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# Energy market uncertainty, consumer protection, and a new duty of care

A response to the Australian Energy Regulator's  
retailer authorisation and exemption review (April 2022)

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<sup>1</sup> The views expressed in this submission are those of the author and not the Monash Business School or its staff.

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## OVERVIEW

This was meant to be a short submission but the Australian Energy Regulator's discussion paper put pay to that ambition.<sup>3</sup> But more about that in a moment.

These days much is said and written about the unfolding energy transition and the opportunities it will involve and enable. Hardly a day goes by without an article or report, tweet or post, engaging in debates about consumer energy resources (also known as distributed energy resources), flexible demand, price signals, dynamic operating envelopes, value stacking, virtual power plants, two-sided markets, microgrids, community batteries, vehicle-to-grid services, peer-to-peer trading, and so on.

There's also a lot said and written these days about trust, confidence, social licence, fairness and consumer-centred regulation. Not so long ago, these concerns played little purposeful role in the regulators' discourse about energy markets. This has changed.

The AER's discussion paper on the retailer authorisation and exemption framework demonstrates a regulatory interest in the convergence between the uptake of technology and the interests of consumers.<sup>4</sup>

*It will be critical for industry to build a strong **social licence** with energy consumers. Developing **trust** and demonstrating a strong willingness to do good by consumers will give consumers the **confidence** and feeling of support they require to take up new technologies and engage with new service models. [emphasis added]*

While eponymously focused on the retailer authorisation and exemption framework, the discussion paper is ostensibly a review into the ongoing efficacy of the National Energy Consumer Framework (NECF).<sup>5,6</sup>

*This review will explore how these new energy products and services interact with the NECF and the essentiality of energy supplies to consumers. It will consider whether the current consumer protection framework is fit for purpose for the future energy market and can support customer uptake of new energy products and services.*

Careful consideration of the discussion paper quickly makes clear the enormity of its objective of developing a "fit for purpose" consumer protection framework.

The future will not be a continuation of the past. The future will not be the past with a few tweaks. The discussion paper clearly recognises this discontinuity in the energy market but does not appear to recognise that this implies a discontinuity, or step change, in the way the consumer-facing market is regulated.

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<sup>3</sup> Australian Energy Regulator (AER) *Retailer authorisation and exemption review* (April 2022)

<sup>4</sup> AER discussion paper, p.42

<sup>5</sup> AER discussion paper, p.2

<sup>6</sup> The National Energy Consumer Framework (NECF) consists of the National Energy Retail Law (NERL) and National Energy Retail Rules (NERR).

It is the enormity of this challenge that has led to this lengthy submission.

For ease of exposition, this submission is written in three parts. While all the parts are related, each part can be read independently of the others.

**Part 1 (The AER's proposed approach)** of the submission provides a careful reflection on the concerns motivating the review the AER has now initiated. Unfortunately, the discussion paper is not particularly forthcoming in describing these concerns. On careful distillation it becomes clear the paper is motivated by three concerns.

First, the challenge of identifying the **essentiality** of services in the future energy market. The discussion paper appears to suggest that the regulator is considering assessing 'essentiality' according to the uses to which energy is put by consumers. This submission highlights this approach risks profoundly eroding the sovereignty and agency of energy consumers because it introduces the possibility that the regulator will sit in judgement of how consumers use energy (or manage their participation in the energy market).

The second concern motivating the discussion paper is the emerging **complexity** of the consumer-facing energy market. This concern is justified. The paper rightly identifies how complexity can impair decision making by consumers. It also recognises that in future, there may be complicated "interlinkages" and "interdependencies" between the different services and products a consumer may purchase. The suggested response to these observations is concerning. The discussion paper appears to be suggesting the regulator will be able to peer through these complexities in order to impose specific regulatory obligations on different service providers. This may prove to be a heroic assumption.

The third concern appropriately motivating the discussion paper is **consumer harm**. Despite frequent references to harm, the discussion paper does not define harm or the harms that must (or should) be avoided. Likewise, while it suggests a risk-based approach should be taken when regulating against harm, it does not identify how a tolerable level of harm will be determined. The paper, however, indicates the AER will apply a consumer risk assessment tool developed by the Energy Security Board. This submission explains the outcome from applying this risk assessment tool will result in either little (or no) significant change to the existing consumer protections, or it will trigger a wave of new pernickety regulatory obligations that are likely to be out-of-date even before they take effect.

Concerns about essentiality, complexity and risk can be traced back to the **uncertainty** that lies ahead for consumers. Part 1 identifies an underlying paradox in the discussion paper's anticipated response to this uncertainty. The paradox arises because the discussion paper is looking to address uncertainty by using a regulatory framework that is almost entirely predicated on certainty. Force-fitting a certainty-based framework to deal with the challenges of uncertainty is clearly problematic. The likelihood of failure is significant and will leave consumers exposed to risks they are not equipped to handle.

Part 1 concludes by proposing a way forward that avoids the paradox. This requires reform of the consumer protection framework so that it is anchored to the single point of certainty that exists about the future energy market – namely: There will always be a consumer.

**Part 2 (The consumer case for reform)** of this submission steps back from the AER's discussion paper to look at the energy market afresh. In doing so, it compares and contrasts the retail energy reforms implemented 20 years ago with the regulatory challenges that are now presenting themselves.

This submission's central concern is that ongoing community support for the energy transition will rest heavily on consumers' confidence in, and trust of, the emerging energy market. Where individual consumers conclude or suspect those developments are working to their detriment, they will demand action – action that will potentially forestall individual and community-wide benefits to be gained from the transition.

The emerging consumer-facing energy market will starkly differ from the retail energy market of the past 20 years. Most prominently, this will require consumers to navigate a market involving multiple decision variables.

For most of the past twenty years, energy consumers have had to negotiate only one decision variable when engaging with the retail energy market – namely, price. In reality, when shopping for an energy contract, the vast bulk of the task facing consumers involved identifying the plan that offered the lowest prices given their energy consumption. In contrast, future contracts could or will require customers to navigate their way through a suite of decision variables. For now, eleven potential decision variables are identified – many of which may be dynamic in nature (meaning they will change with market conditions rather than having set values specifiable in a contract).

The two usual responses to these concerns about complexity – that either service providers or machines (algorithms) will simplify the challenge of navigating the market for consumers – are both found to be wanting.

The part concludes by observing that a successful energy transition requires a total reconceptualisation and revitalisation of the relationship between:

- service providers and consumers
- the regulator and the market
- consumer outcomes and regulatory compliance

**Part 3 (Establishing a new duty of care)** responds to the regulatory challenges posed at the ends of Parts 1 and 2 of this submission.

While consumers may be facing ever-greater choices about *how* they participate in the energy market, many or most consumers will not have a genuine choice over *whether* they participate. If consumers do not have a genuine choice over their participation but they face the increasing complexities described in the discussion paper, then the burden of responsibility for navigating the market must be amended to reflect these realities. Put simply, the responsibility for navigating the emerging complexity of the consumer-facing energy market must be shifted to the parties who (i) are responsible for those complexities, and (ii) participate in the market on an unquestionably voluntary basis.

In other words, this submission concludes that service providers must accept responsibility for assisting customers to navigate the complexities they (service providers) will create in the consumer-facing energy market.

