



16 December 2022

Mr Mark Feather  
General Manager, Strategic Policy and Energy Systems Innovation  
Australian Energy Regulator  
[AERpolicy@aer.gov.au](mailto:AERpolicy@aer.gov.au)

Dear Mr Feather

**Review of consumer protections for future energy services.  
Options for reform of the National Energy Customer Framework**

The AER's options paper is to be commended for reframing, in terms of consumer harm, the challenges presented by the rapidly evolving energy market. Such thinking has simply not been entertained in the past. As the options paper notes, mitigating the risk of consumer harm is a central regulatory challenge because consumer trust is central to a successful energy transition.

New problems require new ways of thinking. The options paper takes a very significant step forward on redefining the regulatory challenge in terms of consumer harm, but its response to the challenge of mitigating that harm remains largely limited to traditional ways of thinking. These limits are most apparent in chapter 1, and models 1 and 2 in chapter 2.

This submission responds in some detail to chapter 1 of the options paper because that is where the AER outlines its conceptual framework. It is crucial the AER invest upfront in a robust intellectual framework because failure to do so will lead to the wrong approach being implemented.

In light of my earlier submission, it will come as no surprise that I strongly favour model 3. The AER will be in for a 'world of pain' under the other two models. These two models will also require a vast expansion in the regulatory apparatus of state (including a substantial expansion of the AER). Perhaps most importantly, however, unlike model 3, models 1 and 2 put the regulator rather than customers at the centre of the regulatory model. It's time to move on from this way of thinking about regulatory design.

Unfortunately, I have once again failed to make a short submission to the AER, but the matters raised by the options paper are too important to ignore. This submission builds on my earlier submission to the AER as well as a recent conference paper, *Minimising consumer harm for a successful energy transition* (references and links are provided below).

I would, of course, welcome the opportunity to discuss with you any of the matters raised in this submission or my other papers.

I wish you and the team a very enjoyable and restful festive season.

Yours sincerely



**Dr Ron Ben-David**

Professorial Fellow

Monash Business School

[ron.ben-david@monash.edu](mailto:ron.ben-david@monash.edu)

Monash Business School  
Monash University  
PO Box 197, Caulfield East, VIC 3145, Australia  
Building S9, 26 Sir John Monash Drive  
Caulfield East, VIC 3145, Australia  
Tel +61 3 9903 [XXXX]  
[www.monash.edu](http://www.monash.edu)

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## References

This submission refers to four primary sources.

**AER: “Issues paper”** (April 2022)

Full title:

*Retailer authorisation and exemption review. Issues paper*

Available at:

<https://www.aer.gov.au/system/files/AER%20-%20Retailer%20authorisation%20and%20exemption%20review%20-%20Issues%20paper%20-%20April%202022.pdf>

**RBD: “Original submission”** (27 May 2022)

Full title:

*Energy market uncertainty, consumer protection, and a new duty of care. A response to the Australian Energy Regulator’s retailer authorisation and exemption review*

Available at:

<https://www.aer.gov.au/system/files/Ron%20Ben-David%20Submission.pdf>

**AER: “Options paper”** (October 2022)

Full title:

*Review of consumer protections for future energy services. Options for reform of the National Energy Customer Framework*

Available at:

<https://www.aer.gov.au/system/files/AER%20-%20Review%20of%20consumer%20protections%20for%20future%20energy%20services%20options%20paper%20-%20October%202022%2814535486.1%29.pdf>

**RBD: “Conference paper”** (17 November 2022)

Full title:

*Minimising consumer harm for a successful energy transition*

Available at:

<https://www.linkedin.com/feed/update/urn:li:activity:6999951285412110336/>

## Introduction

This paper responds to the options paper released by the AER in October 2022. The options paper followed an earlier issues paper released in May 2022.

The options paper takes an important step forward in the regulatory dialogue. It reframes upholding of consumer confidence in the energy market as central to the regulator's task, and it recognises that this requires mitigating the risk of harm to consumers. The options paper identifies that the risk of harm in the consumer-facing energy market will escalate as the market becomes increasingly more complex.

Chapter 1 of the options paper explores the significance of this emerging complexity and the risk of harm from a number of perspectives. so, it never resolves what harm means or how the regulator should treat with the occurrence of harm. Chapter 2 offers three models for the future regulation of the consumer-facing energy market. Surprisingly, chapter 2 does not examine how each of these model responds to the matters raised in chapter 1. This is an odd omission.

The chapters in this paper align with the chapters in the options paper.

Chapter 1 of this paper addresses five analytical devices described in the first chapter of the options paper. In doing so, it seeks to examine how (or indeed, whether) these devices provide a useful framework for thinking about the challenges now facing consumers; or how the regulator might reposition its role in light of those challenges. This paper suggests that while these devices may have had some merit in the past, they are of limited use in defining the regulatory challenges that lies ahead.

