ESSENTIAL SERVICES COMMISSION

Ensuring energy contracts are clear and fair

Issues paper

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Contents

Our journey towards rebuilding trust in the retail energy market

A series of high profile reviews into the retail energy market in recent years have drawn attention to customers' negative experiences of the market, and the surprisingly high costs associated with the retail component of customer bills. A central theme of these reviews was the loss of customer confidence and trust in the retail energy market. These reviews also proposed changes to make retailer conduct fairer and more transparent, and the customer experience clearer and easier.

Over the past year we have implemented a range of new customer entitlements, requiring retailers to do more to help customers understand, compare and switch energy plans. We have taken an approach to implementing these reforms that is intended to encourage and support a culture of shared responsibility within the retail sector.

This issues paper marks the start of our work to implement the next round of rule changes arising from the Independent Review of the Electricity and Gas Retail Markets in Victoria. These changes are intended to make retail energy contracts clearer and fairer. But before getting into the detail of these recommendations, it is useful to step back and review the progress that has been made toward remedying the issues outlined in the review so far, and identify the remaining gaps that this upcoming round of rule changes will target.

Overarching intent of the independent review recommendations

The independent review found that Victorian consumers were paying 'unusually high' electricity prices compared to other jurisdictions. The review concluded that one of the factors contributing to this was industry practices which make it difficult for customers to navigate the market and choose the best deal for them. For example, discounting is intended to make marketing seem simple, but can increase complexity and opaqueness in the market. The varying practices of retailers, particularly at the end of contracts or benefit periods, can also lead to customers ending up on more expensive deals.

The recommendations made by the review were broadly intended to deliver three outcomes:

- to enable customers to easily compare offers and choose one that is suitable for them
- to help customers understand and have greater certainty about what they will pay on a given contract
- to prevent customers being unfairly overcharged.

Delivering improved customer outcomes

The reforms we have already implemented will go some way toward delivering these outcomes. The next round of rule changes to implement recommendations 3A and 4A-E will focus on the remaining gaps.

Enabling customers to easily compare offers and choose one that is suitable for them

Many of the new customer entitlements we have introduced are focused on making it easier for customers to navigate the retail energy market and choose an offer that is suitable for them.

From 1 July 2019, customers can expect to be regularly told if their retailer has a better offer, and given advance notice of any price or benefit changes affecting them. Customers wanting to compare plans will benefit from the Victorian energy fact sheet that provides standardised information across all retailers.

Customers considering signing up to a new plan will be entitled to clear, upfront advice from the retailer about any terms within the contract that could lead to the customer paying more than they expect, including notification if there are other deals that might suit them better.

These changes mean that customers will be given better and more timely information to help them compare offers and choose one, including prompts to do so when there is a better offer available. However, we have not yet directly addressed the issues of discounting practices that make comparing offers difficult for customers. We expect that implementing the recommendations relating to discounting will complement the reforms we have already made to support customers in comparing offers.[1]

Helping customers understand and have greater certainty about what they will pay on a given contract

Some of the new information provision tools we have introduced will also make it easier for customers to understand what they will pay on a given contract.

The new Victorian energy fact sheet will contain information in a standardised format across all retailers about key features of a plan, including details of fees, charges, discounts and other benefits. The clear advice entitlement will ensure customers are made aware of any contract terms that could lead to them paying more than they expect, including conditional discounts or any discounts that expire after a certain period of time.

[1] We note that a recent Order in Council made by the Victorian Government sets out new obligations on retailers relating to the presentation of discounted electricity offers – our work will complement these new obligations.

From 1 July 2019, retailers will also be required to express all tariffs, fees, prices and charges in GST inclusive terms only, making it easier for customers to understand energy price information.

These changes are intended to make it easier for customers to understand what they will pay on a given contract. However, we have not yet directly addressed the potential problems outlined by the independent review on price uncertainty facing customers. For example, retailers are currently able to change the prices of market contracts at any time.

There is also a lack of clarity in retailer practices at the end of contract and benefit periods, which could lead to customers paying substantially more after these periods. We expect that the next round of reforms will address these issues and give customers more certainty over what they will pay on a given contract.

Preventing customers being unfairly overcharged

The introduction of the Victorian Default Offer (VDO) from 1 July 2019 is intended to help address some of the issues identified in the review about customers being overcharged. The VDO will be a different proposition to offers currently available in the market. With the price set independently of retailers and at a level intended to reflect a 'fair' price of supplying electricity, and retailers not able to change this price except at certain times, the VDO may appeal to customers who are unwilling or unable to engage in the market on an ongoing basis.

The VDO will act as a safeguard for customers on standing offers, and for those customers who decide that not engaging in the market is the most suitable option for them. However, the independent review identified further issues relating to customers who do engage in the market being overcharged, namely relating to the increasing size of conditional discounts and the risk faced by customers who do not meet offer conditions associated with these discounts. We expect that implementing the recommendation around capping the costs of customers failing to meet offer conditions will address this issue.

Moving forward

This issues paper outlines our initial considerations on recommendations 3A and 4A-E separately, and describes the potential options we are considering for implementing these recommendations. However, we will also be considering all of the recommendations as a package, as well as how these interact with the reforms that will commence from 1 July 2019. Our focus will be on the overarching customer outcomes intended by the review recommendations, and continuing to require retailers to take responsibility for delivering these outcomes.

1. Introduction

1.1. Context for this round of rule changes

Independent Review into the Electricity and Gas Retail Markets in Victoria

In November 2016, the Victorian Government appointed an independent panel to conduct a review of electricity and gas retail markets in Victoria. The government announced the review following a number of public reports suggesting Victorians were paying too much for energy. In August 2017, the review released its final report and concluded the market was not working for consumers. In reaching its conclusion, the review found Victorians were paying 'unusually high' electricity prices compared to other jurisdictions.

