https://www.esc.vic.gov.au/sites/default/files/documents/Victorian%20Default%20Offer%20to%20apply%20from%201%20January%202020%20-%20For%20web%20publishing.pdf

69 https://www.esc.vic.gov.au/sites/default/files/documents/FD%20-%20%202021%20VDO%20-%20Final%20decision%20-%2020201125.pdf

70 https://www.esc.vic.gov.au/sites/default/files/documents/Victorian%20Default%20Offer%20to%20apply%20from%201%20January%202020%20-%20For%20web%20publishing.pdf

71 https://www.esc.vic.gov.au/sites/default/files/documents/Victorian%20Default%20Offer%20to%20apply%20from%201%20January%202020%20-%20For%20web%20publishing.pdf

measures are wound back, the impact on debt level is potentially more significant than the ESCV has estimated.

5.3 Potential responses

5.3.1 Response 1: Increase the use of sunset clauses in regulation

Description

As a general principle, regulatory interventions that are implemented to address concerns that may be transitory in nature, should only be imposed for a finite time. That is, some interventions should provide for their own cessation. In doing so, the impact of some interventions on retailer costs could be prevented from continuing longer than necessary and avoid contributing to the accumulation of intervention costs over time. This principle could be endorsed by rule makers and economic regulators in their internal guidelines and procedures or imposed via changes to their enabling legislation.

Assessment

This practice could only reduce costs for retailers where there are ongoing operating costs arising from the intervention. Further, the practice could be counterproductive where the end of the regulatory requirement results in a need for retailers to revert to pre-existing systems, potentially causing additional expense.

This approach has been taken by the AER and the ESCV in relation to several of their retail interventions arising from COVID-19. However, we found no pre-determined intervention expiry dates among any of the interventions we looked at that were not related to the pandemic. We searched for, but did not identify, significant examples of time-bound regulatory interventions in our review for UK practices with respect to the management of non-payment risks.

It appears that the policy perspectives or outlooks underpinning most of the regulatory interventions we reviewed are unlikely to characterise the underlying problems as transitory. That is, we think that the rule makers and economic regulators in question will tend to the view that the problems they have sought to address by means of each intervention are enduring in nature.

Our view

While we think that the general principle that interventions should be time limited wherever possible, we are sceptical that this principle, even if it were to be enshrined in

regulated guidance binding the rule makers and economic regulators, would result in many instances of regulatory interventions being subject to sunset clauses.

5.3.2 Response 2: Rule maker to publish cost information

Description

If a rule maker settles on an intervention pursuant to a thorough consideration of the costs and benefits of an intervention, it should consider whether there is additional information that it might be able to publish that could assist a retail price regulator to evaluate any additional costs to include in a price reset. This requirement could be implemented by way of additional obligations in regulatory frameworks. Alternatively, it could be promoted as a reputation-enhancing commitment to better regulation, both on the part of the rule maker and on the part of downstream "consumers" of this information, such as retail price regulators.

Assessment

We anticipate that there is comparatively little quantitative data that the AEMC, for example, has obtained on this point that it did not already include in its determinations as a matter of course. However, we consider that the rule maker may have the scope to increase the proportion of determinations that include a quantified estimate of implementation costs. This process would largely be in retailers' hands as 'owners' of the cost information. Retailers could provide individual cost information on a confidential basis or collectively set up a process to provide estimated industry costs for a rule change.

In some instances, where cost estimates are difficult and expensive to obtain and where the AEMC is satisfied that the benefits are likely to outweigh implementation costs, the AEMC may decline to produce a quantified cost estimate so as to complete its determination more quickly or cheaply. However, if retail price regulators signal their intention to reflect these data in their determinations, this could provide retailers an incentive to provide cost information and increase the focus within the AEMC on gathering and assessing the cost information in its decisions.

Given that frameworks for retail price regulation have only been in place for around a year and a half, we think that there is potentially still some scope for a rule maker – principally the AEMC, but the AER and ESCV to a lesser extent – to consider how well its practices interface with the price regulation framework. Specifically, we think rule makers may be receptive to proposals that they strengthen their practices in recognition of the increased harm associated with implementation costs that cannot be recovered. The case for this is particularly strong in the case of the VDO because of the prohibition

on headroom, which increases the value of timely, specific implementation cost estimates in pricing decisions.

While this approach could be enshrined in regulation, we doubt that this would deliver value commensurate with its cost and effort. Better, we think for it to be pursued by way of positive and multi-lateral engagement with rule makers and price regulators to understand how they see their functions interacting and what they intend to do to enhance those interactions.

Our view

We think that this intervention would make it easier for regulators to acknowledge and include these costs in their price determinations. This is a relatively low cost measure to support, recognising it is also likely to drive only incremental changes in practice. There is potential for advocates to gain traction with this option by highlighting the linkage between the rule maker as an "information seeker and producer" and the price regulator as an "information consumer".

5.3.3 Response 3: An independent cost estimator to establish public benchmarks

Description

Another option could be to vest responsibility under the NER, NGR and/or NERR for an independent expert body – most obviously AEMO – to estimate the system implementation costs associated with market-driven rule changes. This requirement could be triggered by a formal request submitted by the rule maker for cost estimates to be prepared. The expert's determination as to cost could be used as an input by both the rule maker and the retail price regulator.

Assessment

We think that it is important that regulatory interventions are based on strong cost benefit foundations wherever possible and this option could advance that objective. While the AEMC does sometimes give detailed consideration to implementation costs, as it did in the case of the 5 minute settlement rule change, it does not appear to consider it necessary to form a view as to the most likely value of implementation costs.

For instance, in the 5 minute settlement rule change the AEMC:

- reviewed estimates from various submissions;
- compared the largest of these to an estimate of the annual price reduction that might be achieved; and

- concluded that "the enduring benefits of the proposed rule change to align dispatch and settlement at five minutes will quickly outweigh the one-off and any ongoing costs."[72]

Allowing that the independent expert could be a range of parties, we consider here the most obvious option of assigning the function to AEMO, even though its assessments may be subject to bias. As an organisation with an intimate understanding of the IT architecture in the NEM, AEMO would be in a better position to produce robust cost estimates and to evaluate cost claims than most rule makers. However, AEMO would likely still need input from market participants on their own costs. The advantage is that an AEMO cost estimate might be treated as more credible than industry estimates. A disadvantage could be that participants may be less keen to share cost information with AEMO, given its market operator role. The cost of AEMO providing this expert function could be high in some instances, but we see no reason why this cost should not be proportionate to the complexity of the implementation task facing retailers. That is, AEMO's assessment costs might be large in some cases, but probably only for very complex interventions in which case its costs would amount to only a fractional additional cost.

We would envisage that AEMO would face some potential conflicts of interest in performing this role – for instance where it has a preference for particular regulatory interventions to proceed or not proceed. If that were considered a significant problem, it might be appropriate to have recusal procedures, or for the rule maker to simply be required to go to market to obtain suitable cost advice (with that process informed by AEMO's estimate).

We would anticipate that the individual impact of each of these determinations would be small in absolute terms, but the mechanism would improve confidence in the quality of rule making and the continuing suitability of regulated prices.

This option would require changes to the NER, NGR or NERR if AEMO was to be assigned the role as a statutory function, funded out of market fees. Alternatively, if the function is to be funded as an extension of the rule-maker's responsibilities, it could be implemented without further regulation. In either event, we think that there should be some effort to articulate agreed principles to guide these types of assessments, such as the principle of evaluating incremental costs (i.e. deducting costs that would have been incurred anyway), what level of precision is required from the cost estimate (i.e. what is a reasonable estimate uncertainty range) and what methods might be appropriate (i.e. bottom up, top down, etc).

[72] AEMC (2017) 5 Minute Settlement, 28 November, page 17.

The implementation cost estimate would ideally be developed in a manner that maximises its usefulness for retail price determinations in affected jurisdictions. Since a price regulator will consider only the cost applicable to the benchmark efficient retailer, it follows that the most useful estimate of implementation costs would be one appropriate to a retailer of that type. In turn, this suggests that retail price regulators should have input into the guidance materials discussed above. This would then provide AEMO (for instance) with clarity as to the type of entity to assume for costing purposes.

Our view

We consider that this is a worthwhile reform to pursue, noting that it would likely take several years to implement. We consider that advocacy for this approach should build on the advocacy for Response 2.

5.4 Conclusion

It is evident from our review that the costs expected to be imposed by regulatory interventions over the past decade have generally not been closely scrutinised prior to implementation.

Further, the re-imposition of retail price regulation at both the national and Victorian levels more recently has made recovery of all these intervention-related costs more challenging. The increase in intervention costs and imposition of price regulation has compressed retail margins reducing the attractiveness of new market entry.

6 International Review

Key points

- UK energy suppliers also face challenges in recovering debts and managing non-payment risks. However, it appears that more tools and a somewhat better balance of the interests of consumers and retailers has been obtained compared to the NEM.
- In the UK, the combination of licence conditions and a voluntary industry commitment among the six largest energy retailers (the EnergyUK Safety Net) have made retailer-imposed disconnections exceedingly rare for vulnerable customers.
- PPMs are widely used in the UK, including on a non-voluntary basis, and regulatory measures provide further protection for PPM customers, as well as a mechanism for indebted PPM customers to be able to transfer between retailers, taking debts with them.
- In the UK, in certain and limited circumstances, retailers can require a security deposit from a customer.
- A broader international review found that PPMs are used across several countries in Europe and in New Zealand, along with security deposits for risk and debt management.
- In both the mobile phone and banking sectors, we find that consumers and their advocates often consider that their interests are better served by foregoing the provision of credit by their retail service provider.

6.1 United Kingdom

6.1.1 Regulatory framework

We reviewed the UK's consumer protection framework for the energy sector to draw relevant lessons for the Australian consumer protection regime. The UK experience is relevant, as some of the regulatory features observed in Australia (e.g. DMO and incentive mechanisms for regulated entities) are like those applied in the UK.

In the UK, retailers ("suppliers") are licensed and subject to *Standard Conditions of Electricity Supply Licence* and *Standard Conditions of Gas Supply Licence*. The licences set out a range of conditions for suppliers regarding the management of customers and payment.

6.1.2 Managing customers and payments

The extent, and continued development, of rules and conditions for UK suppliers is creating some challenges for retailers to recover debt and manage non-payment risk. However, it appears that more tools and a somewhat better balance of the interests of consumers and retailers has been obtained compared to the NEM.

Debt recovery

As in Australia, suppliers in the UK are required to engage with customers facing difficulty and try to collect debt via all possible means considering customers' ability to pay. This emphasis on early engagement and on retailers proactively re-engaging with customers was stressed again most recently in October 2020 with amendments to principles relating to payment difficulties.

As in Australia, disconnection is treated as a last resort action with strict rules that prohibit suppliers from disconnecting certain customers. In the UK, the combination of licence conditions and voluntary industry agreements have made retailer-imposed disconnections rare.

Licences require suppliers to consider customers' ability to pay when setting debt recovery rates and repayment plans and undertake several payment recovery actions before disconnection. Ofgem requires suppliers to "offer certain options and services for customers who are in payment difficulties, and to take all reasonable steps to ascertain the customer's ability to pay when agreeing the duration and value of a repayment plan, whether through direct debit or a prepayment meter".[73]

In October 2020, Ofgem decided to update the Ability to Pay principles in the supply licence conditions, to give the principles further prominence and emphasise consumer protection for customers who are in potential and actual financial difficulty. The principles are:

1. Having appropriate credit management policies and guidelines;
2. Making proactive contact with customers;
3. Understanding individual customer's ability to pay;
4. Setting repayment rates based on ability to pay;
5. Ensuring the customer understands the arrangement;

[73] Ofgem (2010) Supporting customers struggling with their bills – see 'Debt'. Available at: https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/protecting-and-empowering-consumers-vulnerable-situations/consumer-vulnerability-strategy/supporting-customers-struggling-their-bills

6. Monitoring arrangements after they have been set up; and

7. Re-engaging with the customer after an initial occurrence of a failed repayment arrangement (*new principle consulted on*).[74]

While suppliers have the right to disconnect a customer on the grounds of debt, suppliers must first have tried to collect the debt via all other means, including a repayment plan, deductions from state benefits[75] or, as last resort, a PPM.[76] However, there are strict rules on which customers' suppliers are prohibited from disconnecting, including premises solely occupied by pensioners during winter (October to March), disabled or chronically sick customers during winter; customers eligible for the Priority Services or a 'Safety Net' vulnerable customer; and customers who are bankrupt or owe debts to a former energy supplier.

The Energy UK Safety Net was established to reduce the number of disconnections. The six largest suppliers (British Gas, EDF Energy, Npower, E.ON, Scottish Power, and SSE) have voluntarily agreed to never disconnect a vulnerable customer at any time of year.[77] We conclude that the retailers did this because they judged that even without the right to disconnect customers for non-payment, they possessed adequate "debt management solutions that are appropriate for the customers' circumstances, such as repayment schemes, PPMs, Fuel Direct,[78] referral to debt advice agencies, and social services via dedicated support teams".[79]

The definition of 'vulnerable' agreed by Energy UK members is:

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[74] Note that this formalised practices that were already common in the sector and was a change that had already been foreshadowed ahead of COVID. Ofgem (2020) Ofgem strengthens protections for customers struggling with energy bills this winter, 19 October, https://www.ofgem.gov.uk/publications-and-updates/ofgem-strengthens-protections-customers-struggling-energy-bills-winter; https://www.ofgem.gov.uk/system/files/docs/2020/10/self-disconnection_and_self-rationing_decision.pdf

[75] Customers have the option of paying debt directly from their benefits through the Fuel Direct Scheme. Under this scheme, a fixed amount will automatically be taken from the customer's benefits to cover what they owe, plus an extra amount for their current use. This option comes before the installation of a PPM, which is seen as last resort (before disconnection). Source: https://www.citizensadvice.org.uk/consumer/energy/energy-supply/get-help-paying-your-bills/struggling-to-pay-your-energy-bills/

[76] Ofgem (2020) Energy supply disconnection and prepayment meter rules. Available at: https://www.ofgem.gov.uk/consumers/household-gas-and-electricity-guide/who-contact-if-its-difficult-paying-energy-bills/energy-supply-disconnection-and-prepayment-meter-rules

[77] Energy UK (2020) Safety Net. Available at: https://www.energy-uk.org.uk/our-work/retail/safety-net.html

[78] The UK equivalent of CentrePay.

[79] Energy UK (2016) The Energy UK Safety Net: Protecting Vulnerable Customers from Disconnection, February, https://www.energy-uk.org.uk/files/docs/Disconnection_policy/Sept15_EUK_Safety_Net.pdf.

> A customer is vulnerable if for reasons of age, health, disability or severe financial insecurity, they are unable to safeguard their personal welfare or the personal welfare of other members of the household.[80]

Since the Safety Net was founded, disconnections of residential customers for debt has reduced significantly. In 2003, there were around 16,000 disconnections of domestic customers for debt and in 2015 (the most recent year for which published data exists), there were just over 250. In Australia, there were 70,795 residential electricity disconnections (1.09% of electricity customers) and 10,373 residential gas disconnections (0.48% of gas customers) in 2018-19.[81]

Identifying vulnerable customers can be difficult, so energy suppliers are expected to work with third parties to ensure that their practices are as robust as possible. Energy UK has produced a guide for agencies to illustrate the steps that suppliers may take to identify and managing vulnerable customers[82] and Ofgem published Consumer Vulnerability Strategy 2025, which has five themes underpinning the desired improvements for customers in vulnerable situations. Ofgem also publishes an annual report on vulnerable consumers in the energy market, which presents their assessment of how the energy market is working for these consumers and overview of suppliers' performance on vulnerability.[83] Overall, Ofgem's assessment showed that companies have made some progress since their last report to improve outcomes for vulnerable consumers. However, Ofgem noted concerns about the performance of the sector, and in particular, small and medium suppliers, in some key areas. For example, average repayment rates were found to be going down, but smaller and medium suppliers were still setting the highest repayment rates. Another concern was around these suppliers not looking beyond demographic data of their customer base (i.e. looking beyond those that are pensionable age) to recognise vulnerability.

Under the NERR, rule 75A(1) requires the AER to develop, maintain and publish a binding and enforceable Customer Hardship Policy Guideline. The Guideline creates binding, enforceable obligations on retailers to strengthen protections for customers experiencing payment difficulties due to hardship and retailers must comply with the Guidelines when they submit a new or varied customer hardship policy to the AER.

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[80] Energy UK (2016) The Energy UK Safety Net, February, https://www.energy-uk.org.uk/files/docs/Disconnection_policy/Sept15_EUK_Safety_Net.pdf

[81] AEC (2019) Annual retail markets report 2018-19. Available at: https://www.aer.gov.au/system/files/AER%20Annual%20Retail%20Markets%20Report%202018-19_0.pdf

[82] Energy UK (2016) Protecting Vulnerable Customers from Disconnection.

[83] Ofgem (2019) Vulnerable consumers in the energy market: 2019.

In addition to managing vulnerable customers, suppliers in the UK are not permitted to charge an interest rate on outstanding debt at credit recovery and suppliers can only seek to recover up to 12 months' worth of unpaid electricity amounts.[84]

Prepayment meters (PPMs)

In the UK, suppliers can enforce instalment of a PPM if a customer is in debt, so long as it is 'safe and practicable' to do so – Ofgem prohibits the mandatory installation of prepayment metering in specific circumstances and requires that it only be imposed where all other options have been exhausted, as discussed above. A PPM tariff means the customer pays upfront for gas or electricity use. Licence conditions also require suppliers to provide information to consumers prior to or upon installation of a PPM so they understand how to operate their meter, how to top-up and stay on supply, as well as the advantages and disadvantages of a PPM.

The UK has seen PPMs actively imposed on customers, notwithstanding the additional practical costs and hurdles that this involved prior to the widespread rollout of smart meters. Some measures were introduced to soften the manner in which PPMs were being imposed. In 2017, following the identification of and consultation on several issues,[85] Ofgem modified gas and electricity supply licences to provide further protection for PPM customers.[86] Additional protections were:

- **A prohibition on suppliers using warrants in certain exceptional cases** – requiring that suppliers do not install a PPM under warrant for the purposes of recovering debt where the process would be severely traumatic due to a consumer's mental capacity and/or psychological state.
- **A prohibition on suppliers levying charges for the cost of having a PPM installed under warrant in some cases and a cap of £150 in all other cases** – intended to encourage suppliers to avoid using warrants to impose PPMs where other options are available.
- **Proportionality principle** – covering costs and actions of suppliers, for all customers in the debt recovery process. The intended effect of this measure is to

[84] Standard conditions of electricity supply licence - Condition 21BA.1

[85] Key concerns were around suppliers' failures to identify vulnerability during the PPM warrant application and execution process and inconsistent charging for warrant-related costs where vulnerabilities were discovered.