Chapter 2 of this paper begins with a few general observations about the three models and the overall approach taken in the options paper. Responses are then provided to most of the questions posed in the options paper. In short, if the consumer facing energy market evolves as rapidly, innovatively and dynamically as the pundits currently expect, then it is difficult to see how models 1 and 2 can effectively or efficiently provide the type of protection discussed in chapter 1. This paper strongly supports the approach outlined in model 3 but urges the AER to avoid a drift into prescription and process. Doing so would negate the purpose, impact and benefits of model 3.

New problems require new ways of thinking.

The paper concludes with a brief reflection on how the Financial Conduct Authority (UK) is reforming its approach to regulation, and its imminent implementation of a consumer duty. The AER is urged to draw inspiration from the FCA's approach and its preparedness to be **bold, imaginative, confident and unapologetic** in the pursuit of a modern approach to regulating a complex consumer market.

## 1. General Comments

This chapter responds to chapter 1 of the options paper. This discussion was not meant to be as long as the chapter in the options paper, but the matters raised by the options paper are too important and interesting to disregard.

If there were a central theme in this chapter, it would be something like: Applying an old way of thinking to a new type of problem will produce an old type of solution.

The AER is to be commended for reframing the challenges presented by the rapidly evolving energy market in terms of consumer harm. Such thinking has simply not been entertained in the past. It represents an important acknowledgement that the task now facing the regulatory community is fundamentally different from anything that has been faced to date. This acknowledgement, however, contrasts with chapter 1's response to that challenge. In thinking about how to respond to the unfamiliar notion of harm, chapter 1 retreats to familiar regulatory concepts and analytical frameworks.

This chapter explores five examples where reversionary thinking will constrain the regulatory response to the emergent complexity of the consumer facing energy market.

Section 1.1 explores the various objectives the options paper appears to outline and explains why a traditional 'cost-benefit' approach to regulation will fail to mitigate consumer harm if the regulator has other objectives. An alternative approach is suggested.

Section 1.2 examines the options paper's emphasis on regulating products and services. The discussion suggest that a more dynamic, responsive and modern form of regulation would see the regulator focussing on the customer experience – that is, focusing on consumer outcomes rather than some of the inputs to those outcomes.

Section 1.3 argues the notion of essentiality was easily attached to electricity supply in the past because supply was binary. This meant there was no need for regulators to consider the purposes for which electricity was used. In the future, it will be the control over the local use of electricity that will matter when considering consumer harm. For all intents and purposes, essentiality is an abstract and depersonalised alternative to describing harm. If consumers are indeed at the centre of the AER's thinking, then it should focus on harm.

Section 1.4 contends that because the options paper focuses on products and services, it misses the single biggest risk to consumers –namely, "the risk of risk itself". This idea represents the transfer of risks to customers who either do not understand the risks they are taking or who are ill-equipped to manage those risk. Once the 'risk of risk itself' is taken into account, it exposes the limits of traditional risk assessment frameworks and conventional regulatory mitigation strategies.

Section 1.5 focuses on the inherent limits of a regulatory response to consumer harm that relies on monitoring and reporting – particularly if the consumer-facing energy market evolves as dynamically as is now widely expected. Four undesirable consequences are highlighted. All efforts should be made to avoid these consequences.

## 1.1 Fit for purpose

The options paper rightly identifies the need to reform the regulatory framework to “ensure it will be fit for purpose for future energy services”.<sup>1</sup> The paper does not, however, provide a single, clear statement of the ‘purpose’ which it is pursuing.

The paper makes a number of statements about the review that would also seem to reflect the AER’s thinking about the purpose of the consumer protection framework.<sup>2</sup>

*The objectives of the review which are to ... develop reforms to mitigate potential consumer harms emerging from new products and services*

While this statement is narrowly focussed on mitigating harm, the options paper also suggests a somewhat broader objective:<sup>3</sup>

*First and foremost, this review is concerned with consumer outcomes*

where the relevant outcomes appear to include “understand[ing] how consumers will engage with new products and services, what the points of friction and potential harms are, and how we can minimise these and promote good outcomes for consumers.”<sup>4</sup>

A couple of pages later, the options paper appears to suggest the framework is central to pursuing an even higher purpose, namely, the maintenance of consumer trust.<sup>5</sup>

*Without adequate protections in place, there is a risk consumers could lose trust in the sector if they are exposed to harms from new products and services and may decide these harms outweigh the benefits of participating in new energy markets.*

On p.4, the options paper refers to a number of “key factors” the AER needs to consider.

- essentiality of a product or service to the supply of electricity
- regulatory burden and its impact on innovation and the cost of service
- competitive neutrality between traditional retailers and new energy providers

On the following page, the options paper appears to suggest other factors will also inform the AER’s considerations, namely:

- encouraging market innovation
- supporting consumer uptake of new products and services, and
- ensuring the framework is flexible and continues to be effective as the market evolves.

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<sup>1</sup> Options paper, p.1

<sup>2</sup> *ibid*, p.4

<sup>3</sup> *ibid*, p.5

<sup>4</sup> *ibid*, p.4

<sup>5</sup> *ibid*, p.7

Clearly, all these statements are related in one way or another, but they are different. The paper does not make clear the relative standing of these different elements of purpose. Unless the purpose (in 'fit for purpose') is clearly and unequivocally stated, different parties will continue to interpret the statements in this paper in ways that best satisfy their individual interests. In doing so, they will place the AER in a position of having to judge what weight to place on those different interests.