The submission proposes this can be achieved by creating a single, simple and universal duty of care of the form: *A service provider must act in the best interest of the customer.*

Part C outlines how such a duty would operate and how the regulator can, and should, avoid a descent into prescription – despite the enormous pressure it will face to prescribe every aspect of the duty’s operations. The slippery slope of prescription will lead to regulatory failure and imperil a successful energy transition.

The Part concludes by pre-empting the predictable resistance the duty will face and briefly describes other components of the regulatory framework that will require modernisation in light of the duty.

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For 20 years, the consumer protection framework has operated on the basis of certainty. The regulator has known: *who* it is regulating, *what* it is regulating, *why* it is regulating, *where* it is regulating, and *how* it is regulating. The future will afford the regulator no such certainty. For these reasons the regulatory framework must be reformed, but reform cannot mean doing more of the same. Successful reform will mean embracing uncertainty rather than imagining it can be overcome.

Establishing a duty of care will face many challenges. Resistance is guaranteed. Assurances are not. The duty may not solve every problem that emerges, but as John Maynard Keynes is famously said to have noted:

“It is better to be roughly right than precisely wrong.”

## PART 1. THE AER'S PROPOSED APPROACH

The AER has published a discussion paper on its retailer authorisation and exemption arrangements.<sup>7</sup> Pleasingly, the paper initiates a much broader discussion about the overall regulatory consumer protection framework. It takes a careful read of the discussion paper to realise it is motivated by three central concerns – **essentiality, complexity and harm**.

This submission agrees these are correctly identified as causes for regulatory concern in light of the energy transition that is now unfolding. However, the discussion paper appears to be taking this review of the regulatory framework down a path of limited opportunity in response to these concerns.

### 1.1 Three central concerns: Essentiality, Complexity and Harm

This section reflects on how the discussion paper appears to be responding to the three central concerns mentioned above, and the strengths and weaknesses of these responses.

#### ***Essentiality***

As the discussion paper explains, dedicated regulation for the retail energy market has been premised on the essential nature of energy (electricity and gas) and consumers' limited bargaining power.<sup>8</sup>

The policy rationale behind the creation of the NECF is that the essential nature of the supply of energy requires additional protections beyond those afforded by general consumer protection law.

...a fundamental principle underpinning the NECF is that energy is an essential service and small customers (both residential and small business customers) have little bargaining power and can be put at a significant disadvantage by energy retailers and distributors if these practices are not regulated to ensure minimum standards.

The paper offers a definition of essentiality:<sup>9</sup>

Essentiality in the energy context refers to the provision of vital daily needs in modern life such as lighting, heating, cooling, refrigeration and the operation of appliances and electronics.

While this definition may have been adequate in the past, going forward, essentiality would be more helpfully framed if expressed in terms of consumer outcomes – for example: **physical well-being, economic and social participation, and economic value-adding** – rather than the inputs (ie. lighting, heating, etc) to those social and economic outcomes.

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<sup>7</sup> Australian Energy Regulator (2022) *Retailer authorisation and exemption review. Issues paper* (April)

<sup>8</sup> AER discussion paper, p.1 and 22, respectively.

<sup>9</sup> AER discussion paper, p.7, footnote 13

This input-based approach to defining essentiality foreshadows how the current review will be conducted.<sup>10</sup>

...a key factor when considering how new energy products and services should be treated is whether they have characteristics that make them essential.

In taking this step, the discussion paper does not clearly disclose the leap the regulator is proposing to take. Whereas in the past the regulatory framework did not judge **which** inputs (heating, cooling, etc) were essential to consumers, the AER's proposed approach appears to lead to such judgements being made in the future. This shift of regulatory function – from the physical provision of energy to judgements over **how** consumers use that energy – is demonstrated by an example provided in the discussion paper.<sup>11</sup>

At this point in time, many new energy products and services are unlikely to be considered essential in the same way as the traditional supply of energy. An example of this is that EV charging facilities are unlikely to be essential because there are other modes of travel available to use and access, other than an EV.

This example is problematic and worrying. It relies on the regulator's untested assumption that consumers always have ready, reasonable and safe access to an alternative form of transport. The simplicity of that assumption needs no further elaboration.

The example highlights the slippery-slope that lies ahead for consumers if the regulator begins reaching into their households and businesses to judge the essentiality of their energy use or the essentiality of particular products and services they might purchase.

These risks become even more pronounced once service providers (eg. retailers) gain remote access to consumers appliances. For example, would it be essential for consumers to have 24 hour access to hot water? Is an oven or a television really essential, after all there are substitutes for both. What about access to a third-party offsite battery?

If the regulator deems particular usages, services or products to be non-essential then:

- Could a service provider withdraw these services without fear of regulatory sanction?
- Would consumers lose access to 'independent and 'free' dispute resolution schemes?<sup>12</sup>
- Might customers facing payment difficulty become second-class energy consumers denied access to non-essential energy usage, services or products?

The NECF was predicated on the sovereignty and agency of energy consumers. It does not seek to judge how consumers use energy or which uses are essential. The NECF does not empower energy retailers to impose conditions on the use or consumption of energy (for

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<sup>10</sup> AER discussion paper, p.23

<sup>11</sup> AER discussion paper, p.23

<sup>12</sup> Leaving customers' disputes to be addressed under contract law.

example, in its hardship arrangements). All these fundamental principles would be imperilled under the arrangements being envisaged in the discussion paper.

While it is highly doubtful the AER is contemplating becoming a lifestyle regulator, that may be the unintended consequence of the approach considered in the discussion paper.

### **Complexity**

The spectre of complexity hangs heavily and ominously over the discussion paper. The potential and likelihood of complexity to impair consumers' decisions about their energy arrangements is mentioned many times. For example:<sup>13</sup>

The energy transition is bringing with it the emergence of new technologies and service models and this is driving an increasingly complex landscape. This may make it harder for consumers to understand products and services and make choices best suited to their needs.

This observation is profoundly important. If consumers are expected to find it increasingly difficult to understand and participate in the energy market, then the consequences for the regulation of that market are far-reaching.

As described in Part 2, the NECF was established on the assumption that if the retail market was made contestable, and consumers were given information in support of their freedom to choose, then the "invisible hand" of self-interest would guide the market to a socially optimal outcome.

Although the AER's above observation is qualified by "may", it does acknowledge that complexity can manacle the invisible hand, thereby jeopardising the promise of a competitive market. Complexity can lead to consumers making choices that are contrary to the "choices best suited to their needs". In doing so, complexity can lead to consumer harm – discussed below.

The discussion paper identifies the main source of complexity and the challenge facing any attempt to regulate it – namely, the "interlinkages" and "interdependencies" between the different services and products a consumer may purchase (or need to purchase).<sup>14</sup> Having identified this problem, and that multiple service providers may be involved, the discussion paper proposes a possible way forward for the regulatory framework.<sup>15</sup>

[T]he rise of more complex service offerings means there may be multiple coordinated entities providing energy supply and related services. It may be more appropriate to task each with particular obligations to provide consumers (and the AER) with greater clarity over who has responsibility for compliance with these obligations.

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<sup>13</sup> AER discussion paper, p.5

<sup>14</sup> For example, AER discussion paper, p.7 & 37

<sup>15</sup> AER discussion paper, p.26

This observation contains two worrying elements. First, it appears to suggest that service providers will act to ensure they coordinate among themselves to maximise the benefit they jointly provide to their customers. The basis of this assumption is not explained. Secondly and more significantly, it appears to suggest that the regulator believes it will be able to untangle the “interlinkages” and “interdependencies” between services in order to task the different service providers with particular regulatory obligations. There is no discussion about how the regulator would untangle non-essential services from essential energy services in order to apportion responsibility for the latter. This is likely to prove to be a very heroic assumption about regulatory capacity.

