AUSTRALIAN ENERGY REGULATOR

# Customer Consultative Group

## Feedback report to DMO 7 Issues Paper

**Version 1**
**14 November 2024**

# Introduction

## AER Consumer Consultative Group November 2024 meeting details

Held online Thursday, 14 November 2024, between 1.00 - 2.30pm.

The meeting was chaired by Anthea Harris, AER CEO, and involved two AER Board members; Lynne Gallagher and Kate Symons, who assisted staff with the presentation and facilitated discussion of key topics relevant to DMO 7.

Customer Consultative Group (CCG) members present for the meeting represented the following organisations:

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| ACT Council of Social Service | Justice and Equity Centre |
| COTA Australia | Mark Henley (individual) |
| Ethnic Communities' Council of NSW | NSW Business Chamber |
| Financial Counselling Australia | St Vincent de Paul Society |
| Dr Georgina Davis (individual) | Tenants' Union of NSW |
| Thriving Communities Australia | |

## Purpose

The CCG is a key source of consumer insights and intelligence for the AER, which helps to ensure consumers' voices are heard and considered across the AER's work and decisions.

AER staff provided an overview of the AER's 2025-26 default market offer (DMO) price determination (DMO 7) issues paper and sought CCG member views on a select group of key topics from the DMO 7 issues paper, namely:

- Retail costs
- Competition allowance
- DMO objectives and purpose.

This document provides an overview of the main points discussed and the feedback received by the members of the CCG within the facilitated discussion.

## Main takeaways

- The AER should benchmark the individual **retail cost** components to determine reasonable cost levels. It should also review the cost stack from the top down (or from a whole cost perspective) each year to consider if retail costs are reasonable.
- There is no justification to include any specific retail business growth investment cost (costs to acquire and retain customers) into the **retail cost** component.
- There are concerns in relation to the AER's forecasting approach for **smart meters** overstating the DMO price, and further clarification from the AER is sought on the benefit of smart meters and how that benefit is allocated.
- There should be a **productivity improvement requirement** placed on retailers' costs each year.
- There should be no **competition allowance** included in the DMO 7 price.
- Clarity is required to mitigate the risk of the **DMO's purpose** and objectives being confused and interpreted differently by different people.

# Discussion summary

## *We sought views on*

## RETAIL COSTS

### The AER's approach to calculating retail costs

DMO 7 is the first time the AER has conducted its own retail costs information requests to calculate the various retail cost sub-components. Retail cost data from 25 retailers (made up of retailers with 1,000 customers or more across DMO regions, covering 99% of the market) has been collected. This will allow the AER to see each of these individual retailers' costs (not the weighted average as reported by the ACCC), providing a better understanding of the spectrum of retailers' costs.

**With this broader dataset, and better understanding of retailers' costs, how should the AER determine what proportion of the market should be able to make a reasonable profit at the DMO price?**

### What we heard

CCG members supported the current methodology for assessing retailer costs, but encouraged the AER to explore the subcomponents of the costs to serve more closely and benchmark each of those subcomponents.

There was a wide push from members to limit the AER's consideration of relevant costs to serve to those only relating to and impacting standing offer customers (who are mostly with the Tier 1 retailers). Like in previous DMO periods, CCG members argued:

- the DMO only directly applies to a small portion of customers on standing offers as the majority of customers are on market offers, which is not capped by the DMO price
- most non-Big 3 retailers' customers are on market offers
- the bulk of customers on standing offers are with the Big 3 retailers.

CCG members noted that retail costs calculations would likely be very different if the AER only considered the costs to serve for customers on standing offers.

CCG members sought clarification on the AER's projected approach to calculate smart meter costs, and concerns for instances where those projections are not met and possibly overstating the DMO price.

The CCG members also asked the AER to compare reported retail cost data with costs revealed in alternative sources (e.g. public investor reports and audited accounts) to identify any inaccuracies with retailer cost reporting. CCG members recommended the AER discounts a nominal amount from retailers' cost data to account for any of those inaccuracies.