[86] Ofgem (2017) Decision to modify gas and electricity supply licences for installation of PPMs under warrant. Available at: https://www.ofgem.gov.uk/system/files/docs/2017/11/decision_to_modify_gas_and_electricity_supply_licences_for_installation_of_prepayment_meters_under_warrant.pdf

ensure that suppliers take actions and levy charges that are proportionate in all cases where they seek to recover debt from consumers.

Smart meters can operate in both credit and PPM mode, removing the need to access people's homes and physically change their meter when they move between credit and PPM tariffs, as well as the resultant cost. The smart meter rollout was due to be completed by the end of 2020, so the rules relating purely to warrant-related activities were expected to cease to apply at the end of 2020.[87] However, in December 2020, Ofgem decided to extend existing protections for consumers who may have a PPM installed under warrant until 30 June 2025, to align them with the new framework for the smart meter rollout that will run through to mid-2025.[88]

Credit transfers

PPM customers are entitled to credit transfers – that is, they can churn, taking their debt with them to the next retailer, if currently repaying a debt of £500 or less per fuel. PPM customers may do this regardless of a debt objection by the supplier using a process known as the Debt Assignment Protocol (DAP).[89] Although the DAP mechanism only applies to PPM customers, Ofgem research has shown that some suppliers will allow indebted customers, particularly those with low or moderate levels of debt, to transfer supplier regardless of their payment method.[90] If a customer has fallen into debt, the supplier may install a PPM to help the customer control their usage against their budget.[91] The customer can use a PPM to pay back the outstanding balance over a period of time. In Australia, Rule 133 of the NERR expressly prohibits this: "the retailer must not recover any repayments of the debt under a PPM market retail contract or under any other contract or agreement that adjusts the charges in the PPM system to recover the amount of the debt."[92]

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87 Ofgem (2017) Decision to modify gas and electricity supply licences for installation of PPMs under warrant. Available at: https://www.ofgem.gov.uk/system/files/docs/2017/11/decision_to_modify_gas_and_electricity_supply_licences_for_installation_of_prepayment_meters_under_warrant.pdf

88 https://www.ofgem.gov.uk/system/files/docs/2020/12/decision_extending_28b_final_20201216.pdf

89 Ofgem, Debt Assignment Protocol. Available at: https://www.energy-uk.org.uk/publication.html?task=file.download&id=5937#:~:text=Prepayment%20customers%20can%2C%20however%2C%20still,objection%20and%20complete%20their%20switch.

90 Ofgem (2016) Ofgem stakeholder letter 'Review of domestic debt objections: our decision', 25 July 2016. Available at: https://www.ofgem.gov.uk/system/files/docs/2016/07/decision_on_review_of_domestic_objections.pdf

91 UK Power. Available at: https://www.ukpower.co.uk/home_energy/prepayment-meters

92 National Energy Retail Rules Version 24, Part 8 Prepayment Meter Systems.

In 2016, Ofgem reviewed the likely impact of removing debt objections and found that the impact on customers and suppliers would be significant.[93] Therefore, debt objections have been retained with special conditions given to PPM customers, as discussed above.

Security deposits

In certain circumstances (as set out in suppliers' licence conditions and Ofgem guidance), a supplier can also request a security deposit before providing/reconnecting a supply of electricity. Suppliers with under 50,000 customers must however offer customers the chance to pay for energy through a PPM as an alternative to a security deposit, or if they become aware or have reason to believe that the customer will have difficulty paying for their energy.[94]

If they do require security deposits, they must not exceed a reasonable amount. The amount of a security deposit will depend on all the circumstances of the case. In most cases it is not expected to exceed one and a half times the value of the average quarterly consumption of electricity reasonably expected at the relevant premises. In Australia, the NECF stipulates that there are limited circumstances where retailers can require a security deposit from a small customer (residential or small business). This means that if a retailer considers a residential customer's credit history is not satisfactory, it can require a security deposit before signing this customer unless this customer is a hardship customer and/or experiencing payment difficulties.

Vulnerability

In 2019, Ofgem released its new 'Consumer Vulnerability Strategy 2025'.[95] The Strategy focuses on five themes – improved identification, better support, better customer service, innovation and collaboration. In the first year of the Strategy, Ofgem intended to focus on strengthening rules to protect consumers in vulnerable situations from self-disconnecting their pre-payment meters and updating and strengthening the Ability to Pay principles. While at the moment, it appears that the UK imposes a less restrictive framework regarding vulnerable customers than what exists in the NEM, further tightening in the UK remains a distinct possibility.

[93] Ofgem (2016) Decision on review of domestic and non-domestic objections. Available at: https://www.ofgem.gov.uk/publications-and-updates/decision-review-domestic-and-non-domestic-objections

[94] Ofgem (2019) Supply licence guide: Metering, billing and payments, 21 February 2019. Available at: https://www.ofgem.gov.uk/system/files/docs/2019/02/licence_guide_metering_billing_and_payments_1.pdf

[95] Ofgem (2019) Consumer Vulnerability Strategy. Available at: https://www.ofgem.gov.uk/system/files/docs/2020/01/consumer_vulnerability_strategy_2025.pdf

Retail price caps

Price caps per unit (kWh) are enforced for PPM customer or for customer on a standard variable or default energy tariff.[96] Ofgem calculates price cap levels twice a year. Calculations reflect a broad estimate of how much it costs an efficient supplier to provide gas and/or electricity services to a PPM customer or to customer on a basic 'default' or 'standard variable' energy tariff. The current cap levels are set for 1 October 2020 to 31 March 2021. Ofgem has indicated a willingness to explicitly consider the cost of managing increased bad debts as part of resetting the price caps for the next period – something we consider further under Section 6.1.3 below.

Load limitation

Load limiting, where the flow or amount of electricity supplied to a customer is restricted, is currently not allowed by Ofgem, pursuant to its findings from a 2012 review.

At the time, Ofgem accepted the potential advantages for customers but wanted to see further improvements in functionality and user acceptance. This is consistent with the rules in Victoria, which has near universal penetration of smart meters with load limitation capabilities. The NERR appears to be silent on this question, which is consistent with the more limited deployment of the smart meters required to implement it.

6.1.3 COVID-19 response

Initial response

In March 2020, suppliers have voluntarily agreed to support vulnerable customers through COVID-19, including those on PPMs facing difficulties in topping up while self-isolating or in financial distress.[97] Prior to the COVID-19 outbreak, Ofgem had been undertaking a review of licence obligations regarding vulnerable customers. In October 2020, Ofgem decided on new stronger protections for PPM customers, who are more likely to be in vulnerable circumstances, in the form of new permanent licence requirements.[98] The three main new protections are:

[96] Ofgem. Available at: https://www.ofgem.gov.uk/energy-price-caps/consumers

[97] Ofgem (2020) More help for prepayment customers and those struggling with bills, 29 June 2020. Available at: https://www.ofgem.gov.uk/publications-and-updates/more-help-prepayment-customers-and-those-struggling-bills

[98] Ofgem (2020) Self-disconnection and self-rationing: Decision, 19 October 2020. Available at: https://www.ofgem.gov.uk/publications-and-updates/self-disconnection-and-self-rationing-decision.

- A requirement on suppliers to take all reasonable steps to identify on an ongoing and continuous basis where the PPM customer is self-disconnecting and to offer appropriate support, giving due consideration to customers in vulnerable situations.
- Requirements on suppliers to offer emergency and friendly-hours credit to all PPM customers and to offer additional support credit to PPM customers in vulnerable circumstances who are at risk of self-disconnecting or self-rationing.
- Updated Ability to Pay principles included in the electricity and gas supply licences to ensure consistent support for customers struggling to pay their bills.

Under the emergency and friendly hours credit requirements, suppliers must offer emergency and friendly hours credit (for example, when top-up points are closed) to all PPM customers, plus offer additional credit for consumers in vulnerable circumstances to provide extra breathing space while working out alternative arrangements to pay. These would include customers who temporarily cannot afford to top up or get to their local shop to top up because of a mobility issue or due to self-isolation.

Further responses

Ofgem has been concerned about increasing numbers of PPM customers who go without energy or "self-disconnect" after running out of credit on their meter since before COVID-19 and consulted on initial proposals in 2019. Many suppliers already provided extra support, typically £5-£20 credit per fuel at a time, but this was inconsistent across the industry.[99] The types of credit are:

- "Emergency credit" is a fixed amount of credit provided to customers when their meter runs low or runs out to ensure continuity of supply.
- "Friendly hours credit" is provided overnight, at weekends and public holidays, when top up points may be closed and a customer's PPM runs low or runs out.
- "Additional support credit" is provided to customers in vulnerable circumstances who may have exhausted other options.

Ofgem is proposing to make the offering of these credit functions by suppliers mandatory. The customer usually has to repay this extra credit when they next top up but Ofgem wants suppliers to consider customers' ability to pay and agree to an affordable rate when customers are struggling to repay this credit.

[99] https://www.ofgem.gov.uk/publications-and-updates/more-help-prepayment-customers-and-those-struggling-bills#:~:text=Under%20these%20proposals%20Ofgem%E2%80%99s%20Ability%20to%20Pay%20Principles,after%20an%20initial%20occurrence%20of%20a%20failed%20repayment.

Impact on costs for suppliers and price caps

Retail price caps already have an impact on supplier's ability to recover costs. However, the impact of the COVID-19 pandemic and higher levels of unemployment is leading to more households struggling to pay their supplier and it is expected the number of unpaid bills (or 'bad debts') will rise during winter. Ofgem acknowledges that the pandemic has resulted in anticipated bad debts rising to levels that are not covered by the price cap and it is now considering whether higher 'bad debt' costs for suppliers should be factored into the default tariff price cap when next updated from 1 April 2021.

Ofgem estimated that the average increase in costs would be £21 per household.[100] However, Ofgem proposes to partially offset this increase by ending another allowance, giving a net increase of around £6. The fact that Ofgem simultaneously granted and removed allowances to arrive at a small upwards adjustment suggests it may be facing considerable pressure to both recognise the real viability impacts on retailers and political demands for bill increases to be minimised during the pandemic.

Relevantly, the ESCV in setting the 2021 VDO included an additional allowance of $6 per customer for bad debts to account for the effect of the coronavirus pandemic on retailers' costs. The ESCV expects the additional $6 allowance for bad debts to be temporary, and will be removed from the VDO 'cost stack' at a future review.[101] The ESCV referred to Ofgem's approach (noted in Origin's submission) of treating COVID debt-related costs separately and considering a true-up mechanism to account for differences between the estimate of debt-related costs and actual costs in a subsequent price decision.

6.2 Other jurisdictions

Similar to the UK, key interventions such as PPMs, security deposits and supply suspension are used in several jurisdictions across Europe and in New Zealand. A summary is provided in the table below, showing that PPMs and disconnections are used in all jurisdictions, while security deposits were positively identified as being permitted, and used in practice, in only four. It is notable that many of the countries that we considered experience much more severe winters than mainland Australia.

[100] Ofgem (202) Ensuring suppliers can continue to serve customer during COVID-19, 20 November 2020, available at: https://www.ofgem.gov.uk/news-blog/our-blog/ensuring-suppliers-can-continue-serve-customers-during-covid-19.

[101] https://www.esc.vic.gov.au/sites/default/files/documents/FD%20-%20%202021%20VDO%20-%20Final%20decision%20-%2020201125.pdf

Table 6 Summary of key regulatory framework features in other jurisdictions

Jurisdiction	PPM	Security deposits	Disconnection or supply suspension
New Zealand	✓	-	✓
	Interventions have been limited to voluntary guidelines for assisting vulnerable consumers. Guidelines do not contain any expectations for the service standards prepay customers should receive.		Debt process can lead to disconnection.
Austria	✓	✓	✓
	PPMs include a guarantee deposit for the supplier. It is configured to allow payment for both the grid fees and energy.	Suppliers can ask for advanced payments or guarantee deposits.	Dunning procedure: two reminders, given each two weeks for the customer to react must be sent before the contract is suspended.
Belgium	✓	✗	✓
	Suppliers must follow lengthy dunning procedures (typically take several months) before a PPM is installed – differs across regions.		Only following extensive notice and installation of PPM can supply be suspended. In Brussels, disconnection is only possible after a judicial decision.
Germany	✓	✓	✓
	Some suppliers offer PPMs and payment systems; however, it is only on a small scale. PPMs are not just for bad payers and they are not obliged to get a PPM.	Suppliers can ask for guarantee deposits/ upfront payments (4 weeks in advance) if a customer is repeatedly late with his payments.	It is possible to suspend supply. Customers have little formal protection against disconnections but can rely on the court system to protect them from disconnections.
Hungary	✓	✓/✗	✓
	PPMs are a mandatory option for USP suppliers. Some suppliers also propose prepayment solutions.	Technically possible but are in practice not applied.	For unpaid energy bills, suppliers can cut-off business customers after a 30-day notice, residential customers after a 60-day notice. Exception: vulnerable customers are offered PPMs and a schedule to pay old debt.
Ireland	✓	-	✓
	Pay as you go (PAYG) meters are on offer with a 4% discount.		Contracts can be terminated through disconnection after agreed industry procedures have been applied.
Luxembourg	✓	✓	✓
	A smart meter platform is to be deployed and will allow for prepayment.	Some suppliers ask for guarantee deposits.	If invoices are not paid on time, supply can be suspended until complete payment of the outstanding items. Appropriate notice must be given.
Poland	✓	✓	✓
	PPMs are available.	Guarantee deposits are possible only for commercial customers.	Only possible if the customer has not paid bill 30 days after due date. A letter must be sent requesting payment no later than within 14 additional days (on top of the 30 days period).

Source: Eurelectric (2016) Mitigating credit risk in the interest of electricity consumers; Brattle Group (2018) International Experiences in Retail Electricity Markets.

6.3 Other sectors

Synergies has drawn on experiences in the mobile phone and banking sectors for examples of practices or approaches to managing non-payment risk that offer interesting perspectives on the issues under consideration here. In summary, we find that in both the mobile phone and banking sectors, consumers and their advocates often consider that their interests are better served by foregoing the provision of credit by their retail service provider.

6.3.1 Mobile phone plans

Sector developments

Most telecommunications retailers offer prepaid plans, which made up nearly a third of all mobile phone contracts sold in Australia in 2019.[102] Prepaid plans typically involve a month-by-month arrangement with a cap on the services included (calls, data, etc). Prepaid plans usually feature a hard cut-off to service at the end of the month, unless automatic top-ups are set up, but service can be re-established immediately upon paying the monthly fee. Prepaid mobile plans are not marketed exclusively to customers in financial difficulty, although they would usually be recommended to this group by telcos and financial counsellors.[103]

While post-paid mobile plans have long been more popular with consumers, this appears to be at least partly driven by the fact that telcos bundle handsets with post-paid plans and not with pre-paid plans. In recent years, Australian consumers have moved towards "bring your own phone" options, which removes one of the main selling points of a post-paid plan. Market research firm Roy Morgan cites this explanation for why prepaid plans are increasing their market share in Australia.[104]

Insights

It is apparent that a very significant minority of mobile phone customers appear to be quite happy not to receive credit from their retailer and are willing to manage temporary interruptions to service if they are unable to pay their bill. There are significant differences between interruption to a mobile phone service and interruption to one's energy supply, but interruptions to either can cause significant disruption for

[102] Roy Morgan (2019) "Australians are bringing their own phone to new mobile plans" 1 July, http://www.roymorgan.com/findings/8032-mobile-phone-trends-march-2019-201907010451

[103] Anglicare (2020) *Financial Counselling Fact Sheet #26 I Can't Pay My Phone Bill*, June.

[104] Roy Morgan (2019) "Australians are bringing their own phone to new mobile plans" 1 July, http://www.roymorgan.com/findings/8032-mobile-phone-trends-march-2019-201907010451

consumers. If regulators of the telecommunications sector have concluded that customers on prepaid mobile phone services should be relied upon to manage times when they run out of credit (as the price they pay for having the benefits of a prepaid service) it is not obvious why a similar conclusion should not apply in relation to electricity or gas services.

6.3.2 Banking products for vulnerable customers

Sector developments

There have been recent developments in the banking sectors to establish standardised, no-frills, banks accounts designed with the needs of disadvantaged customers in mind. Among the features common to standards developed in Australia and the United States is the characteristic of offering no overdraft.

In Australia, the Hayne Royal Commission highlighted the practice of banks providing informal overdrafts which allow a customer to withdraw more than the amount of funds available in their account.[105] Banks typically charged an overdrawn fee for this, and sometimes interest on the overdrawn amount until repaid.[106] In response, the Australian Banking Association, with the authorisation of the ACCC, modified the Australian Banking Code of Practice to require that banks which offer basic accounts – marketed as low fee or fee free transaction accounts – would not provide informal overdrafts.[107]

In the United States, similar issues and broadly similar responses are apparent. In a 2019 paper entitled "Financial Inclusion and Credit Access Policy Issues", the Congressional Research Service highlighted the issue of overdrafts for vulnerable customers, stating:[108]

> "For consumers living paycheck to paycheck, maintaining bank account minimums and avoiding account overdrafts might be difficult, leading to unaffordable account fees."

Recently in the US, a not-for-profit organisation called the Cities for Financial Empowerment Fund has established "Bank On", an advocacy platform to reduce the number of Americans without access to affordable bank accounts. Among other things, Bank On provides a set of voluntary standards for low cost accounts called "Bank On

[105] Commonwealth of Australia (2019) Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation, and Financial Services Industry, Vol. 1, p. 260-261.

[106] ACCC (2019) Determination on Application for authorisation lodged by the Australian Banking Association in respect of certain amendments to the 2019 Banking Code, 21 November, page 6.

[107] Australian Banking Association (2020) Australian Banking Code of Practice, 1 March, page 23.