My conference paper makes clear the purpose of the regulatory framework (including its consumer protection elements) must be to **ensure consumers are not exposed to unacceptable risks, namely, risks they are not well-equipped to manage**. The conference paper discusses how this would be achieved. Some further thoughts are shared below.

This suggested purpose would seem to be compatible with the AER's intentions around building trust and "mitigating potential consumer harms". But it invites the question: What happens to other sub-purposes such as minimising regulatory burden, and encouraging innovation and consumer uptake?

The answer requires a multi-tiered optimisation problem. First, it requires evaluating what constitutes unacceptable harms to consumers. Second, the most effective and efficient regulatory mechanisms for protecting consumers from the risk of those harms should be identified. Third, having identified those regulatory mechanisms, then they can be implemented in ways that can most effectively achieve the sub-purposes. In other words, the AER should adopt a **minimax decision rule** whereby only after minimising the risk of unacceptable harmful outcomes for consumers, should the AER turn its mind to optimising its other objectives.

Given a successful energy transition is at stake (as noted in the options paper), a traditional cost-benefit analysis, as has been favoured by the AER and AEMC for many years, will result in a mishmash of regulatory mechanisms that satisfies none of the purposes identified in the options paper. It will fail, because a traditional cost-benefit analysis will not attach a cost to the loss of consumer confidence which the AER's options paper recognises is essential for a successful energy transition. Alternatively stated, cost-benefit analysis will treat the loss of consumer confidence as an unpriced negative externality. As the conference paper notes:<sup>6</sup>

*Under-pricing harm is not a trivial problem from either an economic or moral perspective. If harm is under-priced in the regulatory optimisation function, then regulatory decisions will result in too much harm being caused to consumers. Eventually and inevitably, this will become a non-trivial political problem as well.*

This is too great a risk for regulators and policymakers to take. Rarely can multiple objectives be achieved all at once. Now is not the time for wishful regulatory thinking.

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<sup>6</sup> Conference paper, p.20

## 1.2 Products and services

The options paper has continued to focus on products and services, as per the earlier retailer authorisation discussion paper. This is understandable only insofar as it is consistent with the regulatory approaches of the past, but it is far from obvious that it is an approach that can respond to the challenges of the future. For example:

- New products can be expected to come and go with much greater frequency than in the past. That is the nature of a transition. New technologies will emerge and service providers will experiment in how they utilise these technologies to offer plans to customers. At the same time, consumer preferences are unclear and even unknown (including by consumers themselves). They will need to be discovered and likely to be dynamic – changing over time as new opportunities are offered to them and as their confidence grows when engaging with new products. It is far from clear how or why the AER believes it will be able to keep up with these rapid market developments.
- Markets dynamically respond to regulation. Service providers will seek out and move into regulatory voids if they consider it is in their commercial interests to do so – that is, take advantage of ambiguities or gaps in the regulatory framework. The highly uncertain and dynamic nature of the future market will effectively make it impossible to create comprehensive regulations addressing ever-evolving products and services. Gaps and ambiguities in the regulation of products and services can be expected to grow over time, possibly exponentially. Each attempt to shut off a gap will just create new gaps. Put simply while mixing some metaphors: The AER will find itself ‘chasing its tail in a losing battle of its own making’.
- By focussing on products and services, the AER will create a system of regulatory arrangements centred on itself rather than customers. Service providers will be incentivised to focus on satisfying the regulator. In turn, this will put the regulator in the position of having to decide which products and services are in the interests of consumers. Even if we ignore the resource intensity of such processes, the underlying philosophy of such an approach reflects an old fashioned approach to regulation. It contradicts the AER’s own narrative about putting ‘consumers at the centre’. By focussing on products and services, the AER will, in effect, put itself at the centre of the energy transition.

A more dynamic, responsive and modern form of regulation would focus on the customer experience of the energy market rather than the unspecifiably large number of services and products that *might* contribute to that experience in an unspecifiably large number of ways. A modern regulatory response to the energy transition involves focusing on consumer outcomes rather than some of the inputs to those outcomes.

### 1.3 Essentiality

Up until recently, the notion of essentiality was easily attached to electricity supply because supply was binary. It was either there or it was not. There was no need to consider the purposes to which that electricity was put.