### **Harm**

Concern for the possible harm that might be caused to consumers appears throughout the discussion paper. Despite frequent references to harm, the discussion paper does not define harm or the harms that must (or should) be avoided. Instead, it proposes that a risk-based approach should be taken to identifying and addressing the possibility of harm.<sup>16</sup>

This risk-based approach is designed to identify where new consumer protections or other measures may be needed, reflecting the potential of a new arrangement, product or service to cause harm.

A risk-based approach to regulating against harm is not unusual, however, it does imply that there is a tolerable level of harm or risk of harm.

The risk-based approach mentioned in the above quote is referring to the “consumer risk assessment tool [which] was developed by the ESB in consultation with customer advocates and key industry stakeholders”.<sup>17</sup>

While the assessment tool is reasonably standard in its design, it offers only one insight into its implied tolerance for harm – namely, whether the regulatory response is “proportional to the impacts” of the available risk mitigation options.<sup>18,19</sup> In other words, the tool requires harm caused to individuals to be assessed against the impact any regulatory response would have on the broader market. This means the assessment tool is pitting consumers against ‘the market’ to see who will incur the greatest harm. The market is given equal standing to consumers even though consumers are real while the market only exists in the abstract. Such an approach is misguided. It rests on the fallacy that market impacts can be assessed in comparable terms to harms to real individuals.

The assessment tool also requires harms and potential regulatory mitigants to be assessed against “the consumer protection principles in combination with the National Energy Retail Objective”.<sup>20</sup> These requirements are highly restrictive for two reasons. First, they

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<sup>16</sup> AER discussion paper, p.8

<sup>17</sup> AER discussion paper, p.58

<sup>18</sup> The same approach is typically applied in Regulatory Impact Statements and Benefit-Cost Analysis.

<sup>19</sup> AER discussion paper, p.59

<sup>20</sup> AER discussion paper, p.59

presuppose the outcome of the proposed assessment, and second, they limit the possible regulatory response to ‘more of the same’. This is explained in the following discussion.

The consumer protection principles relevant to the assessment framework are reproduced on page 8 in the discussion paper. Principles 2 and 3 are most relevant to the concerns being raised in the discussion paper.

- Principle 2 (switching providers) states that consumers should be able to change retail providers when they choose.
- Principle 3 (access to information) states consumers should have access to information that is sufficient, accurate, timely and minimises complexity and confusion to allow them to make informed decisions.

As guiding assessment tools these principles suffer from *petitio principii* (or ‘begging the question’) – that is, each principle presupposes its regulatory response. If the AER’s assessment finds consumers cannot switch easily enough, then the response must be to attempt to make it easier for them to switch. If an assessment finds consumers have inadequate access to helpful information, then the only regulatory response must be to pursue opportunities to provide them with this information.

The predetermination of the outcomes from applying the assessment tool – better information and easier switching – is openly foreshadowed in the discussion paper. For example:<sup>21</sup>

Aggregation and energy management devices and services are likely to be complex products. Consumers will require **easy-to-understand information** to comprehend the arrangement, how the devices work and what they are paying for.

[I]ndustry will need to be proactive in providing **clear, trusted information** to consumers.

[T]he development of standards to **support effective switching** and identify where risks or harms may emerge with new services becoming available.

interoperability and technical standards: will ensure consumers’ DER devices can communicate effectively, **enabling consumers to switch easily** between alternative retailers and providers and ensure they can use different energy assets together

Beyond the ESB’s consumer protection principles, the assessment tool also requires harm and its mitigation to be considered against the National Energy Retail Objective (NERO).<sup>22</sup> Applying the NERO as a fixed constraint immediately narrows the possible scope of

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<sup>21</sup> AER discussion paper, p.38, 42, 9 & 43, respectively

<sup>22</sup> The National Energy Retail Objective (NERO) is “to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy.” *National Energy Retail Law (South Australia) Act 2011*, s.13

outcomes from this review. Such narrowness is severely at odds with the discussion paper's opening commitment to consumers.<sup>23</sup>

The review will assess whether these frameworks remain fit for purpose for the post-2025 NEM, whether the NECF should and will capture new energy products and services that emerge in the energy transition, and what regulatory reforms may be required to ensure energy consumers continue to be adequately protected.

As the discussion paper explains, the NECF consists of the National Energy Retail Law (NERL) and National Energy Retail Rules (the retail rules).<sup>24</sup> The retail rules are universally based on, and derive their authority from, the NERO which resides in the NERL.

In other words, the assessment tool immediately narrows the scope of any assessment of harm and its mitigation. It requires that harm be considered within a context framed by a legislative objective that was drafted for a very different retail energy market (discussed in Part 2). Using the ESB's assessment tool presumes the NERO remains adequate despite all the uncertainties and complexities identified in the discussion paper. This presumption is untested in the discussion paper. It would be unlikely to withstand closer scrutiny.

Imposing *ex ante* the ESB's consumer protection principles and the NERO will stifle any possibility of a genuine assessment of the harms, and their potential mitigants, that might emerge as part of the energy transition. The outcome from such a restricted assessment framework is predetermined. It will result in either little (or no) material change to existing consumer protections, or it will trigger a wave of new pernickety regulatory obligations that are likely to be out-of-date even before they take effect. After all, markets almost always outpace regulators. The uncertainties of the unfolding energy transition will only widen the gap between the energy market and the regulator.

## 1.2 Reforming for the uncertainty of the energy transition

The previous section describes the three causes for concern that appear to be motivating the discussion paper. These concerns arise because of the inherent uncertainty associated with the unfolding energy transition. As the discussion paper notes:<sup>25</sup>

There are inherent challenges in designing regulation for a future market where there are still many uncertainties.

In this sense, concerns about essentiality, complexity and harm are symptoms of the underlying condition of uncertainty with which the regulator is contending. The discussion paper then considers whether and how the AER might treat these symptoms. This leads to something of a paradox. This paradox is not recognised in the paper.

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<sup>23</sup> AER discussion paper, p.1

<sup>24</sup> AER discussion paper, p.1

<sup>25</sup> AER discussion paper, p.44

The paradox arises because the discussion paper is looking to address the symptoms of uncertainty using a regulatory framework that is almost entirely predicated on certainty (or near-certainty). Under the NECF the regulator can be quite certain about:

- *who* it is regulating – retailers
- *what* it is regulating – the sale and supply of energy
- *why* this is regulated – because it is essential
- *where* it is regulated – the contract lifecycle (from marketing to termination)
- *how* it is regulated – disclosure requirements and contract terms and conditions

As the discussion paper makes very clear, uncertainty means each of these features will become increasingly unclear, unknown or unknowable as the energy transition unfolds. Force-fitting a certainty-based framework to deal with the symptoms of uncertainty is clearly problematic. The likelihood of failure is significant. Failure will leave consumers exposed to risks they are not equipped to handle.

The ‘law of the instrument’ must not be allowed to prevail.<sup>26</sup> The NECF as currently constructed provides the wrong foundation for dealing with the uncertain energy market of the future. The past must not dictate how the regulatory framework is reformed to deal with concerns about essentiality, complexity and harm.