[108] Congressional Research Service (2019) Financial Inclusion and Credit Access Policy Issues, 24 October

National Account Standards". The American Bankers Association recently endorsed the standards and called on all banks to offer Bank On certified accounts.[109] A core feature of the standards is that accounts certified against that standard must ensure that overdrafts are structurally not possible.

Insights

The response to problems with overdrafts and vulnerable customers suggests that policy makers and industry groups have all converged on the view that providing credit in some circumstances works, on balance, against the welfare of the recipient of that credit. The benefit of this arrangement is that the customer does not unwittingly take on credit it may find difficult to manage, while the service provider assumes no credit risk.

Perhaps as importantly, the customer receives immediate and salient feedback ("transaction declined") which prompts them to take some action regarding their finances. The downside is that customers who attempt to purchase goods or services using one of these basic bank accounts will be able to do so only if their account is in credit, irrespective of how vital or urgently needed those goods or services are at that time.

[109] American Bankers Association (2020) ABA Urges America's Banks to Offer Bank On-Certified Accounts, 19 October, https://www.aba.com/about-us/press-room/press-releases/aba-urges-americas-banks-to-offer-bank-on-certified-accounts.

7 Options to Address Non-Payment Risks

Key points

- Synergies considered 12 potential options to address non-payment risks currently faced by retailers, including tools available to retailers as well as government policy interventions.
- We evaluated the options using criteria concerned with economic efficiency and acceptability to consumers, retailers and policy makers.
- We concluded that the most prospective options are:
  - Advocating for greater recognition of non-payment risks in regulated retail price resets and trialling load information approaches for vulnerable customers, both of which could be implemented in around a year;
  - Increasing the use of smart meters, which would require regulatory changes and would take in the order of three years, but which may also require reforms to address up-front cost barriers associated with smart meters;
- There are several other options that are likely to be unsuitable to pursue in the short term but which may have greater potential in the medium to long term, including:
  - load limitation;
  - increased scope to disconnect (compared to the status quo); and
  - use of security deposits.

7.1 Potential options

7.1.1 Selection process

We identified a range of options based on:

- our review of regulatory and commercial practice and developments in Australia and overseas;
- our consideration of the limitations imposed under the NECF and the Victorian framework;
- suggestions from retailers that we interviewed; and
- other suggestions from the AEC.

We sought to cover a diversity of approaches, some of which contemplate a significant role for government, while others would be largely implemented by market participants. In each case, we considered how the option could be implemented, how long this process might take and how complex it might be.

7.1.2 Summary of options

The options we identified are listed in Table 7 below and a more detailed description of each option provided in the following section. Table 7 also provides our estimate of the time horizon over which each option might be feasible to deploy or implement. In estimating time requirements, we have focussed on the complexity of associated policy development, rule changes, as well as customer education or operational considerations. We have not included in these estimates the time that might be required to win over consumers, advocates or policy makers. The detailed evaluation of the options is separately addressed in section 7.3.

Table 7 Overview of potential options to improve or mitigate retailer non-payment risks

Ref#	Option	Description	Implementation horizon
Options that enhance risk management			
1	Increased use of PPMs	Offer PPM services so customers use energy up to the amount of credit stored in the meter.	1 to 3 years
2	Use of security deposits	Require customers to provide a security deposit at the time of signing up with a retailer.	3 to 5 years
3	Load limitation (business)	Use smart meters to limit maximum supply to the business – auto disconnect when a usage limit is exceeded, business must self-reconnect.	3 to 5 years
4	Load limitation (residential)	Use smart meters to limit maximum supply to the house – disconnect when a usage limit is exceeded.	5 to 10 years
5	Load information	Attach a smart device to customer's meter that automatically sends message about load consumption to customer's phone.	1 year
6	Increased scope to disconnect	Give retailers reasonable control over the timing when they can provide a disconnection threat to customers.	1 year
Options that address capacity to bear risk			
7	Increase targeted government support	Provide targeted support to customers that meet eligibility criteria. For example, the NSW energy vouchers scheme.	1 year
8	Insurance against excessive bad debts	An insurance scheme protecting retailers from losses due to bad debts that exceed pre-agreed thresholds.	3 to 5 years
9	Insurance against retailer failure	An insurance scheme protecting against retailer failure, where increased bad debt is known to have been a significant causal factor.	3 to 5 years
10	Regulated retail price reset for higher cost reflectivity	DMO and VDO to reflect costs incurred by retailers on account of exogenous events including implementation costs of interventions and additional costs of debt management.	1 year
11	Distributors share risk of non-payment ("French" model)	Retailers to avoid paying distribution charges when customers default on payments.	3 years
12	Distributors bill customers directly	Introduce dual billing system with distributors billing customers directly for distribution services and retailers billing customers for retail services.	5 years

7.1.3 Detailed option descriptions

Prepayment meters (PPMs)

Like a prepaid mobile phone, PPMs allow customers to add credit to their energy account in advance of consumption. As the customer uses electricity, the meter records how much credit remains, and when credit runs out the meter self-disconnects the energy supply. The product can be configured to provide a small amount of 'emergency credit' as a contingency against disconnection if a customer has not 'topped-up' their meter in time.[110]

The key feature of a PPM system (irrespective of whether it is a dedicated PPM or a smart meter with prepayment functionality) is the self-disconnection feature that is triggered when credit runs out. The fact that this outcome is effectively hard-coded as the result of failing to keep the account in credit, gives a customer with a PPM an extremely pointed incentive to maintain credit. This, in turn, is what makes it an effective tool for retailers in managing non-payment risk. PPMs established on a smart meter platform can readily combine additional warning and messaging options, more flexible rules for extending credit and convenient payment options.

Under the NECF, relevant jurisdictions can pass an enabling law to allow the use of PPMs within that jurisdiction. To our knowledge, Tasmania, South Australia, ACT and Queensland have passed the legislation enabling the use of PPMs. In Victoria, a standard retail licence condition for all electricity and gas retailers is that they must not implement a PPM arrangement without the prior approval of the ESCV. Among overseas jurisdictions, PPMs are offered in the UK and New Zealand and widely throughout Europe and South East Asia.

Estimated time to implement: 1 to 3 years. To implement a PPM arrangement today, retailers must comply with the relevant provisions of the NECF or seek the ESCV's approval in Victoria. In the context of non-payment risk management, these provisions and metering service regulation more generally, mean the cost of compliance for retailers is likely to be prohibitive (see section 4.4).

Thus, to be workable as a non-payment risk management solution, changes to the NECF and Victorian law would be required to simplify the application of PPM schemes while maintaining reasonable customer protections.

[110] https://www.aer.gov.au/retail-markets/other-retail-roles;
https://www.aer.gov.au/system/files/AER%20retail%20energy%20market%20update%20Q1%202012-13.pdf

From a cost perspective, the barrier of having to install a new smart meter, which will be used to provide the PPM arrangment for high risk customers (with no confidence of recovering its cost), could be overcome if the DMO and VDO appropriately recognise these metering costs (refer to our discussion in section 4.5.3 above).

Security deposit

Under this option, retailers would have increased scope to require the customer to provide a security deposit to manage the risk of non-payment. There would be an increased set of circumstances in which it was acceptable to request a deposit at the time of offer. There might also be limited rights to request a security deposit be extended to situations in which the retailer has identified a change in the risk profile of an existing customer. To make this option more tractable might require that energy retailers be granted access to more detailed credit scoring information currently only permitted to be supplied to financial services firms. Applying security deposits after the retailer has identified that the customer is experiencing difficulty in paying their bills may do little to protect retailers. It may even exacerbate problems as the task of repaying the debt may come to seem unachievable.

That only a few retailers have held security deposits suggests that the cost of complying with security deposit regulations and the administrative burden of managing security deposits – e.g. the requirement to create separate accounts for security deposits under rule 41(3) of the NERR – are the main constraints on more widespread use of what, in principle, could be a reasonably effective non-payment risk management tool.[111]

Other constraints retailers might face in putting this tool to practice could be due to:

- retailers being unable to do thorough credit history checks for customers due to insufficient information, and
- the requirement for retailers to justify their decision to customers to require a security deposit, which could be exacerbated by the lack of information on customers' credit history.

We gathered from the interviews that:

- utilities do not currently have access to comprehensive credit reporting, which is only available to the finance industry;
- credit default listing is banned in Victoria;
- it is difficult to do credit checks in circumstances when there are multiple people at a share house and there is a history of cycling accounts and non-payment.

[111] https://www.aemc.gov.au/sites/default/files/2020-08/NERR%20-%20v24%20-%20Part%202.pdf

Estimated time to implement: 3 to 5 years. For security deposits to play a larger role for energy retailers, regulatory changes would be needed to reduce the compliance cost and administrative burden including relaxing the requirements for retailers to justify their customer credit risk assessment or improving retailers' access to credit information so they can assess whether a security deposit (which is capped under the NERR[112]) would sufficiently mitigate the risk of a non-payment. However, the cap also means retailers may avoid serving very high risk customers (if there was improved credit information available), whose energy needs may only be met if government support was also available.

Load limitation

Load limitation involves smart meters equipped with supply capacity control capabilities. This is similar in concept to the flow restrictors used by water utilities but cannot be implemented as simply because of the properties of electricity and the requirements of electrical appliances.

At its most basic, load limitation would involve the meter monitoring flow through the connection point against a set point and immediately self-disconnecting whenever the flow exceeds that set point. The customer must then switch off appliances and reset the power in order to restore supply. There are many potential variants including:

- providing customers with a warning message (such as a text message) prior to the meter self-disconnecting;
- providing a notification after the self-disconnection, which includes basic instructions on what steps to take to restore service;
- dynamically setting the set point to allow customers to consume more at certain times and less at others;
- imposing load limitation:
  - for a set period as an alternative to disconnection, or
  - in combination with a prepaid product such that self-disconnections occur when both the account runs out of credit and the customer's consumption increases above the set point; and
- at its most sophisticated, relaying control messages to specific devices on the premises to switch off in order to avoid the self-disconnection.

[112] For a standard retail contract, the NERR caps the amount of security deposit to 37.5% of the customer's estimated bills over a 12 month period, based on the customer's billing history, or the average usage of energy by a comparable customer over a comparable 12 month period (rule 42 of the NERR)

There is no difference in technical terms between applying load limitation to a residential or a business customer. However, there are still practical and policy grounds for considering the use cases separately. Firstly, safeguarding access to electricity for residential customers is usually considered a higher order policy priority than for business customers. Secondly, while the procedure for notifying of a trip and restoring power after a trip is straight-forward, it is easy to imagine that there may be many exceptions where residential customers lack the tools or ability to stay informed and/or carry out the restoration procedure. In the case of business customers, this should be less problematic.

Finally, in Australia, the use of network tariffs with a maximum demand component is not uncommon for business customers and we expect that any transition to demand-based network tariffs is likely to proceed faster for business than for residential customers. Customers on demand-based tariffs would be better candidates for a load limitation response. The load limitation approach has been used in France for many years – a device fitted to the fusebox ensures the customer does not use more current than their selected electricity tariff allows, and should they exceed the allowed capacity it will trip the electrical supply.[113]

Estimated time to implement: 3 to 5 years for business customers and 5 years for residential customers. We think that for load limitation to be implemented in the mass market would require pilots, customer consultation, careful liaison with regulators and policy makers and concerted effort in education. We think that the lead times for business customers would be shorter than for residential customers for the practical and policy reasons discussed above.

Provide load information to customers

Load information involves placing a device onto a customer's meter to measure electricity load consumed at the customer's premise.[114] The device records electricity consumption and relays this data to a central repository from where this data can be easily accessed by the customer through an app or interrogated by algorithms designed to produce alerts and tips to help the customer manage their energy bills.

Access to this real-time usage data and to automated decision support messages can help customers to better understand their current electricity use, make better decisions about their electricity consumption and reduce their bills.

[113] https://www.frenchentree.com/living-in-france/utilities/french-electrical-systems/

[114] Examples we considered included those documented here: https://www.choice.com.au/home-improvement/energy-saving/reducing-your-carbon-footprint/articles/home-energy-management-systems; and here: https://www.yurika.com.au/metering/data-and-analytics.

Improving access to timely and salient information is consistent with the AEMC's approach to enhancing the operation of the retail market. However, it remains to be seen to what extent these types of tools would assist vulnerable customers who are already from the perspective of retailers presenting serious non-payment risks.

Trialling load information approaches could provide opportunities to learn more about a suite of related communication and decision support technologies and may assist retailers to develop the basis for load limitation products. Further load information approaches could help build familiarity and acceptance on the part of policy makers that may assist future advocacy around more prescriptive applications of technology for customers with higher non-payment risks.

Estimated time to implement: 1 year. The intent of implementing a load information device aligns well with the general policy and regulatory objective of providing increased information to customers to enhance their engagement with the energy market. We also do not see a need for regulatory changes to support this option. We expect the device could be rolled out within the span of one year.

Increased scope to disconnect customers

Disconnection is already one of the tools retailers use to manage non-payment risk, but the scope for using it has been considerably curtailed in both the NECF jurisdictions and Victoria. The Victorian Payment Difficulties Framework has greatly increased the administrative hurdles and time required before a customer can be disconnected without violating the framework. Some retailers advised that in Victoria they have taken disconnection off their list of strategies for managing non-payment risk because of the cost and risks involved. Retailers also advised that the AER's Statement of Expectations for energy businesses has effectively put a hold on debt collection and disconnections, although that is a temporary intervention (see Appendix A.20).

A more balanced set of controls on disconnection would make this option more feasible for retailers while not allowing them to end the accumulation of debts where there is a high risk that the debts will not be paid. Another important risk management benefit this would confer is that retailers would be able to issue disconnection notices as a tool to prompt customers to re-engage in relation to arranging payment of their energy bills.[115]

We recognise that this option would almost certainly result in more disconnections than currently and increased private cost and inconvenience, which is likely to be politically

[115] Several retailers we interviewed advised of the dramatic difference in response rates they received to a disconnection warning letter, compared with a letter merely advising that the customer was in arrears and needed to pay.

sensitive given the nature of energy as an essential service. Nonetheless, it may be reasonable to present it as an option to consider against other alternatives to help address the risks of non-payment. For example, providing for increased government support for consumers in genuine hardship, so that retailers can avoid bad debt in relation to this customer cohort rather than going down the disconnection route.

Estimated time to implement: 1 year. We anticipate that the amendments to the Payment Difficulties Framework in Victoria could be identified, consulted on and implemented within a year assuming that the ESCV was willing to consider them. We note that the restrictions imposed by the AER through its Statement of Expectations for energy businesses are time limited and expected to conclude at the end of the first quarter of 2021. In saying this, we acknowledge that the sensitivities surrounding these policies mean that a more gradual approach to policy change is likely to be more productive.

Targeted government support

By targeted government support, we have in mind transfer payments from government to retail energy account holders (i.e. benefits that are provided directly to the consumer and administered by energy retailers, applying the criteria imposed by the government in question). This could also take the form of the government providing a tax/levy holiday to vulnerable customers. This option could have many variants depending on:

- the level of assistance to be provided and up to what level of debt the scheme could cover;
- whether the assistance is applied early (like concessions) or late in the customer's journey of increasing payment difficulty (like the NSW Government's Energy Account Payment Assistance voucher scheme);
- whether retailers are to be expected to provide any form of matching contribution;
- the period over which the assistance would continue to be extended;
- how inclusive or narrow are the eligibility criteria; and
- whether there is to be any consistency of approach across jurisdictions.

Targeted government support for vulnerable consumers would reduce a retailer's risk from consumer bad debt. It would be consistent with the role of government in assisting vulnerable consumers from continuing to receive energy services rather than face disconnection. It would also mitigate adverse effects on retailer viability from bad debts arising due to meeting social policy objectives.

Relevantly, the statutory objective of the ESCV requires it to consider both the 'price, quality and reliability of essential services', and 'the financial viability of the industry'.[116] Additionally, the National Energy Retail Objective (NERO) includes the criteria of promoting 'efficient investment' in energy and promoting the 'long term interests of consumers' with respect to the price or reliability of energy supply – which implicitly require a consideration of the financial viability of the industry.

Estimated time to implement: 1 year. We would expect that implementing a program of this kind should be relatively quick, assuming the support and cooperation of governments and their treasuries. Much of the machinery and capabilities to deliver the support should already exist within retailers, with the main implementation hurdles (besides funding approvals) being the establishment of suitable administrative processes within government and developing the interface between government and retailers.

Insurance against excessive bad debts

Under this option, a dedicated insurance scheme would be established. The scheme would provision for the risk that bad debts would rise above some threshold level. Retailers would hold policies with the scheme and would gain the right to claim for losses over and above the cap. The scheme would need to define quite precisely the types of events that it covered, the obligations on retailers to mitigate their losses and the forms of evidence and assurance required to accompany claims. To be fully effective the scheme might require government underwriting.

Again, this option could take different forms, depending on:

- who pays the insurance premiums – governments, retailers or distributors;
- whether governments would underwrite the scheme;
- whether a single scheme serviced multiple jurisdictions;
- how generous or limited the insurance protection was;
- whether retailer participation was voluntary or mandated.

Synergies is not aware of any other jurisdictions that have implemented schemes of this kind.

Estimated time to implement: 3 to 5 years. We think that this option would be complex to implement for several reasons. The funding arrangements would only be relatively straight-forward if funded by government. Retailer funding would involve complex negotiations regarding relative risks, while distributor funding would also be difficult

[116] Essential Services Commission Act 2001 (Vic) sections 8(1) and 8A(1)(b).

to negotiate and would interact with pricing determinations. The administrative framework could also take some time to design and implement – among things the insurer would be obliged to establish robust systems capable of managing varied risks.

Insurance against retailer failure

This option would also involve a dedicated insurance scheme intended to protect against the risk that bad debt will rise to such a level as to be likely to have caused the retailer to default. Retailers would hold policies with the scheme and would gain the right to claim for a predefined benefit should that defined event come to pass. The defined event would comprise both a) a retailer defaulting or reaching a financial position consistent with imminent default (as defined in the policy); and b) that retailer's bad debts exceeding some threshold level.

The scheme would share many of the same features and involve many of the same implementation requirements as the previous option of an insurance scheme for excessive bad debts. However, the threshold for paying out to the retailer would be higher since the losses to the business would need to be so severe as to have contributed to the firm's default on its financial obligations. To work as intended, the benefit would need to be able to be paid out extremely quickly, so as to avoid the retailer failing and having its customer book reassigned under the retailer of last resort processes provided for in the NEM.

