Review of consumer protections for future energy services

Options for reform of the National Energy Customer Framework

October 2022

AUSTRALIAN ENERGY REGULATOR

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1 Introduction and background to the options paper

1.1 Introduction

The purpose of this options paper is to seek stakeholder views on 3 potential reform options to update the energy consumer protection framework to ensure it will be fit for purpose for future energy services. This paper follows our issues paper released in April, which commenced public consultation for the 'Retailer authorisation and exemption review'. In response to stakeholder feedback and in recognition of this review's role in safeguarding energy consumers, we have renamed it 'Review of consumer protections for future energy services'. 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.

Since the release of the issues paper, the AER has been analysing submission feedback, along with input from our risk analysis workshop in June,[2] held in conjunction with the ESB. We would like to thank stakeholders for the feedback and level of engagement we have received thus far on the review.

The 3 reform models developed by the AER take varying approaches to the key questions this review is tackling – whether and how we should regulate new energy products and services. Each model presents challenges in both development and implementation that need to be carefully considered. The models are intended to stimulate discussion and consultation on these options will support the AER to decide which model(s) to further develop and recommend. Elements of each model can be 'mixed and matched', and we are open to discussing suggested changes and 'hybrid options'.

The first section of this paper sets out:

- the background and context for the review
- our progress to date on the risk analysis of new energy products and services
- the rationale for our proposal to regulate new energy products and services
- a summary of the stakeholder feedback received in response to our April 2022 *Retailer authorisation and exemption review issues paper*
- how this review will consider embedded network issues.

The second section of the paper provides further detail on each reform model alongside targeted questions for stakeholders to consider. At a high level these models are:

- Model 1: Tiered conditional authorisation framework, with reduced exemption framework
- Model 2: Authorisation framework based on regulatory principles

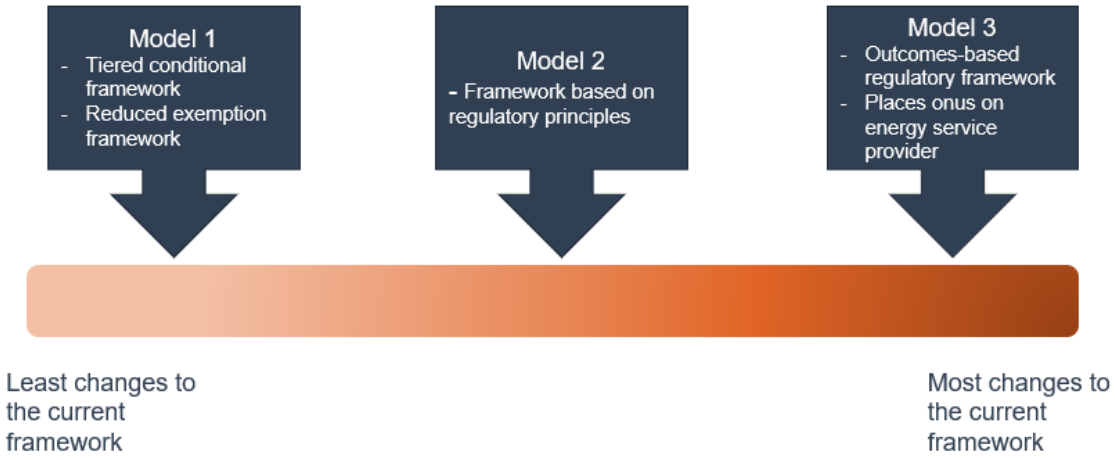
[1] Department of Climate Change, Energy, the Environment and Water, Post 2025 DER Implementation Plan – commencement of design and implementation process, Department of Climate Change, Energy, the Environment and Water, 2021.

[2] This workshop was facilitated by RPS consultants. A report summarising key feedback can be found on the AER website.

- Model 3: Outcomes-based regulatory framework.

The models range in their similarities to the current regulatory framework, as demonstrated in Figure 1.

Figure 1 Range of reform model options



We are particularly interested in stakeholder views on:

1. the AER's preliminary position that the status quo will not be fit for purpose for the future energy market and the need to regulate new products and services
2. which new products and services should be captured by the future framework
3. the policy positions and assumptions underpinning each model
4. which reform model option(s), or elements of models, the AER should continue to develop.

1.1.1 Risk analysis

To support the development of these reform models and our final recommendations, the AER has been undertaking a thorough risk analysis to identify and understand the risks future energy products and services could pose to consumers. This will support us to determine whether energy-specific consumer protections should be extended to cover new products and services not currently captured by the National Energy Customer Framework (NECF). The outcomes of the risk assessment will feed into the development of our draft and final recommendations.

Further details on the risk analysis process can be found in section 1.4.

1.1.2 Timeline for the review

The indicative timeline for the remainder of the review is set out in Figure 2 below.

Figure 2 Indicative review timeline

1.2 Submissions

Interested parties are invited to make written submissions to the AER by close of business 16 December 2022.

Submissions should be sent electronically to: AERpolicy@aer.gov.au

Alternatively, you may mail submissions to:

Mark Feather
General Manager, Strategic Policy and Energy Systems Innovation
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

We ask that all submissions sent in an electronic format are in Microsoft Word or other text readable document form.

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. We will treat submissions as public documents unless otherwise requested. All non-confidential submissions will be placed on the AER's website. For further information on the AER's use and disclosure of information, see the ACCC/AER Information Policy.

We request that parties wishing to submit confidential information:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

If you have enquiries about this paper or lodging a submission or would like to meet with us to discuss issues raised in this paper, please contact the AER Policy Development team on 1300 585 165 or AERpolicy@aer.gov.au.