The spirit of reform motivates and pervades the entire discussion paper as demonstrated in the following statements.<sup>27</sup>

The review will assess whether these frameworks remain fit for purpose for the post-2025 NEM, whether the NECF should and will capture new energy products and services that emerge in the energy transition, and what regulatory reforms may be required to ensure energy consumers continue to be adequately protected.

This issues paper commences our public consultation on the retailer authorisation and exemption review, setting out... [*inter alia*] ...potential options for regulatory reform.

Looking ahead to a future energy market, consumers are going to have a vastly different relationship with the energy market. They are likely to have multiple traders providing energy supply and services and to engage with products and services not covered by the NECF. This creates a strong case for regulatory reform.

Pursuing reform is the correct response to the extensive transformation to the consumer-facing energy market anticipated throughout the discussion paper – but how does the paper propose to undertake this reform?

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<sup>26</sup> The term for this cognitive bias was coined by Abraham Kaplan in 1964. It is commonly known by the maxim, “To a hammer, everything looks like a nail.”

<sup>27</sup> AER discussion paper, p.1, 2 & 44, respectively.

The answer appears in the following statement:<sup>28</sup>

Given there is still uncertainty regarding the future energy market, designing regulation now that is fit for purpose and able to predict the exact harms that require protections is difficult. It is likely that reviewing the consumer protection frameworks for the energy sector will need to be an iterative process driven by ongoing monitoring of consumer detriment.

The references to an “iterative process” informed by “monitoring of consumer detriment” highlight the likely nature of the reform process the AER intends to follow. These references suggest the AER will be updating the framework from time-to-time to account for market developments (presumably, new products and services, and business models). This approach to regulating the consumer-facing energy market will be highly problematic for a number of reasons.

First, it means an adverse market development will need to materialise before the regulator considers its implications. Second, this reactive approach means consumer detriment will likely be incurred before it is addressed. Third, regulatory processes tend to be protracted, meaning the consumer detriment may persist for a considerable period. Experience suggests once consumer detriment is detected, it takes a number of years to develop, consult on, implement and operationalise the regulatory response. Fourth, the discussion paper anticipates a very dynamic consumer-facing market in the future. In the years it will take to develop a regulatory response, the dynamic market will have likely ‘moved on’ from the original source of consumer detriment.

These are not trivial concerns. They highlight the incongruity between the NECF, with its reliance on certainty, and the enormity of the uncertainty that lies ahead. In seeking to maintain an effective consumer protection framework, the regulator will be confronted by a reality in which it may **not** be able to identify or anticipate:

- *who* it needs to regulate – service providers will come in many forms
- *what* it is regulating – energy services will extend beyond sale and supply
- *why* this is regulated – essential and non-essential services may be non-separable
- *where* it is regulating – contracts may be entered with multiple service providers
- *how* it is regulated – incomprehensibility of contract terms and conditions

These uncertainties serve as powerful contraindicators to the discussion paper’s focus on services and products. They foretell of the expected fallibility of the approach anticipated in the paper. Alternatively stated, the conditions of certainty upon which the NECF relies cannot be expected to be sustained in the future.

The discussion paper is right when it observes there is a “strong case for regulatory reform”. The paper’s faith, however, is misplaced when pursuing amended regulatory arrangements

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<sup>28</sup> AER discussion paper, p.7

to “capture new energy products and services that emerge in the energy transition”. Such pursuits will quickly be overrun by the market’s uncertainties.

A new framing of the regulatory challenge is needed in the face of the uncertainties that lie ahead. This requires the regulatory framework to be reformed in a way that anchors it to the single point of certainty that exists about the future, that is: **There will always be a consumer**. New services and products will come and go, but consumers will be there for as long as the energy market exists.<sup>29</sup>

The reforms needed to deal with uncertainty cannot be limited to doing more of the same – that is, providing more information and encouraging more shopping around.<sup>30</sup> The reform required for the energy transition requires the *re-form* of regulatory arrangements.

Part 3 of this submission outlines how a consumer protection framework can be *re-formed* around the consumer. In the meantime, Part 2 outlines the case for enlightened regulatory reform of the consumer-facing energy market.

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<sup>29</sup> This is a truism. Where there are no consumers, there can be no market.

<sup>30</sup> As per principles 2 and 3 of the consumer protection principles outlined on p.8 of the discussion paper.

## PART 2. THE CONSUMER CASE FOR REFORM

This submission's central concern is that ongoing community support for the energy transition will rest heavily on consumers' confidence in, and trust of, the emerging energy market. This Part steps back from the AER's discussion paper to look at the energy market afresh. In doing so, it compares and contrasts the regulatory reforms of 20 years ago with the starkly different environment that lies ahead.

### 2.1 Two energy revolutions

It is now over 20 years since the retail electricity and gas markets were first opened to competition. Deregulating the retail energy market never attracted the intellectual firepower that went into establishing the wholesale energy markets and regulating energy networks. Retail market reform was predicated on five simple precepts, namely:

- An efficient market would see prices reflect costs thereby avoiding hidden cross-subsidisation between services, customer cohorts, regions, technologies, and so forth.
- Enabling customer choice of energy retailer and energy plan (contract) would facilitate the efficient satisfaction of consumer preferences.
- Consumers would be empowered through information disclosure and mechanisms that lower transaction costs (eg. government funded comparator sites).
- Consumer protections would prevent or remedy disputes between customers and their retailer, and prevent the hasty disconnection of customers for non-payment.
- Retailers would innovate as they competed for customers.

For the most part the reformers of the late 1990s and early 2000s did not question these assumptions. They were largely adopted as articles of faith. It was considered to be self-evident that setting to work the 'invisible hand' of self-interest would negate the need for regulatory involvement. If only they had been more curious, they may have *inter alia* predicted the so-called "loyalty tax" that has come at such expense to so many consumers.

Two decades later, the second retail energy market revolution has begun. The discussion paper refers to this latter day revolution as the "energy transition".

There is no shortage of discussions about how the energy transition can and will be achieved. Common themes include: the uptake of consumer energy resources (also known as distributed energy resources), flexible demand, price signals, dynamic operating envelopes, value stacking, virtual power plants, two-sided markets, microgrids, community batteries, vehicle-to-grid services, peer-to-peer trading, and so on.

These opportunities are typically discussed from a technical or system-oriented perspective. The human experience of these potential innovations or reforms is, at best, overlooked. At worst, the response and support of consumers is simply taken for granted. In this regard, most of the discussions presaging the second retail energy revolution echo the faith-based attitudes that accompanied the first revolution.

When it comes to energy consumers, history should be treated as a teacher. What is it they say about those who cannot remember the past?<sup>31</sup>

## 2.2 The term ‘retail’ is unhelpful

The energy law and rules, and countless regulatory documents, refer to “retailers” and the “retail energy market”. The term “retail” has a very specific meaning in this context – namely, it refers to the sale and supply of electricity (or gas) to a customer. In short, this means a retailer is the party responsible for overseeing how much electricity (or gas) a customer draws from the grid and then billing them for that service.

As the AER’s discussion paper identifies, this is far too narrow a conception of how consumers will participate in the energy market in the future. This means the term “retail”, as currently defined, is far too narrow to be useful when discussing consumers’ potential experiences as part of the energy transition.

Wherever this submission is referring to the emerging energy market, it therefore avoids referring to retailers and the retail energy market. Instead, the submission refers to “service providers” and the “consumer-facing energy market”.