The AER's original issues paper adopted essentiality as a guiding condition for regulatory design. Essentiality's prominence remains undiminished in the current options paper. The issues paper offered a tentative definition of essentiality, albeit in a footnote.<sup>7</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.*

There is clearly a circularity problem with this proposed definition because the adjectives essential and vital are synonyms in this context.<sup>8</sup>

The current options paper does not repeat or endorse this definition, nor does it offer an alternative definition. The options paper only observes that the regulator's definition of essentiality will need to evolve:<sup>9</sup>

*[T]here is a distinct likelihood the 'essentiality' of various energy products and services will change.*

So, while the options paper highlights that there was general support for the application of an essentiality condition, no conclusions can be drawn about how each respondent interpreted the AER's discussion of essentiality. Respondents may have had very different definitions in mind when expressing support for the use of essentiality as a guiding condition. Some respondents may have assumed grid connection was the only essential element of future electricity arrangements. Other respondents may have interpreted the issues paper as signalling a much broader definition. These conflicting understandings are reflected in alternative observations reported in the option paper.<sup>10</sup>

*Many stakeholders thought the lens of 'essentiality' appropriate for determining regulatory settings for energy products and services. Some stakeholders highlighted the increasingly essential aspect of energy in supporting health, wellbeing, and everyday life.*

*Others noted the NECF should not cover consumers who opt into a contract beyond the traditional supply of energy*

As things stand so far in this consultation process, it is not clear which interpretation the AER has in mind.

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<sup>7</sup> Issues paper, p.7, footnote 13

<sup>8</sup> The proposed definition in the issues paper effectively collapses to a self-referential statement whereby "Essentiality refers to ... the provision of essential daily need." This statement does not enlighten the reader about the AER's intentions. (See Original submission pp.7-9 for further discussion)

<sup>9</sup> Options paper, p.7

<sup>10</sup> Options paper, pp.9 and 8, respectively.

While the circumstances are very different, the Swiss government is moving to restrict non-essential energy use in response to energy shortages – see Box 1. Does the AER contemplate setting thresholds for essential levels of heating and cooling? Would these thresholds depend on whether the heating or cooling unit was grid supplied or powered by appliances on site? Would the thresholds vary according to the maximum or minimum load on the electricity grid at any point in time? Would certain consumers be exempt? How would such exemptions be administered without abuse? Of course, this is just one example and it can be easily dismissed – but there are countless other examples. One thing is clear, however. **A ‘world of pain’ awaits the AER** if this is the direction in which it is heading.

But perhaps the notion of essentiality is just a distraction; a legacy of past thinking. As the options paper and my conference paper make clear, the real concern for the regulator now involves the mitigation of consumer harm.

It is also worth noting that, for all intents and purposes, essentiality and harm are two sides of the same coin. The denial of an essential services on fair terms results in harm. But whereas essentiality is an abstract and depersonalised concepts that attaches to an inanimate object (ie. product or service), harm is experienced by a person. If consumers are indeed at the centre of the AER’s thinking, then it should just focus on harm.

**Box 1: Netflix and 20 degree chill: Switzerland looks to curb energy use**

The following is an extract from an article in The Age, 5 December 2022.<sup>11</sup>

*The lowest level will see public buildings heated to no more than 20C, with people asked to limit their washing machines to a maximum of 40C.*

*Under the next level, temperatures will be lowered to 19C and streaming services will be asked to lower the resolution of videos from HD quality to standard.*

*If the situation worsens, shops will be asked to close two hours early and electric vehicles limited to essential journeys.*

*Crisis measures could see hot water disabled in public bathrooms and the use of electric leaf blowers barred.*

*Next, escalators will be stopped and outdoor Christmas lighting turned off.*

*Cryptocurrency mining would then be banned if supplies keep dropping, along with swimming pools closed and lights in sports stadiums turned off.*

*If the most extreme shortages hit, sports matches, concerts and theatre performances will be cancelled, and all leisure businesses could be forced to close.*

<sup>11</sup> Full article available at: <https://www.theage.com.au/world/europe/netflix-and-20-degree-chill-switzerland-looks-to-curb-energy-use-20221204-p5c3jy.html>

## 1.4 Risk analysis

Table 1 (p.5) of the options paper outlines 12 risk themes the AER has identified following a detailed process of engagement and analysis. The risk themes relate to products and services and, in that sense, they appear reasonable and traditional — however, the emerging energy market will be anything but traditional. As noted above, limiting the task to regulating products and services understates the complexity of the consumer experience in the consumer-facing energy market.

Because it focuses on products and services, the table misses the single biggest risk to the consumer experience, namely, ***the risk of risk itself***. In other words, the transfer of risks to customers who:

- do not understand those risks, and/or
- are ill-equipped (for whatever reason) to manage those risk.

As the options paper observes:<sup>12</sup>

*The complexity of the future energy market is likely to be overwhelming for many consumers.*

This is probably an understatement (see below). In any event, the option paper's response to this observation is to note that "industry will need to step up" and it will need to:<sup>13</sup>

*...set out clear information detailing the value proposition offered by their products and/or services, fit-for-purpose contracts with clear terms and conditions, and an appropriate level of dispute resolution when things go wrong.*

It is not clear why the AER continues to overlook 20 years of experience of known consumer behaviours in energy markets. It has been widely demonstrated that providing these resources to consumers (detailed value propositions, clear terms and conditions, and dispute resolution) does not assist them to navigate the retail energy market effectively. And that has been in an energy market of vastly simpler dimensions than the consumer facing market that is now unfolding.

The future energy market will look entirely different from the market that has prevailed for the past 20 years, but the risk analysis continues to assess risk using exactly the same intellectual framework as in the past. It is therefore inevitable that this analysis will result in regulatory responses that look very much like those implemented in the past. They did not work well then and they have no hope of working well in the future.