The review concluded there were three main reasons why the market was not working for Victorian consumers: the cost of competition, the structure of the market and the practices of the industry. Specifically, the review found that marketing practices by energy companies were not supporting customers to choose the best price. The review made 29 detailed recommendations, under eleven areas, aimed at improving energy market outcomes for consumers, including changing retailer marketing practices, improving market monitoring, establishing a regulated basic service offer and abolishing standing offer contracts.

The Victorian Government response

As part of its interim response in March 2018, the government referred terms of reference to the commission under section 10(g) of the Essential Services Commission Act 2001. These terms of reference were for the commission to review the Energy Retail Code to give effect to:

- customer outcomes in the energy market, relating to recommendations 3A–H and 9
- efficient pricing in the energy market, relating to recommendation 8.

In October 2018, the government issued its final response to the review, which supported all recommendations subject to some refinements. In December 2018, the government referred terms of reference for the commission to review the Energy Retail Code to give effect to recommendation 4, relating to ensuring contracts are clear and fair.

New customer entitlements to build trust

We have already given effect to recommendations 3B to 3H via two rounds of Energy Retail Code amendments, made in October 2018 and March 2019. These code amendments will take effect from 1 July 2019. The rule changes are intended to restore trust and confidence in the market by requiring retailers to do more to help customers understand, compare and switch energy plans.

From 1 July 2019, retailers will be required to:

- make energy fact sheets available for each of their offers, to help customers compare offers
- include their ‘best offer’ on customer bills
- express tariffs, fees, prices and charges in GST inclusive terms only
- provide customers signing up to a plan with clear advice about terms and conditions of offers
- provide advanced notice of changes to prices and benefits that impact a customer’s bill.

In implementing these reforms we have focused on requiring retailers to take greater responsibility for the outcomes that customers experience. As well as introducing new obligations into the Energy Retail Code, we have also codified the outcomes those obligations are intended to achieve.

This means retailers will not be able to adopt a simple tick-the-box approach to complying with the new obligations. They will instead have to take responsibility for helping customers navigate their way to the retailer’s most suitable energy plan. Their actions will be judged both against whether they have met the obligations, and whether they’ve done so in a way that genuinely gives effect to the overarching objectives of those obligations.

Ensuring contract periods, practices and variations are clear and fair

We are now turning our focus to implementing recommendations 3A and 4A to 4E. These recommendations relate to ensuring that contract periods, practices (including discounting) and variations are clear and fair.

The terms of reference for recommendation 4 required the commission to have regard to its objectives (outlined in Appendix B) under the Essential Services Commission Act 2001, Electricity Industry Act 2000, and Gas Industry Act 2001, as well as:

- the findings from the review
- the government’s published response to the review
- advice from relevant experts
- other matters it deems relevant.

The terms of reference specify that the commission may also consider early adoption of any measures it considers necessary in the context of its statutory objectives, including those introduced in other Australian jurisdictions.

Table 1.1 Recommendations made relating to contract and discounting practices

Recommendation	
3A	Require retailers to market their offers in dollar terms, rather than as percentages or unanchored discounts.

4A	Require retailers to commit to fix any prices they are offering for a minimum of 12 months. During this period, the market contract prices cannot change. Retailers may request an exemption from the ESC to address unforeseen changes in network costs.
4B	Require retailers to clearly disclose to customers the length of time any offered prices will be available without change.
4C	Require retailers to roll customers onto the nearest matching, generally available offer at the end of a contract or benefit period, unless the customer opts for another offer.
4D	Any conditional discount or other benefit offered for paying on-time or on-line billing should be evergreen. Customers should not lose the discount or other benefit when the contract ends.
4E	Costs incurred by customers for failing to meet offer conditions are to be capped and not be higher than the reasonable cost to the retailer.

Related developments in the national framework

Preventing discounts on inflated energy rates

From July 2018, an Australian Energy Market Commission (AEMC) rule change to prevent discounts on inflated energy rates took effect in the national framework.[2] The intention of this rule change was to prevent the practice of retailers applying discounts to rates that are inflated above their standing offers, so if a customer fails to meet the offer conditions they end up paying substantially more than the equivalent standing offer.

We have previously noted that we may consider adopting this rule change in Victoria as part of our work on marketing and discounting rules.

Regulating conditional discounts

In February 2019, the Australian Government submitted a rule change request to the AEMC to ensure conditional discounts for gas and electricity retail offers are no higher than the reasonable cost savings a retailer expects it will make if a consumer satisfies the conditions attached to the discount.[3] This is in line with a recommendation made by the Australian Competition and Consumer Commission (ACCC) in its Retail Electricity Pricing Inquiry.[4]

[2] For more information see https://www.aemc.gov.au/rule-changes/preventing-discounts-on-inflated-energy-rates.

[3] For more information see https://www.aemc.gov.au/rule-changes/regulating-conditional-discounting.

[4] ACCC, Retail Electricity Pricing Inquiry – Final Report, July 2018, p. xxii.

Banning headline conditional discounts

From 1 July 2019, Australian Government regulations will take effect which ban headline conditional discounts for electricity (i.e. conditional discounts are no longer allowed to be the price-related matter that is mentioned most conspicuously in any advertisement of an electricity offer).[5] The regulations also require such advertisements to clearly and conspicuously state the conditions on any conditional discount. This rule change was also recommended in the ACCC's inquiry.

