Energy Retailers Association
of Australia Limited

SUBMISSION TO THE AUSTRALIAN GOVERNMENT'S COMPETITION POLICY REVIEW ISSUES PAPER

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ABOUT ERAA

The ERAA represents the organisations providing electricity and gas to almost 10 million Australian households and businesses. Our member organisations are mostly privately owned, vary in size and operate in all areas within the National Electricity Market (NEM) and are the first point of contact for end use customers of both electricity and gas.

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EXECUTIVE SUMMARY

The Energy Retailers Association of Australia (ERAA) welcomes this review of National Competition Policy (NCP). This submission responds to questions in the following chapters in the Issues Paper:

- Additional reforms in government sectors previously subject to full or partial competition reforms, including competitive neutrality (Chapter 3);
- Specific comments on the effectiveness of Australia's competition laws (Chapter 5); and
- The institutional arrangements through which competition laws are implemented and competition reforms sustained over time (Chapter 6).

This submission makes 11 recommendations concerning future competition policy and law reform.

The reforms that occurred in the energy market and NCP are integrally linked. The NCP provided pre-existing energy reform initiatives with a critical and overarching framework that could be taken forward by jurisdictions in a consistent manner. A consequence of the NCP energy market reform was the creation of the National Energy Market (NEM) one of the most competitive retail markets in the world, directly benefiting Australian consumers.

Accordingly, it is essential that future competition reform does not deviate from NCP principles.

Since the end of the third tranche of competition payments in 2003, which were provided for under the original NCP, the implementation of the reform and development of competitive retail energy markets has been undertaken by jurisdictions in the NEM in an inconsistent manner. As a result, there are a range of original NCP sponsored reforms that remain unfinished or diluted and future competition reform should prioritise and address these original reforms to improve the effectiveness and efficiency of the NEM. These reforms include:

- **Implementation of improved approaches to network pricing in the NEM**. The new Australian Energy Regulatory (AER) Rules regarding network fees are critical to promoting competition in the retail sector.

- **Implementation of retail price deregulation across the NEM**. Price regulation can dissuade entry by retailers into markets and also reduce product and service innovation.

- **Implementation of a national energy customer framework, with limited derogations**. Multiple state based consumer protection regimes add administrative and compliance costs and create barriers to cross-border activity.

- **Development of demand management initiatives through metering reform**. The roll out of new technology should be market driven and policy responses should not embed monopoly control of infrastructure and services.

- **Ensuring competitive neutrality and addressing exemptions that distort competition**. New entrants selling alternative energy contracts should be subject to the same NEM rules as traditional energy retailers.

The ERAA urges the Panel to ensure that future action focusses on incentivising jurisdictions to implement these unfinished reforms. The use of NCP payments was an effective discipline on the manner and speed in which jurisdictions implemented the original NCP. Consideration should be given to reinstating a clear NCP framework and payments for outstanding reforms that have clear productivity benefits.

SUMMARY OF RECOMMENDATIONS

RESPONSES TO CHAPTER 3 - GOVERNMENT PROVIDED GOODS AND SERVICES AND COMPETITIVE NEUTRALITY

Recommendation 1: Future competition policy reform should *not* to deviate from the tried and tested principles in the National Competition Policy (NCP) particularly: the structural separation of monopoly and contestable activities; removal of anti-competitive regulation unless it is in the public interest; and competitive neutrality.

Recommendation 2: Future competition reform should ensure that the development and implementation smart meter technology and services are: consistent with the NCP principle of separating monopoly and contestable activities; and market driven and do *not* lead to monopolies in the NEM and/or gas markets.

Recommendation 3: Future competition reform in the NEM should prioritise regulation to improve the transparency and efficiency of network pricing.

Recommendation 4: Future competition reform should ensure that in the NEM: the implementation of price deregulation is accelerated where it has not occurred and the public benefit test is more systematically and consistently applied by jurisdictions to assess the merits of maintaining or pursuing legislation and regulation that has an anti-competitive impact, like price regulation.

Recommendation 5: Consistent with NCP principles, the National Energy Consumer Framework (NECF) should be implemented by all jurisdictions with limited derogations only where there is a demonstrable need to address a specific jurisdictional issue or circumstance.

Recommendation 6:
The AER ring fencing guidelines need to be revised to ensure that competitive neutrality is properly applied in a market where related parties engage in both monopoly and contestable services, and may consist of government owned and private businesses.

Recommendation 7: Future competition reform should extend the National Energy Retail Law (NERL) and NECF to apply to alternative energy sellers. At a minimum, activities of alternative energy sellers should be subject to relevant consumer protection conditions to ensure consistent application and promote competitive neutrality in the energy retail market.

RESPONSES TO CHAPTER 5 - COMPETITION LAWS

Recommendation 8: The competition-related provisions of the *Competition and Consumer Act 2010* (Cth) (CCA) should be drafted consistently with the *Developing Clearer Laws Quick Reference Guide* to reduce their complexity.

Recommendation 9: It would be premature to change the current unconscionable conduct provisions of the CCA because important test litigation is now before the Federal Court of Australia.

RESPONSES TO CHAPTER 6 - ADMINISTRATION OF COMPETITION POLICY

Recommendation 10: The enforcement activities of state and national regulators should be subject to review to ensure a balanced approach that does not have a detrimental impact on the level of competition in a market where it is not warranted.