1.3 Background to review

The 'Review of consumer protections for future energy services' is a key component of the Energy Security Board's (ESB) Consumer Energy Resources (CER) implementation plan. As outlined in our April issues paper, the review is concerned with understanding the evolving energy market and designing a fit-for-purpose regulatory framework to ensure consumers are adequately protected as new energy products and services emerge. The issues paper outlined the objectives of the review which are to:

- identify the gaps in the current consumer protection framework likely to emerge as the energy market evolves
- develop reforms to mitigate potential consumer harms emerging from new products and services
- design a robust monitoring framework to understand impacts of the evolving market on consumers.

The paper detailed how the NECF operates, including existing and emerging challenges with the authorisation and exemption frameworks, the evolution of the energy market and emerging energy products and services, and potential regulatory reforms to address these challenges. It also highlighted some key factors we will need to consider as we develop our recommendations, including:

- essentiality: is a product or service essential or does it impact on the essential supply of energy?
- regulatory burden: will regulation stifle innovation and/or how will costs be passed on to consumers?
- competitive neutrality: what is a fair balance between the obligations placed on traditional retailers versus new energy providers?

This next stage of the review will continue to interrogate many of the questions and issues raised in the issues paper and asks for stakeholder feedback on 3 key questions:

1. **What protections do consumers need to effectively engage with the future energy market?** First and foremost, this review is concerned with consumer outcomes. When designing a fit-for-purpose regulatory framework for the future we need to understand 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.
2. **Who should be regulated in the future energy market?** Currently, the NECF regulates entities that sell energy to consumers at premises. In the future, we are likely to see providers offering products and services that don't involve the sale of energy. We need to determine whether these providers should be captured by the future regulatory framework.
3. **How and when are energy providers regulated?** Once we determine who should be captured by the future regulatory framework, we need to then establish the obligations that should apply and in what circumstances they apply. This could vary depending on the type of product or service being offered by a provider and the types of consumers they sell to.

These questions are complex and require thoughtful consideration, meaningful consultation with stakeholders and a thorough risk analysis to ensure we strike the right balance between encouraging market innovation and supporting consumer uptake of new products and services. We can learn lessons from the current framework and what has and has not worked but looking ahead to the future energy market remains difficult. We can make certain assumptions about the types of products and services that will emerge and how consumers are likely to engage with the market, but there are still many unknowns. This means we need to design a regulatory framework with inbuilt flexibility to ensure it can continue to be effective as the market evolves.

1.4 Risk analysis of new energy products and services

As part of this review, the AER is undertaking a thorough risk analysis of new energy products and services to identify the risks they may pose to consumers. This will support us to determine what type of regulatory interventions, such as the introduction of new energy consumer protections or continued monitoring, are required to mitigate harms to consumers. This process has involved:

- holding stakeholder workshops in collaboration with the ESB and consultants RPS to identify the risks that could occur when consumers engage with new products and services
- identifying risk 'themes' from risks that are likely to occur across many new energy products and services (these are listed in Table 1 below)
- undertaking customer journey mapping across various use cases to understand at which stage in a customer's engagement with a product or service the risks are likely to occur
- analysing existing protection measures, such as the Australian Consumer Law (ACL), to understand how well the identified risks will be mitigated if they fall outside of the NECF
- analysing the likelihood of risks occurring and their potential consequences
- exploring how other jurisdictions around the world are treating the question of whether to regulate new energy products and services to understand if there are potential learnings we can apply to this review.

Table 1 Risk themes identified through stakeholder consultation

Risk theme	Description
Access	Are there barriers to consumers accessing certain products/services (for example financial, infrastructure, understandability)?
Appropriate technical standards	Are there technical standards in place to ensure technology works the way it should and is interoperable with other technologies?
Bundling	Are bundled products and services appropriate for the consumer's circumstances? Are they explained properly to reduce complexity? What happens if one component of the bundle stops working?
Contracts	Can the consumer understand the contract terms and conditions and whether they are fit for purpose for their circumstances? Consumers

Risk theme	Description
	need to be made aware of the financial commitment and any lock-in terms.
Control of assets	What are the implications for consumers if a product or service in their household is being remotely controlled by a provider? Are there checks and balances in place to ensure decisions about managing the product or service are to the consumer's benefit?
Data	How is the consumer's data being used and shared with third parties?
Dispute resolution	Do consumers have a clear pathway to dispute resolution when something goes wrong?
Hardship/change in circumstance	Are there processes in place to support consumers if their circumstances change and/or they can no longer pay their bills?
Information provision	Are consumers being provided with key information at the point of sale so they understand the value, costs, fit/appropriateness and complexity of the product or service?
Poor conduct	Are energy providers meeting sufficiently high standards of conduct to ensure consumers have trust in the sector and are not experiencing detriment resulting from poor conduct?
Reliability	Does the product or service work in the intended way?
Supplier failure	What are the implications for customers if a provider goes out of business?

We will continue to progress our risk analysis through further engagement with stakeholders and use the outcomes of this analysis, together with the feedback on the reform model options, to inform our draft recommendations. Further details of the risk analysis process and outcomes will be included in the draft recommendations paper.

1.5 Regulating new energy products and services

Based on our risk analysis, feedback in submissions, and workshops and stakeholder discussions, we are of the view that given the range and potential significance of risks that may emerge from new energy products and services, there is a strong case for extending energy specific consumer protections to these new products and services. Therefore, the proposed reform models in this options paper all involve extending the scope of the energy consumer protection framework beyond the sale of energy to premises. This means they aim to capture, to varying degrees, new energy products and services, and do not include an option to maintain the status quo.

Key reasons for this are summarised below:

- **The complexity of the future energy market is likely to be overwhelming for many consumers:** to minimise complexity and support consumers in making decisions about energy products and services that best suit their needs and lifestyle, industry will need to step up and ensure a strong degree of trust in the sector. This will require energy

providers to 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. This will likely require some degree of formal regulation.