1.2. Overview of the review recommendations

Issues identified by the independent review

Contract periods, practices and variations

The review highlighted a number of concerns with retailer practices relating to contracts:

- Retailers can change market offer prices at any time, and are not required to notify customers before they do so.[6] This means consumers cannot always avoid price increases before they happen. Customers may experience price increases soon after starting a new contract, which could erode confidence in their ability to get a good deal.
- Customers entering market contracts may only get benefits for a fixed period, which may be shorter than the contract term. Customers may not realise that this is the case. If the customer doesn't engage again before the end of the benefit period, they may lose the discount or benefit and end up being on a contract that is worse off.
- Similarly, customers who do not take action before the end of a fixed term contract may end up being rolled onto another contract with higher prices. There is no consistent practice among retailers at the expiry of a customer's contract or benefit period.

As such, contracts in the energy market are not necessarily operating to provide price certainty. The uncertainty associated with such contracts means that customers, not knowing or understanding what will happen at the end of a contract or benefit period, often end up paying higher prices for their energy, despite the availability of better offers.

Discounting practices

The use of discounts when marketing offers is a common practice among retailers in the Victorian energy market. The review highlighted a number of ways in which retailer discounting practices may be leading to sub-optimal outcomes for customers:

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[5] Competition and Consumer (Industry Code—Electricity Retail) Regulations 2019.

[6] This was true at the time of the review, though we have since implemented rule changes that require retailers to notify customers at least five business days before a price (or benefit) change takes effect.

- The use of discounts can be difficult to understand. It is not always clear what the discount is from (e.g. the total bill or just the usage component). Practices also vary between retailers which makes it hard for customers to compare offers.
- The use of discounts could be misleading customers when comparing offers. While customers are more likely to be drawn to offers with larger discounts, these do not necessarily represent the best value offers.
- The majority of discounts are conditional on customers meeting offer conditions, such as paying on time. As the size of discounts has been increasing over time, so has the impact on customers of missing offer conditions. This can disproportionately impact on low income and vulnerable consumers.
- The review also highlighted concerns that in order to enable discounts to continue increasing over time, retailers have been inflating the rates from which discounts are made.

The review considered that the combined effect of these discounting practices has eroded customer confidence in the retail market that they are receiving value for money.

Current status of these issues

It appears that many of the issues identified by the independent review are still prevalent in the current energy market in Victoria.

Contract periods, practices and variations

- We observe from the Victorian Energy Compare website that retailers still offer a variety of contracts including those with a fixed term or fixed benefit period. Fixed benefit periods appear to feature in the majority of offers available on Victorian Energy Compare, meaning issues around customers needing to engage at the end of a benefit period to avoid paying more are likely to still exist. However fixed-price offers are not common, meaning there are relatively few options for customers seeking price certainty.
- Conditional discounts have generally been increasing in recent years (see figure 1.1 below). It therefore seems likely that the impact on customers of reaching the end of a benefit period will have increased since the review, as customers would be losing a larger discount.

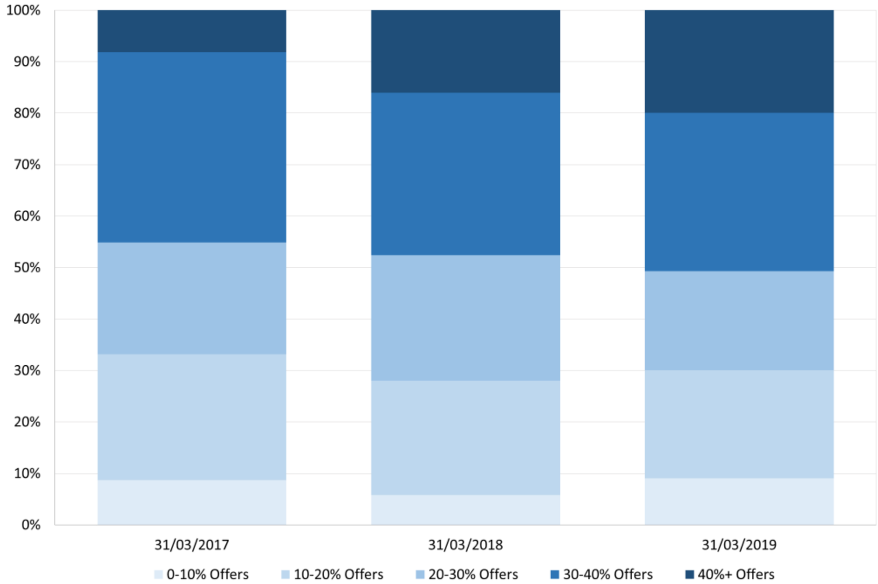
Discounting practices

- Discounts are still widely used in the market. In 2017-18, 76 per cent of all residential electricity market offers and 83 per cent of residential gas market offers in Victoria included discounts and almost all of these had conditions that were required to be met before the discount would be applied.[7]

[7] Essential Services Commission, Victorian Energy Market Report 2017-18, February 2019.

- The ACCC inquiry into retail electricity prices in June 2018 found that large discounts have been becoming increasingly common in Victoria.[8] Recent data as at 31 March 2019 shows this trend has continued, with more than half of all current electricity market offers including a discount larger than 30 per cent (shown in figure 1.1). Customers who receive a larger discount are not necessarily paying less, and may even be paying more than if they were on a standing offer if their offer includes a large conditional discount.

Figure 1.1 Single rate residential electricity market offers in Victoria with discounts



Source: ESC analysis of the Victorian Energy Compare website data, April 2019

1.3. Our approach to the recommendations

We are considering recommendations 3A and 4A-E thematically. One group of recommendations relates to contracts (4A-C) and the other relates to discounting practices (3A and 4D-E).