Recommendation 11: The NCP payments regime was effective in accelerating reform and should be reconsidered to incentivise jurisdictions to fully implement the original NCP reforms with respect to the NEM.

RESPONSES TO CHAPTER 3 - GOVERNMENT PROVIDED GOODS AND SERVICES AND COMPETITIVE NEUTRALITY

Questions: Is there a need for further competition-related reform in infrastructure sectors with a history of heavy government involvement (such as the water, energy and transport sectors)? What are the competition policy reform priorities in sectors such as utilities, transport and telecommunications?

1. Previous Energy Market and NCP Reform

1.1 NCP Reform Underpinning the National Electricity Market

The adoption of the NCP was a seminal and rare moment in Australia's economic history when all governments, regardless of political persuasion, agreed that the national interest would be best served by a suite of reforms that could boost the nation's productivity and international competitiveness.

Improving competition in key markets that represented input costs in the economy and in which government businesses played a significant part delivering goods and services, such as energy transmission, distribution and retail, was identified as essential for driving down the costs of production and boosting gross domestic product.

The NCP provided a framework in which energy reform could be pursued in line with economy wide competition principles, but it is important to note that commitment of Australian Governments to a national electricity market (the NEM) was conceived almost twenty years ago and preceded their commitment to the NCP in 1995.

In July 1991, State and Territory Governments took the first step towards electricity market reform by agreeing to establish the National Grid Management Council (NGMC). The NGMC was tasked with promoting the "efficient, economic and environmentally sound development of the electricity industry" and asked to "encourage open access to the eastern and southern Australian grid and free trade in bulk electricity for private generating companies, public utilities and private and public electricity customers"[1]. After a series of subsequent commitments by the Council of Australian Governments (COAG), the NEM was launched in 1998.

Thus the NEM and NCP have been integrated for almost 20 years, as part of an evolving process. Within the NCP framework the development of the NEM has relied on and been enabled by the following key three NCP principles[2]:

- Structural separation of contestable and natural monopoly elements/activities;
- The removal of anti-competitive regulation unless maintaining it is in the public interest; and
- The application of competitive neutrality.

The progress and pace of reform in energy markets was also governed and stimulated by the *Agreement to Implement the National Competition Policy and Related Reforms*, which was one of the instruments in the NCP package along with the *Competition Principles Agreement* and *Conduct Code Agreement*. The *Related Reforms Agreement* incorporated existing COAG agreed reforms in electricity, gas, water and road transport into the NCP and provided for three tranches of Commonwealth government payments to encourage State and Territory governments to implement NCP reforms. These payments were linked to electricity reforms in the following ways:

- First tranche payments (1997-98) were tied to governments implementing an interim competitive NEM from 1 July 1995.
- Second tranche payments (1999-2000) were tied to the implementation of a fully competitive NEM by 1 July 1999; and
- Third tranche payments (2001-2002) were linked to the continuing implementation of electricity reforms.

[1] Special Premier's Conference, Communique, Sydney 30 July 1991.
[2] Council of Australian Governments, National Competition Policy Principles Agreement, 1996.

1.2 Contribution of NCP to Energy Retail Market Outcomes

The electricity and gas retail market encompasses the provision of energy services by retailers to end use business and residential customers. Retail markets provide[3]:

- The framework for retailers to offer energy services to customers;
- Retail competition - allowing consumers to choose between competing retailers; and
- Balancing and reconciliation services - for instance, managing the daily allocation of gas usage to enable settlement of gas supply contracts.

The three key NCP principles underpinning the NEM have led to the market participation of over 15 retailers with sufficient scale to compete for business and residential customers across borders. This is because the NCP reforms have enabled two key outcomes for consumers:

- The capacity of consumers to choose their retailers. Consumers have the ability to choose their electricity retailer in five of the six NEM jurisdictions with Tasmania scheduled to also introduce full retail contestability from July 2014; and
- Promoting competition. The capacity of retailers to offer consumer's choice through market offers. In Queensland, New South Wales, Victoria and South Australia residential consumers are able to shop around for the best offer from retailers. In 2012/13, as example, consumers, depending on location and consumption, were able to save between 5 to 16% by switching from a regulated tariff to a market contract[4].

These two outcomes are a success story for NCP reform and demonstrates the importance of retaining these principles to guide future competition reforms in the energy market.

Recommendation 1: Future competition policy reform should *not* to deviate from the tried and tested principles in the National Competition Policy (NCP), particularly: the structural separation of monopoly and contestable activities; removal of anti-competitive regulation unless it is in the public interest; and competitive neutrality.

2. Future Competition Reform Priorities in Energy Retail Market

Despite the success to date of NCP, in promoting competition in the NEM, there is a need to ensure that:

- Unfinished NCP reforms are fully implemented; and
- Competition policy is able to accommodate ongoing changes in the NEM which have and will continue to diversify energy services and suppliers. Low barriers to entry in the NEM means that new technologies, like smart metering, and the increased participation of alternative energy sellers, such as solar power companies, will alter the rights, obligations and opportunities of service providers and customers.