There is something incongruous and troubling about a regulator embracing transformation and innovation in the market it regulates, but then applying an analytic framework that will restrict its own transformation and its ability to pursue regulatory innovation.

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<sup>12</sup> Option paper, p.6

<sup>13</sup> *ibid*, pp.6-7

In the cognitive sciences, there is a bias known as ‘the curse of knowledge’. It represents a situation in which better-informed people find it extremely difficult to think about problems from the perspective of lesser-informed people. Perhaps this explains the option paper’s understatement that the complexity of the future energy market will likely be overwhelming for many consumers (cited above). There is nothing likely about it. It is a certainty.

The conference paper outlines why the future energy market will be incomprehensible for almost everyone and the implication of this incomprehensibility for regulators.<sup>14</sup>

*‘[C]omplexification’ of the energy market will shift assessment of risk and opportunity beyond human computational ability for most (if not all) consumers.*

*[The regulatory community cannot continue] to treat the limits of human computational capacity as a mere inconvenience while the consumer-facing energy market ‘complexifies’ ever faster.*

As the conference paper explains, the risks of ‘complexification’ are not limited to customers who have invested in consumer energy resources (CER). Every customer will be exposed to the transference of risks for which they are ill-equipped to manage. This means a risk assessment framework that focusses on products and services, may miss a wide suite of risks to which many (or most?) consumers will be exposed.

( Note: This concern arises because the options paper states, “This review forms part of the Energy Security Board’s (ESB) Consumer Energy Resources (CER) Implementation Plan 1 which is a reform road map designed to support the integration of CER and flexible demand into the energy market.”<sup>15</sup> )

Once **the risk of risk itself** is recognised, the limits of traditional risk assessment frameworks and regulatory mitigation strategies are exposed.

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<sup>14</sup> Conference paper, pp.13 and 17, respectively.

<sup>15</sup> Options paper, p.1

## 1.5 Monitoring and reporting

One of the stated objectives of the current review is to:<sup>16</sup>

*design a robust monitoring framework to understand impacts of the evolving market on consumers*

The options paper then explains monitoring would form part of the AER's ongoing "risk analysis of new energy products and services" and it would inform:<sup>17</sup>

*...what type of regulatory interventions, such as the introduction of new energy consumer protections or continued monitoring, are required to mitigate harms to consumers.*

For the avoidance of doubt, this submission supports an active and probing compliance and performance monitoring and reporting framework. Nonetheless, a few observations are warranted.

First, monitoring should be the last line of defence against consumer harm. As noted in the conference paper, the likelihood of harm will rapidly escalate as energy-related contracts become increasingly complicated. In reality, the eventuality of harm is as near to certain as possible.

While it is very important to monitor for the emergence of harm, if its emergence is certain, then the regulator should not avoid acting until harm is observed. The emergence of harm must be anticipated and addressed pre-emptively. To do anything else, would be to accept that harm is tolerable. If that is the case, then regulators (and policy makers) should articulate their tolerance for consumers enduring harm while they monitor and respond.

Second, the regulatory cycle for action is long. Moving from monitoring to identification of a source of harm, to consultation on the problem and options for mitigating that harm, to issuing a draft decision, then a final decision, then consulting on draft regulations and a final decision on the regulations can easily take two to three years. Then, no doubt, industry will insist it requires another two or more years to operationalise the new rules. It would not be unreasonable to expect there could be *in toto* a four or five year lag between the identification of harm and action to mitigate that harm. And of course, in the meantime, new sources of harm will be identified – each demanding its own regulatory process. It won't take long before these overlapping regulatory processes begin tripping over each other (read: very little will actually be implemented in a timely manner).

Third, companies typically report on their compliance and performance against pre-specified measures set by the relevant regulator. In other words, the regulator identifies the relevant matters of interest against which businesses must report. This means the AER would only be collecting information about sources of harm it was anticipating and it would be unlikely to detect sources of harm that do not require reporting by regulated entities. Unfortunately, because the types of harms made possible in the future energy market will

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<sup>16</sup> Options paper, p.4

<sup>17</sup> *ibid*, p.5

be innumerable, the harms monitored by the regulator will almost certainly be outweighed by the harms not monitored.

Fourth, as the previous point highlights, if it is up to the regulator to define the harms requiring reporting by regulated entities, then it places the regulator at the centre of the regulatory framework rather than the consumer – despite the AER’s efforts to become a consumer-centred regulator. As a consequence of this approach, regulated entities will focus on complying with the regulator’s reporting requirements rather than attending to the best interests of their customers (in this case, harm minimisation).

## 2. The three models proposed by the AER

This chapter responds to chapter 2 of the options paper. Section 2.1 provides some general observations while section 2.2 responds directly to the questions in the options paper.

### 2.1 General comments

Before responding to the questions posed after each of the models described in chapter 2, some general observations are warranted.