We note there are interactions between many of the recommendations. For example implementing 4E may affect how, or if, we would implement 4C and 4D. At this stage of the consultation process we are seeking views on each recommendation separately, to ensure we have fully considered options, opportunities and challenges associated with implementing each. We invite stakeholder feedback on the benefits and risks of the options we have identified for implementing each recommendation, as well as any other options we have not identified.

As we progress to making proposals on implementing the recommendations, we will consider them as a package to test the practicality in their inter-relationship, particularly in light of the reforms that commence from 1 July 2019.

[8] ACCC, Retail Electricity Pricing Inquiry – Final Report, June 2018.

2. Recommendations relating to contracts

Recommendations relating to contracts (recommendations 4A-C):

4A: Require retailers to commit to fix any prices they are offering for a minimum of 12 months. During this period, the market contract prices cannot change. Retailers may request an exemption from the ESC to address unforeseen changes in network costs.

4B: Require retailers to disclose the length of time any offered prices will be available without change.

4C: Require retailers to roll customers onto the nearest matching, generally available offer at the end of a contract or benefit period, unless the customer opts for another offer.

2.1. Fixing contract prices (recommendations 4A and 4B)

Recommendation 4A is to require retailers to commit to fix any market contract prices they are offering for a minimum of 12 months. The terms of reference set out that retailers should be able to request an exemption from the commission to address unforeseen changes in network costs. The Victorian Government also advised the commission to interpret this recommendation as applying from the date an individual customer enters into a new contract (rather than retailers having to fix price offers available to all customers in the market for 12 months at a time).

The intent of recommendation 4A is to give customers certainty that their prices will not change soon after they sign up to a new contract, either because of a scheduled price increase or because of retailer strategies such as low priced or win back offers. This in turn should give customers more confidence in switching to a new offer.

Recommendation 4B is to require retailers to disclose to customers the length of time any offered prices will be available without change. Recommendation 4B is intended to give customers certainty about how long the prices they sign up to will remain unchanged, whether that is for 12 months (in line with recommendation 4A) or a different period of time.

Recommendation 4B could serve as an additional informational requirement that clarifies the effect of 4A for customers, or it may serve a more distinct purpose if a narrower interpretation of 4A is taken. In either case, we anticipate that recommendation 4B would apply to any product a retailer offered, rather than just those captured by 4A.

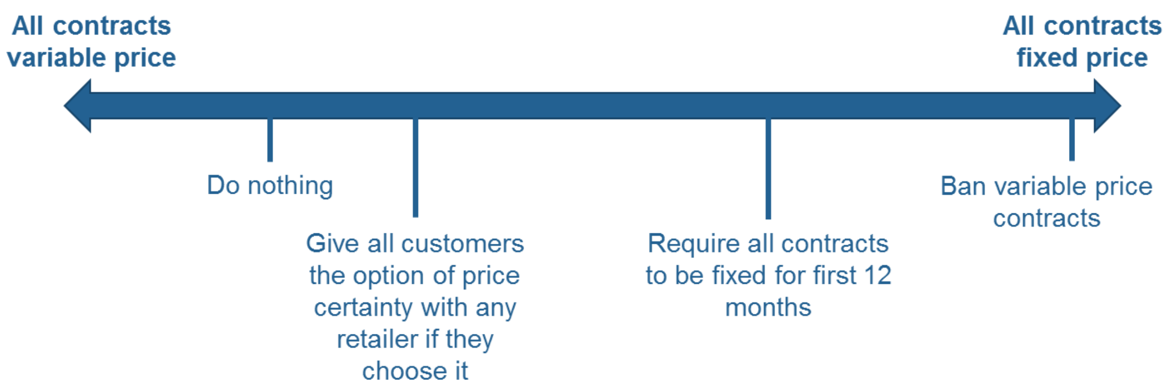
We note that there are interactions between recommendations 4A and 4B and the new rules we have introduced around price and benefit change notices that will take effect from 1 July 2019.[9] Retailers must provide written notice to customers at least five business days before any price or benefit change is made to their contract. The Code also specifies a minimum standard for information that must appear on this bill change notice.

These reforms are designed to ensure customers are given clear and timely notice at the end of a contract or benefit period, so they can better understand and respond to changes to their plan. Implementing 4A and 4B would build on this policy intent but go further, by ensuring customers are not required to act to avoid price changes soon after signing up to a contract.

Options for implementing recommendations 4A and 4B

There is a range of options for how the intent of recommendation 4A could be delivered, as shown in figure 2.1. At one end of the scale, it would be up to retailers to determine what products are offered to customers, and how often prices are changed. Current evidence shows that the vast majority of market offers are not fixed-price. At the other end of the scale would be a ban on variable price market offers, which would mean retailers would only be able to offer fixed-price offers.

Figure 2.1 Range of options for implementing recommendation 4A



We consider that retaining the status quo would not directly tackle the issue of consumers potentially facing price changes soon after signing up to a new offer, and banning all variable price offers could unintentionally limit the way that both consumers and retailers engage in the market. We therefore are considering options towards the centre of this scale.

[9] Essential Services Commission, Building trust through new customer entitlements in the retail energy market: Final Decision, October 2018.

We are currently considering two main options, outlined in table 2.1. We invite stakeholder views on additional benefits or risks of these options that we have not identified, and whether there are other options we should also consider.