- **The line between NECF-protected services, and non-NECF-protected services will become increasingly blurred:** with growing complexity and the bundling of products and services, consumers are unlikely to be able to distinguish between their energy services that have energy-specific protections (for example those currently captured by the NECF), and those that don't. This is likely to pose problems, for example, for external dispute resolution if only some services are covered by an ombudsman service. Further, in the future, there is a distinct likelihood the 'essentiality' of various energy products and services will change. So too will consumer expectations as to what services are regulated and to what extent (that is, what consumer protections should apply to what energy products and services).
- **The AER's risk assessment to date indicates existing protection frameworks are unlikely to be adequate:** our risk assessment identified several risks where regulatory intervention may be warranted. We are continuing to consult with stakeholders to assess the likelihood and magnitude of the identified risks. Our understanding of existing mitigations is they are unlikely to go far enough to minimise some of the risks we have identified. While the ACL will provide some protections, these are not tailored specifically to energy products and services which are likely to have a high degree of complexity. For example, the complexity of new products and services means consumers are likely to require very specific information and support to understand what they are buying at the point of sale. While the ACL provides misleading and deceptive conduct provisions, it does not set out specific information that must be provided to consumers. This means there is a risk consumers could miss out on key information to help them decide if a product or service is appropriate for their needs.
- **The uptake of new energy products and services is a vital component to realising the benefits of the broader energy system transformation:** new products and services, such as aggregation and home energy management services will support consumers to reduce their energy bills, be more energy efficient, and to be rewarded for exporting energy back into the electricity network when it is most useful for the system. If we want consumers to actively engage with the energy market by using these services and hence play a part in the energy system transformation, it is important they are supported through adequate consumer protections. 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.

While the AER is of the view there is a strong rationale for regulating new products and services, the details of how and where to draw the line (for example which types of new services and products should be regulated) remains to be determined. It may be that regulation should cover services that impact in some way on the supply of energy to a customer's premises (for example aggregation) but not energy assets (for example solar PV panels or batteries) or software that provides home energy management services.

The reform options set out in section 2 of this paper allow, to varying degrees, new energy products and services to be captured. We are interested in feedback regarding which new

energy products and services should be captured by the future energy regulatory framework and which potential reform models are best placed to ensure consumers are protected from the potential risks of these products and services.

1.6 Overview of key stakeholder feedback to the issues paper

There was significant stakeholder interest in the issues paper with 31 public submissions received. There were some clear themes across submissions, which are summarised in this section. Full submissions can be found on our website.

1.6.1 Scope and objectives of the review

Many submissions supported the focus of the AER's review on the scope of the NECF. Some submissions noted the review should ensure the development of the future regulatory framework focuses on consumer perspectives and outcomes, not just outcomes of the 'system'.

Some stakeholders raised issues with the name of the review, suggesting it should be changed to better reflect the scope of the review. Accordingly, we renamed the review to provide a more accurate description of its scope and focus.

1.6.2 Scope of the NECF

Many stakeholders were supportive of expanding the NECF to create consistency in obligations across all energy products and services. Some submissions noted the AER must first understand the degree of consumer harm before deciding whether to expand the scope of the NECF to new energy products and services.

On the other hand, some stakeholders suggested expanding the NECF may stymie innovation and the uptake of new energy services. Others noted the NECF should not cover consumers who opt into a contract beyond the traditional supply of energy. Some stakeholders advised that any reopening of the NECF should involve revisiting the whole framework and determining the essential components of energy products and services. Ensuring consumers aren't burdened with compliance costs was also highlighted as an important consideration.

The 3 reform models we have set out in this paper take varying approaches to expanding the scope of the NECF to capture new energy products and services.

1.6.3 Consumer protections

Most stakeholders agreed consumer protections should be a focus for this review. Many supported a focus on how fundamental protections such as access to external dispute resolution, effective information provision, explicit informed consent, and guards against supply interruptions and hardship policies should apply to new energy products and services. Some stakeholders reminded the AER to strike the right balance between applying such protections to new products and services and encouraging innovation in the market.

While some stakeholders were supportive of expanding the NECF to capture all emerging energy solutions, others proposed the new framework should apply an 'essentiality' lens to deciding what should be captured and that this should complement the existing ACL. Other views included reforming the ACL to provide a clear set of rights and obligations for

consumers, operators and suppliers of consumer energy resources, rather than expanding the NECF. There was also the suggestion of adopting an outcomes-based framework guided by the overarching objective that a service provider must act in the best interests of the customer. We have used this feedback in the development of model 3 in our reform options.

1.6.4 Exemption framework reform and embedded network issues

Stakeholders largely agreed that the current exemption framework requires reform. Many submissions called for tighter regulations around exempt sellers, suggesting the AER enhance its approach to exempt selling monitoring, compliance, and enforcement as well as highlighting issues such as consumer harm and limited access to a retailer of choice. The lack of access to consumer energy resources for embedded network occupants was also raised, which is likely to be a growing issue in the future. Others encouraged the AER to regulate any business model involved in the supply of energy.

Some stakeholders highlighted that embedded networks vary in business types, occupants, and ownership arrangements. These stakeholders argued that embedded networks such as holiday parks and residential land lease communities should continue to be exempted from the retail framework because they were the original intended recipients of the exemption framework, and it would be costly and not benefit the end customer for these embedded networks to be authorised as retailers. Other stakeholders also noted the benefits of the existing embedded network framework, including that embedded networks can reduce the cost of building greenfield residential buildings, which can reduce property prices.

Feedback on these issues has been considered in developing the 3 reform models. The models have varying approaches to managing embedded network issues in the future regulatory framework, with some narrowing the scope of the exemption framework.

1.6.5 Essentiality

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. A key message from submissions was that the definition of essentiality in the context of energy needs to evolve as the energy market changes.

Some submissions suggested the essentiality of a product or service depends on how it is used, with some suggesting factors such as affordability, protection from loss of supply, equitable distribution and consumers’ electricity usage should factor into whether a product or service is considered essential.

Some submissions stated that electric vehicles should not be considered essential due to the availability of other transport modes.

