29 January 2007

By email: wendy.heath@esc.vic.gov.au

Ms Wendy Heath
Senior Regulatory Manager
Essential Services Commission
Level 2, 35 Spring Street
MELBOURNE VIC 3000

Dear Wendy

Early Termination Fees Compliance Review – Consultation on Code Amendments

We refer to the Final Decision: Early Termination Fees Compliance Review (the **Final Decision**), released by the Essential Services Commission (the **Commission**) on 21 December 2006. The Final Decision proposes amendments to the Energy Retail Code (the **ERC**). We would like to make the following comments in relation to the proposed amendments.

Final decision

As outlined in our submission to the Revised Draft Decision, we support the approach of the Commission in assessing the appropriateness of early termination fees (**ETFs**). By limiting ETFs to the incremental administrative costs, hedge book imbalance costs and unamortised inducement costs relating to an early termination, consumers can more easily benefit from competitive market outcomes. That is, consumers will not be unfairly prevented from switching where they receive poor service or are offered a better deal. Further, consumers who switch without full understanding of their contact will not be overly disadvantaged.

Code Amendments

The ERC regulates early termination fees through clauses 17, 24.1(d) and 32. This seems overly-complicated and may create contradictions. For example, clause 17 prohibits the recovery of any amount in respect of a consumer's breach of contract greater than the amount recoverable at common law. Conversely, clause 24.1(d) allows the recovery of an ETF. It would be less confusing and more efficient for the proposed amendment to rationalise the clauses that deal with ETFs.

Consumer Action Law Centre
Level 7 459 Little Collins Street
Melbourne Victoria 3000
ABN 37 120 056 484 CAN 120 056 484
Telephone 03 9670 5088
Facsimile 03 9670 7205
info@consumeraction.org.au
www.consumeraction.org.au

ERC clause 32(c)

The Commission proposes to insert a new clause 32(c) (agreed damages terms) into the ERC to give effect to its decision. The proposed clause states:

> *The amount of an early termination fee payable by a **customer** upon the **customer** breaching their **energy contract** [entered into after [date]] must be determined by reference to, and must not exceed, the total of the following direct costs incurred by the **retailer** in relation to that particular **customer** which remain unamortised at the time of termination:*
>
> *a) pro-rata costs of procuring the **customer** to enter into the contract;*
> *b) costs of giving effect to the termination of the contract, final billing and ceasing to be **responsible** for the **supply address**; and*
> *c) the value of any imbalance in the **retailer's** electricity or gas hedging program to the extent that it is directly attributable to that breach of contract.*

We agree that this term largely implements the Final Decision. We note, however, that the costs of giving effect to the termination of the contract, final billing and ceasing to be responsible for the supply address are costs incurred whenever a customer terminates their contract and, as such, are simply the costs of doing business, not costs relating to the early termination of the contract. A retailer will have to expend these costs whenever a consumer terminates their contract, regardless of whether or not the consumer terminates early. The Final Decision makes it clear that only the *incremental* administrative costs are recoverable, that is, the time value of the retailer having to incur those costs earlier than expected. In our view, sub-clause 32(c)(b) should therefore make this clearer by the addition of the word "incremental" to the start of the sub-clause and the addition of the word "early" before the word "termination".

We also note that the Commission states in its Final Decision that:

> recognising that these costs may exist and that a small deterrent to customers from frivolously switching after entering into an arrangement is consistent with the operation of competitive markets, the Commission considered that a fair and reasonable allowance for these costs in an ETF would be no more than $20, irrespective of when the contract is terminated.

While we welcome the Commission's efforts to provide guidance to retailers as to the amount that may, in practice, be recovered as an ETF, as stated in our submission to the Revised Draft Decision, we believe that such incremental costs would be negligible.

We note that the common law provides that a contracting party can only recover genuine losses relating to breach of contract, and cannot penalise the other party for their breach. The statement that ETFs act as a deterrent, if given in evidence to a court, would potentially go some way in proving that an ETF charged under the ERC was a penalty and thus not recoverable at law. We therefore note that the Commission will need to monitor any ETFs charged by retailers on a case by case basis to ensure they do not exceed the actual costs incurred by retailers in those cases, rather than allowing retailers to rely on the $20 calculation as a matter of course.

In addition, we note that the Commission's decision might also be achieved by adding the proposed sub-clause to clause 24.1(d), which also provides limits on a retailer's

recover of ETFs. We note, however, that those limits relate to process, rather than the substance of the fee. As such, we agree that it is more appropriate to include the term under clause 32 which deals with the amount of agreed damages terms, although as stated above, this highlights that rationalisation of these clauses would be desirable.

ERC clause 17

The Commission proposes to amend clause 17 (indemnity) by inserting the words "Except as permitted by this Code" at the beginning of the sentence. It is unclear why this amendment is required.

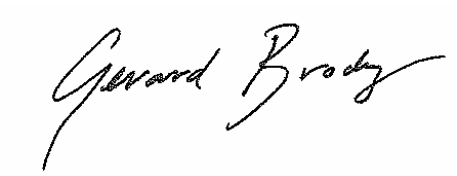
The Commission states that the proposed amendments accommodate the possibility that a Court could find that a retail contract offends common law rules about calculation of damage, the law about penalties and any fair trading laws (for example, the unfair contract terms provisions of the *Fair Trading Act 1999* (Vic)). That is a possibility that remains proper — as subordinate legislation administered by an independent regulator, the ERC should not override common law or statute. The amendment, however, appears to intend for the ERC to override those rules.

Clause 17 states that a retailer must not include a term in an energy contract that entitles them to recover from the customer, in respect of contractual breach or negligence by the customer, more than is obtainable under the common law or statute. As such, the clause is merely re-stating the law – contractual provisions cannot override the common law or statute. By adding the words "Except as permitted by this Code", the Commission appears to be providing that a retailer can recover more than is obtainable under the common law or statute if it is allowed by the Code (ie, by clause 32(c)). In our view, this is not only an improper exercise of the Commission's functions, it also appears not to have been intended, as the Commission's Final Decision states that an ETF should be 'the lower of what the Code allows and what the common law allows'.

We seek clarification from the Commission as to why this amendment is necessary to implement the Final Decision. Again, this also demonstrates a need to rationalise the clauses in the Code relating to ETFs.

Should you have any questions, please contact me on 03 9670 5088.

Yours sincerely
CONSUMER ACTION LAW CENTRE



Gerard Brody
Senior Policy Officer