However, in removing a significant portion of retailers' commercial risk, we consider that this option could dangerously undermine a fundamental principle of the NEM design. There is a considerable risk that this option would incentivise retailers to sign up consumers on cheap rates without having regard to debt management, because the government will simply bail them out if things go wrong. For these reasons, the options of insurance for retailers against non-payment may be preferred over insurance against retailer failure.

Estimated time to implement: 3 to 5 years. We think that this option would be too complex to implement for all of the reasons given in relation to the previous option of an insurance scheme against excessive bad debts, including the potentially negative incentives it would create for retailers in efficiently managing non-payment risk.

Regulated retail price reset for higher cost reflectivity

The fundamental regulatory principle applied in price setting in Australia is that the service provider is provided with a reasonable opportunity to recover at least the

efficient costs it incurs in providing the regulated service, including an allowed return commensurate with the regulatory and commercial risks involved in providing it.[117]

Pursuant to this principle, under this option, the DMO and VDO methodology would be modified to account for the additional costs of interventions on retailers, namely implementation costs, and/or increased costs from bad debts. This can be done by accounting for additional implementations costs and increasing the bad debt allowance component in the estimate of retailer operating cost (or increasing the rate of return to compensate for increased risk).

Accounting for these costs requires the regulator to have a realistic view of the costs reasonably likely to be incurred by retailers in the future, allowing for uncertainty, or to adjust prices ex post (through a 'true up' mechanism) to allow for the impact of unforeseeable deviations from forecasts (in the way that revenue cap adjustments occur for distributors).

The ESCV and the AER are monitoring the impacts of the COVID pandemic on retailer debt levels, and the AER has flagged that energy debt levels for residential and small business customers increased sharply from the onset of the pandemic. As previously noted, the ESCV has included a temporary uplift in the bad debt allowance in setting the 2021 VDO to account for the effect of the coronavirus pandemic on retailers' costs, based on the cost information retailers provided.[118] Synergies has not identified any statements from the AER as to whether it will follow suit or not in 2021-22, although it chose not to recognise elevated bad debt costs in setting the DMO for 2020-21.

As discussed in Section 7 of this report, there are currently gaps in the price determination approaches of the AER and ESCV. Under the option proposed here, these regulators could address these gaps by explicitly accounting for:

- implementation costs borne by retailers that the AEMC has recognised in its rule change determinations;
- implementation costs borne by retailers relating to interventions imposed by the AER or ESCV (as appropriate); and
- the additional costs of managing or bearing bad debts borne by retailers due to interventions that increase the likelihood of bad debt and debt write-offs (which should not be limited to the effect of an exogenous event such as COVID-19).

[117] National Electricity Law, section 7A – Revenue and pricing principles (https://www.legislation.sa.gov.au/LZ/C/A/NATIONAL%20ELECTRICITY%20(SOUTH%20AUSTRALIA)%20ACT%201996/CURRENT/1996.44.AUTH.PDF)

[118] ESCV (2020) Victorian Default Offer 2021 Final Decision, 25 November, https://www.esc.vic.gov.au/sites/default/files/documents/FD%20-%20%202021%20VDO%20-%20Final%20decision%20-%2020201125.pdf.

In principle, these costs can be recovered through the retail margin or retail cost component applied in setting the VDO and DMO, consistent with the above regulatory pricing principle regarding efficient cost recovery. Specifically:

- for the 'ground-up' approach applied in the VDO, retailers could demonstrate the costs that are not accounted for in the retail cost stack. The ESCV's approach to providing a temporary uplift to account for COVID-related elevated debt costs is a welcome precedent in this respect;
- for the top-down approach applied in setting the DMO, where retail margin and cost are a residual component of the calculation methodology, retailers could use the step-change mechanism to demonstrate that elevated bad debt related costs are now above the level implicitly assumed in this component of the DMO methodology.

While very difficult to fully quantify, the AER and ESCV could also better account for the overall costs of regulatory interventions by being cognisant of the fact that the cumulative burden of proliferating and diverging regulatory requirements is likely to create significant drag on the operating efficiency of retailers. The fact that both the DMO and VDO methodologies are reliant on a CPI-escalated retailer own-cost benchmark undertaken by IPART in 2016 (prior to the recent spate of regulatory interventions) supports a contemporary and rigorous assessment of these costs.

Notwithstanding concerns about the regulated price outcomes currently being delivered under the DMO and VDO methodologies, it is not clear to us that retailers should consider a change to the calculation approaches to ensure a more robust assessment of retail costs. Both the DMO and VDO methodologies are different but legitimate ways of establishing an electricity retail price cap. The fundamental issue under both approaches and any other feasible alternative, is the reasonableness of the economic regulator in recognising legitimately and efficiently incurred retail costs.

The issue of how the retail price regulation framework should address multi-year recovery in a single-year pricing framework like the DMO and VDO depends on the incorporation of recurring retail costs in the regulated retail cost base. This would then allow for non-recurring costs (e.g. temporarily elevated COVID bad debt costs) to be included and removed from the retail price cap periodically while leaving a stable recurring base.

We are aware that one year regulatory periods have very low incentive properties in terms of promoting productive, allocative and dynamic efficiencies regarding retail price service offerings. In this regard, a yearly reset process appears to us to be more consistent with the DMO than VDO methodology given its benchmarked market price basis. In contrast, the rolling one year cost-based VDO methodology is more likely to harm

competition because of the risk of the retail price cap being set too low. However, in terms of possible alternatives, it is not clear to us that retailers would be supportive of longer term and stronger incentive-based regulatory frameworks (such as that applied to distribution networks in the NEM) given the significant regulatory compliance costs associated with such frameworks.

Recognising the current politically challenging circumstances regarding electricity prices, we consider that the onus will be on retailers to substantiate the case for better recognition of their elevated recurring and non-recurring costs under the DMO and VDO methodologies from operating in the NEM today compared to the pre-2016 period.

In terms of a medium to longer term goal regarding prices oversight in the NEM, price monitoring may be a feasible alternative to price regulation. However, we consider that a reasonable period of stable retail electricity prices and a re-building of retailers' social licence would be critical pre-conditions. This suggests that achieving better retail price outcomes under the DMO and VDO frameworks should remain the priority.

Estimated time to implement: 1 year. We would expect that under either or both the DMO and VDO frameworks, reasonable steps could be completed within a year to improve the explicit consideration of, and thus make better allowance for, increased retailer costs.

Distributors bill customers directly

This option would make distributors bill customers, instead of retailers, for the distribution services consumed at each connection point. Distributors would assume the risk of non-payment by end users. Customers would have to manage the timely payment of two separate quarterly bills, in place of the current single bundled bill from retailers. Retailers would bill for the generation and retail components of the electricity service, and in so doing would avoid the credit risk on the network charges.

Distributors would need to establish and run their own customer billing systems with all the ongoing complexities and operating resources this entails. The regulatory protections relating to retailer's billing and debt recovery processes would also need to be reviewed and expanded to cover distributors. Distributors would pass through the costs of their expanded billing systems and the cost of bad debts in their regulated network charges.

Estimated time to implement: 5 years. We would expect that this option would take around 5 years to implement. We consider that extensive work would be required in many areas to implement it smoothly, including significant policy advocacy, protracted regulatory design work, consultation and consumer education.

French model (distributors share risk of non-payment)

Under this option, retailers would have the right to seek to have network charges refunded in the event that recovery of those network charges from the customer was written off. This follows the basic outline of a model used in France. French retailers must pay the distributor for any network charges incurred at a connection for which it is the financially responsible retailer. However, where the retailer has exhausted reasonable avenues to obtain payment for energy bills from the customer, it is entitled to claim back the network component of these bills from the distributor.[119]

We have not been able to find additional details on the mechanism applied in France and some of the critical details requiring consideration would include:

- whether the scheme requires retailers to demonstrate reasonable efforts to recover debts, or trusts that they retain sufficient incentive (noting that majority of the bill debt will remain with the retailer);
- whether the distributor acquires any rights to recover or sell the network component of the customer debt; and
- how distributors pass the cost of bad debts through to customers.

Estimated time to implement: 3 to 5 years. We think that this option would be complex to implement for several reasons. The regulatory framework would require a significant amendment for distributors to bear this uncertain cost and have this appropriately reflected in their pricing determinations. The systems and processes by which retailers would make claims and provide evidence for non-payment could be quite complicated as they would need to be able to track individual cases and claims. We note that this is quite different to processing the occasional large claim under an insurance policy.

7.2 Approach

Judging policies when considering how to proceed from an advocacy perspective requires that the AEC consider multiple perspectives.

This should start with economic efficiency – discussed in Section 3 and is a fundamental guiding objective for policy making with respect to the national energy market. It must then expand out to consider the perspectives of consumers and retailers as the core interest groups in this policy question, as well as those of public policy makers – the decision makers. This recognises that economic efficiency alone cannot be relied upon, particularly because the issue of non-payment risk allocation raises sensitive social

[119] Eurelectric (2016) Mitigating credit risk in the interest of electricity consumers.

policy concerns regarding energy affordability and customer hardship that do not form part of economic efficiency considerations.

Table 8 sets out the evaluation criteria we have adopted in order to capture these multiple perspectives.

Table 8 Option evaluation criteria

#	Criteria	Description	Scoring
1	Economic efficiency	Considers welfare maximisation, optimal incentives for market participants and transaction costs.	Score out of 5
2	Acceptability to consumers	Consider factors such as price impacts, simplicity and convenience; freedom to choose; perceptions of fairness, scope to reduce financial uncertainty. These are predominantly economic indicators that we consider provide a proxy to identifying consumer acceptability. Whilst the AEC will need to further analyse the broader societal impacts of potential policy responses on various sub-sections of the community before additional steps are taken, we consider this metric enables us to assess the benefits and costs of the options discussed. In addition, we have focussed on consumers most affected by the option – such as the views of customers receiving a PPM – unless the reform is systemic in nature, such as whether government, retailers or distributors pay the cost, in which case consideration is from the perspective of customers in general.	Score out of 5 (0 where red flag identified)
3	Acceptability to retailers	Consider operational and financial effects on retailers such as: susceptibility to political interference and regulatory risk; costs of implementation; locus of control (e.g. centralised in the market institutions or decentralised in jurisdictional rule making); transitional impacts; regulatory burden.	Score out of 5 (0 where red flag identified)
4	Acceptability to policy makers	Consider general policy / political perspectives on options including: distributional impacts; retail price impact; fiscal impacts; complexity and regulatory risk and disruption.	Score out of 5 (0 where red flag identified)

Source: Synergies analysis

We applied the criteria to each of the identified options and set out our scoring and reasoning below in the following sequence:

- First, we set out our assessment against the economic efficiency criterion, considering the relative performance of the options by this critical measure;
- Second, we considered the timeframes over which each option could feasibly be implemented to evaluate whether a portfolio of short, medium and longer-term options might be available; and
- Finally, we assessed the likely acceptability of the options to consumers, retailers and policy makers to evaluate how this affects the relative performance (recognising that economic efficiency is not necessarily the primary way in which stakeholders will assess the options).

When applying each of the criteria for consumers, retailers and policy makers (but not economic efficiency), we identified red flags for two options – being issues we considered likely to be of such strong concern to some stakeholders that these options

should be set aside, at least for the foreseeable future. These red flags are noted in our results below.

More generally, we did not evaluate the relative magnitude of impact that each option could realistically achieve, since to assess this would require judgements as to how extensively each option might be deployed by individual retailers. Instead, we focussed more on the expected ratio of economic benefits to costs.

7.3 Evaluation

As explained in section 2 of our report, our two-stage evaluation approach first assesses the alternative non-payment risk management tools from an economic efficiency perspective and second by applying broader policy, consumer and retail acceptability criteria.

7.3.1 Assessment against economic efficiency criterion

We consider that applying an economic efficiency criterion to the alternative non-payment risk management tools is important because it provides an objective test based on applying productive, allocative and dynamic efficiency concepts to the various tools. This criterion also reflects the principles contained within the NERO.

In practice, a relatively high efficiency-related score implies that a tool is likely to offer economic benefits to participants in the market taken as a whole. This provides an appropriate first-pass filter on policy alternatives before distributional and social constraints are considered.

In Table 9, we present our scoring and reasoning in applying this criterion.

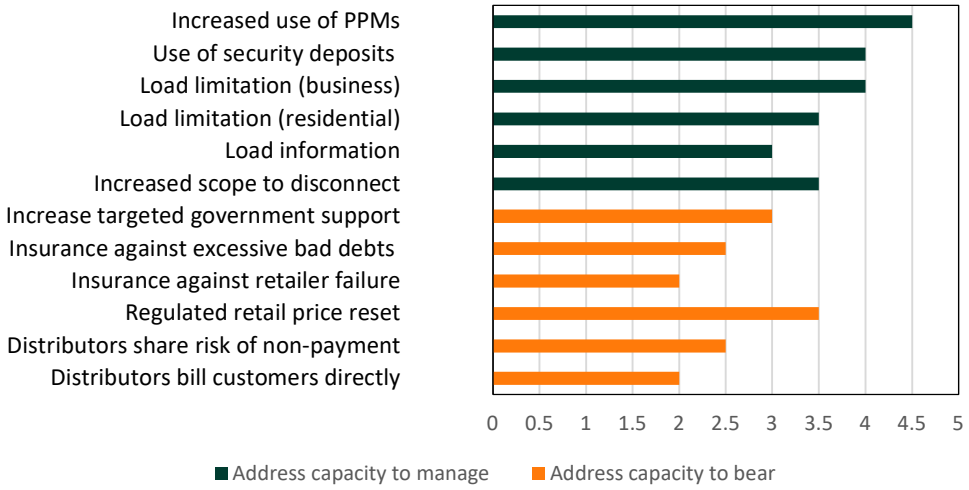
Table 9 Assessment of policy approaches to improve or mitigate non-payment risks (economic efficiency criteria)

Policy approach	Economic efficiency	Score
Increased use of PPMs	• Frequent, timely and salient incentives for consumers, which drive strong engagement. • Effectively manages non-payment risk by removing scope for debt to accumulate. • Assumes that the other benefits of smart meters defray the economic costs of meter installation.	4.5
Use of security deposits	• Good incentives for customers to pay on-time, but less effective in providing customers with timely feedback than PPMs. • Effectively manages non-payment risk if it can be widely applied for new customers and is supported by access to detailed creditworthiness information.	4
Load limitation (business)	• Frequent, timely and salient incentives for consumers – provides excellent usage monitoring and encourages customers to reveal their willingness to pay for a better service. • Significant establishment costs, including education, and many benefits may be a long way in the future. • Expected to manage non-payment risk quite effectively – empirical question as to whether customers will pay to avoid.	4
Load limitation (residential)	• Similar to load limitation for business but with higher transaction costs for residential customers, as residential customers would lack the tools/information to engage with the technology. Political acceptability is also likely to be problematic.	3.5
Load information	• Better information about load consumption will provide incentive for customers to manage their load, but that is not same as managing non-payment risk. Hence, this is a complementary rather than primary non-payment risk management tool.	3
Increased scope to disconnect	• Provides a strong incentive for customers to engage and repay debt, both at the warning stage and the physical disconnection stage. • Because it is a significant step, disconnection can't provide high frequency and timely feedback to reinforce desired behavior. • Provides leverage to encourage payment, however, if a customer simply cannot pay, disconnection can only limit the losses.	3.5
Increase targeted government support	• Links government energy policy, including associated social policy objectives, with the fiscal consequences, thus internalising the costs of the intervention on the decision maker. • Reduces non-payment risk for retailers by reducing the number of customers not able to afford their energy bills. • Reduces incentives for customers to manage their electricity costs; may also dull incentives for retailers to manage non-payment risks.	3
Insurance against excessive bad debts	• Allocates non-payment risk to an entity with greater capacity to bear, which reduces the costs of disruption from excessive bad debts. • Reduces incentives for retailers to manage non-payment risk – the moral hazard problem. • Significant transaction costs for insurer to obtain assurance and verification of sound retailer practices and evidence around claims.	2.5
Insurance against retailer failure	• Similar to insurance against excessive bad debts but with added challenges in designing the rules of the scheme to be able to identify and attribute the cause of retailer failure to bad debts, which in turn needs be attributed to policy/regulatory intervention rather than retailers' inaction.	2
Regulated retail price reset for higher cost reflectivity	• Allows competition to determine the appropriate level of cost / risk premium to include and recover – predominantly in market offers. • The equilibrium price level will change, but during periods where non-payment risk outlook is worsening, larger premia are likely to be included in market offers, allowing retailers to better bear the increased risk of non-payment. • Retains existing incentives for managing non-payment risks and provides reasonable opportunity for retailers to recover own-costs under regulated price cap.	3.5
Distributors share risk of non-payment ("French" model)	• Allocates a portion of non-payment risk to a party with equal or greater capacity to bear – opportunity for retailers to recover own-costs the distributor. • Diminishes the incentives for retailers to manage non-payment risks (though 70% of the bill is still at risk for the retailer). • Does not address inefficiencies arising from restricting retailer's tools for actively managing non-payment risks.	2.5
Distributors bill customers directly	• Allocates a portion of non-payment risk to a party with equal or greater capacity to bear. • Large transaction costs due to the duplication of mass-market billing. • Significant regulatory re-design, consultation, education and implementation costs and worse customer experience (due to two energy bills).	2

Note: our detailed assessments of each option against the additional criteria of consumer, retailer and policy maker acceptability is set out in Appendix B

Figure 9 presents our scores for all the options graphically. Note again that this stage of the assessment is limited to the economic efficiency criterion. It shows the clear clustering of higher scores among those options that address the capacity to manage non-payment risks (dark green). This is what we would expect, given that the risk allocation principles give first priority to the ability to reduce the magnitude or probability of a risk presenting.

