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Australian Energy Regulator
By email: DMO@aer.gov.au

Submission to the Australian Energy Regulator's Draft Determination on the Default Market Offer Prices 2024-25

Dear Daniel,

Thank you for the opportunity to provide comment on the Australian Energy Regulator's (AER) Draft determination on the Default market offer (DMO) prices 2024-25. Australian consumers are currently under immense cost-of-living pressures from all fronts. For this reason, we are pleased to see the AER acknowledge in this determination the important role the DMO plays in ensuring consumers have access to an essential service at a fair price.

In our submission to the AER's Issues Paper we highlighted that there are larger issues, beyond the AER's jurisdiction, that are impacting its effectiveness as either a price cap for disengaged consumers or a reference price. We maintain that, while there are measures the AER can take to ensure the DMO is protecting consumers in its current form, we need to take a broader look at how the DMO will support consumers in the future energy market.

Our submission offers our support for the AER's emphasis on consumer protections.

- We agree with the decision to leave off the competition allowance. We also believe that competition in other jurisdictions is evidence it will not be necessary to include in future determinations.
- A reduction in wholesale costs is positive for consumers. We expect the AER will continue to monitor wholesale costs until the Final Determination and pass through any potential savings.
- The AER could further demonstrate its intention to support consumers by reducing the small business margin in line with residential.

Our submission also provides evidence the DMO is not meeting its original intentions and broader reforms are needed to ensure consumers are protected and supported in the future.

- There remains a growing loyalty tax, as evidenced by the number of consumers on plans priced about or equal to the DMO.
- Consumers continue to face barriers to engagement.
- The transitioning energy market is accelerating these issues and creates obstacles to calculating a fair annual price.

All consumers need access to a just price for energy. The perceived binary between an engaged vs a disengaged consumer is growing increasingly problematic as a way of framing how we expect consumers to access to a fair price. Increasing barriers to engagement withhold many from engaging with the market in the first place while those that do engage are frequently met with an array of offers so vast and complex that they are unlikely to choose the true "best offer" anyway. Engaging with the market cannot continue to be put forth as a silver bullet and instead we need to reassess our current tools to ensure they are truly protecting and supporting consumers.

We support measures the AER is taking to prioritise protecting consumers

Removing the competition allowance reflects the original intentions of the DMO

The Australian Competition and Consumer Commission (ACCC) identified two key benefits to the DMO when it was recommended as part of their Retail Electricity Pricing Inquiry in 2018. These two benefits were:

- "a cap for the price of default offers to limit the 'loyalty tax' that is levied on disengaged consumers
- a reference bill amount which all discounts must be taken from".[1]

These two outcomes reflect the DMO's foundational purpose, which is to protect consumers and ensure they are not paying unreasonably high prices. It was intended that the DMO would protect consumers by capping the price paid by disengaged consumers and by providing a tool to help engaged consumers trying to navigate a complicated energy market. These benefits are also explicitly referred to in the AER's explanatory statement accompanying the Final Determination on the DMO in 2019[2].

The AER includes in its determinations additional objectives it considers relevant when determining an annual price. These include maintaining incentives for competition, innovation and for consumers to engage in the market and allowing retailers to recover their costs. Despite this, our view remains that the primary function of the DMO is as a consumer protections tool.

This is particularly significant given the current cost-of-living crisis. Our December Energy Consumer Sentiment Survey revealed over half of households are more concerned about their ability to pay their electricity bills than they were a year ago. 17% of households say it is the bill they are most concerned about paying, second only to mortgage and rent payments.

At the same time we have seen average retail margins on consumer bills in most jurisdictions increasing in 2022-23 compared to a year earlier (with an average decrease in NSW the result of one outlier)[3]. This suggests retailers have recovered somewhat from the volatility of recent years. Considering this, *we are pleased to see the AER's decision to leave off the competition allowance from this determination.*

We do not believe that a retail margin of 10% for residential consumers and 15% for small business consumers is justifiable or fair given adequate competition remains in jurisdictions where a lower retail margin is used, notably Victoria.