Table 2.1 Options we are considering for implementing recommendation 4A

Option	Opportunities/benefits	Challenges/risks
1. Require retailers to fix the tariffs of all market offer contracts for at least the first 12 months after a customer has signed up.	• Gives all customers price certainty for at least 12 months.	• May impact on retailers' hedging strategies. • May limit retailers' ability to offer innovative products e.g. shorter-term fixed tariffs, or tariffs that track the wholesale market. • Offers price certainty in a rising market, but if prices fall then customers may be locked into higher prices.
2. Implement recommendation in way that gives all customers the option of price certainty with any retailer if they choose it. Examples include: (a) Requiring all retailers to have at least one generally available offer where the tariff(s) are fixed for at least the first 12 months after a customer has signed up. (b) Requiring retailers to offer customers the choice of whether they want to fix the tariff(s) of their plan for the first 12 months after signing up (potentially at a different price) or not.	• Gives all customers the option of price certainty for at least 12 months. • Provides retailers with more flexibility in designing offers.	• Likely to impact fewer customers, as customers have to make a choice in order to benefit from price certainty. • Could add further complexity to the retail energy market if retailers are required to offer additional plans or variations on plans.

As the way we implement recommendation 4B could depend on what option we choose for 4A, we will consider options for giving effect to 4B at a later stage.

The terms of reference include the ability for retailers to request an exemption from the commission to address unforeseen changes in network costs. We welcome stakeholder views on whether there are additional circumstances under which retailers should be able to seek an exemption. We also invite suggestions for how this exemption process might work, for example if there are similar processes in other jurisdictions that we might look to model ours on.

Questions for stakeholders

1. Do you agree with how we have expressed the customer outcome [at the start of section 2.1] that recommendations 4A and 4B are intended to achieve?

2. Please provide your views on the options outlined in table 2.1. Are there are any benefits or risks we have not identified, or any operational challenges or opportunities we should be aware of for any of these options?

3. Are there any other options for implementing recommendation 4A that we should consider?

4. How should an exemption process work? Are there any circumstances other than unforeseen changes in network costs that should be covered? Are there processes in other jurisdictions that work well or do not work well that we could learn from?

5. What are the operational challenges and opportunities of retailers being required to disclose the length of time the offered price will be available once a customer signs up to a plan?

6. Are there any other considerations we should take into account in implementing recommendations 4A and 4B?

2.2. Practices at the end of benefit and contract periods (recommendation 4C)

Recommendation 4C is to require retailers to roll customers onto the nearest matching, generally available offer at the end of a contract or benefit period, unless the customer opts for another offer. The intent of the recommendation is to give customers confidence that if they do not take action at the end of a benefit or contract period, they will not be on a significantly more expensive plan. This would give customers who cannot, or do not want to, engage with the market some level of protection from being put onto a more expensive offer.

We began addressing the issue of end-of-contract uncertainty through our rule changes around price and benefit change notices, which will take effect from 1 July 2019. This is a first step in ensuring a transparent, fair and consistent approach between retailers at the end of market contracts and benefit periods. Recommendation 4C suggests the same level of clarity and consistency should be applied to the action a retailer is required to take at end of a contract or benefit period, where a customer does not engage.

Defining benefit and contract periods

To clarify the terms used in recommendation 4C, below we set out the difference between the end of a contract period and end of a benefit period, and our understanding of current retailer practices in these cases. We welcome views as to whether stakeholders share this understanding of current practices.

End of a contract period

The Energy Retail Code provides for a number of scenarios in which a market contract between a customer and a retailer can be terminated, which would result in a customer reaching the end of a contract period. These include if the retailer and customer agree on a date to terminate the contract, if provision of services to the premises in question commences under a contract with a different customer, and if a date or event specified in the contract is reached (subject to certain conditions). The latter provision covers fixed term contracts, which contain a term or condition that either specifies the date on which the contract ends, or a method for calculating the end date which is ascertainable at the time the contract is entered into.

We understand that some retailers may use terms and conditions in their contracts to address what happens in the event that market contract comes to an end without the customer choosing to enter into a new contract. These terms and conditions may set out that at the end of the contract, supply will continue under another market contract rather than a deemed arrangement.

The law provides that if a relevant customer commences to take supply at premises from a relevant licensee without having entered into a contract with that licensee, there will be a deemed contract covering the supply and sale of energy between that customer and licensee.[10] Under these deemed arrangements the customer pays the same price as the retailer’s standing offer. From 1 July 2019, this will be the price of the VDO, at least for flat tariff offers.[11]

End of a benefit period

A benefit period is a period during a market retail contract, with a defined end, where a benefit (such as a price discount) is available to a customer. A benefit period may be shorter than the length of a contract, so a customer may reach the end of a benefit period and still be on the same contract with their retailer.

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[10] Section 39 of the Electricity Industry Act, section 46 of the Gas Industry Act.

[11] For more details, see the Order in Council issued by the Victorian Government in May 2019.

There are no Energy Retail Code requirements specifying what happens to a customer at the end of a benefit period. We understand this may vary between retailers, and is likely to depend on the terms and conditions a customer signs up to at the start of a contract. The customer may continue on the same contract with the retailer but no longer receive the same benefit, or the retailer may engage the customer to discuss them signing up to a new contract. In any event, a retailer would not be allowed to move a customer onto a new market contract without their explicit informed consent.

Options for implementing recommendation 4C

The VDO coming into effect on 1 July 2019 has implications for recommendation 4C, as the VDO will be the prevailing tariff applied where a customer's market contract ends if that customer takes no action. We have considered the scope of 4C in relation to the VDO and consider the two have a shared intention in providing for customer protection where a customer is unable or unwilling to engage with their retailer.

Recommendation 4C requires a customer to be rolled onto the 'nearest matching, generally available offer' at the end of their market offer. We consider that the VDO – as an efficient, transparent and accessible offer – could represent this.

While the VDO may cover the recommendation in 4C relating to the end of a contract, under the current framework of rules it does not cover the end of a benefit period (where this occurs before the contract end). We have identified a number of options for what the 'nearest matching, generally available offer' could be in this case, set out in figure 2.2.