- There is a large and strange gap between chapters 1 and 2 of the options paper. While chapter 1 attempts to set out the AER's reasons for examining the regulatory framework, chapter 2 provides no discussion about how each of the three models addresses the matters raised in chapter 1. It seems as though some bridging chapters have been inadvertently omitted from the options paper.
- Although extending consumer protections and mitigating consumer harm are key themes in chapter 1, chapter 2 provides no examination of how the three models would protect consumers or mitigate harm. This may be because 'harm' remains undefined in the options paper. While analogies are not always very helpful, in this case it feels like chapter 2 is asking readers to help design a truck without telling the readers what type of goods the truck will be hauling. It is for this reason the conference paper recognises the first step in modernising consumer protections must involve the development of a 'theory of harm'.
- Despite the AER's ambitions of being a consumer-centred regulator, chapter 2 is completely silent on how models 1 and 2 would appear from the perspective of an energy consumer. At least the reader can anticipate how model 3 might improve a consumer's experience when engaging with service providers.
- Three models have been largely presented from the perspective of their implementation challenges for the AER. This can leave the reader with the impression that the options paper is primarily concerned with the AER (and its future role) – rather than mitigating harm and upholding consumer confidence in the energy transition.
- As the option paper notes, the models will require a substantial expansion in regulatory machinery. This will see the AER injecting itself deeper into the consumer-facing energy market and playing an even greater role in defining the relationship between consumers and service providers. Only model 3 provides relief from regulatory expansionism.
- If the consumer facing energy market evolves as rapidly, innovatively and dynamically as the pundits currently expect, models 1 and 2 will destine the AER to a future where it is constantly chasing new product and service developments (in the pursuit of its authorisation activities). If it is designed well, model 3 can avoid this regulatory hamster wheel.

## 2.2 Specific responses

This section offers a few initial reflections on some of the questions posed in chapter 2 of the options paper. To avoid laborious reading, the following discussion avoids repeated cross-references to the concerns described elsewhere in this paper. Nonetheless, those earlier concerns are germane and should be read together with the following comments. This submission does not respond to questions in chapter 2 regarding matters of regulatory mechanics such as the treatment of embedded networks or on-sellers.

### Model 1: Tiered conditional authorisation framework operating alongside a reduced exemption framework

#### AER questions

#### **Q1. What are your views on the policy positions and assumptions outlined for Model 1?**

The first principle in section 2.1.2 states, “the entity selling energy to a customer at a connection point ... is the primary provider of energy and loss of this service carries the greatest customer risk.” The relevance and significance of this statement appears to be explained by the second dot point (top of p.15) which refers to the action of a service provider “affect[ing] the customer’s access to energy.”

When read together, these two dot points appear to suggest the AER views the denial of access to electricity imported from the grid as the only source of consumer harm. While such a view aligns with past interpretations of essentiality, such interpretations will be left lacking in the future.

For example, consumers may be harmed if a service provider denies them opportunity to export electricity into the grid. Or, they might incur harm if a service provider over-rides a customer’s preferred use of an appliance – for example, by remotely turning down (up) the thermostat on cold (hot) day so the service provider can export more of the power stored in a customer’s battery. There are countless other examples of harm that may not be strictly limited to the inflow of electricity across the connection point.

The AER should work with interested parties and policy makers to establish a clear ‘theory of harm’ so that questions such as these are addressed before the regulatory response is designed. The conference paper explains:<sup>18</sup>

*If managing the risk of harm is a necessary condition for a successful energy transition, then the cornerstone of the new framework will need to be a **theory of harm** which identifies and assesses the nature of detriment consumers can incur from the complexification of energy market contracts. This theory would be a consumer-centred analysis showing how misjudged contracting would disadvantage consumers, financially and otherwise.*

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<sup>18</sup> Conference paper, p.15

**Q3. Do you have any comments on the AER’s suggested principles for expanding the jurisdiction of the NECF as outlined in Model 1? Please provide details of any suggested additional or alternate principles.**

The following response focuses on the first dot point in section 2.1.1 which outlines the more conceptual elements of model 1 – namely, access to energy, access to competition and energy interoperability.

- As noted in the response to question 1, under future energy contractual arrangements, the denial of access to energy may not be the only source of consumer harm.
- What constitutes “energy needed for health and wellbeing” is a question fraught with ambiguity and value judgements. At a minimum, these are not judgements that can be delegated to a regulator to make.
- In response to the inevitable complexity of the emerging consumer-facing energy market, ‘consortia’ of service providers may find it beneficial to cooperate to create a bundled service offering – for example, involving a traditional retailer partnering with a data analytics company, an onsite energy management service and a leasing or financing company. Such bundled offerings may offer very attractive consumer benefits but will presumably limit or prevent the customer from ‘defecting’ to another service provider for one of the sub-elements of the bundled arrangement. It is not clear what the AER has in mind when it comes to “access to competition” and “energy interoperability”. Is the AER suggesting service bundling should be prohibited despite the potential consumer benefits?