## 2.3 The complexity awaiting energy consumers

For most of the past twenty years, energy customers have had to negotiate a single decision variable when engaging with the retail energy market, that is, price. When shopping for an energy plan, the task facing consumers principally involved identifying the plan that offered the lowest prices given their energy consumption. This one-dimensional minimisation problem is evidenced in the design of government and private comparator sites.

In the future, the consumer facing electricity market will look very different. Future contracts could or will be specified in multiple dimensions. This will involve consumers negotiating the energy market across a wide suite of decision variables, such as:

- the price of grid supplied electricity
- the price of electricity exported to the grid
- volume controls on outflows (exports) of electricity

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<sup>31</sup> “Those who cannot remember the past are condemned to repeat it.” – George Santayana, *The Life of Reason*, 1905

- volume agreements regarding the use and timing of load
- delegated control over onsite electricity load
- exceedance penalties when consumers breach or over-ride previously agreed volume limits
- delegated control of onsite battery services
- terms of access to offsite battery services
- the price of offsite battery services
- control and 'ownership' of electricity stored in offsite batteries
- payments for provision of ancillary system services
- other?

In addition:

- many of the decision variables listed above can be expected to be dynamic in nature, meaning they will change with market conditions rather than having set values specifiable in a contract
- future contracts may also involve financing arrangements (eg. lease-purchase agreements for equipment)
- customers may contract with multiple service providers each supporting specific, but interacting, services or products.

Of course, not all these decision variables are entirely new. Some are already observable in the consumer-facing energy market. For example, there are already energy plans competing in the two dimensions of electricity supply and feed-in-tariffs. However, complexity will increase geometrically with the addition of each new variable; and multi-dimensional contracts are likely to become far more pervasive than in the past.

Ongoing community support for the energy transition will rest heavily on consumers' confidence in the emerging consumer-facing energy market. Where individual consumers conclude or suspect those developments are working to their detriment, they will demand action – action that will potentially forestall individual and public (or community-wide) benefits to be gained from the transition.

For as long as electricity is an essential service, the design and regulation of consumer-facing markets is an exercise consisting of economics and political economy in equal measure.

## 2.4 Consumers navigating complexity

There is now plenty of evidence about the misplaced assumptions upon which the first retail energy revolution was implicitly predicated. The vast majority of customers are not the highly active and discerning shoppers they were required to be. Choice, disclosure and consumer protections may have been necessary features when designing the retail energy market. They were certainly not sufficient.

Even in the one dimensional market of the first retail energy revolution, many (or most) consumers cannot solve the minimisation problem they faced. Even when they do shop around, they rarely end-up on the cheapest deal.<sup>32</sup>

Retailers did not help resolve this problem. With little opportunity to differentiate themselves in a one-dimensional marketplace, retailers created artifices of difference. The market became (and remains) awash in offers – despite every one of those offers selling and supplying exactly the same electricity (or gas) to consumers from the grid.

Between 2004 and 2017, there was no shortage of reviews into the competitiveness and efficiency of the retail energy market.<sup>33</sup> Shortcomings were identified, often repeatedly, but they were dismissed as transitional glitches while competition was still taking hold.

Inevitably these reviews responded to these shortcomings in the retail energy market by advising regulators to require better disclosure from retailers and urging customers to shop around for a better deal. These two prescriptions for solving the shortcomings of the retail energy market remain prevalent to this day, even after 20 years of full retail competition.<sup>34</sup>

The implication of these two prescriptions is rarely acknowledged.<sup>35</sup> They act to lay responsibility for the market's shortcomings at the feet of consumers. They imply consumers have failed to benefit from the market because **they** have failed to shop around (or shop around effectively). This is despite, as noted above, every offer in the market selling and supplying exactly the same electricity (or gas) to consumers.

By 2017, consumers were 'jack' of taking the blame for bad deals. They demanded action by the polity. This led to the Thwaites review in Victoria and the Retail Electricity Price Inquiry by the ACCC, as mentioned above. There followed a wave of action by regulators and, in some cases, a tidal wave of new regulation. But for the main part, all this new regulatory activity continued to focus on disclosure and measures to encourage and support customers shopping around.

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<sup>32</sup> Mountain, B., Burns, K. *Loyalty taxes in retail electricity markets: not as they seem?* Journal of Regulatory Economics 59, 1–24 (2021). <https://doi.org/10.1007/s11149-020-09418-9>

<sup>33</sup> For example: Australian Energy Market Commission (2020) *2020 Retail Energy Competition Review: Final Report* (30 June)

<sup>34</sup> For example, see respectively: AER (2022) *Better Bills Guideline* (31 March), and Essential Services Commission of Victoria (2021) *A 'striking consumer preference' for large energy retailers* in Victorian Energy Market Report 2020-21 (November)

<sup>35</sup> Perhaps with the notable exception of: Ben-David (2015) *If the retail energy market is competitive then is Lara Bingle a Russian cosmonaut?* <https://www.esc.vic.gov.au/sites/default/files/documents/If-The-Retail-Energy-Market-Is-Competitive-Then-Is-Lara-Bingle-A-Russian-Cosmonaut.pdf>

Herein lies the central dilemma for ongoing community and consumer support for the energy transition. If customers haven't successfully navigated a market constructed around one decision variable, how can they be expected to navigate a labyrinthine market involving all the decision variables noted above?

This question usually prompts one of two answers.

First, it is suggested the competitive market will solve complexity by creating products consumers can readily understand. Unfortunately, 20 years of experience with full retail competition lays bare the falsity of that claim.

Second, it is suggested "machines" (algorithms) will do the work for consumers by optimising across multiple decision variables in real time. It's an understandable response given the platform technologies now emerging, however, it misses the point entirely. How will consumers assess the value of each machine? How will they compare the benefits promised by competing machines? How will they be able to judge whether a machine is delivering the value it promised?

Then there are two findings from two independent studies commissioned by the AER.<sup>36</sup>

44 per cent of Australians have literacy levels considered to be below what is required to fully participate in society.

40–45 per cent of consumers were unable to select the cheapest offer when presented with three options, let alone when comparing plans from the 40 retail brands currently offering products in the NEM.

When viewed against all these realities, the AER's intended approach for updating the consumer protection framework risks failing consumers. Seeking to regulate on the basis of new services, products and business models will face untold problems and insurmountable challenges – some of which are discussed in Part 1 of this submission.

In the emerging dynamic and multi-dimensional market, the way forward won't be found in more regulation. The market will always outpace the regulator. Ever more so in the future when the universe of possible new products and services will be almost without limit.

A successful energy transition therefore requires a total reconceptualisation and revitalisation of the relationships between:

- service providers and consumers
- the regulator and the market
- consumer outcomes and regulatory compliance

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<sup>36</sup> AER (2021) *Consumer Vulnerability Strategy: Draft for consultation* (December), p.9 and 29, respectively

If consumers, who do not voluntarily participate in the energy market, face little prospect of successfully navigating the multidimensional contracts of the future, then responsibility for navigating this complexity must be shifted to the parties who do, in fact, choose to operate in this market and create these complex contracts – namely, service providers.

The time has come to repeal (and avoid) hundreds of pages of (additional) fussy rules and replace them with a single, simple and universal duty of care as proposed in Part 3.