1.6.6 Dispute resolution

Many submissions agreed that consumers need accessible and low-cost dispute resolution for all energy services, which would help build consumer trust in the sector. Stakeholders highlighted that consumers will likely find it difficult to distinguish the ‘essential’ components of their energy services that are covered by an ombudsman scheme and those that aren’t, given they are likely to be interlinked. Many suggested that reducing the complexity of

complaints resolution and ensuring consumers have a single entity to manage energy-related complaints should be a key objective of the review.

1.6.7 Authorisation framework reform

Many submissions agreed the current authorisation framework should be amended to address existing and emerging issues, including point-in-time authorisations, market acquisitions, white-labelling and potential risks from bundling retail contracts with behind-the-meter services.

Suggested reform options varied among stakeholders. Some were supportive of introducing a tiered authorisation approach, while others suggested authorised retailers be subject to routine audits and be obliged to advise the AER of material changes to the scope of business operations. Some submissions noted any adjustments to the framework should not deter new energy market entrants and the AER should balance any increased oversight with the need for investor certainty and consumer outcomes.

1.6.8 Competitive neutrality and the cost of regulation

Many stakeholders noted the AER's reform options should be guided by the principle of competitive neutrality between traditional retailers and future energy service providers in the energy market. Stakeholders highlighted the potential imbalance of regulatory burdens placed on traditional authorised retailers compared with new energy providers. They suggested the development of future regulatory frameworks should carefully balance consumer protections, the financial burden of compliance and entry barriers for innovators.

1.6.9 Alternative forms of regulation

Broadly speaking, stakeholders were supportive of a flexible regulatory model that avoids the need for constant reform and agreed an outcomes-based or a principles-based approach could provide this in different ways.

Some submissions were supportive of giving the AER a product intervention power, similar to that granted to ASIC in the financial services industry, to target concerning behaviour within the market. There was mixed support for the use of industry codes, with some submissions arguing they can promote best practice and consumer confidence, while others were wary given industry negotiation can lead to a lowest common denominator approach.

1.6.10 Approach to using the consumer risk assessment tool

Many submissions were open to the use of the consumer risk assessment tool and customer archetypes to undertake a risk analysis. They agreed the tool is effective in developing an understanding of the potential risks from new energy products and services. However, some stakeholders noted its limitations given it is grounded in a traditional understanding of consumer protections required for the essential supply of electricity. These stakeholders argued it should be more focused on consumer circumstances, experiences and needs in the future energy market.

There was also some criticism of the tool – some submissions suggested it implies some tolerance for harm, which could pit consumers against the market. Some stakeholders wanted further information about how the outcomes of the AER's risk analysis would guide policy decisions.

1.7 Addressing issues with embedded networks

The regulation of embedded networks into the future has also been at the forefront of our thinking as we progress this review. As discussed in section 1.6.4, stakeholder feedback in submissions was overwhelmingly supportive of reforming the exemption framework.

The AER is of the view that consumers in embedded network settings may have a higher risk factor for harm and this needs to be explored and addressed. As we progress this review, a central consideration in the further development of the reform models will be ensuring consumers in embedded networks can access new energy products and services and receive adequate protections. This may require increased consumer protections for embedded network customers and/or restrictions on the availability of exemptions. In developing the future regulatory framework, we will draw lessons from past experiences and the harms that have emerged in embedded networks.

Stakeholder feedback to the issues paper also highlighted the need to take a nuanced approach to reforming the exemption framework. This is because some embedded network operators, such as caravan parks, may not have the resources to manage and comply with increased regulatory obligations (such as would result from a requirement to become an authorised retailer) resulting in minimal benefits to their end customers. The further development of reform models in this review will carefully consider these factors and how different types of embedded network operators should be treated in the future framework.

We note there is work being undertaken separately by various jurisdictions to understand and address the potential harms of embedded networks. This includes the decision by the Victorian Government to limit the creation of new residential embedded networks from 2023 and to conduct further work to determine the details of a licensing framework.[3]

While the AER's review will consider how embedded networks should be regulated in the future framework, it will not seek to address existing issues with embedded networks under the current framework. This is a distinct and complex issue and requires a separate reform process. We will consider how this issue can be progressed separate to this review.

1.8 Retailer of Last Resort (RoLR)

The AER recognises that changes to market entry will also necessitate consideration by policymakers of how to manage market exit. We have included some consultation questions in section 2 of this paper asking for stakeholder views on the implications of different reform models on the RoLR regime.

[3] Premier of Victoria, Ban Delivers Cheaper Energy And More Choice, 25 July 2022

2 Reform models for consideration

As discussed in section 1, we have developed 3 potential models that attempt, in different ways, to reform the NECF to ensure it will be fit for purpose for future energy services and the transitioning energy market. This section provides the detail behind these models and describes how each aims to address the key question of whether and how we should regulate new energy products and services.

Each model contains a discussion of its underpinning policy positions and assumptions as well as the probable pros and cons of implementation. The AER does not have a preferred model and are seeking stakeholder views on these policy positions and assumptions along with consideration of the specific consultation questions referenced throughout the models. We are also open to stakeholder feedback on 'mixing and matching' elements of each model and proposed 'hybrid' models. We note the boundaries for market entry to the models are still to be decided and will be guided largely by the outcomes of our risk analysis of future energy services.

2.1 Model 1 – Tiered conditional authorisation framework, with reduced exemption framework

2.1.1 Description

Model 1 creates a tiered conditional authorisation framework operating alongside a reduced exemption framework. It envisages a principles-based element to the framework, on which the extension of the NECF beyond the current 'sale of energy' boundary will be based. Although the transition to this proposed framework would be resource intensive in both creation and implementation, it is the model closest to the current regulatory structure so may be the least problematic. For this reason, it has also been easier to provide greater detail on how this model could work compared to Models 2 and 3, which offer more innovative approaches.