Figure 2.2 Options for how to define the 'nearest matching, generally available offer'

1. Victorian default offer	2. Best offer	3. Cheapest overall offer (incl. restricted offers)	4. Cheapest equivalent offer	5. Retailer discretion

A number of these options (2-5) were considered as options for how 'best offer' should be defined, and many of the opportunities and risks are the same. Given this, we are minded not to proceed with options 3-5 (as these options were disregarded during best offer considerations due to their impracticability), and to focus on considering options 1 and 2. We welcome stakeholder views on this, and suggestions of any other options we should consider.

Table 2.2 Options for implementing recommendation 4C

Option	Description	Opportunities/benefits	Challenges/risks
1. The VDO	A simple, trusted and reasonably priced electricity offer intended to safeguard consumers unable or unwilling to engage in the electricity retail market.	• Consistent with VDO being the default offer customers are rolled onto when they do not engage at the end of a contract. • Protects customers from paying more than they should have to at the end of a benefit period while also leaving room for retailers to compete and incentivising customers to shop around.	• The VDO might represent a higher tariff than a customer would be paying under their market contract, even after the expiry of a benefit period. • The VDO is likely to be simple offer with no benefit period, which may not be anything like customer's current offer.
2. Best offer	The cheapest offer that is: • generally available • does not require paid membership or affiliation as an eligibility criteria with the retailer having discretion to present cheaper plans from among their non-generally available offers.	• Results will be accurate and tailored, as retailers will have to use customer's actual meter data to find the best available offer for the customer. • Customers see cheapest market offers available from their retailer, including with conditional and unconditional discounts applied.	• 12 months of data might not be available to provide a meaningful data analysis and determine the best offer. • Conditional discounts are not always indicative of a best offer, especially for vulnerable customers who may not always meet the conditions required to receive a discount.

Option	Description	Opportunities/benefits	Challenges/risks
3. Cheapest possible offer (including restricted offers)	Includes all possible offers, including non-public 'bottom draw' offers.	• Conceptual simplicity. • Customers see absolute cheapest offers available from their retailer.	• The offer may not be available to the customer. • No ability for customers to verify the offer using publicly available information. • Difficult for the Commission to enforce due to 'bottom draw' offers not being public.
4. Cheapest equivalent offer	Offers that are 'equivalent' to the customer's current offer.	• Low risk of offer being unavailable to the customer. • Low risk of offer being unsuitable for the customer. • Fulfils 'nearest matching' part of criteria most closely – tailored to customer preferences.	• Elevated conceptual complexity. • Higher risk the offer presented is not the cheapest the customer would accept. • Need to define 'equivalence', requiring either the Commission or retailers to make judgements about how customers weight the value and importance of different plan attributes. • Reduced incentive for customers to engage.
5. Retailer discretion	Let the retailer decide how to define 'nearest matching, generally available offer'.	• Avoids the need to establish a single definition. • Allows the retailer to flexibly apply the definition, potentially accounting for customers preferences.	• Elevated risk of inconsistent customer outcomes, within retailers, between retailers and across time. • Management of elevated risks require additional mechanism (e.g. a retailer policy), adding regulatory complexity, potentially simply shifting around definitional issues.

Questions for stakeholders

7. Do you agree with how we have expressed the customer outcome [at the start of section 2.2] that recommendation 4C is intended to achieve?

8. Do you share our understanding of current retailer practices at the end of a contract period and end of a benefit period?

9. Please provide your views on the options outlined in table 2.2. Are there are any benefits or risks we have not identified, or any operational challenges or opportunities we should be aware of for any of these options?

10. Are there any other options for implementing recommendation 4C that we should consider?

11. Are there any other considerations we should take into account in implementing recommendation 4C?

3. Recommendations relating to discounting

Recommendations relating to discounting (recommendations 3A and 4D-E):

3A: Require retailers to market offers in dollar terms, rather than as percentages or unanchored discounts.

4D: Any conditional discount or other benefit offered for paying on-time or on-line billing should be evergreen. Customers should not lose the discount or other benefit when the contract ends.

4E: Costs incurred by customers for failing to meet offer conditions are to be capped and not be higher than the reasonable cost to the retailer.

3.1. How discounts are presented (recommendation 3A)

Recommendation 3A is to require retailers to market offers in dollar terms, rather than as percentages or unanchored discounts. The independent review noted this could be similar to the standardised mandatory comparison rate required for home mortgages.

The intended outcome of this recommendation is that offers are marketed in a standard way, making it easier for customers to compare and ultimately select an offer.

We note that some of the reforms we have already implemented, such as the best offer and fact sheet requirements, are also aimed at achieving the same underlying customer outcome of making it easier for customers to compare offers.

There are also interactions between recommendation 3A and the introduction of new regulations by the Australian Government that ban headline conditional discounts, as this also limits the way in which retailers can present discounts. We discuss this further in relation to recommendation 4E.

Using the Victorian Default Offer as a reference price for electricity discounts

In implementing the VDO, the Victorian Government has made an Order requiring retailers to use the VDO as a reference price for advertised discounts for electricity offers.[12] The Order requires the commission to amend the Energy Retail Code to give effect to this.

Retailers will be required to compare the estimated annual cost of the discounted offer with the estimated annual cost of the VDO for any type of electricity tariff where a discount applies, and

[12] Victorian Government, Order under section 13 of the Electricity Industry Act 2000, May 2019.

present this in percentage or dollar terms when the offer is advertised. The government's stated intent of this is to make it easier for customers to compare discounts.[13]

We consider this aligns with the intended customer outcome of recommendation 3A. We therefore consider that making code amendments to require the VDO to be used as a reference price for discounts on electricity tariffs would give effect to recommendation 3A for electricity.