### PART 3. ESTABLISHING A NEW DUTY OF CARE

The transition of the energy market has begun and it will accelerate in the years ahead. Consumers will face an almost unlimited array of choices about how they participate in this emerging market. The AER's discussion paper on the retailer authorisation and exemption framework is ostensibly a review into the ongoing efficacy of the NECF.<sup>37</sup>

This review will explore how these new energy products and services interact with the NECF and the essentiality of energy supplies to consumers. It will consider whether the current consumer protection framework is fit for purpose for the future energy market and can support customer uptake of new energy products and services.

Part 1 of this submission outlines the inherent obstacles to the AER pursuing regulatory reforms (based on services and products) in response to the changing nature of essentiality, the accelerating complexity of the consumer-facing energy market, and the breadth of potential harms that face consumers. Part 2 highlights that 20 years of experience with retail energy markets has disproved the presumption that providing consumers with information (product and price disclosure) and urging (and even assisting) them to shop around, enables them to navigate the energy market efficiently.

While consumers may be facing ever-greater choices about *how* they participate in the energy market, few consumers will have a genuine choice over *whether* they participate in the market. If consumers do not have a genuine choice over their participation and they face the increasing complexities anticipated by the discussion paper, then the burden of responsibility for navigating the market must be amended to reflect these realities. Put simply, the responsibility for navigating the emerging complexity of the consumer-facing energy market must be shifted to the parties who (i) are responsible for creating that complexity, and (ii) participate in the market on an unquestionably voluntary basis – that is, service providers.

Service providers' responsibility should be enshrined in a single, simple and universal duty of care to their customers.

#### **A note before proceeding:**

***The terms used in the following discussion are used conversationally, that is, in their colloquial sense rather than in accordance with any strict or contested legal meaning(s) ascribed to these terms.***

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<sup>37</sup> AER discussion paper, p.2

### 3.1 A new duty of care

It may be argued that service providers (for now, retailers and networks) already have a duty of care to customers which they fulfil by complying with their regulatory obligations. This is a particularly narrow interpretation of how a duty to consumers ought to be defined in a highly dynamic market. It is anachronistic for three reasons. First, it supposes the regulator (or legislator) knows what is in a consumer's best interests when drafting those regulatory obligations. This supposition cannot possibly be sustained given the rapidly changing nature of the energy market described in the AER's discussion paper. Second, regulations are made at a point in time. They lock-in the regulator's understanding of the market at that moment. In a market as dynamic as the energy market is anticipated to be in the future, the regulator's understanding is likely to date far more quickly than in the past. Third, a business focussed on complying with a regulatory obligation is ultimately defining itself as primarily having a duty to the regulator, not consumers. Such an outcome does not sit comfortably with the AER's focus on promoting consumer-centred approaches to regulation.<sup>38</sup>

If the energy transition is to succeed with consumers' ongoing support, then a forest of increasingly irrelevant regulatory obligations can, and should, be replaced by a simple, single and universal duty of care.

#### What the duty might look like

***A service provider must act in the best interest of the customer.***

For the purpose of the duty, references to the "customer" applies to:

- customers in an existing contractual relationship with a service provider, and
- potential customers with whom a service provider is engaging by any means and for any reason.

The following questions and answers begin a discussion about how the duty might operate.

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<sup>38</sup> For example see:

- AER (2020) *Strategic Plan 2020-2025 - Our commitment to make energy consumers better off, now and in the future*
- AER (2021) *Better Resets Handbook. Towards Consumer Centric Network Proposals*

## To whom would the duty apply?

*The duty should apply to any service provider who can (or is seeking to) control, constrain or prevent the flow of electricity to, around, or from, a customer's premises.*

This description recognises that in future it will not be possible to define neatly which activities, services, products or parties (or combination thereof) constitute a consumer's participation in the energy market. Unlike in the past, market participation won't be as simply definable as entering a retail contract for the sale and supply of electricity (or gas). Instead, it recognises the duty should apply to any party (service provider) who, by virtue of contracting with a customer, can interpose itself between the customer and the energy market.

The bracketed reference to "or is seeking to" is included to reflect the duty applies for service providers dealing with prospective customers – that is, it also applies to service providers marketing activities and when they make an offer to a potential customer.

## Who decides what is in a customer's best interests?

*Customer sovereignty prevails in a market-based energy transition.*

Customer sovereignty is the fundamental principle of any market-based system for providing goods and services – that is, individual customers determine the nature, quantum and mix of goods and services they wish to procure. This sovereignty is largely held to be sacrosanct. To the extent customer sovereignty is intruded upon by the state, it is almost always exercised through prohibitions on the production or sale of particular goods or services. The role of markets, then, is to satisfy the multitude of consumer interests as best as possible and at the lowest sustainable overall cost (including search and other transaction costs).

The market-based energy transition envisaged by the AER (and ESB) therefore demands the sovereignty of customers is upheld. Alternatively stated, each customer is left free to determine the mix of services and products that reflect their best interests. The role of the energy market regulators is to enable the market to satisfy those interests; and not to guide customers or the market toward a particular outcome.

Unfortunately, the discussion paper is not as clear as it otherwise might be on the matter of customer sovereignty. The paper appears to straddle two competing premises: Customer sovereignty and System primacy. While not central to this submission, these dualling premises are briefly discussed in **Appendix A**.

## What makes a “best interest” a best interest?

***There is no universal definition of what constitutes a best interest.***

When the retail energy market was established over 20 years ago, this question was moot. The only outcome customers could procure from the retail energy market was the sale and supply of energy (electricity and gas). As discussed at length in the discussion paper and this submission, the notion of a single purpose energy market is becoming increasingly defunct as a consequence of the energy transition.

Today, and more so in the future, there are a range of objectives customers may wish to pursue through their participation in the energy market. These might include:

- minimising their energy bills
- minimising their reliance on grid-supplied energy
- minimising emissions associated with their energy use
- maximising the return they earn on their energy-related investments
- securing certainty (or greater certainty) over the size of their energy bills

Of course, customers might have other objectives or combinations of objectives.

In any event, the duty imposes, before anything else, a positive responsibility on a service provider to:

- ascertain each customer’s objectives and expectations – for example, over what period a customer expects their objectives to be realised (daily, weekly or monthly (ie. aligned with the billing cycle) or annually)
- clarify whether it has offerings that align with the customer’s objectives and expectations, taking into account the terms and conditions (including price structures) that would be imposed on the customer
- confirm the customer’s understanding of, and willingness and capacity to comply with, those terms and conditions
- satisfy itself that entering a contract with the customer would not be to the customer’s detriment.

In other words, responsibility rests with service providers for determining compatibility between their service offerings and a customer’s best interests. The principle of *caveat emptor* would no longer serve as a refuge for service providers entering contracts that are not demonstrably in a customer’s interests.

## When should the duty apply?

***The duty should have force at every stage in the contract lifecycle, from marketing activity and service offer through to contract termination.***

The duty should rule any and every interaction between a service provider and a customer. The 'presumption of understanding should always lie in the direction of the service provider – that is, the service provider is always assumed to have a better understanding than a customer about the operations and implications of the terms and conditions of a contract. The duty would therefore apply whenever a service provider presents, applies or amends the terms and conditions of a contract.