Under Model 1 the suggested framework is:

- the requirement to be authorised could be extended beyond the current NECF definition to include energy providers whose services and products fall under certain principles, for example
  - *access to energy*: where the energy product or service may impact the customer's ability to access energy needed for health and wellbeing
  - *access to competition*: where the energy product or service may impact the customer's ability to access substitute, or related, products and/or services
  - *energy interoperability*: where the energy product and/or service affects the functionality of other energy products and/or services
- all entities that sell energy to residential customers, including embedded network sellers, could be required to hold an authorisation (although entry requirements may be minimal for some authorisation tiers)
- each authorisation tier could have different (but overlapping) entry requirements and obligations. These are detailed in table 2 below

- ongoing conditions could be applied to individual authorisations. These may include conditions relating to business model, customer numbers and periodic performance and compliance reviews. Conditions could also be applied to an authorisation post-grant as a response to poor conduct. This is similar to the Essential Services Commission of Victoria's conditional licensing scheme[4]
- the grounds on which an authorisation can be cancelled could be expanded to allow for revocation of an authorisation in situations where the operating parties behind the authorised business no longer meet the authorisation criteria – for example, where an entity that would not meet the suitability criteria has circumvented the authorisation process by purchasing an authorised retailer[5]
- in certain energy selling circumstances (for example, in embedded networks) if an energy selling 'agent' is engaged by the embedded network seller to perform certain 'high risk' energy selling functions it could be required to apply for an authorisation even if it is not contractually selling energy. Alternatively, authorised sellers could be prohibited from outsourcing these functions (this element is aimed at addressing the issue of agency in embedded networks, as discussed under section 2.1.2)
- once authorised, a seller or other authorised energy service provider could apply for derogations from certain obligations. This would be to allow small service providers to seek relief from obligations they can demonstrate are unreasonably burdensome in relation to potential customer harm. We could limit the ability to seek a derogation to certain tiers
- where a service provider no longer 'fits' within its authorisation tier (for example, it wishes to start selling outside of embedded networks or to residential customers) it could be required to apply for a new authorisation under the newly appropriate tier. In these circumstances, a truncated authorisation process could apply addressing only those entry requirements not met under the service provider's current tier
- the responsibility to ensure appropriate authorisation/exemption falls on the service provider (as it does currently). If the service provider is not selling under the correct authorisation, it could be in breach of the National Energy Retail Law (NERL) and subject to penalties
- where a service provider's activities fall within multiple tiers, the provider could be required to apply for the highest applicable tier
- retail and network exemptions could be available to a small group of 'low risk' sellers including sales to large businesses, related businesses, on construction sites and holidaymakers. We would use experience gained from the current exemption frameworks to consider the feasibility of a more principles and outcomes-based approach to exempt selling

Alternatively, Model 1 could be amended to create a compromise position which does not require all residential embedded network sellers to be authorised (and comply with all NECF

[4] The Victorian energy retail licensing framework gives the Essential Services Commission significant discretion to attach ongoing conditions to licences.

[5] Similar to ASIC's powers to suspend, cancel and vary financial services licences.

obligations). This would involve creating an exemption class for residential embedded network sellers whose total annual sales are less than a certain amount (we have yet to determine what an appropriate amount would be). The exemption class would be designed to relieve very small sellers from some of the more burdensome and complex NECF obligations (much as it does now, albeit for a greater range of sellers) and to allow selling in certain circumstances (such as within small caravan parks or apartment blocks) to continue much as it has done in the past. However, this goes against the argument that the consumer protection focus should be on the type of customer (for example, residential and potentially vulnerable), not the volume of energy an entity sells.

Table 2: details on potential authorisation tiers, entry requirements and obligations

Authorisation tier	Entry requirements	Customer protections
Tier 1) Traditional 'grid' connected energy seller	Similar to current NECF authorisation criteria	Similar to current NECF customer protections
Tier 2) Entities seeking to sell energy within a proposed residential retrofitted embedded network	Similar to current NECF authorisation criteria with additional requirements to address potential loss of customer access to competition	Similar to current NECF customer protections
Tier 3) Entities selling energy to residential embedded network customers	Simplified authorisation criteria	Similar to current NECF customer protections with ability to seek derogation from certain obligations
Tier 4) Entities selling energy to small business embedded network customers	Light handed authorisation process similar to NECF exemption registration process	Based on NECF protections deemed essential to protect small business customers from harm
Tier 5) Entities that provide energy services to residential and/or small customers that fall within the principles/characteristics added to the NECF 'sale of energy' definition	Will be based on risk assessment of new energy products and services	Will be based on risk assessment of new energy products and services

2.1.2 Policy positions and assumptions underpinning Model 1

This model is intended to give effect to the following policy positions and assumptions:

- the entity selling energy to a customer at a connection point (including a connection point within an embedded network) is the primary provider of energy and loss of this service carries the greatest customer risk. Energy is an essential service and significant obligations must be imposed on this entity to ensure customer access is maintained