**Model 2: Authorisation framework based on regulatory principles**

**Clarification sought**

The substantive difference between models 1 and 2 is not clear. Both appear to suggest a principles-based and tiered approach to regulation. That is, the options paper states that model 1, “envisages a principles-based element to the framework ... [extending] ... beyond the current NECF definition to include energy providers whose services and products fall under certain principles.” At the same time, model 2 is described as, “using a principles-based approach to the regulation of market entry and exit, particularly in relation to the emergence of new and future energy products and services.”<sup>19</sup>

<sup>19</sup> Options paper, pp.12 and 18, respectively.

The options paper also explains that under model 1, “*each authorisation tier could have different (but overlapping) entry requirements and obligations*”, while model 2 is described as involving, “*customer protection principles [which] could vary according to the authorisation tier*.”<sup>20</sup>

The apparent similarities in these two key design features, and the lack of any discussion about the expected operation or impact of the two models, makes it difficult to distinguish between them (or comment on their relative merits).

### **AER questions**

#### **Q5. What are your views on the policy positions and assumptions outlined for Model 2?**

The policy positions and assumptions outlined in section 2.2.2 of the options paper are self-evidently true, albeit expressed a little unclearly. That is:

- The first dot point does not need to refer exclusively to “large” retailers.
- The second dot point would be enhanced if it referred to “new and future ways of selling energy-related services”. As noted above, the denial of access to grid-supplied electricity may not be the only source of consumer harm (as the second dot point appears to imply). The AER is urged to adopt a broader principle or definition such as the one offered in my original submission. This would see energy-related services defined as:

*[A service provided by] 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.*

#### **Q6. Model 2 sets out a market entry and consumer protection framework based on regulatory principles. If Model 2 proceeds, the regulatory principles we would recommend would be based in part on the outcomes of our risk analysis and feedback from stakeholders. What do stakeholders consider these regulatory principles should be?**

See chapter 1 and section 2.1 of this submission.

#### **Q7. Are there any advantages or disadvantages to a principles-based energy framework that we have not explored here? Would a less prescriptive principles-based framework support innovation or would it create regulatory uncertainty and why?**

See chapter 1 and section 2.1 of this submission.

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<sup>20</sup> Options paper, pp.12 and 19, respectively.

## Model 3: Outcomes-based regulatory framework

### AER questions

#### **Q8. What are your views on the policy positions and assumptions outlined for Model 3?**

Section 2.3.2 of the options paper outlines the policy position and assumptions underpinning model 3. The first three policy positions are axiomatic and therefore require no further comment.<sup>21</sup> The fourth principle could be read as suggesting every service provider has a responsibility to help every customer find the most appropriate contract available in the entire market.<sup>22</sup> This was not the intention of the suggestion made in the original submission.<sup>23</sup>

For the purposes of the options paper, it would be more appropriate to state this policy position in terms such as:

the onus should be on the service and/or product provider, given it has chosen to offer an energy-related service to a customer, to determine, before entering a contract with a customer, whether the provider's offering can be reasonably expected to benefit the customer in the customer's circumstances.

#### **Q9. How practical and effective do you think an outcomes-based regulatory framework would be?**

On page 22 of the options paper, the AER refers to base- and flexible obligations but does not explain what these obligations might look like or why the AER considers it would be necessary to establish such obligations. The options paper does, however, state: "the obligations would focus on consumer outcomes," noting, "This approach has similarities to the new 'Consumer Duty' created by the UK Financial Complaints [sic] Authority [FCA]."

It is crucial to note that the avoidance of prescriptive regulatory obligations is a central plank in the FCA's approach to implementing a consumer duty. The FCA's primary objective is to create a regulatory environment that:<sup>24</sup>

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<sup>21</sup> The first three policy positions outlined in section 2.3.2 are: (i) the energy retail market is in a process of transition and the effects of new energy products are unknown, (ii) prescriptive legislation is difficult to future proof; outcomes-based legislation will be more flexible and adaptable, and (iii) the most important aspect of regulation is to ensure consumers receive good outcomes.

<sup>22</sup> The fourth policy position in section 2.3.2 reads: "the onus should be on the service and/or product provider, given they have chosen to participate in the energy market, to assist customers in navigating the new market and to ensure any outcome is beneficial to the customer."

<sup>23</sup> Original submission, p.21

<sup>24</sup> Financial Conduct Authority (2022) *A new Consumer Duty Feedback to CP21/36 and final rules. Policy Statement. PS22/9* (July). Paragraph 1.14. Available at: <https://www.fca.org.uk/publications/policy-statements/ps22-9-new-consumer-duty>

*...sets a higher, clearer standard by requiring firms to ensure their products and services are fit for purpose and offer fair value, and to help consumers make effective choices or act in their interests.*

This objective supports the FCA's desired market outcome in which firms take responsibility for their customers' experience.<sup>25,26</sup>

*[F]irms would need to take responsibility for judging whether their conduct serves consumers' interests and delivers good outcomes.*

It is for these reasons that the FCA avoids prescriptive detail when outlining the four consumer outcomes it has identified and which have now been proposed in the AER's options paper.<sup>27</sup> When the FCA describes these four consumer outcomes, it does so only in terms of **reasonable expectations rather than in terms of prescriptive obligations**.