Our arguments made to the Issues Paper and previous determinations remain true. Victoria is still a prime example of how a lower retail margin does not have a detrimental impact on competition. Currently, Victoria has operated on a lower retail margin than the 6% proposed by the AER, reducing from 5.7% to 5.3% in the previous determination. Despite this, the number of retailers with advertised market offers is the same or more than every network where the DMO is used[4]. The ACCC has also shown that Victoria has the least concentrated market, with 44% of small customers served by non-Tier 1 retailers[5] (Figure 1).

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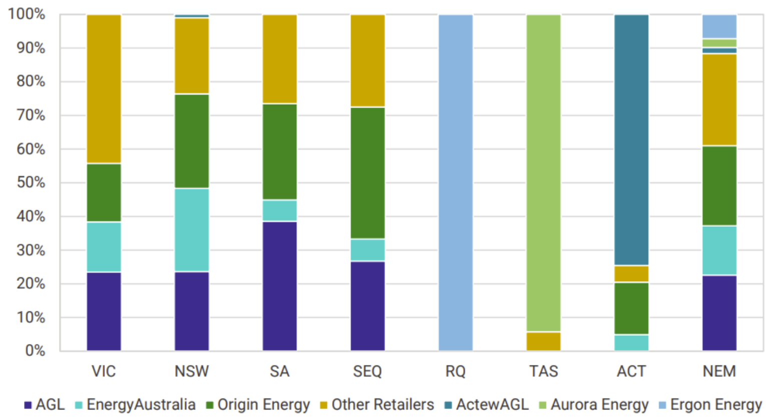
[1] Retail Electricity Pricing Inquiry—Final Report June 2018 p. 249
[2] Explanatory Statement accompanying the DMO Regulations, 2019
[3] ACCC Inquiry into the National Electricity Market December 2023 p.34
[4] St Vincent de Paul Tariff Tracking Project
[5] ACCC Inquiry into the National Electricity Market December 2023 p. 21

Figure 1: Retail electricity market share by region 2022-23



Source: ACCC Inquiry into the National Electricity Market December 2023

While we are happy to see the competition allowance left off for this determination, continued evidence of competition in Victoria suggests there is little justification for its inclusion in future determinations. We expect the AER will monitor any impact on competition over the next year with a lower retail margin and consider whether a competition allowance is appropriate for DMO 7.

Any decreases in wholesale costs must be passed through to consumers

We are pleased to see that the decrease in futures contract prices has resulted in a decline in the wholesale cost component of this determination. Over the past two years we have seen consumers bearing the brunt of extreme increases in wholesale energy costs, with the DMO rising up to 29% for some consumers last year following increases of up to 20% the previous year.

Despite decreasing marginally for some consumers in the Draft Determination, the DMO remains significantly elevated compared to where it was prior to the extreme volatility beginning in 2022. As we have seen, consumers are still concerned about their ability to keep up with high energy costs in the context of increasing cost-of-living pressures across all fronts.

We recognise that the DMO must reflect changes in underlying wholesale costs. Given increases have been passed on quickly and in full to end consumers, we expect that the AER will monitor wholesale costs from now until the Final Determination to ensure any potential savings are also passed through.

There should be no difference in margin for residential and small business consumers

The AER could further demonstrate its commitment to protecting consumers in this determination by lowering the allowed retail margin for small business consumers. We maintain that there is no justification for the inclusion of a higher retail margin than residential consumers. This approach is inconsistent with the approaches of other jurisdictions, such as Victoria and the ACT, where a single margin is used both for residential and small business.