The CCG members considered there was no justification to include costs to acquire and retain customers into the retail costs component, or it should be benchmarked at a reasonable level, and once again sought efficiency/productivity incentives from retailers in the market.

> *"It seems sensible to benchmark each of the individual retailers' costs and determine a reasonable level to apply each year"*

> *"Concerned if accounting for the least efficient/smaller retailers (that can encourage competition) would make the DMO more expensive"*

> *"There is NO justification to bake in retail business growth investment cost (which is what discounts/new entrance cost stacks are) into the retail cost component. New businesses invest in growth - if they can't do that WHILE providing efficient/competitive services, then they shouldn't and won't last in the market. That is the essence of competition"*

> *"If the AER is basing smart meter costs on projected levels and those projections are not met – it is highly possible that the DMO cost would be overstated"*

> *We want assurance that there is a productivity improvement requirement placed on retailers each year. It's included for networks, why not retailers as well?*

Participant comments/responses

# RETAIL MARGIN AND COMPETITION ALLOWANCE

## Including/Excluding the competition allowance

The DMO 7 issues paper proposed to maintain the existing decision framework:
"Where CPI is **materially** above the Reserve Bank of Australia's (RBA) target band (of 2 to 3%) for a **sustained** period, we will not apply the competition allowance to prioritise consumer protection."

**Should the competition allowance be included in DMO 7 and what other factors, if any, should the AER consider in deciding whether to apply it?**

## What we heard

Like previous positions in earlier DMO consultations, CCG members continue to strongly oppose the inclusion of a competition allowance in the DMO price.

CCG members asked the AER to seek more information from retailers on how they use any competition allowance received for the purposes of innovation and producing competitive offerings.

CCG members do not support CPI as a measure for determining the inclusion of a competition allowance. When asked for alternative measures for our decision framework to to apply/disapply the allowance, CCG members proposed consideration of the wage price index, affordability of electricity and the performance of new market entrants.

*"We are wary of additional allowances included to allow for competition. If customers have a choice between genuinely competing businesses, then that's acceptable. There should not be an allowance to ensure retailers who are making a loss are captured"*

They also proposed consideration of profit levels of incumbent retailers, especially without the benefit of the competition allowance (as was the case for DMO 6). The fact that there is a profit to be made should be the signal for new entrants to enter the market. An allowance isn't needed for this.

*"The AER should consider the performance of new entrants more closely, which may highlight we don't need a competition allowance"*

They further noted that whatever measure is used should be explained and signalled in a clear and understandable manner.

*"We do not support CPI as a measure to apply/disapply the competition allowance. Lower inflation does not immediately equal lower prices. Consumers' experiences of prices and affordability are based on the absolute price, rather than whether prices are higher now than they were yesterday"*

*"Affordability of electricity is another factor/measure that could be considered by the AER"*

*"On the DMO's retail margin, the difference between residential and small business feels arbitrary. Why are small business customers penalised? These are often family-owned businesses who are struggling with current economic conditions just like residential consumers"*

*"A wages price index may be more appropriate than CPI as it is more people based"*

Participant comments/responses

## DMO OBJECTIVES AND PURPOSE

In prior DMO consultations, CCG had called for a review of the DMO's objectives to be undertaken given the changing market environment we are experiencing.

**We invited CCG members to raise any current concerns relating to the DMO's broader objectives and purpose.**

### What we heard

CCG members continue to consider the DMO, which acts as a reference price, problematic. They seek more discussion and consideration each year of what the DMO's objectives should be based on, noting the changing market environment Australians are experiencing.

*"There is a risk that the DMO is/will be interpreted differently by different people. The AER needs to be clear about what the DMO is, and what it isn't. It's a basis for comparison for total retailer bills + a price ceiling (for standing offers). This needs to be restated in each DMO determination"*

*"The AER should be considering what the DMO should be each year. It is reasonable to have the discussion with stakeholders on what we think the DMO should be, not just focus or consult on what should or should not be included in the cost stack"*

Participant comments/responses