## What does “acting” in the best interests mean?

***Service providers should advise customers proactively, conscientiously, reasonably and demonstrably.***

The duty obliges service providers to assist customers navigate the energy market. The duty is exercised through service providers advising customers about how they (service providers) can help customers meet their objectives. The obligation rests with service providers to provide advice:

- *proactively* – the obligation lies with service providers to provide advice and not wait for customers to ask for it.
- *conscientiously* – the advice should be provided in good faith and be motivated by ensuring the customer's objectives can be met or can continue to be met; or where objectives cannot be met, then that advice is provided honestly and helpfully.
- *reasonably* – before advising a customer to act, the service provider will have taken steps to inform its advice by inquiring about the customer's expectations, capacities and tolerances. This includes advising a customer when not to act in light of any change in circumstances.
- *demonstrably* – the service provider will document and keep an auditable record of its advice and the reasons for providing that advice.

The duty to act in a customer's best interest prohibits a service provider from taking advantage of a customer by acts of omission or by acts of commission. A service provider should 'put itself in the shoes' of the customer in *all* its dealings with a customer and ask itself: *What would the customer do if they knew everything we know?*

The answer to that question should guide a service provider in all its actions towards a customer.

### 3.2 Avoiding a descent into regulatory prescription

Establishing the duty should take no more than a page or two. However, doing so can be expected to unleash relentless tidal forces seeking very specific instruction about how service providers are required to act in an endless array of circumstances. If the regulatory response to these appeals is to codify expected standards of conduct, it will:

- limit the opportunity for service providers to innovate, experiment and take risks
- leave the regulator forever chasing to ‘keep up’ with the market. As Parts 1 and 2 of this submission make clear, this will be an impossible task in the dynamic market of the energy transition
- transfer responsibility for identifying what constitutes a good consumer outcome to the regulator. That is, prescription contradicts the purpose of the duty.

The duty is not intended to leave service providers guessing how the regulator will assess compliance with the duty (and when they will take enforcement action). To avoid service providers wastefully second-guessing the regulator, the regulator may issue **guidance notes** to advise service providers of the types of conduct that the regulator considers acceptable or desirable. Importantly, the guidance notes should be **non-binding** to ensure service providers take responsibility and have room to innovate. Although the guidance notes would be non-binding, in the event of a dispute or challenge (from customers, the ombudsman or the regulator), the onus would lie with the service provider to demonstrate its conduct was either the equal or better of the conduct described in the guidance. The test of ‘equal or better of’ would be judged from a consumer’s perspective. To support its judgement of ‘equal or better of’, the regulator could consider establishing a consumer panel or jury to advise it on whether this test had been satisfied by the service provider.

The guidance would be updated and revised by the regulator to reflect market developments. The process of review would be conducted openly and in consultation with service providers, consumers, representative organisations, and other interested parties.

An alternative approach, albeit less desirable, would be for the regulator to prescribe **minimum standards** of conduct by service providers. It would be important that these standards are truly minimal to avoid the descent into prescription described above.

Being minimal, these standards should be non-binding to the extent that, in the event of dispute or challenge (by customers, the ombudsman or the regulator), service providers are afforded the opportunity demonstrate they have acted to a higher standard of conduct than those required by the minimum standard. The test of exceeding the minimum standards would be judged from a consumer’s perspective.

If minimum standards are adopted, a **requirements clause** should be added to the duty. This clause would specify that mere compliance with minimum standards does not, in its own right, confirm compliance with the duty. In other words, even if a service provider puts in place systems and processes to ensure compliance with the minimum standard, it is still required to satisfy itself that none of its actions have the effect of breaching the duty.

### 3.3 A fit for purpose framework

The discussion paper explains reform is required to ensure the consumer protection framework remains “fit for purpose”. The paper does not expressly define what this term means but various references suggest a fit for purpose framework:<sup>39</sup>

...will capture new energy products and services that emerge in the energy transition

...can support customer uptake of new energy products and services

...improves the experience for all customers

The approach proposed in the discussion paper is self-evidently focussed on achieving the first of these outcomes (see Part 1 of this submission). The discussion paper does not explain how the second and third outcomes will be achieved. It seems the AER considers achieving the first outcome will deliver the second and third outcomes perform. For the reasons outlined in Part 1 of this submission, this result is far from guaranteed.

In contrast, the duty proposed in this submission directly focuses on the second and third outcomes identified by the AER as meeting a fit for purpose framework.

At this point, it is necessary to highlight that the first outcome identified above reflects a desirable outcome for the regulatory framework. In contrast, the second and third outcomes focus on delivering outcomes for consumers. Surely this suggests that the duty-based approach to regulation described in this submission would better serve consumers while also more clearly fulfilling the AER’s desire to be a consumer-centred regulator.

#### ***Consistency with the NERO***

The national energy retail objective (NERO) states that the objective of the national energy retail law is:<sup>40</sup>

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

There is no conflict between the duty and the NERO, indeed, the duty directly promotes efficiency in the “operation and use of energy services” in ways that cannot be claimed by either the current framework or the proposed approach outlined in the discussion paper.

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<sup>39</sup> AER discussion paper, p.1, 2 & 4, respectively.

<sup>40</sup> *National Energy Retail Law (South Australia) Act 2011*, s.13

### ***Responding to predictable resistance to the duty***

There will, predictably, be many voices decrying the duty for imposing unreasonable cost on industry (and therefore consumers). Many eye watering claims will be made about the costs of reform, regulatory burden, red tape and so on. Few of these claims will be substantiated but all will need to be interrogated against a clearly outlined counterfactual.

As Parts 1 and 2 of this submission make clear, a successful energy transition cannot be taken for granted. Different regulatory approaches need to be assessed realistically against the likelihood that they will support a successful transition for consumers. At the same time, the consequences of an unsuccessful transition for consumers must be identified and quantified wherever possible. Many consumer harms will defy quantification, yet these will probably be the harms that most severely erode ongoing community confidence in the ability of a market-based approach to deliver fair outcomes for energy consumers.

The discussion paper clearly outlines the market complexity that is expected to emerge in the years ahead. There is plenty of evidence from the behavioural sciences that complexity impairs decision making. Alternative regulatory approaches to the duty cannot simply assume that some *deus ex machina* will emerge to assist consumers navigate this complexity. After two decades of retail energy market competition, it is clear there is no 'ghost in the machine' waiting to be released. This is precisely why the duty is required.

When considering alternative approaches to the duty, rigorous analysis needs to be undertaken to identify how service providers will construct their relationship with customers to maximise their own profits. With hindsight, the so-called "loyalty tax" of the past 20 years was highly predictable – if only someone had asked the right questions when the regulatory framework was being established. History must not be allowed to repeat itself. Questions need to be asked now about the likely evolution of the consumer-facing market under different regulatory scenarios and based on *realistic* assumptions about consumer behaviour.

Likewise, these assessments cannot simply assume the regulator will be able to respond quickly to harmful developments in the consumer-facing market. Nor can the counterfactual scenario assume the polity would never let "bad politics get in the way of good economics". Indeed, it cannot even assume "good economics" is, in fact, good economics.

Assumptions about how consumers, service providers, regulators and policy makers will act during the energy transition must not be allowed to sit silently in the background – hidden, unchallenged and shielded from public scrutiny.

This submission unapologetically recognises the duty will require service providers to invest in different cultures and behaviours to those that have operated over the past 20 years.

The question for service providers is why they should be trusted to deliver the energy transition if they are unwilling to embrace the responsibilities embodied in the duty. The question for the regulator in conducting this review is why it, or the community, should expect anything less from service providers than the responsibilities embodied in the duty.