Figure 9 Option scores – economic efficiency alone



Data source: Synergies' analysis

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7.3.2 Timeframes

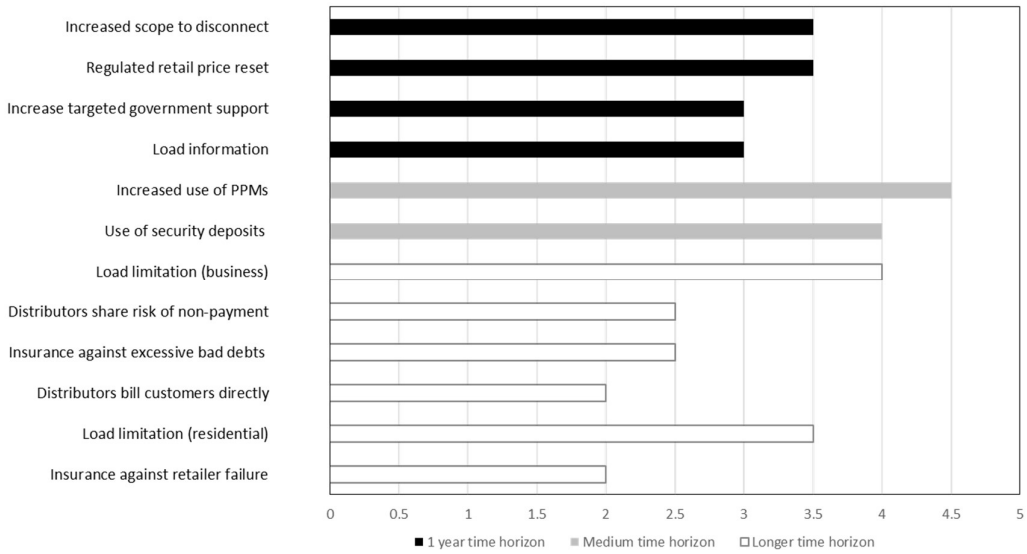
The same results are plotted again in Figure 10, but this time grouped and ordered according to our judgement regarding implementation timeframes.

Of the measures that could be implemented over the next year or so, an enhanced price regulation reset process and increased scope to disconnect would be preferred.

Of the measures able to be implemented over a somewhat longer timeframe (around three years), increased use of PPMs would be the best option.

Looking out over a still longer horizon (around 5 years), the load limitation for business performs better than the various options for re-allocating the non-payment risk and associated costs to insurers or distributors.

Figure 10 Option scores – grouped by implementation horizon (economic efficiency alone)



Data source: Synergies' analysis

We consider the PPM option to be considerably better than the option to increase the scope for disconnections and we think that these are largely policy substitutes, particularly when considering responses to existing customers that start to exhibit an increased risk of non-payment.

PPMs are superior to load limitation, in our view, by virtue of being better supported by precedent and experience, which not only makes them feasible to implement sooner, but also reduces their actual or perceived risk and probably reduces the costs of implementation. These options may represent substitutes for a retailer, in that they might not implement both simultaneously.

However, they could be complementary in the longer term, as both measures actively limit the supply of electricity and thereby the level of liability to retailers. Moreover, the deployment of PPMs in the form of smart meters would establish infrastructure that could also be used to activate load limitation. Further, there might be scope for future product innovation involving permutations of prepayment and load limitation as an alternative to disconnections or self-disconnection that might provide better outcomes for consumers and better address the concerns of policy makers.

7.3.3 Assessment against broader considerations

Next, we evaluate the options by introducing the consumer, retailer and policy maker acceptability perspectives and preferences, to test whether the likely views of key

stakeholders will significantly change the economic efficiency-based results. Our scores against criteria 2 to 4 are set out in Table 10, below, while the reasoning behind our scores is set out in Appendix B.

Table 10 Option scores against stakeholder acceptability criteria

Policy approach	Consumer acceptability score	Retailer acceptability score	Policy maker acceptability score	Total score
Increased use of PPMs	3	4	3.5	10.5
Use of security deposits	2	4	1.5	7.5
Load limitation (business)	1.5	3.5	1.5	6.5
Load limitation (residential)	0	3	0	3
Load information	4	3	4	11
Increased scope to disconnect	2	4	1	7
Increase targeted government support	4	4.5	0.5	9
Insurance against excessive bad debts	3	4.5	1	8.5
Insurance against retailer failure	3	2.5	0	5.5
Regulated retail price reset for higher cost reflectivity	3	4.5	2.5	10
Distributors share risk of non-payment ("French" model)	3	3	1.5	7.5
Distributors bill customers directly	1	2	1	4

Source: Synergies analysis

Table 10 indicates that the provision of load information, increased use of PPMs and an enhanced regulated retail price reset process are the most highly ranked options based on applying our assessment of stakeholder acceptability.

Apply all assessment criteria

Load limitation, increasing the scope to disconnect customers and expanding the use of security deposits are unlikely to be acceptable to key stakeholders, notwithstanding their reasonable performance from an economic efficiency perspective.

Distributors billing customers directly is not only inefficient, it is likely to be opposed by the three stakeholder groups considered.

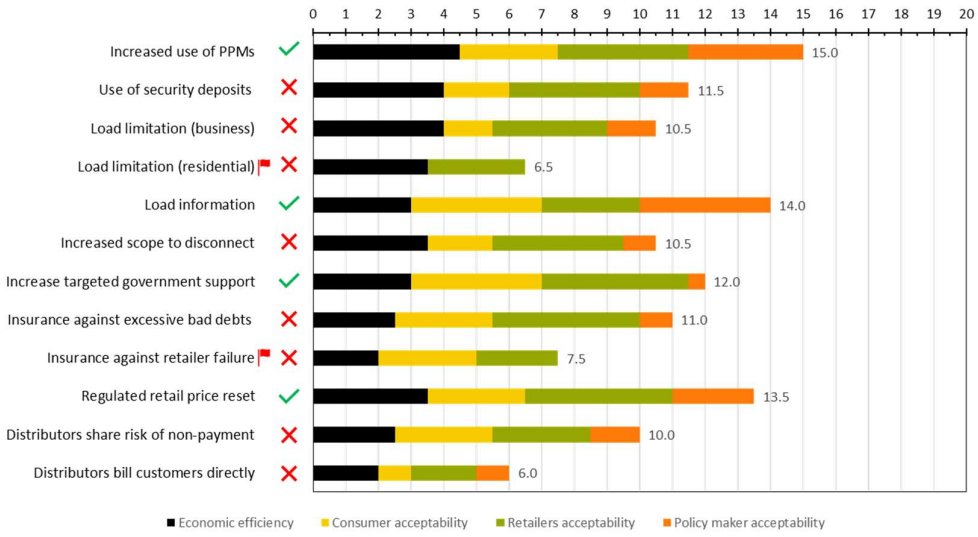
- Increased targeted government support appears marginal, primarily due to the likelihood of strong opposition from within government.

Figure 11 below provides a graphical depiction of the scores when all criteria are combined with equal weightings. The following points on these results are highlighted:

- The three best performing options when applying this approach are:

  - increased use of PPMs;
  - increased provision of load information; and
  - resetting the regulated retail price.
- Load limitation, increasing the scope to disconnect customers and expanding the use of security deposits are unlikely to be acceptable to key stakeholders, notwithstanding their reasonable performance from an economic efficiency perspective.
- Distributors billing customers directly is not only inefficient, it is likely to be opposed by the three stakeholder groups considered.
- Increased targeted government support appears marginal, primarily due to the likelihood of strong opposition from within government.

Figure 11 Option scores – all criteria (equal weights)



Data source: Synergies' analysis

We consider PPMs, security deposits, load limitation, and more disconnection latitude tend to be substitutes for one another, with PPMs performing better than the others. Load information, on the other hand, we regard as a complement for other options. While load information is expected to have a modest effect on economic efficiency, we would expect it to cause minimal objections among stakeholders – hence its stronger performance when considering all criteria. It may also facilitate stronger non-payment risk management measures being adopted over time.

Increased government support, insurance options, retail price reset and distributor risk taking (with or without distributor billing) are substitutes in general terms. Based on this

all-criteria assessment, among these policy substitutes, only the enhanced retail price reset option performs well.

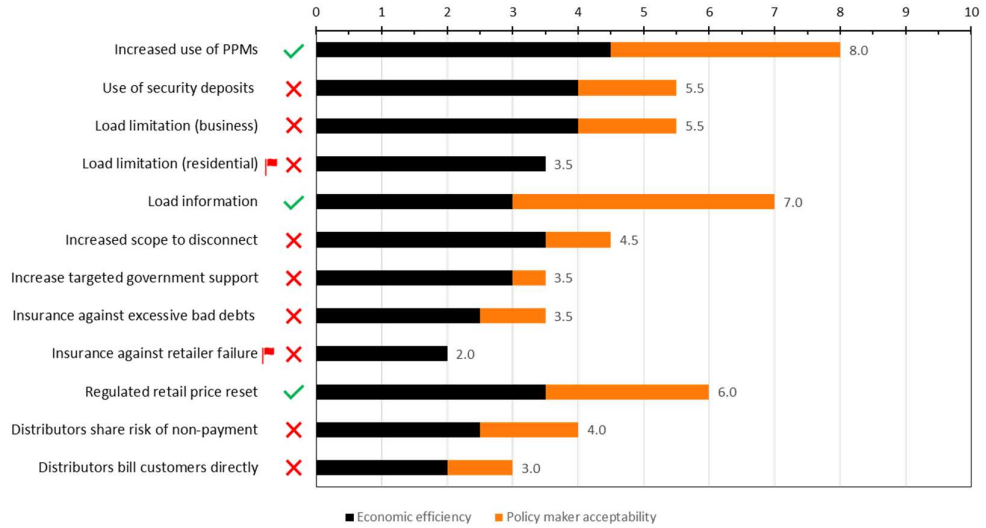
With respect to load limitation, we note our assessment that stakeholders will tend to be unsupportive is based on perceived technical and end-user familiarity problems that exist today, but which should be gradually addressed over time. By contrast, we think stakeholder opposition to disconnections and security deposits goes to concerns that are unlikely to lessen with time. If customers are easier to disconnect, then more customers will be left without power for potentially considerable periods. If security deposits are easier to require later in the credit risk cycle, then customers may be accelerated towards disconnection as an end point. If retailers are given access to more sensitive financial data to support better credit checks and targeting of security deposits, then many customers will receive worse offers or may be denied a new connection entirely.

Apply economic efficiency and policy maker criteria

A reasonable criticism of using all of the criteria together is that policy makers are bound to consider the views of major interest groups like consumers and retailers in forming their own views on what will be acceptable. To correct for this, Figure 12 below compiles the scores from just the economic efficiency and policy maker acceptability criteria (equally weighted).

Two of the options have red flags against them, suggesting they may not be workable in the short term, nor workable within the foreseeable future. In this regard, we think that insurance against retailer failure may never be workable, at least not without significantly compromising good market design principles. We also think that load limitation would not be operationally workable within the next five years for residential customers in Australia, due to the need for extensive education and consumer adjustment.

Figure 12 Option scores – economic efficiency and acceptability to policy makers (equal weights)



Note: The scores for the two options with red flags is based solely on the economic efficiency criterion score
Data source: Synergies' analysis

These results suggest that:

- increased use of PPMs is the strongest option when viewed through a broad public policy lens, notwithstanding the likelihood that this would create significant new complexities for retailers and consumers;
- the option of providing additional load information is likely to be received favourably in policy discussions, notwithstanding its middle of the road economic efficiency performance;
- again, increasing the use of disconnections and security deposits are unlikely to be highly regarded policies;
- of the various options to improve the capacity to bear non-payment risks, the option of increasing the allowance in the regulated price is the strongest.
  - targeted government support is likely to fail to make it through the policy assessment process within government for obvious reasons of fiscal constraint and current fairly hostile attitude towards retailers/generators;
  - policy makers are also likely to be resistant to the idea of distributors adopting risks contrary to the originally intended risk allocation of the NEM, particularly since the alternative of providing explicit compensation for non-payment risks in retail price caps is simpler but similar in effect to doing so in distribution pricing determinations.

Assessment adjustments

Synergies considers that the results derived from including all assessment criteria and combining just economic efficiency and policy maker views, broadly confirm the approaches highlighted in the previous section, with the following qualifications:

- PPMs may be more readily accepted by policy makers than the similarly efficient option of load limitation;
- the options to broaden the scope for disconnections or security deposits are probably not tractable policy proposals in the short to medium term;
- increasing targeted government support is likely to be harder to promote than the main alternative of enhanced regulated retail price resets.

7.4 Conclusion

Our analysis and rankings show that the following non-payment risk management options are most likely to satisfy economic efficiency and social policy criteria and could be implemented in the short to medium term:

- PPMs
- Provision of load information to customers
- Enhanced regulated price resets.

Achieving greater recognition of the increased cost and risk of bad debts and of the costs associated with a range of regulatory interventions, while challenging, appears to be the most promising short-term option. This is because the regulatory frameworks in NECF jurisdictions and in Victoria already allow for adjustments to be made. Hence, it could be implemented relatively quickly if the respective price regulators were disposed to do so. Building this willingness may require retailers to put greater effort into substantiating such costs to regulators and rules makers.

There are several other options that are likely to be unsuitable to pursue in the short term but have greater potential in the medium to long term, including load limitation (primarily for business customers), increased scope to disconnect and use of security deposits. These options will fundamentally depend on a more favourable political environment than what currently exists for retailers/generators.

We stress the priority given in our assessment to measures that can improve the capacity of retailers to manage the risk of bad debts, because we consider that more could be done to reduce the incidence of bad debts, without unreasonably downgrading existing safeguards for genuinely vulnerable customers.

Indeed, if we did not believe this was the case, it follows that we should conclude that only policy options to increase the capacity to bear risk need be considered. If so, the logical path would lead back to direct funding by governments targeted to genuinely vulnerable customers – being the most robust mechanism for socialising this cost. Yet, the choices made by recent policy makers creates a tension insofar as they continue to allocate customer non-payment risks to retailers consistent with the intent of the original NEM design, while implementing interventions that make it harder for retailers to both manage and bear this risk. As we noted repeatedly in this report, retailers are a class of market participants with a comparatively strong natural ability to manage risks but comparatively weak capacity to bear.

8 Recommendations

The purpose of this section is to present our recommendations regarding preferred non-payment risk management options having regard to political and broader market circumstances.

8.1 Political and broader market context

We consider that energy retailers currently have a fragile social licence within some sectors of the community and limited goodwill and trust among policy makers. This limits the degrees of freedom available to retailers in choosing and advocating for their preferred non-payment risk management options in the short to medium term. However, AEC members cannot and should not remain silent regarding the mounting non-payment risks they face, but they will need to choose and present their advocacy positions with care and patience.

In this context, we consider that energy retailers should rule out advocating for certain reform options on the grounds that they will be seen as evidence of energy retailers not understanding the current policy and political climate. For example, we consider that calls to relax many of the restrictions on disconnections could be interpreted in precisely this way and be dismissed by policy makers as naive or insensitive. In a similar vein, we consider that energy retailers must take care not to be seen as "passing the buck" on credit risk, either up the supply chain (e.g. by sharing non-payment risk with distributors) or to government (through increased transfer payments).

This means that a key strategic consideration is to build credibility in the short term, which can then provide energy retailers with a stronger voice in calling for more significant non-payment risk reforms in the medium to long term.

8.2 Recommendations on options for managing non-payment risks

Based on our evaluation of the options to address retailers' increasing exposure to non-payment risks, we find that:

- The best option in the short term (within one year) is to ensure that the costs of managing bad debts is appropriately (and prospectively) accounted for in retail price determinations (i.e. in the DMO and VDO):
  - this option can be implemented quickly and without changing the forms of regulation applied by the AER and ESCV;

  - we note that the ESCV has recently included an additional temporary allowance of $6 per customer for bad debts to account for the effect of the coronavirus pandemic on retailers' costs – this is a welcome adjustment;
  - gaining greater recognition of the large costs of regulatory interventions over the past decade is also likely to depend on retailers' ability to provide robust cost estimates to regulators (including on a commercial-in-confidence basis) – such data provision seems to have been important in the ESCV decision to include the additional $6 per customer allowance.
- Voluntarily trialling load information technologies as a way of assisting vulnerable customers to better understand and manage their energy costs may be a widely accepted way of testing the scope for voluntary approaches to improve energy debt and non-payment outcomes:
  - whether load information approaches will make an appreciable difference in these specific circumstances is a question to be tested empirically;
  - if it proves ineffective, a trial of an information-only approach could still provide retailers with a useful reference point when making the case for policy options to restore to retailers modest powers to impose some arrangements or requirements on customers that better address non-payment risk issues. As such, a trial may also facilitate other reforms being pursued over time.
- The most promising option to advocate over a medium (~three year) timeframe is to increase the use of PPMs:
  - The credibility of this option is enhanced by the widespread use of PPMs in Australian and overseas jurisdictions.
  - We consider that the arguments to allow greater scope for using PPMs to manage non-payment risks are strongest in Victoria, where the retail regulatory framework places greater restrictions on retailers' non-payment risk management and imposes a stricter retail price cap constraining retailer capacity to bear non-payment risk.
  - Implementing this option is likely to require regulatory changes in NECF jurisdictions to expand the scope for PPMs to be imposed, where other methods of managing payment risks have not been effective. In Victoria, the support of the ESCV will be required in order to ensure that approved PPM schemes are practical and allow for PPMs to be imposed where appropriate.
  - The cost of installing smart meters (and relatively low penetration of such meters in the residential customer cohort) is a barrier to the use of PPMs in NECF jurisdictions and rule makers should consider how existing regulatory requirements exacerbate this by increasing the risk that a retailer will not be

able to recover the cost of the meter. Options to socialise the cost of smart meters deployed specifically to provide for prepayment metering should be considered.

- Over longer timeframes (five years or more) we consider that establishing protocols for load limitation offers potential to help retailers minimise non-payment debt accumulation, while allowing the supply of an essential service to continue, albeit at a reduced level.
  - This option needs to be cautiously advocated and carefully tested, potentially through pilots involving retailers, distributors and regulators.
  - The barriers posed by the availability of smart meters outside Victoria should be raised with policy makers, again with the option in mind of finding ways to socialise the cost of these meters where deployed to provide load limitation in high credit risk situations.
  - Distributors should consider offering low cost, low capacity network tariffs that might be suitable to nominate for connection points that have become subject to a load limitation.
- AEC membership should consider its longer-term policy goal with respect to disconnection, in particular:
  - It may be possible for skilled advocacy to restore some of the scope for disconnections that was available to retailers in the past.
  - AEC members should assess whether the right to disconnect vulnerable customers would remain as critical a tool for managing non-payment risks if retailers gained adequate access to other debt management tools, like the ability to insist on a PPM.
  - AEC members should consider whether a voluntary commitment from the sector along the lines of the Energy UK Safety Net might be held out as a pro-consumer trade-off, in return for other concessions from policy makers (such as facilitating greater penetration of PPMs or improving cost recognition in the DMO/VDO price capping processes).