The four consumer outcomes are described as follows by the FCA.

### Products and services

*We want all products and services for consumers to be fit for purpose. We want them to be designed to meet the needs, characteristics and objectives of a target group of customers and distributed appropriately.*<sup>28</sup>

### Price and value

*We want all consumers to receive fair value. Value is about more than just price, and we want firms to assess their products and services in the round to ensure there is a reasonable relationship between the price paid for a product or service and the overall benefit a consumer receives from it.*<sup>29</sup>

### Consumer understanding

*We want firms' communications to support and enable consumers to make informed decisions about financial products and services. We want consumers to be given the information they need, at the right time, and presented in a way they can understand.*<sup>30</sup>

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<sup>25</sup> Financial Conduct Authority (2021) *A new Consumer Duty. Consultation paper. CP21/13* (May). Paragraph 3.13. Available at: <https://www.fca.org.uk/publication/consultation/cp21-13.pdf>

<sup>26</sup> The FCA is careful to explain firms' responsibilities do not derogate from consumers' responsibilities, but act to support the exercise of the latter. For example, see paragraph 3.15 and 3.25 in: Financial Conduct Authority (2021) *A new Consumer Duty. Consultation paper. CP21/13* (May). Paragraph 3.13. Available at: <https://www.fca.org.uk/publication/consultation/cp21-13.pdf>

<sup>27</sup> Options paper, p.22

<sup>28</sup> Financial Conduct Authority (2022) *A new Consumer Duty Feedback to CP21/36 and final rules. Policy Statement. PS22/9* (July), paragraph 6.1

<sup>29</sup> Ibid, paragraph 7.1

<sup>30</sup> Ibid, paragraph 8.1

## Consumer support

*We want firms to provide a level of support that meets consumers' needs throughout their relationship with the firm. This means firms' customer service should enable consumers to realise the benefits of the products and services they buy and ensure they are supported when they want to pursue their financial objectives.<sup>31</sup>*

Like the FCA, the AER should avoid prescription. By focussing on the consumer outcomes it expects service providers to deliver, rather than attempting to regulate those outcomes or the inputs to those outcomes, the AER can deliver:

- a modern, flexible and responsive framework for protecting consumers from poor outcomes due to decision they are ill-equipped to make
- a model of regulation that focusses on minimising consumer harms rather than operationalising regulatory processes, and
- a regulatory framework that is genuinely consumer-centric, rather than regulator-centric.

**Q10. If Model 3 proceeds, the regulatory principles we would recommend would be based in part on the outcomes of our risk analysis and feedback from stakeholders. What regulatory principles do you think Model 3 should be based on?**

See chapter 1 and section 2.1 of this submission.

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<sup>31</sup> *ibid*, paragraph 9.1

## CONCLUSION

If the energy market is traversing a once-in-a-generation technological transition – fundamentally altering how consumers will participate in that market – then it is reasonable to presume the regulatory framework is also confronting a fundamental reform challenge.

The AER is to be commended for reframing the regulatory challenge posed by the energy transition – that is, setting it within the context of mitigating consumer harm. Such thinking has simply not been entertained in the past. While the notion of consumer trust and confidence in the energy market has always featured in the regulatory dialogue, the response has always been the same – namely, the need for improved product disclosure, better educated consumers and more shopping around. *Yeah, nah.* The AER's review of the consumer protection framework has the potential to change all of that.

The options paper recognises the complexity of the emerging energy market and the new (dare we say, unprecedented) challenges and risks this will pose for consumers. Nonetheless, much of the options paper seeks to understand these new challenges by using the conventional tools of regulatory analysis. Not surprisingly then, two of the models it proposes appear to rely on a very traditional view of consumers' place in the energy market.

In this sense, much of the options paper is limited, tentative and even apologetic in its approach. It does not need to be this way.

The Financial Conduct Authority (UK) is reforming how it regulates a different but similarly complex and rapidly evolving consumer-facing market. The AER should draw inspiration from the FCA's willingness to be bold, imaginative, confident and unapologetic in the pursuit of a modern approach to regulation.

A consumer duty (by whatever name it goes) not only recognises, but also embraces, the limits of prescriptive regulation. In doing so, it liberates the regulator. It liberates the regulator from having to decide *ex ante*, and in all instances, which outcomes (or processes) are in a consumer's best interests. The duty holds service providers responsible for good consumer outcomes. It denies service providers the refuge offered by frameworks which merely focus on compliance with prescriptive obligations. A consumer duty places consumers (and outcomes) rather than the regulator (and compliance) at the centre of the model. That's the way it *should* be. That's the only way it *can* be in the future market.

If the consumer-facing energy market evolves as rapidly, innovatively and dynamically as the pundits currently expect, then surely now is the time to pursue new ways of thinking, and new regulatory responses to new market challenges.

**Now is the time for a bold regulator. After all, if not now, when?**

### **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 and regulatory 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 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, and a member of the AER's Consumer Reference Group and Consumer Challenge Panel. In July 2022, Ron was appointed to the Victorian Gambling and Casino Control Commission as deputy chair.