Competition policy reform priorities to address these issues are as follows:

- Adherence to the principle of separating monopoly and contestable activities in policies aimed at promoting demand management through new technologies;
- Regulatory approaches to pricing and customer protection that are pro-competition, unless it is in the public interest; and
- No exemptions from competitive neutrality for participants in the energy retail market.

[3] Australian Energy Markets Commission.
[4] Australian Energy Markets Commission, 2013 Residential Electricity Price Trends, 13 December 2013.

2.1 Structural Separation and New Technologies for Demand Management

2.1.1 NCP Principle that should underpin new technologies

Allowing distributors (poles and wires businesses) to offer new contestable services may be inconsistent with the objectives of the *Competition Principles Agreement* to separate contestable and natural monopoly activities and assets of government businesses. While some distributors in the current market are privately owned, some remain government corporations and therefore the application of the *Competition Principles Agreement* remains relevant.

Under NCP existing state and local government electricity distribution entities were rationalised into a few government businesses, provided with exclusive franchise areas, corporatised or privatised, and separated from retail assets and functions. In some jurisdictions distributors were permitted to participate in the retail market under a separate licensing regime.

By establishing a fixed number of distributors with exclusive franchise areas, governments recognised that distributors exhibit the features of a natural monopoly because they can supply the market more efficiently as a result of their technology, incumbency and economic integration.

It was also recognised that the infrastructure required to manage the distribution of electricity represents the characteristics of a natural monopoly, primarily because it is not economically feasible to duplicate the infrastructure. To promote competition in downstream (retail) markets, state or national access regimes were implemented to govern third party access to distribution infrastructure.

These structural separations and regulatory measures were applied to end the vertical integration of distribution businesses in the electricity market. Economic policy recognises that vertically integrated natural monopolies with significant market power tend to have higher production costs, may charge higher prices and may innovate more slowly than firms which are subject to competitive pressures[5].

Despite these structural separations and regulatory arrangements, economic theory and public policy assumes that natural monopolies will always seek to vertically integrate or control a related market if possible. If the related market is perfectly competitive, it is difficult for the monopolist to vertically integrate and raise profits because there is only one monopoly rent that can be earned in a supply chain or network[6]. However a natural monopolist may still want to vertically integrate into a related market for a range of reasons which include[7]:

- Avoiding regulatory restrictions or to preserve cross subsidies;
- Taking advantage of vertical economies of scale and scope, reduce transaction costs or internalise network spill over effects; and
- Price discriminating in a downstream market.

The electricity retail market cannot be regarded as a perfectly competitive market but NCP imposes structural and regulatory barriers to the capacity of distributors to vertically integrate in the retail market.

2.1.2 Enabling "smart" technology

In 2012, the Australian Energy Market Commission (AEMC) made a series of recommendations to the COAG Energy Council to promote new technology to support demand management initiatives. One of the reforms proposed was to expand competition in metering and related services for all consumers, putting greater discipline on metering suppliers and service providers to provide services at efficient cost and consistent with consumer preferences[8].

[5] New Zealand Treasury and Ministry of Commerce, Discussion Paper – Regulation of Access to Vertically Integrated Natural Monopolies, 1995, p 4.
[6] Ibid, p 73.
[7] Ibid.
[8] Australian Energy Markets Commission, Power of Choice Review 2012.

On 17 April 2014, the AEMC published a consultation paper seeking views on a proposed change to the National Electricity Rules (NER) and National Energy Retail Rules (NERR) regarding expanding competition in metering and related services.

These initiatives followed the mandated roll out of smart meters in Victoria[9] where regulation nominated distribution businesses exclusively as the Responsible Person for small customer sites.

The ERAA has consistently advised the Victorian government and the COAG Energy Council that the approach taken in Victoria is *not* consistent with the NCP principles governing the separation of monopoly and contestable activities, and creates the following key risks to competition in downstream retail markets:

- Meters are central to the NEM and the retail market. By controlling the roll out of metering, distributors have the opportunity to install and use proprietary technology that provides them with exclusive advantages in relation to the market for meter provision, installation and maintenance, market for remote customer data collection and communication and market for in situ data collection. Dominance in these markets enables distributors to shape the nature of what may be considered to be retail services, compete directly in the provision of retail services, and/or use related companies or subsidiaries to compete in retail markets. The significant anti-competitive effects associated with natural monopolies like distributors controlling technology platforms that are essential to product design and customer service offerings in retail markets is well known in the telecommunications industry;

- Smart meters are key enablers of smart grids. In reality smart grids are likely to be controlled by asset owners like distributors. Permitting distributors (one party in the grid) to control enabling technology (smart meters) as well as the grid is not consistent with promoting competition in downstream markets (retail) which will rely on the enablers and grid to operate in a contestable manner; and

- It is not clear that the current regulatory frameworks are capable of ensuring that distributors cannot use their control of smart grids and smart meters to enjoy competitive advantages in the smart meter infrastructure and services markets. This creates a risk that customers are not receiving smart metering services at least cost or receiving the full range of services and products available through the technology.

More broadly, impediments to competition in meter infrastructure include prohibitively high meter exit fees, bundled annual meter charges and jurisdictional regulatory differences. For example, indicative network exit fees for basic meter installations proposed in NSW may impede a market driven roll out of smart meters.

The ERAA supports the provisioning of smart metering, but considers that it should be based on a market driven roll out. This would facilitate maximum competition for new technology and technology related services and optimise customer choice.