### 3.4 Completing a modernised consumer protection framework

The consumer protection 'ecosystem' consists of many other components which will need to be modernised as part of a move to a duty-based framework. Other relevant components of the regulatory framework include:

- Defining a 'customer' for the purpose of the duty
- Payment difficulty (or Hardship) arrangements
- Disconnection & Wrongful disconnection
- Responding to consumer vulnerability
- External Dispute Resolution
- Compliance and Performance reporting
- Enforcement measures
- A default best interest

**Appendix B** briefly notes some of the matters that will need to be considered when modernising these other components of the consumer protection framework.

## Customer sovereignty & System primacy

This submission presumes that, in supporting a market-based energy transition, the AER (and ESB) support the sovereignty of customers – that is, each customer is free to determine the mix of services and products that reflect (or most closely reflect) their best interests; and service providers attempt to respond as best as possible to those interests at the lowest sustainable cost (including search and transaction costs).

In the current context, a market-based energy transition implies the role of the energy market regulators is to facilitate the processes of discovery and matching, rather than seeking to steer the market towards a particular system-wide outcome.

Surprisingly, the discussion paper is a little ambiguous in this regard. There appears to be a tension between:

- **customer sovereignty** where customers decide what they require and the market responds by delivering the energy system that meets those interests, and
- **system primacy** where the regulatory framework seeks to steer the market toward a particular energy system outcome and consumers make their decisions in response.

In some places, the discussion paper appears to unequivocally support customer sovereignty with customers autonomously determining how they participate in the energy market. For example, when describing the ESB's DER implementation place, the paper identifies that:<sup>41</sup>

consumers [should] have access to secure, reliable, affordable, and sustainable energy **no matter how they participate** in the energy market [emphasis added]

Elsewhere, the discussion paper appears to lean toward system primacy when it suggests there is a predetermined definition of success for the transition – and therefore, the role customers are required to play to realise that success. For example:<sup>42</sup>

The **successful transition** of the energy market and the integration of DER into the NEM is heavily dependent on consumer uptake of DER. **Consumers need to be positioned** to readily participate and be **actively encouraged to engage** with new products and services. [emphasis added]

A successful transition is defined as:<sup>43</sup>

an estimated reduction in electricity system costs of \$6.3 billion over the next 20 years

where the paper expects those reduced costs will benefit all consumers.

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<sup>41</sup> AER discussion paper, p.9

<sup>42</sup> AER discussion paper, p.6

<sup>43</sup> AER discussion paper, p.5

These messages are somewhat inconsistent. They appear to suggest customers will 'do as they do' and the market will respond as efficiently as possible (customer sovereignty), while at the same time suggesting customers must be guided to act in a way that minimises overall system costs (system primacy).

Perhaps these conflicting messages reflect the energy transition's dislocation of many of the principles that have guided economic regulation since the national energy market was liberalised. Perhaps it is just a matter of unclear drafting.

In any event, the AER should reaffirm its commitment to customer sovereignty as this review into the consumer protection framework progresses.

## Completing a modernised consumer protection framework

Numerous other components of the consumer protection ‘ecosystem’ will need to be reconsidered as part of a move to modern, duty-based consumer protection framework. The purpose of this section is simply to identify some of the main components that will require consideration.

### ***Defining a customer for the purpose of the duty***

While the above description of the duty identifies to whom the duty applies, it leaves open the question of how a customer is identified for the purpose of the duty. Till now, the regulatory framework has defined a relevant customer based on an upper limit on annual energy consumption. Given the multidimensional nature of future contracts (see Part 2) this definition of a relevant customer may need to be revisited.

### ***Payment difficulty (or Hardship) arrangements***

Till now, the only option for retailers to address payment difficulty has been to offer customers more accommodating payment arrangements. In the future, service providers will *potentially* have access to a great suite of options to address payment difficulty. Most obviously, this could involve remotely limiting a customer’s load (as well as energy supply and storage facilities where available) when it is most profitable for the service provider to do so. Such actions could cause considerable detriment to the consumer.

### ***Disconnection & Wrongful disconnection***

Disconnection or de-energisation of a property for non-payment has, till now, been an ‘all-or-nothing’ measure open to energy retailers.<sup>44</sup> In the future, service providers will have a wider array of measures open to them. This could potentially and perversely see one service discontinued without fully disconnecting the property, but which leads to an increase in the payments required to the service provider (or other service providers where there are multi-provider contracts in place – as envisaged in the discussion paper).

### ***Vulnerability***

In recent years, energy market regulators have paid increasing attention to pre-emptively assisting customers experiencing vulnerability – ensuring they are “offered timely and effective supports that work for both consumers and energy businesses, improving energy affordability, helping consumers stay connected and reducing energy businesses’ cost to serve.”<sup>45</sup> The multi-dimensional contracts and potentially multi-provider service models of the future energy market will present challenges to how this objective is operationalised.

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<sup>44</sup> *National Energy Retail Rules* (Version 24) Rule 119(1)(c)

<sup>45</sup> AER (2021) *Consumer Vulnerability Strategy. Draft for consultation* (December) p.6

### ***External Dispute Resolution***

A key pillar of the retail energy market reforms of the past 20 years has been customer access to 'free' and independent external dispute resolution (provided by jurisdictional Ombudsman schemes). The remit of these schemes has already been tested by the emergence of new services and products, and novel business models (eg. embedded networks). The Ombudsman schemes' authority to resolve disputes will be further tested with the emergence of multi-dimensional contracts and multi-provider service models.

### ***Compliance and Performance reporting***

Till now, assessing retailer compliance with a prescriptive set of regulatory obligations has been a relatively straightforward exercise. Likewise, measuring the performance of a one dimension market (see Part 2) has not been a particularly taxing exercise for regulatory bodies. Neither of these conditions – prescriptive regulatory obligations and a one dimension market – will be sustainable or sustained in the future.

### ***Enforcement measures***

In recent years, retail energy market regulators have been given expanded enforcement powers to deal with non-compliance with their prescriptive regulatory obligations. A non-prescriptive duty will require considerable re-examination of the powers and options available to regulators to take action against a broader cohort of service providers.

### ***A default best interest***

The duty is predicated on service providers ascertaining a customer's best interests. This may not always be possible which suggests default arrangements may be required. Some general principles would inform how a default best interest operates. For example, default best interest contracts would:

- be the simplest contracts in the market, and
- require the customer to satisfy as few conditions as possible under the terms of the contract, and
- not take financial advantage of the customer.

These principles should apply to first time customers and customers amending or changing their energy service arrangements.

### **About the author**

**Dr Ron Ben-David** currently holds a Professorial Fellowship with the Monash Business School and Monash Sustainable Development Institute. He is also the principal of Solrose Consulting providing policy, regulatory and governance advice across various (utility) sectors.

Between 2008 and 2019, he served as full-time chair of the Essential Service Commission (Vic) where he led far-reaching reforms in many areas of regulation administered by the commission. Prior to his appointment to the commission, Ron was a Deputy Secretary in the Department of Premier and Cabinet (Vic) and headed the secretariat for the national Garnaut Climate Change Review.

Ron is a board member at Climate Works Australia, the Consumer Policy and Research Centre, and the Regulatory Policy Institute (A-NZ). He is an advisory board member for the Centre for Market Design and Customer Stewardship Australia. Ron is a member of the AER's Consumer Reference Group and the Consumer Challenge Panel.