8.3 Recommendations regarding regulatory intervention costs

In relation to improving the consideration of implementation costs associated with regulatory interventions in retail price determinations, we recommend:

- The AEC engage with rule makers and retail price regulators in multilateral forums to encourage rule makers and regulators to publish as much information on implementation cost estimates as possible, in order to furnish retail price regulators with quantitative data to inform their pricing determinations.

- The AEC advocate for rule makers and retail price regulators to be subject to requirements to obtain advice from a suitable independent cost estimator on the implementation costs for market participants associated with each regulatory intervention and that the main elements of this advice be published within the rule maker's final decision.

A. Additional information on interventions

A.1 Retail pricing information guideline[120]

Under the NERL, the AER has developed Retail Pricing Information Guidelines that prescribes how retailers must present their standing offer plan prices and market offer plan prices to customers. The Guidelines also provide direction to energy retailers about providing data and information to the AER for the purposes of the energy price comparison website, Energy Made Easy.

The AER acknowledged that requiring retailers to adhere to a template may increase compliance costs and that a highly prescriptive template may limit product innovation and that this may not be in the best interests of consumers. However, the AER considered that the key reason for the Guideline is to ensure that consumers are able to readily compare different energy retail offers which required some form of standardisation. The AER considered that where consumers are able to understand the price and non-price elements of the products available in energy retail markets, they can more effectively engage in the markets and select products that are most suitable for them, thereby promoting economic efficiency. Accordingly, the AER considered it appropriate to create a simple template that retailers must follow when presenting pricing information.

The first version of the guideline was released in September 2011.[121] The AER reviews and amends the guidelines from time to time. The AER has been consulting on version 6 of the guideline.[122]

A.2 Customer hardship policy binding guideline and approval[123]

The NERL requires retailers to have customer hardship policies and specifies minimum requirements to support residential customers facing financial difficulty.

A retailer's customer hardship policy is subject to the AER's approval, to ensure the policy covers the minimum requirements in the NERL and achieves the purpose of assisting customers to better manage their energy bills on an ongoing basis.

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120 https://www.aer.gov.au/retail-markets/retail-pricing-information; https://www.aer.gov.au/system/files/Position%20paper%20and%20draft%20guideline.pdf

121 https://www.aer.gov.au/retail-markets/guidelines-reviews/retail-pricing-information-guideline-september-2011

122 Retail Pricing Information Guidelines review 2019 | Australian Energy Regulator (aer.gov.au)

123 https://www.aemc.gov.au/rule-changes/strengthening-protections-customers-hardship; https://www.aemc.gov.au/sites/default/files/2018-05/Consultation%20paper_4.pdf; https://www.aemc.gov.au/sites/default/files/2018-11/Final%20determination.pdf

Until December 2018, the AER issued guidance to retailers on the information they should include in their hardship policies; however this was not enforceable and was for general guidance only.

In December 2018, the AEMC made a rule change to allow for the development of binding Customer Hardship Policy Guidelines by the AER. The rule change was triggered by the AER's reviews of retail electricity market performance during 2016 and 2017, which found issues and deficiencies in the implementation of hardship policies.

The purpose of the rule change is to improve hardship policies so customers can better understand their rights and get the help they need to pay their power bills.

The AEMC's final determination recommends civil penalties, such as fines, to protect customers if retailers fail to comply with the new obligations. The AEMC has also recommended that COAG Energy Council make a law to prevent new retailers from starting their business until they have approved hardship policies in place.

On 29 March 2019, the AER published its Customer Hardship Policy Guideline.[124] Retailers are required to comply with the Guideline when submitting a new or varied customer hardship policy from 2 April 2019.

A.3 Minimum disconnection amount[125]

The NERR prohibits retailers from disconnecting a customer's premises for non-payment of a bill when:

- the amount outstanding is less than an amount approved by the AER, and
- the customer has agreed with the retailer to repay that amount.

In April 2012 the amount approved by the AER was $300 (GST inclusive). In 2016, the AER retained the minimum disconnection amount of $300 (GST inclusive).[126]

The purpose of the rule is to prevent customers potentially incurring significant debt before seeking assistance. It also encourages retailers to proactively offer assistance and attempt early identification of customers who may be experiencing payment difficulties. A number of retailer submissions to the AER noted they use the amount to identify customers experiencing possible payment difficulties to engage in hardship dialogue with that customer to avoid disconnection. The rule does not prohibit retailers from de-

[124] https://www.aer.gov.au/retail-markets/guidelines-reviews/customer-hardship-policy-guideline

[125] https://www.aer.gov.au/retail-markets/guidelines-reviews/minimum-disconnection-amount-march-2017

[126] AER, March 2017, p. 4

energising premises where the amount outstanding is above or below the minimum disconnection amount if the customer has not engaged or entered into a repayment agreement.

A.4 Waiver of late payment fee[127]

The NERR requires retailers to waive late payment fees for hardship customers (i.e. "a residential customer identified as experiencing financial payment difficulties due to hardship in accordance with the retailer's customer hardship policy").[128] The implementation of this rule depends on state-specific provision.

On the one hand are Tasmania and NSW that have expanded the categories of customers to which this wavier rule applies (for example, customers holding health care cards, pensioners, and customers on payment plans).

On the other hand is South Australia where retailers may impose late payment fees, provided the fee does not exceed reasonable costs of the retailer in recovering the overdue amount. Also, the retailer cannot take steps to recover a late payment fee where the customer has lodged a complaint in relation to the retailer's bill.

A.5 Retailer price variations in market retail contracts[129]

The rule change requires retailers to improve the information they give to consumers when entering energy contracts about whether prices can change and when they will notify consumers of any price changes. The AEMC considered that improved information will enable consumers to engage more confidently in retail markets and make decisions that they consider better meet their needs, which is likely to enhance competition in retail markets.

A key issue driving the rule change was that consumers may have been entering contracts unaware that prices may change.

The final rule applies from 1 May 2015.

Among the factors the AEMC considered in assessing the rule change were:

- the impact on the future level of competition in retail energy markets,

[127] https://www.aemc.gov.au/regulation/energy-rules/resources-stakeholders/guide-application-necf

[128] https://www.aer.gov.au/system/files/AER-Customer-Hardship-Policy-Guideline-March-2019.pdf

[129] https://www.aemc.gov.au/rule-changes/retailer-price-variations-in-market-retail-contrac

- the impact on the transparency and information required for consumers to make informed decisions, and on consumer participation in retail markets; and
- whether the efficient allocation of risks between retailers and consumers is being adversely affected by the current rules that allow price variation clauses in fixed period contracts.

A.6 Meter read and billing frequency[130]

The rule enables retailers to bill small customers on a standing offer based on their metered consumption, rather than an on estimate. It does this by providing retailers with some flexibility regarding when they issue a bill if a meter read from a Metering Data Provider is delayed.

Previously, there was an inconsistency between the obligations on retailers and Metering Data Providers, which resulted in retailers issuing estimated bills if the Metering Data Provider has not provided them with a meter reading in time.

The AEMC considered the following principles in making the rule change:

- Facilitating the efficient use of energy services: rule change is likely to provide small customers with better information about the costs they incur in using energy services, allowing them to make more informed choices about how they use these services.
- Enhancing consumer experience: reducing the number of estimated bills is likely to enhance consumer experience and is likely to reduce the number of complaints that small customers make in relation to their energy bills.
- Providing a proportional response to the issues identified: the rule change is not likely to impose additional costs on retailers or Metering Data Providers.

A.7 AER Sustainable Payment Plans Framework[131]

The NERL and NERR require retailers to offer payment plans for customers experiencing payment difficulties, having regard to a customer's capacity to pay, any amount they owe, and how much energy they expect to use.

130 https://www.aemc.gov.au/rule-changes/meter-read-and-billing-frequency

131 https://www.aer.gov.au/retail-markets/guidelines-reviews/aer-sustainable-payment-plans-framework

To help customers and retailers agree to payment plans that are affordable and sustainable, in July 2016, the AER developed the Sustainable Payment Plans Framework that consists of:

- a set of principles to guide retailers' capacity to pay conversations with customers; and
- a flow chart outlining good practice actions and considerations at different stages of a payment plan.

Adopting the Framework is voluntary. It is not a compliance obligation under the Retail Law and Rules.

A.8 NSW Energy Accounts Payment Assistance Scheme

The Energy Accounts Payment Assistance (EAPA) Scheme is funded by the NSW Government and administered by the Division of Energy, Water and Portfolio Strategy. The purpose of the EAPA Scheme is to help customers who are experiencing a financial crisis or emergency and need help to pay their home electricity and/or natural gas (energy) bills.[132] The Scheme is designed to help these customers stay connected to essential energy services. It is a crisis scheme and not intended to offer ongoing income support.

Applicants are assessed by an EAPA Provider[133] to determine eligibility. If eligible, the provider will transmit the vouchers electronically to energy retailers who credit the vouchers as part payment of a customer's energy bills. Retailers are reimbursed by the NSW Government. As such, the cost to retailer to implement this intervention is low.

In 2010, vouchers equated to $10[134] and currently each voucher has a face value of $50. EAPA vouchers that can be issued to a customer are:

- Maximum $300 (6 vouchers) per bill;
- Maximum $600 (12 vouchers) per financial year, household & energy type (Electricity & Gas);
- Maximum of two EAPA grants per household per energy type per financial year; and

[132] Energy & Water Ombudsman NSW. Available at: https://www.ewon.com.au/page/customer-resources/help-paying-bills/eapa-vouchers

[133] EAPA providers include the NSW Government and organisations such as Anglicare, Salvation Army, Wesley Mission, Local Land Councils and neighbourhood centres.

[134] https://www.piac.asn.au/wp-content/uploads/10.12.24_PIAC_Sub_EAPA_Review.pdf

- Maximum of two EAPA grants per bill.[135]

In order to support households struggling to pay their energy bills during COVID-19, the NSW Government has temporarily increased the EAPA assessment threshold so people can receive up to $400 per assessment twice per year, compared to the normal amount of $300.[136]

A.9 Competition in metering services

Commencing on 1 December 2017, the AEMC made a rule to open up competition in metering and facilitate a market-led deployment of advanced meters by providing for the overall responsibility for metering services under the NER to be performed by a new type of registered participant - a Metering Coordinator.[137] This rule change was part of a series of changes recommended in the AEMC's Power of Choice review to support demand side participation in the National Electricity Market.

The new arrangements allow any party to be able to compete to provide metering services to retailers, subject to registration requirements. Metering services encompass a number of activities, including making sure a customer has a working meter and providing necessary parties with metering data for billing.

In terms of costs, consideration was given to the impact on regions/jurisdictions without effective retail competition and the risk that the cost of implementing may outweigh benefits. The AEMC considered that the final rule provided the minimum regulation necessary to achieve the intended objectives of the rule change request.

The Final Decision found that where retail competition is not as strong, retailers may be less likely to offer some of these benefits to consumers. However, even in those jurisdictions that do not currently have effective retail competition, the new metering framework in the final rule is likely to deliver many of the above benefits to consumers – for example through the competitive provision of metering services, avoiding the costs of manual meter reading, implementation of cost reflective network prices, better

[135] https://mavs.vinnies.org.au/wp-content/uploads/2017/12/1.-EAPA-SUMMARY-SHEET-DEcember-2017-new-format.pdf

[136] https://nsw.liberal.org.au/NSW-GOVERNMENT-BILL-RELIEF-FOR-ENERGY-CUSTOMERS

[137] AEMC (2017) Competition in metering services: Information Sheet. Available at: https://www.aemc.gov.au/sites/default/files/content/87a49036-707f-446b-92fb-b333543da21b/Information-sheet-overview.PDF

network services and the ability of third party energy service companies to offer new products and services to consumers.[138]

A.10 Victorian Payment Difficulty Framework[139]

Introduced in January 2019, the Victorian Payment Difficulty Framework (PDF) was introduced to reduce the number of disconnections.

The purpose of the framework is to provide customers facing payment difficulty with a set of minimum entitlements to assistance to avoid or repay arrears, and ensure that disconnection for non-payment of a bill is a measure of last resort. Under the framework, energy companies must work with customers to help manage customer's energy costs and avoid disconnection. While receiving assistance from their energy company a customer cannot have their electricity or gas disconnected or be pursued for debt, however it is important that they stay in contact with their energy company and meet their agreed payment plan terms.[140]

The framework entitles customers facing payment difficulty to two different types of assistance measures:

- Standard assistance: customers will gain access to standard assistance simply by asking for it and they do not need to be in debt to gain access to these entitlements. Retailers are required to offer at least three out of the following four payment options: payments arrangements that allow customers to pay a set amount on each bill; allow customers to pay at shorter intervals (e.g. monthly or fortnightly); opportunities for customers to delay payment of one missed bill to the next billing cycle; providing customers with a 'pay in advance' option.
- Tailored assistance: available to customers who are in arrears because they have been unable to pay their bill. It entitles customers to:
  - nominate a payment arrangement to enables them to repay arrears through regular repayments over a timeframe that is no longer than two years;
  - receive advice from their retailer about different payment options, and how each option would help to repay arrears.;

[138] AEMC (2015) Rule Determination: National Electricity Amendment (Expanding competition in metering and related services) Rule 2015; National Energy Retail Amendment (Expanding competition in metering and related services) Rule 2015. Available at: https://www.aemc.gov.au/sites/default/files/content/ed88c96e-da1f-42c7-9f2a-51a411e83574/Final-rule-determination-for-publication.pdf

[139] https://www.esc.vic.gov.au/sites/default/files/documents/payment-difficulty-framework-final-decision-20171009.pdf

[140] Victorian Energy Saver (2018) Having trouble paying your energy bills? Available at: https://www.victorianenergysaver.vic.gov.au/having-trouble-paying-your-energy-bills?a=465609

  - receive advice from their retailer to help them lower their energy costs including tips to help the customer use less energy; and
  - receive assistance in accessing government and non-government support services.
- Customers in more severe types of payment difficulty will be entitled to a greater level of assistance, including:
  - a period of at least six months where repayment of arrears is put on hold; and
  - practical assistance to lower energy costs including placing the customer on tariffs that help lower the customer's cost of energy use, and helping them reduce the amount of energy, for example, through appliance replacement programs.

The impact on customers and retailers were assessed by ACIL Allen and KPMG. The ESC also consulted with stakeholders. The key costs to retailers included system upgrades and staff training.

The ombudsman in Victoria released a paper in December 2020 analysing the impacts of the PDF.[141]

- On one hand, the EWOV observes that large numbers of vulnerable customers continue to present to EWOV with significant arrears and their PDF entitlements unmet, concluding that the PDF is not always operating as it should, and there is scope for retailers across all tiers of the market to improve their compliance.
- On the other hand, the EWOV also observes that the framework might catch too many customers and recommends giving consideration to whether the entitlement to tailored assistance for customers who can afford their ongoing usage is currently too broad, and whether the PDF could be made more effective for those in genuine payment difficulty if it was narrowed.

A.11 Advance notice of price changes

Introduced in February 2019, the rule requires that retailers provide advance notice of price increases and decreases (i.e. 5 business days in advance of the change using the customers preferred form of communication whilst clearly indicating that the notice is a

[141] Energy and Water Ombudsman Victoria, December 2020, Missing the Mark – EWOV insights on the impact of the Payment Difficulty Framework (PDF) – 1 January 2019 to 1 October 2020 (https://www.ewov.com.au/reports/missing-the-mark)

price change notice).[142] The notice must include the date of change, the customer's existing tariff and then new tariff inclusive of GST so the change is easy to compare. The supplier also needs to provide a prompt that the customer can access their historical billing and usage data if required. The rule provides greater transparency and confidence in the retail energy market, helping consumers to avoid being surprised by their energy bill and giving them the opportunity to consider a variety of actions to manage changes to their energy bill before they occur.

Prior to the rule, retailers were only required to inform energy consumers on market retail contracts of changes to their contracts "as soon as practicable". Depending on the time of the billing cycle, this could often be not until three months after price changes came into effect. As a result, customer may have not been sufficiently prompted to reconsider their energy consumption plans, their retail contract or their choice of retailer before the new prices come into effect.

While requiring additional notices to be sent to consumers may create additional costs for retailers, particularly when required outside the billing cycle, the AEMC considered the benefits of the final rule versus the implementation costs that would likely pass through to consumers in a workably competitive market.[143] The AEMC found that the final rule results in manageable implementation costs by prescribing a simple and concise notice that is focused on the primary purpose.

A.12 Preventing discounts on inflated energy rates[144]

This rule change relates specifically to the practice of discounting off rates above the standing offer. It addresses confusing retailer discounting practices where retailers applied discounts to market offer rates that significantly exceeded the rates of the retailer's standing offer. A particular concern raised was that energy offers with large percentage discounts did not always lead to the lowest bills for consumers.

The rule change prohibits the practice where retailers provide discounts in a market retail contract where at least one rate is above the equivalent rate in a standing offer and no rates in the market offer are below an equivalent rate in a standing offer. The AEMC considered that in this case, no consumer could be better off under the undiscounted

[142] AEMC (2019) Information Sheet: Advance notice of price changes. Available at: https://www.aemc.gov.au/sites/default/files/2018-09/Information%20sheet_2.pdf; https://www.aemc.gov.au/sites/default/files/2018-09/Final%20Determination_2.pdf

[143] AEMC (2018) Rule Determination: National Energy Retail Amendment (Advance Notice of Price Changes) Rule. Available at: https://www.aemc.gov.au/sites/default/files/2018-09/Final%20Determination_2.pdf.

[144] https://www.aemc.gov.au/rule-changes/preventing-discounts-on-inflated-energy-rates; https://www.aemc.gov.au/sites/default/files/2018-05/Information%20sheet_2.pdf; https://www.aemc.gov.au/sites/default/files/2018-05/Final%20determination_1.pdf

market retail contract than under the standing offer. The AEMC also recommended making retailers' non-compliance with the AER's Retail Pricing Information Guidelines subject to a civil penalty of up to $20,000 per breach.