In this context the ERAA supports the current AEMC examination of competition in metering services and suggests that the Competition Review Panel consider the outcome of the AEMC review

Recommendation 2: Future competition reform should ensure that the development and implementation of smart meter technology and services are: consistent with the NCP principle of separating monopoly and contestable activities; and market driven and do *not* lead to monopolies in the NEM and/or gas markets.

[9] Victorian Advanced Metering Infrastructure Project

2.2 Regulatory Approaches to Pricing and Consumer Protection

2.2.1 NCP Principle that should underpin regulatory pricing and consumer protection

The *Competition Principles Agreement* requires all jurisdictions to ensure that their legislation and regulation is *not* promoting anti-competitive outcomes, unless there is a public benefit in doing so.

The public benefit test is included in as governments recognised that competition is not an end in itself but rather a means to achieve:

- Lower prices for consumers;
- Increased choice for consumers; and
- Better quality of services for consumers.

The Hilmer Report confirmed that competition is a "positive force that assists economic growth, job creation, creativity and innovation"[10] while recognising that competition policy should not be pursued for its own sake, but rather to achieve efficiency and growth where this serves the overall social good[11].

Australian governments responded to this by including in the *Competition Principles Agreement* a requirement that, before applying competitive neutrality, implementing structural reform of public monopolies and repealing anti-competitive legislation, governments must consider:

- The benefits and costs of such responses, including the competitiveness of business and interests of consumers;
- The overall merits of such responses; and
- Whether alternative responses could achieve the same policy objectives[12].

This enables governments to retain anti-competitive arrangements, but only where the benefits of doing so outweigh the costs.

2.2.2 Future Pricing Regulation

In the NEM, competition in the retail market is affected by two kinds of pricing regulation:

- The regulated network tariff and charges that retailers must pay distributors for access to the distribution network (Network pricing); and
- The regulated retail price that some jurisdictions continue to maintain (Standing retail pricing).

Network Pricing

Third party access arrangements to energy distribution (network) infrastructure are a critical instrument to promote competition in retail markets. Accordingly, the nature of network pricing is an important determinant of the extent to which network assets work for or against facilitating retail competition. According to the AEMC[13]:

- Network pricing reflects the costs associated with building and operating transmission and distribution networks, including a return on capital. These costs currently make up about 50 per cent of the national average electricity price;
- Network prices are expected to increase by 4.6 per cent a year over the three years from 2012/13 to 2015/16. These increases partly reflect revenue allowances that were included in regulatory network determinations made prior to the recent network regulation rule changes, some of which continue until the end of 2015; and

[10] Australian Government, National Competition Policy Review, 1993, pxv
[11] Ibid, pxvi
[12] Competition Principles Agreement, clauses 1(3), 3, 4 and 5
[13] Australian Energy Markets Commission, 2013 Residential Electricity Price Trends, 13 December 2013.

- The increases also reflect moderation in the underlying factors which had previously driven network cost increases. These factors include the cost of capital, expectations of peak and average demand and changes to jurisdictional reliability standards.

The AER is primarily responsible for the approval of electricity access arrangements in the jurisdictions involved in the NEM. A network owner can ask the National Competition Council (NCC) to conduct a merit review process of the decisions of the AER.

In late 2012 the AEMC recommended to the COAG Energy Council that distribution network pricing principles be reformed to improve consumer understanding of cost reflective network tariffs and give people more opportunity to be rewarded for changing their consumption patterns[14]. The AEMC also amended the framework for the regulation of network revenues, which should improve the AER's capacity to determine efficient revenues and the competitiveness of networks across the NEM.

In December 2013 the merit review process was amended to require a network owner to demonstrate that a materially preferable decision exists compared to the one determined by the AER. This decision should mean that changes to access arrangement decisions are more balanced, making networks more competitive and efficient, in the interests of customers.

The AEMC is currently preparing a rule change to the NER to improve the efficiency of electricity network pricing updates. This will be crucial to improving efficiency and competition in retail electricity markets. The draft rule is currently scheduled to be released by the AEMC in August 2014, and the final rule in November 2014. However, the success of these reforms will depend on the AER's approach to implementing the rules through the forthcoming access arrangement resets (the first resets commence mid-2014).

The regulated control of network pricing and regulations to improve efficiency and transparency are consistent with the NCP principles because:

- There is no alternative but to regulate the prices charged by natural monopolies;
- Network pricing can and does have a high impact on customer bills; and
- More transparent and efficient network pricing can promote increased customer awareness and retail competition.

An appropriate national framework for the efficient investment in energy networks is one area of outstanding competition reform. It has been an item on the COAG Reform Council agenda for some time and should be pursued.

Recommendation 3: Future competition reform in the NEM should prioritise regulation to improve the transparency and efficiency of network pricing.

Regulated Retail Prices

The NCP tranche payments in the *Agreement to Implement the National Competition Policy and Related Reforms*, along with the *Competition Principles Agreement* intended for all jurisdictions to implement a fully competitive NEM by 1 July 1999 and maintaining regulated pricing is not consistent with this intention.