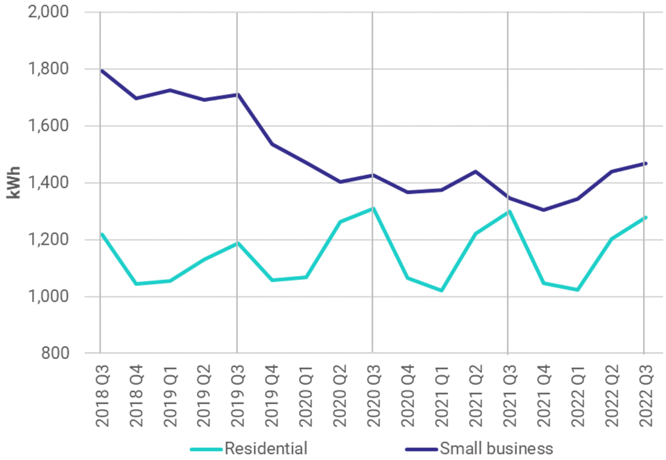
Median electricity consumption for small businesses is significantly higher than for residential consumers (Figure 2). Therefore, the margin being recovered for small business customers is already greater in dollar terms than for residential customers. The AER's decision to double the retail margin for small businesses will only exaggerate this difference.

While households are dealing with cost-of-living pressures, small businesses are also facing substantial rises to the cost of doing business. In November last year, the Australian Retailers

Association found that 93% of small retailers had faced cost increases over the past year, with a third saying these increases were more than 10%, above the level of inflation[6].

The Australian Retailers Association found that 54% of surveyed businesses had chosen to pass on higher costs to consumers. Increases to the cost of doing business have a two-fold effect, impacting both the small business owner and adding to cost-of-living pressures for household consumers if the business passes on these price rises. Minimising increases to electricity bills for small businesses is therefore just as important as for residential consumers and the AER should reconsider the higher margin used in the determination.

Figure 2: Median usage by residential and small business customers



Source: ACCC Inquiry into the National Electricity Market June 2023

BROADER REFORMS ARE NECESSARY TO MEET THE ORIGINAL INTENTIONS OF THE DMO

There is a significant and growing loyalty tax for disengaged consumers

In our submission to the AER's Issues Paper we raised anecdotal evidence that existing customers on market offers are being charged prices that are higher that the DMO. This has since been confirmed by the ACCC in their December Inquiry into the National Electricity Market Report. The ACCC found 47% of all residential customers were on plans that were equal to or higher than the default offer, increasing from 30% in 2022. Concerningly, while there is an assumption that consumers in financial hardship are incentivised to shop around for a better offer, the ACCC found that there were still 42% of concession customers on a plan equal to or higher than the default[7].

While the DMO has successfully capped the price of standing offers, over 90% of residential consumers are on market offers. Most acquisition market offers remain priced below the DMO however retailers are free to increase the prices paid by their existing customers above the DMO at the end of their contract or benefit period.

The ACCC's December findings prove that the 'loyalty tax' has not been eliminated but has shifted to consumers on market offers who are not regularly engaging with the market. We do not believe it is acceptable that there are many consumers paying higher than what the AER has determined a justifiable price, especially considering the barriers to engagement. We believe it is particularly

[6] Australian Retailers Association Small Retail Index December 2023
[7] ACCC Inquiry into the National Electricity Market December 2023

concerning that this number has grown at the same time as consumers are facing extreme cost-of-living pressures.

Reform is needed to ensure no consumer is being rolled on to a price that is higher than that determined by the AER (as originally intended by the ACCC).

Consumers continue to face barriers to engagement

Despite the reference price's intention to simplify how consumers navigate the retail electricity market, we know that, for many consumers, the market remains too complex to engage with. Our Energy Consumer Behaviour Survey finds that over a third of households do not know what kind of tariff they are on. And this number increases to 44% for renters and 48% for households who identify as under financial pressure.

Our last Energy Consumer Sentiment Survey found only one in five households had switched energy company or plan in the past year. One in four said they had considered switching but ultimately decided against it with many citing it was either too complicated, time-consuming or confusing.