The rule change commenced operation on 1 July 2018.

In assessing the rule change request against the NERO, the principles and the reasoning of the AEMC are as follows:[145]

- Transparency of information: the final rule is likely to promote greater transparency of information to consumers which is crucial to competition and consumer engagement.
- Regulatory and administrative burden: the final rule is unlikely to have a significant impact on regulatory burden because the practice being restricted is not common within the industry.
- Facilitating service and tariff innovation: retailers offering innovative extra services and innovating in their market retail contract tariff structures beyond their basic standing offer tariff structures will not have the risk of a discounting prohibition applying to these contracts.

A.13 Notification of changes to customer benefits[146]

Commencing on 1 February 2018, the final rule requires energy retailers to notify electricity and gas customers when benefits in their contract, such as a discount, are about to end or change.

The rule's key requirements apply only to retailers with small customers on market retail contracts for electricity or gas where the contract provides a benefit to the customer (such as a price discount) for a minimum period or fixed benefit period that does not continue for the life of the contract. The rule requires retailers to send a notice to customers on such contracts 20-40 business days before their benefit changes.

The AEMC considered that:

- The rule is likely to lead to greater consumer engagement and participation in the retail energy markets as customers will be given clear and timely information both

[145] https://www.aemc.gov.au/sites/default/files/2018-05/Final%20determination_1.pdf (pp. 13-16).

[146] https://www.aemc.gov.au/rule-changes/notification-of-end-of-fixed-benefit-period; https://www.aemc.gov.au/sites/default/files/content/319fe7ad-6136-4daf-b4ce-41a975b53360/RRC0010-Determination-Notification-of-the-end-of-fixed-benefit-period.PDF

on why they should review current market offers (as their current benefits are ending) and on how to do so.

- The rule should lead to greater competition in the retail market as customers will have greater awareness of changes to the amounts they will pay as well as greater awareness of the comparator website.
- While retailers that offer contracts with benefit periods will incur some initial system change costs, the initial and ongoing costs are expected to be smaller than the benefits flowing to consumers.

A.14 Meter installation timeframes

Commencing in February 2019, under the new rule retailers will be required to provide a meter for a new connection or perform a simple meter exchange by a date agreed with the customer.[147] If no timing can be agreed, then the retailer will need to install the meter within six business days at a new connection, or within 15 business days if the customer has requested a simple meter exchange. The final rule also includes a range of additional measures that seek to reduce meter installation delays and increase consumer confidence.

There has been a high demand for smart meters and some customers have experienced meter installation delays since December 2017. Delays in the installation of new meters has significant implications on customers and particularly for those in hardship. Delays in the installation of meters can also leave customers without an electricity supply and delayed ability to access new products.

Noting that the new obligations on retailers and DNSPs may necessitate changes to their systems, processes and contractual relationships with other parties, the AEMC found that those concerns need to be balanced against the costs of no action, including the substantial harm to consumers that may continue to arise from meter installation delays. Taking these factors into account, the AEMC considered the benefits to consumers under the new obligations outweigh the additional regulatory burden on retailers.

A.15 Self-meter reads

Commencing in February 2019, under the new rule, if a small customer receives an estimated bill and they consider it is based on an inaccurate estimate, the customer can

[147] AEMC (2019) Information Sheet: Meter installation timeframes. Available at: https://www.aemc.gov.au/sites/default/files/2018-12/Information%20sheet.pdf

request that the retailer adjust the bill by providing their own reading of the meter.[148] This ability to request an adjustment will be available to small customers with electricity accumulation meters or gas meters. The rule requires retailers to inform relevant small customers of their right to request an adjustment to an estimated bill using their own meter reading and, in addition, includes additional measures to strengthen existing consumer protections related to estimated meter reads.

Bills that are based on inaccurate estimates can have a significant impact on consumers, either through imposing financial hardship or making it difficult for customers to align their behavioural or consumption patterns with the bills they receive. The AEMC found that the National Energy Retail Rules (NERR), in their current form, did not adequately protect consumers from the harm that can be created by inaccurate estimates.

In terms of implementation costs, the AEMC considered that the rule struck an appropriate balance between enhancing consumer protections and maintaining flexibility for retailers to design their own approach.[149] The AEMC found that the rule is not prescriptive in the processes to be adopted by retailers to comply with the draft rule, which should reduce the implementation costs.

A.16 AER Default Market Offer (DMO)

The Default Market Offer (DMO) came into effect on 1 July 2019 (DMO-1).[150] DMO-2 refers to the period from 1 July 2020 to 30 June 2021. The DMO limits the price that retailers can charge electricity customers on default contracts (known as standing offer contracts). The AER's role is to determine the maximum price a typical customer can expect to pay for electricity over a year. The DMO applies to small business and residential customers in areas where there is no other retail price regulation – South Australia, New South Wales and south-east Queensland (see separate section on Victoria below).

The DMO price for each area also acts as a 'reference price' for residential and small business offers in that area. When advertising or promoting offer pricing, retailers must show the price of their offer in comparison to the DMO. While this helps customers more simply compare the price of different offers, retailers argue that this implementation of price benchmarking has constrained their ability to offer pay-on-time discounts because savings must be expressed relative to the DMO.

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148 AEMC (2019) Information Sheet: Estimated meter reads. Available at: https://www.aemc.gov.au/sites/default/files/2018-10/Information%20sheet_1.pdf

149 AEMC (2018) Rule Determination: Estimated Meter Reads. Available at: https://www.aemc.gov.au/sites/default/files/2018-10/Final%20determination.pdf

150 AER Final Determination - Default Market Offer Prices - April 2019.pdf

Since the introduction of the DMO, the AER has observed reductions in the median market offer, and a move away from conditional discounts. It also noted that more than 95 per cent of market offers are priced at or below the DMO.[151]

Methodology

DMO prices are set to allow retailers to recover their efficient costs in servicing customers. The AER sets the DMO based on different costs retailers face to supply electricity to customers, which include:

- wholesale electricity costs
- network costs
- environmental costs

Retail costs are incurred by retailers to acquire, service and retain customers, including meeting regulatory obligations. These costs plus a retail profit margin form the residual cost component of the AER's DMO price.

For DMO-1, the AER used a price-based top-down approach for determining DMO prices. The AER set the DMO price for each distribution zone at the mid-point (50th percentile) of the range between the median market offer and median standing offer, based on generally available offers in October 2018.

The methodology used to determine DMO-2 is an extension of the top-down methodology used to determine the DMO-1 prices. DMO-2 adjusts DMO-1 prices to reflect forecast changes in wholesale, environmental and network costs. The residual costs (including retail costs) are adjusted according to changes in the Australian Consumer Price Index (CPI). The AER's approach to estimating the residual costs involves two steps:

- calculating the residual component in 2019-20 by deducting forecast wholesale, environment, and network costs from the DMO-1 price; and
- indexing this residual component by forecast CPI to forecast the residual component in 2020-21.

[151] AER - Default Market Offer - Price determination 2020-21 Final Determination - 30 April 2020

Potential re-opener provision in setting DMO (COVID effect)[152]

Submissions to the DMO-2 process raised the need for some form of uncertainty mechanism or regulatory "re-opener" that could be used to adjust the 2020-21 DMO determination in light of COVID-19-related market developments.[153] The AER considered that a re-opener provision would provide scope to respond in a timely way to COVID-19, once all parties have a better understanding of the cost implications and the impact of the various policy measures being put in place now. It would function to reset the price cap on standing offers for the remainder of the regulatory period – that is, it would function prospectively to adjust the current DMO prices. The re-opener should be symmetric in that it would apply to material cost increases or decreases.

A.17 Victorian Default Offer (VDO)

The Victorian Default Offer (VDO) was introduced by the Victorian Government on 30 May 2019 (commencing on 1 July 2019) to regulate standing offer prices for electricity in Victoria.[154] Electricity retailers must make the Victorian Default Offer available to customers who request it, but they can continue to offer customers contracts that differ from the default offer, through market offers.

Before January 2020, the VDO only applied to customers on standing offers with flat tariffs. Since 1 January 2020, the VDO covers all standing offers, including those based on time-of-use, demand, and flexible tariff structures. If a retailer offers their standing offer customers these tariff types, they must comply with the maximum annual bill amount set in ESC's price determination.[155]

The VDO includes a daily supply charge as well as a usage charge (per kilowatt hour). Differences in tariffs across distribution zones reflect the unique costs of providing electricity services in each area. Electricity retailers are required to calculate any discounts from the VDO tariff, known as the reference price. Current default offer prices apply for 1 January to 31 December 2020.

Methodology (2020 VDO)

The ESCV applies a cost-based approach to determining the VDO which includes:

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152 AER - Default Market Offer - Price determination 2020-21 Final Determination - 30 April 2020, p.22

153 https://www.aer.gov.au/retail-markets/guidelines-reviews/retail-electricity-prices-review-determination-of-default-market-offer-prices-2021-22

154 https://www.esc.vic.gov.au/electricity-and-gas/prices-tariffs-and-benchmarks/victorian-default-offer; https://www.energy.vic.gov.au/about-energy/policy-and-strategy

155 https://www.esc.vic.gov.au/electricity-and-gas/prices-tariffs-and-benchmarks/victorian-default-offer/victorian-default-offer-price-review-2020

- wholesale electricity costs – including hedging costs and network losses for electricity.
- network costs – which are directly taken from tariffs approved by the AER.
- environmental costs – including national renewable energy schemes and the Victorian Energy Upgrades program.
- retail operating costs – including costs of customer acquisition and retention.
- other costs – such as licence fees and Australian Energy Market Operator (AEMO) fees.
- retail operating margin – which is applied to all underlying costs.[156]

The ESCV does not include an allowance for headroom in establishing the VDO, consistent with the requirements of the order issued by the Victorian Government.[157]

COVID and the 2021 VDO

The ESCV's 2021 VDO accounts for the effect of the coronavirus pandemic on retailers' costs by increasing the amount in the VDO cost stack for bad debts. This is based on new information provided to the ESCV by retailers in response to its draft decision. The ESCV's expectation is that the additional $6 it has allowed for bad debts is temporary, and a specific response to the effects of the coronavirus pandemic and its impact on the economy that will be removed from the VDO 'cost stack' at a future review.[158]

A.18 Best offer on bills (Victoria)

This intervention came into effect on 1 July 2019[159] and involves three new entitlements intended to assist Victorian customers with navigating market complexities and identifying better deals. Firstly, customer bills will now periodically[160] include retailers'

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156 The retail operating margin is expressed as a percentage of the cost stack. The ESC has stated it is not required to base retail operating margins on actual retailer operating margins.

157 We note that regulators have generally been receptive to headroom allowances when setting retail tariffs. For instance, a 2020 QCA decision concluded that the inclusion of headroom to promote competition is consistent with the AEMC's advice on best practice retail regulation (AEMC, Advice on Best Practice Retail Price Regulation Methodology, Final report, September 2013) and is consistent with the past practice of other regulators, including IPART. In setting regional QLD retail electricity prices, the QCA had previously included a headroom allowance of 5% of total costs in notified prices for large and very large customers to promote retail competition in this market segment. However, in the 2020-21 determination, the QCA decided against including a headroom allowance.

158 https://www.esc.vic.gov.au/sites/default/files/documents/FD%20-%20%202021%20VDO%20-%20Final%20decision%20-%2020201125.pdf

159 There are transitional arrangements in place for some elements of the new requirements.

160 Every three months for electricity bills and every four months for gas bills.

best offer based on personalised information from their actual meter data. Secondly, customers must now receive a "bill change notice" informing them of changes before they come into effect. Thirdly, customers are now entitled to clear advice about their selected offers, with retailers required to disclose upfront any contract terms that may result in customers paying more than expected (e.g. conditional discounts or discounts that expire). In addition, for transparency purposes, all tariffs and charges must now be expressed inclusive of GST.

This intervention emerged in response to stakeholder concerns around the clarity of regulation, with several high-profile reviews (such as the 2017 Thwaites review) drawing attention negative customer experiences as well as high retail component costs on bills. In light of complaints that retailers' approaches to marketing, pricing and contracting left customers unwilling or unable to navigate the market, these changes attempt to encourage retailers to take responsibility for helping customers find their most suitable energy plan.

A.19 Reducing customers' switching time (retail)

The final rule determination for this intervention was released on 19 December 2019 in response to an AEMO rule change request.[161] AEMO's design proposes the creation of a market process that will provide for customers to transfer electricity retailers within two days, irrespective of metering type (e.g. accumulation or advanced electricity meter). The rule removes outdated requirements in the customer transfer process and amends the standard contract terms and conditions, and it provides clarity on some issues where industry has expressed doubt in the interpretation of rules.

To assess whether the determination met the NEO and NERO, the AEMC's assessment framework considered whether the rule change provided adequate consumer protections related to retail customer transfers and supports consumer choice of retail energy market products and services; improved transparency and certainty of market processes; and reduced regulatory and administrative burden. The rule provides flexibility to AEMO and industry to implement changes to the market process which enables customers to switch their energy retailer. It also addresses improvements to the customer transfer process in the NEM and responds to recommendations from the ACCC's Retail Energy Pricing Inquiry Final Report (REPI).

[161] Refer: https://www.aemc.gov.au/rule-changes/reducing-customers-switching-times

A.20 AER's Statement of Expectations of energy businesses[162]

The AER released the Statement of Expectations at the start of the COVID-19 pandemic in March 2020. Since then it has published two updates, which together apply from April 2020 to March 2021.

They set out the AER's expectations of energy businesses to protect customers, including:

- Offer residential and small business customers facing financial stress a payment plan or hardship arrangement.
- Not disconnecting residential or small business customers who may be in financial stress.
- Deferring referrals of customers to debt collection agencies for recovery actions, or credit default listing.
- Modifying existing payment plans if a customer's changed circumstances make this necessary.

Importantly, subsequent statements released by the AER has sought to emphasise customer engagement. For example:

- retailers are prevented from disconnecting customers who have made contact with the retailers or are accessing retailer support (July and November statements); and
- defer referrals to debt collection agencies for customers who have made contact with the retailers or are accessing retailer support (November statement).

The AER has also acknowledged that its expectations may add to the risks and costs facing energy businesses and said it was working with stakeholders on options to appropriately balance these risks and to ensure energy businesses get the assistance they may need (see AEMC rule deferring payment of network charges).

A summary of the AER's expectations is provided in Table A.1.

Table A.1 AER's expectations [changes between statements are underlined]

April 2020 Statement (for April to July 2020 period)	July 2020 Statement (for July to October 2020 period)	November 2020 Statement (for Nov 2020 to March 2021 period)
Offer all residential and small business customers who indicate they may be in financial stress, including	Offer all residential and small business customers who indicate they may be in financial stress (including	Offer all residential and small business customers who indicate they may be in financial stress a payment

[162] https://www.aer.gov.au/publications/corporate-documents/aer-statement-of-expectations-of-energy-businesses-protecting-customers-and-the-energy-market-during-covid-19

April 2020 Statement (for April to July 2020 period)	July 2020 Statement (for July to October 2020 period)	November 2020 Statement (for Nov 2020 to March 2021 period)
small businesses eligible for the JobKeeper Payment, a payment plan or hardship arrangement, regardless of whether the customer meets the 'usual' criteria for that assistance	small businesses eligible for the JobKeeper payment) a payment plan or hardship arrangement. This may include agreeing a period in which no payment will be made.	plan or hardship arrangement. These payment plans or arrangements may include agreeing a period in which no payment will be made. Work with customers who may be in financial stress to make payment plans and hardship arrangements sustainable by taking into account their capacity to pay, and ensuring customers are on the tariff most likely to minimise their energy cost. Retailers must consider actions that will minimise customers' debt such as re-calculating debt obligations using a lower cost plan if available. Customers should be moved to another plan only with their explicit informed consent.
Do not disconnect any residential or small business customers who may be in financial stress (including small businesses eligible for the JobKeeper Payment), without their agreement, before 31 July 2020 and potentially beyond.	Do not disconnect any residential or small business customer who may be in financial stress (including a small business eligible for the JobKeeper Payment) who: (a) has made contact with you or responded to communications from you; or (b) is accessing any retailer support. before 31 October 2020 (and potentially beyond),	Do not disconnect (a) any residential customer who may be in financial stress who (i) is in contact with you in relation to their debt; or (ii) is accessing any retailer support, and (b) any small business customer who continues to adhere to a payment plan or other agreed payment arrangement. before 31 March 2021 (and potentially beyond),
Do not disconnect any large business customer, including businesses eligible for the JobKeeper Payment, without their agreement, before 31 July 2020, and potentially beyond, if that customer is on-selling energy to residential or small business customers (for example, in residential parks or retirement villages).	Before 31 October 2020 (and potentially beyond), do not disconnect – other than at their request – any large business customer who may be in financial stress (including a business eligible for the JobKeeper Payment) who is on-selling energy to residential and small business customers and: (a) has made contact with you or responded to communications from you; or (b) is accessing any retailer support.	Before 31 March 2021 (and potentially beyond), do not disconnect – other than at their request – a body corporate or other large business customer who is on-selling energy to residential and small business customers, who may be in financial stress and who: (a) is in contact with you in relation to their debt; or (b) is accessing any retailer support.
	In the event a customer has not made or responded to any contact and has been disconnected for non-payment, the retailer must process an order for reconnection immediately on contact from the customer, and waive disconnection, reconnection and contract break fees.	
Defer referrals of customers to debt collection agencies for recovery actions, or credit default listing until at least 31 July 2020 / 31 October 2020, and potentially beyond.		Defer referrals to debt collection agencies for recovery actions or credit default listing until at least 31 March 2021, and potentially beyond for: (a) a retailer's residential customer or former customer who may be in financial stress who: (i) is in contact with you in relation to their debt; or (ii) is accessing any retailer support, and (b) a retailer's small business customer who continues to adhere to

April 2020 Statement (for April to July 2020 period)	July 2020 Statement (for July to October 2020 period)	November 2020 Statement (for Nov 2020 to March 2021 period)
		a payment plan or other agreed payment arrangement.
Be prepared to modify existing payment plans if a customer's changed circumstances make this necessary.		
Waive disconnection, reconnection and/or contract break fees for small businesses that have ceased operation, along with daily supply charges to retailers, during any period of disconnection until at least 31 July/31 October 2020.		Networks and retailers should waive disconnection, reconnection and/or contract break fees for small businesses that have ceased operation, along with daily supply charges to retailers, during any period of disconnection until at least 31 March 2021

Source: AER Statement of Expectations, April 2020, July 2020, November 2020

A.21 Network relief packages - NRP1 (April 2020) and NRP2 (August 2020)[163]

Recognising the need for the sector to assist in mitigating the economic burden resulting from the COVID-19 crisis, electricity and gas networks established packages that provided direct support for small business customers impacted by COVID-19, as well assisting large and small retailers so they can support impacted households.[164]

The key objectives of the relief packages were:

- tariff relief for small business customers impacted by COVID-19
- Incentivising all retailers to offer affected customers payment plans
- ensuring viability of small retail businesses
- supporting retail competition

Networks considered that these packages would have a significant impact on the network sector and could impact the creditworthiness of some networks, foreshadowing that it would be necessary to reconsider network expenditure to maintain credit metrics and loan covenants. Networks argued that there was a need to assess the relative priorities of regulatory changes under the current circumstances, drawing particular attention to the significant expenditure required to implement Five Minute Settlement obligations.