In Queensland, New South Wales, the Australian Capital Territory and Tasmania retailers can offer market prices for electricity, but each jurisdiction also has a regulated price set by the government that customers can request. Regulated prices for gas are only available in New South Wales. Victoria and South Australia have no regulated prices for electricity or gas, and therefore energy retailers set all of their own prices consistent with the intention of the NCP.

[14] Australian Energy Markets Commission, Power of Choice Review 2012.

In regulated markets price setters have tended to use actual network, wholesale and retail operating costs to set the regulated retail price at a competitive level, limiting a retailer's capacity to offer discounted or more competitive market offers. As a result, more efficient ways of meeting energy demand are foregone and the costs of supplying energy increase.

The ERAA has consistently advocated for deregulation of retail energy markets to drive the best outcomes for consumers. Open, competitive energy markets free from distortions such as retail price regulation naturally encourage prices to be efficient through the development of market offers. Competition in retail energy markets, as in other sectors of the Australian economy, incentivises businesses to improve service, develop products that meet consumer needs and find ways to lower their costs and to pass these savings onto consumers. Price regulation is an oddity in the Australian economy as it does not apply to almost any other contestable good or service such as food, fuel, telecommunications, insurance and housing.

Much of the increase in energy prices over recent years has been due to higher cost factors outside retailers' control. It was often viewed that regulating prices would protect those consumers most in need. Yet price regulation does not operate to protect hardship customers because of the hardship they are facing.[15] Similarly, price regulation cannot protect hardship customers from being disconnected.[16] Using retail price regulation to artificially suppress retail prices only delays an inevitable price increase in the future and can make increases worse than they otherwise might have been.

Since price caps were removed in Victoria on 1 January 2009, and South Australia in January 2012, competition has developed strongly; with new and existing retailers offering customers more diverse and innovative energy products, and enabling consumers to save on their power bills by shopping around. Since these dates there have been a growth in the number of smaller retailers. The Victorian market, for example, is the least concentrated in the country with the three incumbent retailers having about 70-75 per cent of the market while a range of new entrant retailers have secured about 25-30 per cent of overall customers.

A further reason to support jurisdictions removing regulated retail pricing is the externalities facing the retail market and their impact on competition. One of the key pressures on retail markets is the level of demand for energy. In markets where demand is falling, retailers have to offer more innovative services and products to be competitive. Price regulation is a barrier to their capacity to achieve this and implied threats to reregulate markets introduce uncertainty and sovereign risk.

In most markets that have a set of policies committed to demand side management, consumption per capita has been falling for years. Global data indicates that this trend will continue. Australia has experienced a 6 per cent decline in consumption since 2007, while New Zealand has experienced an 8 per cent decline since 2006 and Great Britain has experienced a 15 per cent decline in 2006[17].

Slowing energy demand that is driven by consumers also raises questions about the need for additional government sponsored demand management policies. Policies aimed at slowing demand even further than market responses may act to reduce the level of competition in the retail market, particularly if it dissuades new entrants and discourages innovative services and products.

When taking into account the savings customers can obtain from moving from regulated to market pricing, the comparative levels of competition that can be generated in markets where regulated pricing has been removed and the externalities impacting the energy sector, it is clear that Queensland, New South Wales, the Australian Capital Territory and Tasmania should remove regulated pricing. Recently the New South Wales and Queensland Governments have committed to introduce price deregulation and the ERAA welcomes this commitment.

[15] AEMC (2013), *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales Draft Report*, p.98.
[16] Ibid, p. 99.
[17] VaasaETT data and analysis based on international information sourced from regulators and retail markets

Recommendation 4: Future competition reform should ensure that in the NEM: the implementation of price deregulation is accelerated where it has not occurred, and the public benefit test is more systematically and consistently applied by jurisdictions to assess the merits of maintaining or pursuing legislation and regulation that has an anti-competitive impact, like price regulation.

2.2.3 Future Customer Protection Framework

The National Energy Customer Framework (NECF) governs the sale and supply of electricity and natural gas to retail customers and applies to the NEM electricity and natural gas market. It aims to promote retail competition and empower customers to negotiate energy contracts that suit their needs. It does this by strengthening the position of customers in areas such as hardship, retailer failure, access to market information, and disconnections. Specifically, it deals with:

- The rights and obligations of retailers and their customers, including marketing, informed consent, security and privacy provisions and consumer protections;
- The rights and obligations of the relationship between distributors and customers and retailers and consumer protection measures;
- Retailer authorisations (licences) to sell electricity and/or natural gas to customers; and
- Requirements for retailers and distributors to comply with their obligations under the customer framework.

The energy specific consumer protections in NECF are intended to complement and operate alongside existing consumer protections. These include protections under the Australian Consumer Law and also state and territory consumer protection laws. States and territories can choose to apply the NECF either in full or with derogations.

The implementation of the NECF was due to commence on 1 July 2012 in all NEM markets but has only been adopted in the ACT, NSW, South Australia and Tasmania to date. Adoption in Victoria and Queensland is yet to occur (Queensland aim to implement on 1 July 2015).

By standardising consumer protection regulation, the NECF has the capacity to reduce costs for retailers and ensure all customers regardless of location receive the same protections. The failure of all jurisdictions to accept the NECF in full and existence of multiple consumer protection regimes creates barriers to entry, such as increased regulatory, administrative and compliance costs, for retailers wishing to expand their operations across borders. Actions by jurisdictions that inhibit the capacity of retailers to compete across borders is inconsistent with the intention of the NEM.