However as the VDO only relates to electricity, we must consider the most appropriate way to implement recommendation 3A for discounts on gas tariffs. We invite stakeholder views on options for doing this. We are also mindful of the implications for presenting reference prices for dual fuel tariffs, and welcome views on how to manage this.

Questions for stakeholders

12. Do you agree with how we have expressed the customer outcome [at the start of section 3.1] that recommendation 3A is intended to achieve?

13. What options could we consider to implement recommendation 3A for discounts on gas tariffs? What are the benefits and risks of these options?

14. How should reference prices be calculated and displayed for dual fuel tariffs?

15. Are there any operational challenges or opportunities we should be aware of relating to implementing a reference price (for electricity, gas and/or dual fuel tariffs)?

16. Are there any other considerations we should take into account in implementing recommendation 3A?

3.2. Making discounts evergreen (recommendation 4D)

Recommendation 4D is that any conditional discount or other benefit offered for paying on-time or on-line billing should be evergreen, so customers do not lose the discount or other benefit when the contract ends. The intended outcome of this recommendation is that customers who sign up to receive a conditional discount at the start of a contract continue to receive it on an ongoing basis, and do not end up paying substantially more because of the discount expiring.

If we were to implement this recommendation, it would effectively end the practice of benefit periods, as retailers would no longer be able to offer discounts that lasted for a shorter duration than a contract period (and in fact retailers would have to offer discounts for as long as they continued to supply a customer). There are therefore links with recommendation 4C, that seeks to

[13] Victorian Government, Victorian Default Offer - Draft Orders consultation paper, April 2019.

reduce the impact of the end of benefit periods on customers. There are also links with recommendation 4E, which have already been discussed.

Implementing recommendation 4D

Table 3.1 sets out some key opportunities and challenges we have identified in implementing recommendation 4D. We invite stakeholder views on these.

Table 3.1 Opportunities and challenges in implementing recommendation 4D

Opportunities/benefits	Challenges/risks
• Gives customers choosing to sign up to a discount or benefit certainty that they will receive it for the whole contract and will not need to re-engage at the end of a benefit period to avoid potentially paying more.	• Potential implementation challenges if a customer is entitled to receive the same discount/benefit on any contract they have with a retailer.

Questions for stakeholders

17. Do you agree with how we have expressed the customer outcome [at the start of section 3.2] that recommendation 4D is intended to achieve?

18. What are your views of the opportunities and challenges of implementing recommendation 4D? Are there any operational challenges we should be aware of?

19. Are there any other considerations we should take into account in implementing recommendation 4D?

3.3. Ensuring discounts are cost-reflective (recommendation 4E)

Recommendation 4E seeks to cap costs incurred by customers for failing to meet offer conditions, so they are not on plans higher than the reasonable cost to the retailer. This is intended to make conditional discounts cost-reflective, and so limit the penalties faced by customers who fail to meet offer conditions.

We note the synergies in the customer outcomes intended to be achieved by 4E and both the July 2018 AEMC rule change (to prevent discounts on inflated energy rates) and the regulations recently introduced by the Australian Government to ban headline conditional discounts.[14] These

[14] For more details see https://www.aemc.gov.au/rule-changes/preventing-discounts-on-inflated-energy-rates and https://www.legislation.gov.au/Details/F2019L00530 respectively.

policies are all intended to limit the ability of retailers to offer excessive conditional discounts. We will consider this further as we develop draft proposals for recommendation 4E.

Options for implementing recommendation 4E

In February 2019 the Australian Government lodged a rule change request with the AEMC related to regulating conditional discounts.[15] This is closely aligned with recommendation 4E. We are mindful of the options proposed in this rule change request, and will bear any developments in mind as we progress thinking on recommendation 4E.

We consider there are two main approaches we could take to implementing recommendation 4E. These are set out in table 3.2. We invite stakeholder views on the benefits and risks of each of these approaches, and welcome suggestions of other options we could consider.

Table 3.2 Options for implementing recommendation 4E

Option	Opportunities/benefits	Challenges/risks
1. The commission develops a cap based on a determination of reasonable costs. Retailers are required to limit conditional discounts to this cap.	• Ensures consistent approach across retailers, so customers know what they can expect.	• Potential challenges in developing a robust methodology and sourcing appropriate data in timeframes required. • Costs are likely to change over time, and a commission-set cap may need to be revisited from time to time.
2. Retailers are required to ensure their discounts are reflective of the reasonable costs of an offer condition being missed. Retailers must provide justification to the commission as to how they have met this requirement.	• Puts the onus on retailers who have better information about their own costs.	• Likely to result in different outcomes across retailers. • Added complexity for compliance and enforcement.

[15] For more details see: https://www.aemc.gov.au/rule-changes/regulating-conditional-discounting.

Questions for stakeholders

20. Do you agree with how we have expressed the customer outcome [at the start of section 3.3] that recommendation 4E is intended to achieve?

21. Please provide your views on the options outlined in table 3.2. Are there are any benefits or risks we have not identified, or any operational challenges or benefits we should be aware of for any of these options?

22. What costs should be considered in any assessment of 'reasonable costs' to a retailer of a customer failing to meet offer conditions?

23. For option 1, what methodology and/or data sources could the commission use to make an assessment of 'reasonable costs'? What factors should be taken into consideration?

24. For option 2, what (if any) guidance should be given to retailers on determining 'reasonable costs'? What evidence should the commission look to get from retailers to evidence compliance?

25. Are there any other considerations we should take into account in implementing recommendation 4E?

4. Next steps

4.1. Responses to the issues paper

We invite stakeholders to make submissions in response to this issues paper.