The AER's own Towards Energy Equity Strategy identified numerous barriers to consumer engagement, for example the one in five Australians with a disability who may find if difficult to search for and assess energy deals or the 44% of Australians who have literacy levels below what is required to fully participate in society[8]. As we note in our submission to the Issues Paper and further below, the transitioning energy market is complicating engagement as consumers are required to consider numerous variables such as feed-in tariffs, cost-reflective pricing, or offers that provide access to Consumer Energy Resources.

Further, engagement in the market often does not result in the significant benefits promised to consumers. For many, the vast list of offers with unique characteristics means that even if you do choose to engage, there is no guarantee you'll pick the right offer. This, along with the high number of consumers not engaging at all, has likely contributed to the 79% of consumers the ACCC identified as not on the best offer. Retail practices also limit the likelihood of a customer benefitting from engagement. For example, retailers in DMO jurisdictions are free to change the rate of variable electricity plans at any time, with some circumstances only requiring notification of the change five days in advance. We have heard anecdotal evidence of consumers being moved on to rates that are higher than the DMO mere weeks after switching retailer or plans. The impact of this is two-fold, contributing to the high proportion of consumers on prices above the DMO and further complicating the energy market by reducing any benefit to switching, deterring consumers from engaging at all.

Given the challenges to engagement, the onus should not be placed on consumers to switch retail offers in order to achieve a fair price. Consumers must have access to a fair price for energy regardless of whether they are engaged in the market. The DMO must reflect a fair and justifiable price with any additional built-in headroom minimised.

The transitioning energy market is complicating the function of the DMO and reference price

Changes to how consumers interact with energy markets are further complicating the role of the DMO as both a price cap and as a reference price. Our submission to the Issues Paper goes into further detail on this issue and the need to consider how we protect and support consumers in a transitioning energy market. In short:

- The changing energy market is reducing the relevance of the reference price. Designed to compare simple offers based off price, the reference price does not offer assistance to consumers wishing to compare the benefits of more complicated plans such as those designed for electric vehicle charging or offering access to a virtual power plant.

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[8] AER Towards Energy Equity Strategy October 2022 p. 14

- Changing usage behaviour is complicating the determination of an annual usage amount. New energy products and services are allowing consumers to become increasingly diverse in how they use and produce energy. Going forward, a single usage amount will reflect how fewer and fewer consumers actually use energy. As a price cap, this has the potential to cause harm if a consumer uses more than the defined amount. As a reference price, it also has the potential to cause harm if, for example, a consumer uses more energy in peak times than the AER's pattern outlines, leading to higher bills than what was advertised initially.
    - We are also concerned about anecdotal evidence that there are standing offer customers on demand tariffs who are not protected by the DMO. Networks are increasingly making cost-reflective tariffs the default for customers in many jurisdictions. The Ausgrid network is one example where customers are being automatically assigned demand tariffs, which the AER is not currently required to determine a price for should a retailer choose to pass this structure on to its customers. Determining a DMO price that is reflective of how all demand customers use energy would prove exceedingly difficult and further evidence of how changes in energy usage and behaviour is already complicating the determination of a price cap and reference price.
- The objectives of the DMO and reference price are contradictory. As the energy market grows more complicated, so too does the importance of the two benefits outlined by the ACCC. The inability for many consumers to engage will increase alongside the need to provide them with a fair price for energy. Additional considerations in the DMO that do not apply to these consumers, such as acquisition costs and a competition allowance, should not be included in order to provide them access to a fair price. However, this contradicts with the role of the reference price which applies to all consumers.

Energy markets are transforming at rapid rates. Current tools designed to protect and support consumers, particularly those who struggle to engage with the market, are more important than ever as we see increased complexity introduced into the market. The DMO and reference price, two key parts of the consumer protections landscape, are falling short of their intended impacts. We need to consider how these tools can be amended, and what more can be done outside them, in order to ensure consumers benefit from a transitioning energy system and market. Please reach out to Alice Gordon at alice.g@energyconsumersaustralia.com.au with any questions.

Yours sincerely,

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Director Energy Services and Markets