Approaches to consumer protection should be consistent with the NCP principles and particularly the public benefit test. It is not clear that multiple jurisdictional based consumer protection regimes or derogations from the NECF which limit competitive behaviour would meet the public benefit test in the NCP.

Even in markets with retail price de-regulation, state based consumer protection regulations can create unnecessary burdens for business. For example, even though Victoria was the first jurisdiction in the NEM to de-regulate retail prices and has the most competitive retail market in the NEM, it is one of the most costly markets to operate in. This is largely because its consumer protection framework permits poor consumer behaviour and erodes the responsibility of consumers in meeting their obligations. For example its framework prohibits retailers recovering the additional cost incurred where consumers fail to meet their financial obligations, such as late payment fees.

Accordingly the ERAA strongly favours a national consolidated approach to energy policy and regulation rather than individual state based initiatives.

Recommendation 5: Consistent with NCP principles, the NECF should be implemented by all jurisdictions with limited derogations only where there is a demonstrable need to address a specific jurisdictional issue or circumstance.

2.3 Competitive Neutrality

Questions: Does competitive neutrality policy function effectively, and does it apply to the appropriate government business activities? Has the method of implementing competitive neutrality principles improved competition and productivity? What are the disadvantages that private businesses face when competing with government business activities? Could the mechanism for dealing with competitive neutrality complaints be improved?

Competitive neutrality remains a critical NCP principle to ensure that government and private sector businesses, as well as incumbent and new entrants in markets are subject to the same sets of taxes, rules and regulations that are part of the cost of doing business.

In relation to future competition reform there are two main issues that are relevant:

- The application of ring fencing arrangements; and
- Competitive neutrality between alternative energy sellers and traditional energy retailers

2.3.1 Ring Fencing

The implementation of appropriate ring fencing provisions is integral for the establishment of competitive neutrality in the energy industry. It should be applied as part of the structural separation of contestable and monopoly activities whether market participants are government or privately owned.

The ERAA has always advocated that contestable markets should operate in an environment of competitive neutrality. In our 2012 submission to the AER's review of electricity distribution ring fencing guidelines the ERAA raised concerns that there is increased risk that distributors will subsidise their activities in the retail market with regulated revenue (irrespective of current ring fencing provisions).

This view is also relevant when considering developments in contestable metering. The ERAA notes that the AER "*has advised that distributors' using regulated revenue to fund unregulated activities is unlawful".*[18] While current jurisdictional ring fencing measures is one way to minimise this risk, it is the opinion of the ERAA that these are not sufficient to eliminate it all together. The ERAA recommends that the AER develop national ring fencing guidelines ensuring that competitive neutrality, as intended under the NCP, applies in the market. A review should also ensure that there are appropriate ring fencing arrangements between meter provision and meter data services businesses from distribution businesses to assist the development of competition in smart metering services.

Recommendation 6: The AER ring fencing guidelines should be revised to ensure that competitive neutrality is promoted in markets where there is a mix of government owned, former government owned and private retail and distribution businesses.

2.3.2 No Exemptions to Competitive Neutrality

The ERAA has previously provided views to the AER on the issues surrounding alternative energy sellers[19] particularly its concerns regarding the AER's approach of not requiring alternative energy sellers to hold a retail

[18] Accenture Final Report: Department of Primary Industries IHD Inclusion into ESC scheme, December 2011, p 85.

[19] Definition taken from the AER's consultation at http://www.aer.gov.au/node/22188 .
"A number of businesses wishing to sell energy under alternative energy selling models are approaching the AER, seeking guidance on whether a retailer authorisation or a retail exemption is required for their business activities.There are a range of features that alternative energy suppliers may have in common. As example
- *they have previously limited their activities to other energy related services (for example, the installation of photovoltaic (PV) infrastructure) and are new entrants to the energy retail market*
- *they sell energy through a medium to long term contract*

authorisation under the National Energy Retail Law (NERL). The ERAA is of the opinion that this is in direct contradiction to the principle of competitive neutrality.

As a general principle, the ERAA does not believe that it is in the long term interests of consumers to require different service standards from businesses that are providing the same services. It creates an uneven playing field that distorts competitive market outcomes. The ERAA supports competitive neutrality between energy businesses through the consistent application of regulatory frameworks, including for consumer protections.

Whilst there may be barriers to entry in the retail energy sector, these barriers are not unnecessarily high, and where they exist they exist because they were deemed necessary to ensure that consumers are adequately protected. These barriers should apply equally to all parties. Should obligations apply to energy retailers but not to alternative energy sellers, energy retailers will take on additional compliance costs, credit risk and liabilities for network charges, placing them at a competitive disadvantage where they are providing the same service. This approach is not consistent with the principle that risks are apportioned to those parties best able to manage them.
It is the view of the ERAA that the NERL was developed to ensure a consistent and harmonised approach to consumer protections for all energy services. As such, maintaining appropriate standards of consumer protections for all customers and competitive neutrality between competitors as espoused under the NCP must govern emerging business models that offer energy as part of their service offering.