Submissions should be made by **5pm 2 July 2019**.

Submissions, preferably in electronic format, and marked Submission to Ensuring energy contracts are clear and fair – issues paper, should be sent by email to

RetailEnergyReview@esc.vic.gov.au,

or by mail to:

Essential Services Commission

Level 37, 2 Lonsdale Street

Melbourne, Victoria 3000

Submissions will be made available on the commission's website, except for any information that is commercially sensitive or confidential. Submissions should clearly identify which information is sensitive or confidential

4.2. Key timelines

The key timelines are:

- Mid June 2019 – workshop to inform stakeholder responses to this issues paper.
- 2 July 2019 – submissions on the issues paper close.
- September 2019 – the commission will publish a draft decision on recommendation 4 rule changes.
- December 2019 – the commission will publish a final decision on recommendation 4 rule changes.
- 1 July 2020 – rule changes take effect.

Appendix A: Terms of reference

Ensuring Contracts are Clear and Fair

Terms of Reference to the Essential Services Commission

The Essential Services Commission (ESC) is requested to conduct a review under section 10(g) of the *Essential Services Commission Act 2001* on the appropriate amendments to the Energy Retail Code (the Code) to give effect to recommendations 4A to 4E of the *Independent Review of the Electricity and Gas Retail Markets in Victoria* (the Review).

Background

The Review commissioned by the Victorian Government in November 2016 found that the deregulated energy market was not delivering the anticipated benefits to consumers. It made 29 recommendations designed to place consumers back on a level playing field, including changing retailer marketing practices, introducing a basic service offer and abolishing standing offer contracts.

On 26 October 2018, the government released its final response to the Review. The final response gave full support for all 11 recommendations and in particular:

- supported recommendations 1 and 2 by proposing to require electricity retailers to offer a fairer price for energy, to be called the "Victorian Default Offer" (VDO), and replace standing offers; and
- supported recommendation 4, noting the government will direct the ESC to review the *Energy Retail Code* (the Code) to give effect to the recommendation.

Recommendation 4 is concerned with contract periods, practices and variations being clear and fair, and comprises 5 sub-recommendations:

> **4A** Require retailers to commit to fix any prices they are offering for a minimum of 12 months. During this period, the market contract prices cannot change. Retailers may request an exemption from the ESC to address unforeseen changes in network costs;
>
> **4B** Require retailers to disclose the length of time any offered prices will be available without change;
>
> **4C** Require retailers to roll customers onto the nearest matching offer, generally available offer at the end of a contract or benefit period, unless the customer opts for another offer;

4D Any conditional discount or other benefit offered for paying on-time or on-line billing should be evergreen. Customers should not lose the discount or other benefit when the contract ends;

4E Costs incurred by customers for failing to meet offer conditions are to be capped and not be higher than the reasonable cost to the retailer.

Request

The government is now requesting the ESC to review the Code to give effect to Review sub-recommendations 4A to 4E. The ESC is also asked to advise of any implementation issues arising from these Terms of Reference.

The ESC is advised to interpret recommendation 4A, requiring retailers to fix prices for a minimum of 12 months, as applying from the date an individual customer enters into a new contract. This recommendation is not intended to prevent retailers from updating price offers available to other customers in the market.

In conducting its review, the ESC is required to have regard to its objectives under the *Essential Services Commission Act 2001, Electricity Industry Act 2000, and Gas Industry Act 2001,* findings from the Review, the Government's published response to the Review, advice from relevant experts, and other matters it deems relevant.

While undertaking its review, the ESC may consider early adoption of any measures it considers necessary in the context of its statutory objectives, including those introduced in other Australian jurisdictions.

The ESC should engage in its work with an expert panel including the Secretary of DELWP and members nominated by the Minister for Energy, Environment and Climate Change.

Consultation

In undertaking this review, the ESC is required to publicly consult.

Reporting

Throughout the review, the ESC will advise the Assistant Treasurer and the Minister for Energy, Environment and Climate Change about its progress and final approach.

Completion

The ESC is required to complete and publish its review, so that changes to the relevant instruments can take effect from 1 July 2020.

Appendix B: Role of the commission

Role of the Essential Services Commission

The commission is Victoria's independent economic regulator of essential services. Primary legislation passed by the Victorian Parliament sets out the objectives and expectations for the commission in the regulation of retail energy markets.

The *Essential Services Commission Act 2001* (Vic) sets out the commission's overarching objective to promote the long-term interests of Victorian consumers.[16] The commission is also guided by objectives under the *Electricity Industry Act 2000* (Vic) and *Gas Industry Act 2001* (Vic) to promote the protections for customers, including in relation to customers who are facing payment difficulty.[17]

The legislation establishing the regulatory framework for the energy industry in Victoria assigns the commission a range of functions and powers, including the power to grant licences to energy market participants and to create codes and guidelines.

The Energy Retail Code is the principal instrument used to set out retailers' obligations and was first established in 2002.[18] The commission amends the code to reflect new reforms and other changes. Version 12 of the code is currently in force today.

[16] Section 8 Essential Services Commission Act 2001 (Vic).

[17] Section 10(c) Electricity Industry Act 2000 (Vic) and section 18(c) Gas Industry Act 2001 (Vic).

[18] The commission replaced the Office of the Regulator-General (ORG), which was established to oversee regulation of electricity and gas industries during the privatisation of the industry and accompanying establishment of markets in generation, distribution and retail segments of the industry. The legislative objective for the ORG in relation to consumers was expressed as: "to ensure that users and consumers benefit from competition and efficiency" (Office of the Regulator-General Act 1994 (Vic), s7(1)(e)).