The relief package was implemented in two stages, as summarised in Table A.2.

[163] https://www.esc.vic.gov.au/sites/default/files/documents/covid%20workshop%20stakeholder%20summary%20-%20network%20charge%20deferral%20.pdf

[164] https://www.energynetworks.com.au/miscellaneous/covid-19-electricity-and-gas-network-relief-package/

Table A.2 Details of voluntary network relief package from distributors

Elements of package	Initial package (April 2020 – July 2020)	Current package (August 2020 – January 2021)
Eligible retailers	All retailers	All retailers, except for retailers of last resort, directly or indirectly government-owned retailers and known affiliates.
Eligibility criteria to receive network charge deferrals	Network charges can be deferred for: - residential customers receiving payment assistance, who started from 1 April 2020 (and were with their retailer prior) - small business customers who had a 75% consumption reduction. Network charges were automatically deferred for small retailers on 20% of residential customers.	Network charges can be deferred for residential and small business customers on a COVID-19 arrangement, payment plan, hardship arrangement, deferral debt arrangement (including those who entered into those arrangements prior to 1 March). Small business debt will no longer be written off.
Interest on network charge deferrals	No interest applied	No interest applied
Length of deferral	No more than 3 months	No more than 6 months
Transmission network charges	Unknown	Where a network charge has been deferred, transmission charges to be deferred
Negotiation between retailers	Instigated by distributors and negotiated within a week	Instigated by distributors and negotiated within a week
Declaration of payments	No requirement	Retailers to write a statutory declaration alongside payment deferral request to a distributor, that the request is in accordance with the package
Disconnection/reconnection fees	Fees are waived	Fees are waived
Agreement	Acceptance response via letter	Acceptance response via letter

Source: ESC

A.22 Capping conditional discounts

The AEMC made a final rule change, which came into effect on 1 July 2020, that protects consumers from large penalties when they miss pay-on-time conditions, by capping the level of conditional discounts and fees to reasonable costs.[165] In 2017, the ACCC found 27% of residential consumers failed to realise their pay-on-time conditional discount and subsequently recommended restrictions on these pricing structures. While the majority of offers in the market included a conditional pay-on time discount set above 20%, in many of these cases, missing a payment resulted in a considerable financial burden to small consumers.

[165] Refer: https://www.aemc.gov.au/rule-changes/regulating-conditional-discounting; Regulating Conditional Discounting - RRC0028 - Information sheet (aemc.gov.au); https://www.aemc.gov.au/sites/default/files/documents/regulating_conditional_discounting_-_rrc0028_-_final_determination.pdf

The rule change applies to gas and electricity retail contracts entered after July 2020. It does not set a specific level for "reasonable costs" because these will vary by payment condition and retailer. It applies only to conditional discounts and fees related to payment or timing method. Furthermore, the rule change includes an AEMC recommendation for new civil penalties for breaches of the rules.

A.23 AEMC deferral of network charges rule[166]

The AER submitted the rule change request in May 2020 to help mitigate the cash flow impacts of COVID-19 on the retail electricity market and help retailers to continue to support vulnerable customers having difficulty paying their bills.

The final rule introduces a mechanism to allow eligible retailers to defer the payment of network charges to distribution network service providers (DNSPs) for customers impacted by COVID-19 (i.e. residential and small business customers on a payment plan, hardship arrangement or deferred debt arrangement). Network charges incurred between 6 August 2020 and 6 February 2021 can be deferred for a period of six months. The two key conditions inherent in the final rule are:

- Retailers that are government-owned or registered as a Retailer of Last Resort (RoLR) are not eligible.
- Retailers are required to pay 3 per cent per annum interest on those deferred payments in order to allow NSPs to recover the efficient costs they may incur as a result of the payment deferrals.

In assessing the rule change request against the NEO, the AEMC considered the following principles:[167]

- Promoting financial resilience — whether the rule change proposal would support industry viability and financial resilience by deferring costs for retailers facing cash flow risks as a result of the COVID-19 pandemic.
- Efficient allocation of risk — whether the rule change proposal would appropriately allocate any associated risk and cost to the parties best placed to manage them.
- Implementation costs — where costs are imposed in implementation and cannot be mitigated through market mechanisms, these costs should be minimised relative to the benefits of the proposed deferral mechanism.

[166] https://www.aemc.gov.au/rule-changes/deferral-network-charges

[167] https://www.aemc.gov.au/sites/default/files/documents/final_determination_0.pdf (pp. 13-14)

A.24 Utility relief grant application (Victoria)

Based on evidence since the start of the pandemic, the ESCV considered that there was a need for targeted reforms to support residential customers paying their bills through the pandemic.[168] The reforms aimed to provide affected customers with consistent communication on the range of payment assistance measures available to them. Retailers are required to support residential customers in completing utility relief grant application forms, including by submitting forms online on behalf of the customer where possible and where the customer consents. This is an ongoing requirement, effective from 1 October 2020.[169] These changes expand protections embedded in the state's payment difficulty framework.

The ESCV's overarching statutory objective is to promote the long-term interests of Victorian consumers, having regard to the price, quality and reliability of essential services. The ESCV is also guided by objectives under section 10 of the Electricity Industry Act 2000 and section 18 of the Gas Industry Act 2001 to promote protections for customers, including in relation to customers who are facing payment difficulty.

A.25 Offering tariff checks (Victoria)

Under this initiative, retailers are required to conduct a tariff check for all residential customers receiving tailored assistance, not just those who cannot afford the ongoing cost of their energy. This is a temporary requirement in effect for six months from 1 October 2020. This measure is consistent with the ESCV's overarching statutory objective to promote the long-term interests of Victorian consumers, having regard to the price, quality and reliability of essential services.

While the existing payment difficulty framework allows customers to receive tailored assistance if they cannot afford their ongoing energy costs, the increase in average household energy consumption (due to Victorians spending more time at home due to the pandemic) means that it is more important than ever that customers are on a tariff appropriate to their circumstances. The ESCV also noted the potential for more

[168] Essential Services Commission of Victoria (2020) Supporting energy customers through the coronavirus pandemic Final decision, 24 August 2020

https://www.esc.vic.gov.au/sites/default/files/documents/supporting-energy-customers-through-coronavirus-pandemic-final-decision-20200824.pdf

https://www.esc.vic.gov.au/electricity-and-gas/inquiries-studies-and-reviews/supporting-energy-customers-through-coronavirus-pandemic-2020#tabs-container2

[169] Note that under the Utility Relief Grant Scheme (URGS), the Victorian Government pays the grant directly to the retailer, which credits the grant against the customer's outstanding debt.

customers to fall under the umbrella of the payment difficulty protections as the pandemic progresses.

A.26 Payment assistance small business (Victoria)

Under this initiative, retailers are required to provide assistance that is reasonable to small businesses that are experiencing financial stress due to the coronavirus pandemic. This is a temporary requirement in effect for six months from 1 October 2020. Small businesses adhering to a payment plan will not be able to be disconnected for non-payment, as set out in the current requirements of the Energy Retail Code.

In addition to its overarching statutory objective of promoting the long-term interests of Victorian consumers, the ESCV is also guided by objectives under section 10 of the Electricity Industry Act 2000 and section 18 of the Gas Industry Act 2001 to promote protections for customers, including in relation to customers who are facing payment difficulty. Thus, the ESCV emphasised the need to assist customers experiencing payment difficulties as a result of the coronavirus pandemic. The ESCV noted that it also has regard to other statutory objectives, including the financial viability of the retail energy market and promoting full retail competition.

A.27 Wholesale demand response mechanism

This rule introduces a low-cost mechanism for transparently engaging the demand side in central dispatch.[170] Until now, the demand side has rarely participated in central dispatch. This mechanism enables consumers to actively participate in central dispatch and be rewarded for the value they provide to the system. Furthermore, it will capture the benefits of greater demand side participation and share these benefits with all consumers.

[170] https://www.aemc.gov.au/rule-changes/wholesale-demand-response-mechanism

Figure 13 Design of wholesale demand response mechanism

Data source: AEMC

This mechanism has been designed in a way that seeks to minimise the costs and complexity of implementation. It will not require retailers to change their billing systems, which would add further cost and complexity. It has also been designed to minimise the costs incurred by AEMO.

The final rule:

- introduces a new market participant category, a demand response service provider (DRSP);
- places obligations on DRSPs that, as much as practicable, replicate those applied to other scheduled participants, for example, similar information provision and scheduling obligations;
- sets out a process for having baseline methodologies determined and applied to wholesale demand response units; and provides for DRSPs to be settled in the wholesale market for the wholesale demand response they have provided at the prevailing spot price; and
- sets out implementation timeframes for the mechanism, with the mechanism commencing on 24 October 2021.

A.28 5-minute settlement

This rule change seeks to align operational dispatch and financial settlement by reducing the time interval for financial settlement in the NEM from 30 minutes to 5 minutes.[171] From July 2021 onwards, the following procedures will occur on a 5-minute basis:

- Bidding and offering into the National Electricity Market
- Settlement
- Intervention Pricing
- Calculation of Trading Amounts
- Calculation of the cumulative price threshold

Sun Metals Corporation Pty Ltd submitted a rule change request to reduce the time interval for settlement in the wholesale industry from 30 minutes to 5 minutes, arguing that the mismatch between dispatch and settlement leads to inefficiencies in the operation and generation mix of the market. Specifically, it accentuates strategic late rebidding where generators have been observed to withdraw generation capacity in order to influence price outcomes and it impedes market entry for fast response generation and demand side response.

In contrast, the 5-minute settlement is expected to lead to improved price signals for more efficient generation and use of electricity, as well as more efficient investment in capacity and demand response technologies to balance supply and demand. The five-minute settlement commences Thursday 1st July 2021. Because the 30-minute settlement has been in place for nearly two decades, the implementation process is expected to be extensive, because all existing IT systems, metering infrastructure and financial contracts have been designed with reference to the 30-minute settlement.

A.29 Bill simplification rule change (in progress)

This rule change aims to simplify energy bills so that households and small business owners can better understand their bills and find better energy deals if needed.[172] This has been motivated by two major changes underway in the energy sector relevant to

[171] Refer: https://www.aemc.gov.au/rule-changes/five-minute-settlement; https://www.aemc.gov.au/rule-changes/delayed-implementation-five-minute-and-global-settlement

[172] https://www.aemc.gov.au/rule-changes/bill-contents-and-billing-requirements; https://www.aemc.gov.au/sites/default/files/documents/rule_change_submission_-_rrc0036_-_australian_energy_council_-_20201022.pdf

consumer bills: increasing two-way energy flows (as consumers generate or consume energy at different times), and digitalisation, which offers opportunities for more data-rich and convenient forms of communication with consumers.

The new requirements pertain to information that households and small businesses may require when they wish to pay their bill, understand their energy usage, perform administrative tasks, seek assistance, or understand how their bill was calculated whether it complies with their plan/offer. Among the key concerns with the existing arrangements is that there is no standard nomenclature or consistent format across bills, leading to consumer confusion. This results in bills with too much complex data, causing information overload, and failing to educate consumers about support tools (e.g. Energy Made Easy). The main components of the rule change proposals are:

- replacing rule 25 of the NERR with provisions requiring the AER to develop a mandatory guideline that would apply to gas and electricity retailers for households and small business's bills;
- the new rule provisions would be subject to civil penalty if a retailer fails to comply; and
- the AER could amend the guideline from time to time in accordance with retail consultation procedure.

Submissions on the rule change request were due in October 2020 and the process remains in progress at the time of writing.

A.30 Maintaining life support customer registration when switching (in progress)

The draft AEMC ruling aims to reduce barriers for life support customers who want to switch retailer or distribution network service provider (DNSP).[173] The proposed rule change offers greater protection to consumers on life support (most life support equipment, including oxygen concentrators, rely heavily on electricity or gas to operate).

Under current rules, customers that are registered as life support customers may be required to re-submit medical confirmation following a change of premises or retailer. The requirements facilitate the provision of information to parties that need to be aware of life support equipment at a premise, and impose obligations on retailers and DNSPs to provide additional safeguards around de-energisation. The AEMC is currently

[173] https://www.aemc.gov.au/rule-changes/maintaining-life-support-customer-registration-when-switching

accepting submissions on this draft rule determination, including the preferable draft rule, until 14 January 2021.

B. Options by stakeholder acceptability criteria

Table B.1 provides our assessment of policy approaches to improve or mitigate non-payment risks applying stakeholder acceptability criteria.

Table B.1 Assessment of policy approaches to improve or mitigate non-payment risks (stakeholder acceptability criteria)

Policy approach	Consumer acceptability[174]	Score	Retailer acceptability	Score	Policy maker acceptability	Score
Increased use of PPMs	• Conceptually simple • Familiar from telco service models, used in parts of Qld, WA and Tasmania for electricity • Less convenient than status quo	3	• Reduce necessity to chase customers for payment • Some transaction costs in switching customers to PPM arrangements	4	• Some weight attached to prevalence in other jurisdictions • Concerns regarding self-disconnection, particularly for vulnerable customers	3.5
Use of security deposits	• A barrier to accessing the service • A significant cost for some customers	2	• Payment in advance mitigates risk and streamlines some administrative processes • Slightly less favoured compared to government or distributor support due to likelihood of customer complaints	4	• Concern over such a significant shift in policy • Concern over barrier to access for disadvantaged customers	1.5
Load limitation (business)	• Unfamiliar and potentially considered intrusive • Keeps the lights on – reducing the disruption compared to PPMs	1.5	• Increases incentive for customers to engage and to pay • Likely to require considerable support for customers for some years to use properly	3.5	• Noting expectation of basic competency for business customers, potentially political acceptable • Concerns over confusion and good communication • Need to be persuaded of efficacy	1.5
Load limitation (residential)	• Red flag on grounds of not being operationally workable and end-user familiarity problem	0	• Increases incentive for customers to engage and to pay • Likely to require substantial support for customers that would lack information to engage with the technology	3	• Red flag on grounds of not being operationally workable and end-user familiarity problem	0
Load information	• Conceptually simple • Familiar from smart meter models • Helps in managing consumption	4	• Increases incentives for customers to engage and manage their usage • Does not directly address the non-payment risk	3	• Consistent with the overall policy objective of providing customers with better information • Enhances customer engagement with the market	4
Increased scope to disconnect	• Some customers may feel less secure	2	• Helpful power to be able to exercise (or to be able to refer to in communications)	4	• Concern over increased loss of access to an essential service	1

[174] The consumer acceptability scores are based on Synergies' perspective and are preliminary. We acknowledge there are different consumers and some approaches may be more acceptable to some consumers than to others. These scores will need to be tested with consumers/consumer representatives.

Policy approach	Consumer acceptability[174]	Score	Retailer acceptability	Score	Policy maker acceptability	Score
	• Customers with bad debts who do not or cannot pay suffer greater supply disruptions		• Difficult to deploy in a timely way		• High impact consequence that can attract significant negative attention	
Increase targeted government support	• Highly convenient • Costs are diffuse, remote and difficult to observe	4	• Reduces incidence of customers being unable to pay • Increases incentive for customers to engage • Easier for call centre staff to manage customers	4.5	• Concessions, grants and subsidies are well established tools • Large fiscal burden problematic and unlikely to be supported by treasuries	0.5
Insurance against excessive bad debts	• Highly convenient • Costs are diffuse, remote and difficult to observe	3	• Offsets retailers' NP risk with additional funds to bear those risks	4.5	• Concerns regarding efficacy and potential for perverse incentives • Large fiscal burden problematic • Perceptions of "free lunch for retailers"	1
Insurance against retailer failure	• Highly convenient • Costs are diffuse, remote and difficult to observe	3	• Concerns regarding implementation issues i.e. how to demonstrate failure is due to bad debts caused by intervention	2.5	• Red flag on grounds of not being operationally workable	0
Regulated retail price reset for higher cost reflectivity	• Likely minimal impact on prices albeit there will be an increase for those on DMO/VDO	3	• Maintains existing incentives for retailers • Offsets retailers' NP risk with additional funds to bear those risks	4.5	• Will result in higher DMO/VDO prices (albeit relatively small) • Perceptions of "free lunch for retailers" • Scope to characterise as giving in to free-riding	2.5
Distributors share risk of non-payment ("French" model)	• Minimal impact on prices • Minimal impact on customer experience	3	• Reduces NP risk for retailers • Introduces new complexities concerning claims handling and process auditing etc	3	• Some weight attached to use in other jurisdictions • Resistant to the idea of distributors assuming risks contrary to the originally intended risk allocation of the NEM • Would require amending the regulatory framework for distributors to bear this risk and for it be appropriately reflected in their pricing determinations	1.5
Distributors bill customers directly	• Greater complexity and confusion for customers • Managing multiple bills may exacerbate difficulties for some households to manage debt • Higher retail price due to higher costs of distributors	1	• Concerns regarding customer confusion over differentiation of roles • Potential loss of sales revenue	2	• Resistant to the idea of distributors adopting risks contrary to the originally intended risk allocation of the NEM • Concern that customers won't understand the policy • Concern that the policy change will be regarded as broader in scope and	1

Policy approach	Consumer acceptability[174]	Score	Retailer acceptability	Score	Policy maker acceptability	Score
					intention and will duplicate billing systems • Concern about higher electricity prices	

Source: Synergies analysis