As energy is considered an essential service, there is a basis for requiring alternative energy sellers to be subject to some form of retail authorisation, rather than being granted retail exemptions, as has been the recent experience. The central consideration that must be taken into account in making the decision as to whether to grant an exemption from retail authorisation is the set of three policy principles set out in section 114 of the NERL:

a) regulatory arrangements for exempt sellers should not unnecessarily diverge from those applying to retailers;
b) exempt customers, should, as far as practicable, be afforded the right to a choice of retailer in the same way comparable retail customers in the same jurisdiction have that right; and
c) exempt customers, should, as far as practicable, not be denied customer protections afforded to retail customers under this Law and Rules.

A proper consideration of the first and third of these policy principles in particular should weigh in favour of a decision to require alternative energy sellers[20] to operate in the market under some form of retail authorisation.

As noted in the AER (Retail) Exempt selling guideline, “These principles are, in part, aimed at ensuring that exempt customers are not unreasonably disadvantaged compared to customers of authorised retailers.”[21]

Furthermore the AER is required to comply with section 205 of the NERL, which requires the AER to:

- contribute to achievement of the National Energy Retail Law objective, to promote efficient investment in and efficient operation and use of energy services for the long-term interests of energy consumers with respect to price, quality, safety, reliability and security of supply of energy; and
- exercise that function or power in a manner that is compatible with the development and application of consumer protections for small customers, including (but not limited to) protections relating to hardship customers.

[20] Or any other party that wants to offer energy as part of their customer service offering.

[21] AER (2013), AER (Retail) Exempt selling guideline – version 2, p 11.

Alternative energy sellers have made statements to the effect that if they can no longer continue supplying energy, the primary retailer will automatically provide the customer with their full energy needs.[2] Whilst the NCP entitles alternative energy sellers to become significant players in Australia's retail energy market, it doesn't assume that this should be done by diluting the principle of competitive neutrality, by assuming that authorised energy retailers (the primary retailer):

1. effectively subsidise their activities by being the default provider of their consumer protection requirements; and
2. be saddled with the onerous energy retail regime while a new competitor free of the cost and resource intensity of that regime gains a substantial competitive advantage.

The ERAA's view is that the current framework requires amendment in order to more appropriately achieve the right balance between facilitating new energy supply options and ensuring competitive neutrality and consistent consumer protections.

The NERL was developed to ensure a consistent and harmonised approach to consumer protections for all energy services. As such, maintaining uniform standards of consumer protections for all customers must be a strong consideration for the AER. This framework for a nascent but rapidly expanding energy industry segment is essential as the consistency of product and service delivery is more variable.

Recommendation 7: Future competition reform should extend the National Energy Retail Law to apply to alternative energy sellers. At a minimum, activities of alternative energy sellers should be subject to relevant consumer protection conditions to ensure consistent application and promote competitive neutrality in the energy retail market.

RESPONSES TO CHAPTER 5 - COMPETITION LAWS

3. Objectives, Structure and Legal Framework

Question: Are the current competition laws working effectively to promote competitive markets, given increasing globalisation, changing market and social structures, and technological change?

The current competition laws have not been reviewed thoroughly since the Hilmer Review in 1993. There has been no equivalent in Australia of the work of the US Antitrust Modernization Committee in 2007. This is regrettable given that the competition laws are part of the core legal framework that governs the retail energy sector as well as other sectors of the economy. Accordingly this current review is welcome.

The ERAA strongly supports the position that the competition laws need to be based on clear and cogent competition principles and consistent with international best practice.[22]

Many of the provisions in the *Consumer and Competition Act 2010* (Cth) (CCA) are convoluted and have not been drafted for easy comprehension or application. Such complexity should be avoided, for the reasons recently summarised by a judge of the Federal Court of Australia:

"*First, attempts at codification involving many permutations on a theme are inevitably complex and likely to miss something, secondly, complexity can, and often is a handmaiden of incomprehensibility, thirdly, the unravelling of complexity requires time and effort, fourthly, the more detailed and complex legislation is, the harder it is for the ordinary person, including the scions of the business community, to grasp the point and comply, fifthly, complexity makes litigation more complex, lengthy and expensive for the parties and, sixthly, those factors create*

[22] As envisaged by the terms of reference of the review and the Hon Bruce Billson MP, Competition Review Panel Press Conference, Parliament House Canberra, 27 March 2014, see http://bfb.ministers.treasury.gov.au/transcript/015-2014/.

the need for the Courts to deal with more and more in judgments or summings up to juries leading to delay, the greater likelihood of appellate challenges and, of course, error".[23]

The CCA could and should be simplified by following the guidance given in the Office of the Parliamentary Counsel's *Developing Clearer Laws Quick Reference Guide* (2010) which states that policymakers, instructing agencies and drafters should apply the following general principles when developing Commonwealth legislation.

- Consider all implementation options – don't legislate if you don't have to;
- When developing policy, reducing complexity should be a core consideration;
- Laws should be no more complex than is necessary to give effect to policy;
- Legislation should enable those affected to understand how the law applies to them; and
- The clarity of a proposed law should be continually assessed – from policy development through to consideration by Parliament (for Acts) or consideration by the rule-maker (for legislative instruments).

Recommendation 8: The competition-related provisions of the CCA should be drafted consistently with the *Developing Clearer Laws Quick Reference Guide* to reduce their complexity.