- expanding the scope of the NECF would allow for coverage of new energy products and services. Where the actions of an energy service provider may affect a customer's access to energy they should be regulated even where there is no NECF 'sale of energy'. Potential examples of such service providers are energy aggregators and operators of virtual power plants (VPP)
- with the emergence of new energy products and services, increasing variation in the business models proposed by applicants, and a diversification in the kind of businesses seeking authorisation, the 'point in time' authorisation framework is no longer a sufficient 'gatekeeper' to the energy retail market. A conditional authorisation framework would allow the AER to impose ongoing conditions that, for example, restrict the authorisation to a specific business model, cap the number of customers or impose additional compliance requirements. This would reduce the risk of customer detriment resulting from energy service providers undertaking activities for which the AER has not assessed their suitability
- 'agency' arrangements between exempt sellers and third party embedded network service providers are common under the current exempt selling framework. Under these arrangements the exempt seller outsources all their energy selling functions (bar the contractual relationship to buy and on-sell energy from the parent connection retailer) to a third-party agent. In these circumstances, the exempt seller (for example a body corporate) may not have the resources or knowledge to control or understand the actions of the agent (in the way a 'traditional' retailer does). In the case of an alleged breach, enforcement action against the exempt seller is not an effective deterrent given the involvement of the agent. It is unclear whether the AER may take enforcement action under the current NERL 'aiding and abetting' provisions[6] against the agent unless it also takes action against the exempt seller, which may not always be appropriate. Such agents should be either covered directly by the authorisation framework or, alternatively, the framework must prohibit certain types of sellers from outsourcing key energy selling functions
- all residential (and arguably all small business) customers should receive the full suite of customer protections, regardless of whether they are supplied energy through an embedded network
- embedded networks restrict competition and may be incompatible with some new energy products and services. By making the criteria for holding a retail or network exemption more stringent, it will be easier to ensure that new and/or retrofitted embedded networks will provide ongoing customer benefits. Areas where additional stringency may be appropriate include consent, access to competition and access to new energy products and services
- low risk sales of energy, such as to holidaymakers and sales between related businesses, require only minimal legislation and an exemption regime remains the most appropriate form of regulation.

2.1.3 Implementation

[6] Retail Law, Section 298

A number of legislative changes are needed to implement this model. These include:

- amendments to the NERL to
  - include as regulated entities energy services and products that fall outside the current definition of a 'sale of energy'. The revised definition would set out the principles/characteristics of the types of services and products to be covered
  - create a tiered authorisation framework, with each tier having its own entry requirements and regulatory obligations
  - modify the RoLR framework to accommodate the expanded authorisation framework. Where changes are made to entry requirements for the retail market, decisions must also be made regarding exit from the market and what this means for the RoLR framework. For example, it may be decided that where an energy service or product at a connection point is deemed critical to a customer's ability to access energy, a RoLR scheme must exist to ensure continuity of supply of that service or product
  - move some provisions, such as those relating to authorisation application requirements and obligations, to the National Energy Retail Rules (NERR) so they are easier to amend in the future
- amendment of the retail and network exemption frameworks to restrict and/or remove the availability of some exemption classes
- modification of the National Electricity Rules (NER) and National Gas Rules (NGR) to accommodate the proposed market entry changes, including for entities proposing to create and sell within embedded networks. Additional supporting legislative changes may also be needed and require further exploration
- changes to the NER and NGR to ensure each child connection point in a compatible embedded network has a National Meter Identifier (NMI) (we are not proposing that legacy embedded networks be required to retrofit compliant metering)
- considering whether capturing residential embedded network sellers as 'regulated entities' may conflict with some jurisdictional legislation, including tenancies legislation, body corporate legislation and caravan park and manufactured homes legislation. This would need to be addressed and would likely require coordination with state jurisdictional legislators
- current sellers would need to be transitioned to the most appropriate authorisation tier or exemption class.

2.1.4 Pros and cons

Pros:

- widening the types of energy services covered by the NECF will provide flexibility to regulate new energy products and services where appropriate
- allowing for authorisations to have ongoing conditions would enable the AER to have greater ability to address the ongoing suitability of authorised businesses. Conditional authorisations would enable the AER to reduce the risk of customers being harmed by authorised businesses who do not, or no longer, meet the necessary authorisation criteria

- allowing certain authorised entities to seek a derogation from a particular obligation would address circumstances when the regulatory burden of the obligation outweighs the customer risk. This could be an important tool for managing embedded network sellers and new product/service providers
- by requiring all residential embedded network sellers to hold an authorisation, these sellers would become 'regulated entities' and would need to meet all NECF obligations placed on such entities. This would include obligations relating to standing offers, as well as performance and compliance monitoring and reporting[7]
- increasing the regulatory obligations and entry requirements for current and future embedded network sellers, particularly for retrofitted embedded networks, will help ensure new and retrofitted embedded networks are created only where there is long-term customer benefit
- maintaining a reduced exemption framework for lower risk sales of energy, including sales to large businesses, related businesses, on construction sites and to holidaymakers, would ensure the retention of a light-handed regulatory approach where the risk of consumer harm is low.

Cons:

- extending the NECF to energy products and services that do not involve a 'sale of energy' (as currently defined) creates a risk of over regulation where customer risks are not yet fully known. This may stifle innovation as providers of new energy products and services may consider regulatory costs too high and entry into the market unprofitable. Or they may design their product or service based on the requirements of the regulatory framework, rather than on the best outcomes for consumers
- if 'traditional' energy sellers are authorised under tier 1, they will bear most of the regulatory burden. This arguably creates regulatory inequality. If the customer sources a significant proportion of their energy from solar, batteries and/or other consumer energy resources that are owned or managed by other providers, is it equitable to place the most onerous customer protections onto the 'traditional' seller? In this scenario, the 'traditional' seller may be making only a small profit from the customer while having to bear all the regulatory costs
- capturing all residential embedded network sellers as 'regulated entities' may be impractical. These sellers are a diverse collection of individuals and businesses that have markedly different resources, expertise and motivations and usually more complex relationships with their customers than the traditional retailer/customer relationship. Many may not have the required level of human or financial resources to meet all NECF customer protection obligations, particularly those relating to performance and compliance monitoring and reporting, and sensitive hardship and family violence protections. For small sellers, buying in resources may not be financially viable and an authorised retailer may not be interested in taking over the site (noting it would likely need to handle both the network and retail side). As a result, sellers may be left unable

[7] The Commonwealth Government is currently undertaking further consultation to consider how to extend the Default Market Offer (DMO) protections to embedded network customers. See their website for more details.

to comply, leading to an unmanageable enforcement burden and no increase in the end protections received by customers

- requiring certain energy selling agents to be authorised or, alternatively, drafting the authorisation framework so that it prohibits certain types of sellers from outsourcing key energy selling functions, may lead to unintended consequences. We do not want to create a situation whereby all third parties that provide regulatory functions are caught by the authorisation framework, regardless of circumstance, thus preventing outsourcing even where it is the most effective and efficient way of meeting regulatory obligations
- implementation and management of this model will likely be more resource intensive than current NECF arrangements, for both energy businesses and the AER. Moving to a multi-tier conditional authorisation framework will require greater ongoing engagement and management by both the authorisation holder and the AER. The regulatory burden of market entry and exit for both entrants and the AER would be increased.