4. Unfair and Unconscionable Conduct in Business Transactions

Questions: Are existing unfair and unconscionable conduct provisions working effectively to support small and medium sized business participation in markets? Are there other measures that would support small and medium sized business participation in markets?

The ACCC has instituted proceedings in the Federal Court against Coles Supermarkets Australia Pty Ltd and Grocery Holdings Pty Ltd (together, Coles) alleging that Coles engaged in unconscionable conduct in relation to its Active Retail Collaboration (ARC) program, in contravention of the Australian Consumer Law (ACL).

This litigation is likely to clarify the application of the unconscionable conduct provisions to small business in the context of their dealings with larger corporations. The decision of the Federal Court (or, in the event of appeal, the Full Federal Court or the High Court of Australia) may or may not reveal possible shortcomings in the present law.

Small businesses typically are not in the same position as consumers when dealing with contracts; businesses can be reasonably expected to read supply contracts more carefully and to have a better understanding of them than consumers. If the unfair contract provisions were to be extended to small business contracts, there should be strict limitations in relation to number of employees, business turnover and contract value. Furthermore, unfair contract provisions should not apply where the contractual terms (including price) have been negotiated.
The ERAA notes that the Australian Treasury has released a Consultation Paper seeking comments on a proposed extension of the current unfair contract provisions in the ACL to standard form small business contracts. The ERAA would welcome findings from this review.

Recommendation 9: It would be premature to change the current unconscionable conduct provisions because important test litigation is now before the Federal Court of Australia.

[23] Justice Rares, "Competition, Fairness and the Courts", Competition Law Conference, Sydney, 24 May 2014.

RESPONSES TO CHAPTER 6 - ADMINISTRATION OF COMPETITION POLICY

Question: Are competition-related institutions functioning effectively and promoting efficient outcomes for consumers and the maximum scope for industry participation?

The ERAA considers that there are two important issues in relation to the administration of competition policy in the NEM. These are:

- Regulators at state and national level should seek to minimise regulation and be focussed on intervention in response to actual market failure, rather than promoting regulatory action to solve perceived issues; and
- Since the integration of NCP and the NEM, the energy market has been subject to numerous reviews and the competitiveness of the retail market is assessed each year by the AEMC in every jurisdiction.

The enforcement activities of regulators at state and national level should be subject to review and assessment. This is likely to improve the effectiveness of administration and these kinds of reviews have long been used by the US Department of Justice and Federal Trade Commission.

A program of regular analysis and assessment would:

- Produce important insights to inform and improve the effectiveness of agency future enforcement decision-making and activity;
- Assist agencies in setting annual enforcement priorities and allocating scarce resources between different types and areas of enforcement action; and
- Assist agencies secure the most effective balance between enforcement activity and outreach and compliance-related activity.

Recommendation 10: The enforcement activities of state and national regulators should be subject to review to ensure a balanced approach that does not have a detrimental impact on the level of competition in a market where it is not warranted.

Question: Was the Council of Australian Governments competition agenda, with reform payments overseen by the National Competition Council, effective?

The original NCP agenda was very effective in securing significant changes to the Australian economy that had a major positive impact on productivity.

The NCP agenda was successful because the political leadership at State and Commonwealth level at the time were unanimously committed to competition reform. They were willing to accept the political risks associated with changing the ways in which government businesses operated and subjecting the legislation regulating a wide array of industries to scrutiny and amendment where the costs of anti-competitive provisions did not outweigh the benefits.
The three tranches of competition payments that were embedded in the original NCP were a useful and successful instrument to offer jurisdictions appropriate incentives to implement reform while also clearly articulating the consequences of them not making required changes. Where jurisdictions chose not to implement reform in particular circumstances in accordance with NCP principles they clearly understood the process they were required to undertake to justify these decisions (the public benefit test).

The use of competition payments and enforcement by the NCC provided an effective discipline to guide the actions of jurisdictions, but its effectiveness relied more on the fact that jurisdictions had already committed to the implementation of the NCP and the process to achieve it. As a result of this commitment and the clear framework for its implementation significant changes occurred in a relatively short time in key industries representing major input costs in economic production (energy, water and transport).

This can be contrasted with the competition reform agenda managed under the COAG Reform Council which replaced the NCP framework. Since 2005, very little competition reform has been progressed and the agenda has been dominated by red tape concerns of business groups.

This is because the NCP was pursued by governments with the primary purpose of reforming government business for the advantage of the economy generally. In the absence of a government led agenda for competition reform, to which all jurisdictions are committed, it is likely that required competition policy change will languish.

As competition reform has a proven benefit for economy wide productivity it is appropriate that payments be used as a carrot and stick to incentivise jurisdictions to either implement agreed reforms in a timely manner or justify why such reforms will not be pursued.

During the period of the original NCP, energy market reforms, including in the retail sector, to create a NEM were pursued consistently and diligently by jurisdictions with clear derogations on justified grounds. Since the end of the third tranche of NCP payments, implementation by jurisdictions of structural separation of government owned retail and distribution businesses, price de-regulation in the retail energy market and other agreed reforms to develop the NEM has been largely inconsistent.

Recommendation 11: The NCP payments regime was effective in accelerating reform and should be reconsidered to incentivise jurisdictions to fully implement the original NCP reforms with respect to the NEM.