Consultation questions

1. What are your views on the policy positions and assumptions outlined for Model 1?
2. What are your views on the proposal to capture all residential embedded network sellers as “regulated entities”? What practical issues do you think may result from such a change?
3. 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.
4. What are your views on how a RoLR scheme would work in the context of the inclusion of new products and services under the NECF? Additionally, to what extent should there be a RoLR scheme for new energy products and services?

2.2 Model 2 – Authorisation framework based on regulatory principles

2.2.1 Description

Model 2 represents a significant departure from the current authorisation and exemption framework by 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.

Under Model 2 the suggested framework is:

- market entry and exit:
  - the requirement to hold an authorisation, or an exemption from that requirement, could depend on whether a business provides energy services and products that are covered by certain principles
  - these same principles, or a subset of them, could be used to determine which products and services require a RoLR regime to protect customers in the case of market exit
  - authorisations could be granted on a conditional basis, which may include the type of energy service, number of customers and ability to review business systems

  - a reduced exemption framework for specified classes could exist to regulate very small or low-risk sellers. As discussed under Model 1, we would use our experience of the current exemption framework to look at refining our approach to exempt selling

- customer protections:
  - customer protection principles could be created that set out, at a high level, the obligations that authorised, or exempt, energy businesses must meet. These could vary based on the potential harms associated with the particular service and/or product
  - expectations about the kind of systems and processes required to meet the customer protection principles could vary according to the authorisation tier (these tiers would be defined by different energy selling principles, all of which would be based on the overarching principles governing market entry and exit) or exemption, under which the energy business is operating
  - principles-based categories could be created to require certain service and/or product providers to meet certain customer protection obligations even where they are not authorised or exempt
- the principles governing both market entry and exit, and customer protection, could be based on the key risk factors for customer harm and would be broad enough to cover both existing, new and future energy services and products
- the AER could be empowered to create guidelines setting out how these principles should be interpreted. Where necessary, the guidelines could be amended to reflect the changing market.

2.2.2 Policy positions and assumptions underpinning Model 2

Model 2 is intended to give effect to the following policy positions:

- the energy market is in the process of transitioning away from the model of a traditional large retailer selling to a grid connected customer
- access to energy is an essential service. A significant regulatory rethink is required to accommodate new and future ways of selling energy that could become essential, or impact the essential supply of energy, and to ensure management of the risk of customer harm
- given the uncertainty around future energy services and products, the regulatory framework must be flexible and minimally prescriptive. Prescriptive legislation is difficult to future-proof.

2.2.3 Implementation

Transitioning from the current prescriptive framework to a principles-based framework is likely to be complex given Model 2 would require a wholesale change to the NECF. The definition of ‘sale of energy’ on which the NECF is based would be removed and replaced with a set of principles governing entry into the energy retail market. The RoLR framework would likely require significant amendment to reflect these market entry changes and ensure customers continue to have access to energy in the event of provider failure.

The prescriptive customer protection requirements set out under the current legislation would mostly be replaced by high-level customer protection principles. Some customer protections, where the risk and impact of customer harm is considered very high (such as disconnection and life support protections), are likely to remain prescriptive. Authorised and exempt providers would be required to have systems and processes in place to ensure they meet these principles. The AER would create guidelines to assist businesses in their interpretation of the principles.

2.2.4 Pros and cons

Pros:

- a principles-based authorisation framework will be more flexible and adaptable to a changing market. New energy products and services would be more easily captured (where appropriate) under the framework
- the flexibility and adaptability of a principles-based framework with less prescription may also help support innovation of energy services, potentially reducing barriers to entry and investment
- much of the regulatory detail would be made under regulatory guidelines. Guidelines are simpler to change than the NERL or NERR
- a complete rethink of how energy services should be regulated may result in more efficient outcomes for both providers and customers
- a conditional authorisation framework would allow the AER greater control over the ongoing suitability of authorised product/service providers. Conditional authorisations would enable the AER to reduce the risk of customer harm from authorised businesses that do not, or no longer, meet the necessary authorisation criteria.

Cons:

- determining the ‘correct’ regulatory principles may be challenging
- a principles-based authorisation framework may result in a lack of regulatory certainty which could lead to barriers to entry
- the implementation and management of a principles-based framework is likely to be more resource intensive for the regulator than a prescriptive framework, with additional resources required to assist stakeholders to interpret and comply with the framework
- where businesses struggle to interpret the regulatory framework they may rely more heavily on third parties for assistance, which may increase the risk of businesses receiving inaccurate regulatory advice
- this type of regime results in a significant amount of discretionary regulatory power. Given this, the AER would need to carefully consider whether market entry requirements should be more stringent and how to approach compliance and enforcement.

Consultation questions

5. What are your views on the policy positions and assumptions outlined for Model 2?
6. 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?
7. 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?

2.3 Model 3 – Outcomes-based regulatory framework

2.3.1 Description

Model 3 is an outcomes-based regulatory framework and represents the most significant departure from the current framework of all options canvassed in this paper. It would be the most resource intensive and complex to develop and implement but potentially provides the greatest flexibility to address potential customer harms resulting from new energy products and services.

In an outcomes-based regulatory framework, legislation sets regulatory objectives and parameters to be met, and then places the onus on the service provider to develop a coherent and convincing method for regulatory approval as to how they will achieve the objective(s). For example, ASIC recently introduced 2 types of outcomes-based regulatory frameworks for the financial services sector[8] that are intended to:

- place greater accountability on financial product firms to appropriately design and distribute products in a way that ensures a certain outcome for consumers
- allow ASIC to make product intervention orders when a financial product or a credit product (or a class of such products) has resulted in, will result or is likely to result in significant consumer detriment.

Model 3 focuses on the characteristics of the end customer. Its primary focus is the achievement of the following objective: ‘A service provider must act in the best interests of the customer’.

The model would set primary principles, requiring the service provider to act in the following ways, by providing advice to its customers:

- *proactively* – the obligation lies with service providers to provide advice and not wait for customers to ask for it

[8] Australian Securities and Investments Commission (ASIC), RG 274 Product design and distribution obligations, ASIC, and RG 272 Product intervention power, ASIC, 2020

- *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, which 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.

Regulatory obligations could apply to any energy service provider that is active at the end customer's connection point (note there are different options for setting market entry parameters for this model, as discussed in section 2.3.3). The model could apply obligations based on the desired outcomes across the customer journey, for example advertising, contract formation, contract terms and conditions, billing, notification for change of supply.

Model 3 would require energy service providers to prepare a regulatory compliance plan that demonstrates how they will achieve compliance. This plan would need to provide details on how the service provider would meet the objective, the primary principles, and the obligations that apply depending on the type of customer (small/large; residential/business) and the stage of the customer journey (for example, marketing, sales). This compliance plan would need to be approved by the AER.

The applicable obligations could include:

- 'base obligations' that are to apply no matter the identity of the end customer or the service being provided
- 'flexible obligations' that could be ramped up or down depending on a matrix of factors, including identity of the end customer, the product and/or service being provided, the characteristics of the service provider, and other factors.

In this sense, the obligations would focus on consumer outcomes and be flexible and scalable, resulting in proportionate regulation for a variety of energy services. This approach has similarities to the new 'Consumer Duty' created by the UK Financial Complaints Authority, which comes into force in July 2023. The rules and guidance for the new 'Consumer Duty' require firms to deliver 4 key customer outcomes relating to:

- products and services
- price and value
- consumer understanding
- consumer support.[9]

2.3.2 Policy positions and assumptions underpinning Model 3

This model is intended to give effect to the following policy positions:

[9] Financial Conduct Authority, A new Consumer Duty, 2022

- the energy retail market is in a process of transition and the effects of new energy products are unknown
- prescriptive legislation is difficult to future proof; outcomes-based legislation will be more flexible and adaptable
- the most important aspect of regulation is to ensure consumers receive good outcomes
- 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.

2.3.3 Implementation

Given this model is significantly different from the current framework, its implementation would need to be thought through carefully, particularly regarding how existing authorisations and exemptions should be treated and potentially transferred to the new regulatory framework. The need for, and operation of, a RoLR regime would also need to be explored.

There are multiple options for setting the parameters for who is captured by this model. One option would be to apply it only to energy service providers active at connection points on the national grid. However, this would mean child, or secondary connection points would not be included (for example, consumers in an embedded network) and could risk excluding new energy services where consumer engagement occurs via a child, or secondary, connection point. We note the Flexible Trading Arrangement rule change proposal envisages a significant number of new energy products and services may be active at secondary connection points.[10]

Alternatively, the model could be implemented to apply to all connection points. This would then encompass customers in embedded networks and potentially a greater range of energy products and services. An entirely different characteristic for market entry could also be used.

2.3.4 Pros and cons

Pros:

- allows flexibility and adaptability because it does not focus on the type of service being sold, but rather the customer outcomes. This means it could apply to any type of service sold to customers
- as with Model 2, a less prescriptive model could promote market innovation
- a focus on customer outcomes may support development of trust and social licence in the sector. It could also result in more efficient outcomes for both providers and customers
- where new business models are developed, and new services are created, it does not require pre-emptive regulation but rather empowers the service provider to set appropriate obligations.

[10] AEMC, Flexible trading arrangements for consumer energy resources, 2022

Cons:

- this is a very different approach to the current framework and would take time for industry to transition
- smaller service providers, particularly those for whom energy is not their core business, may struggle to interpret and implement an outcomes-based regulatory framework and would be likely to rely heavily on the AER, or other third parties, for compliance advice
- the approach to both market entry requirements and compliance and enforcement would require careful consideration and may be challenging to set at the 'right' level
- it gives the regulator greater discretion and arguably raises issues of regulatory accountability
- it would require significant trust between industry, consumers, and the regulator.

Consultation questions

8. What are your views on the policy positions and assumptions outlined for Model 3?
9. How practical and effective do you think an outcomes-based regulatory framework would be?
10. 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?

3 Glossary

Term	Definition
ACL	Australian Consumer Law
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ASIC	Australian Securities and Investments Commission
CER	Consumer Energy Resources: 'behind the meter' renewable energy resources and can include rooftop solar PV units, battery storage, thermal energy storage, electric vehicles/chargers, smart appliances, and home energy management technologies.
DMO	Default Market Offer
ESC	Essential Services Commission Victoria
ESB	Energy Security Board
NECF	National Energy Customer Framework
NEL	National Electricity Law
NER	National Electricity Rules
NERL	National Energy Retail Law
NERR	National Energy Retail Rules
NGR	National Gas Rules
NMI	National Metering Identifier
RoLR	Retailer of Last Resort
VPP	Virtual Power Plant

4 Summary of consultation questions

1. What are your views on the policy positions and assumptions outlined for Model 1?
2. What are your views on the proposal to capture all residential embedded network sellers as “regulated entities”? What practical issues do you think may result from such a change?
3. 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.
4. What are your views on how a RoLR scheme would work in the context of the inclusion of new products and services under the NECF? Additionally, to what extent should there be a RoLR scheme for new energy products and services?
5. What are your views on the policy positions and assumptions outlined for Model 2?
6. 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?
7. 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?
8. What are your views on the policy positions and assumptions outlined for Model 3?
9. How practical and effective do you think an outcomes-based regulatory framework would be?
10. 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?