public interest
ADVOCACY CENTRE

Default Market Offer Prices 2021-22

Position Paper

19 November 2020

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About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in Sydney.

Established in 1982, PIAC tackles barriers to justice and fairness experienced by people who are vulnerable or facing disadvantage. We ensure basic rights are enjoyed across the community through legal assistance and strategic litigation, public policy development, communication and training.

Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales. The program develops policy and advocates in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives input from a community-based reference group whose members include:

- NSW Council of Social Service;
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- Physical Disability Council NSW;
- Anglicare;
- Good Shepherd Microfinance;
- Financial Rights Legal Centre;
- Affiliated Residential Park Residents Association NSW;
- Tenants Union;
- The Sydney Alliance; and
- Mission Australia.

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Public Interest Advocacy Centre

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The Public Interest Advocacy Centre office is located on the land of the Gadigal of the Eora Nation.

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Introduction

PIAC welcomes the opportunity to respond to the Australian Energy Regulator's (AER) position paper on Default Market Offer (DMO) prices for 2021-2022.

PIAC supports the role of default pricing in improving outcomes for consumers. In previous submissions to DMO processes PIAC has advocated for alternative formulations of the DMO based upon efficiency. We noted the approach taken to the Victorian Default Offer (VDO) and presented arguments demonstrating why its approach is both more appropriate as a consumer protection, and more effective in directing competition in the interests of consumers. In previous decisions the AER have asserted the objectives of the DMO are incompatible with such an approach. PIAC considers the experience of the DMO to date demonstrates a focus on efficiency would deliver better outcomes for consumers and the market.

PIAC recommends the AER give greater consideration to the overall impacts of the DMO, and identify opportunities to maximise its benefit to consumers and improve outcomes from retail market competition.

Impact of the DMO on consumers

The DMO has had positive outcomes for consumers as a whole and particularly for individual consumers on standing offers. Following the introduction of the DMO:

- Standing offers have remained at or below the level of the DMO, ensuring consumers on them are paying a fairer price for their electricity service.
- Median market offer prices decreased across all distribution zones and customer types, representing an 'overall' improvement in market price outcomes for consumers.
- The spread of market prices decreased, indicating less 'subsidy' between consumers.
- The prevalence of conditional discounting has decreased, with increased competition that is not exclusively price-based.

These outcomes demonstrate the value of default pricing, however a DMO that reflects efficient costs would be still more beneficial for consumers. Basing the DMO on the efficient cost of supplying energy in a region would ensure a fair price for those on standing offers, and provide consumers with a clear reference for the value of a service many find complicated and confusing.

PIAC recommends the AER focus on further improving consumer outcomes in setting DMO prices for 2021-22. This will include work to examine how a DMO based on efficiency could be formulated and implemented in future years.

Impact of the DMO on competition

PIAC has consistently rejected the Australian Energy Market Commission's (AEMC) and AER's assumption that default pricing will lead to poorer long-term outcomes by materially curtailing or impeding competition. Evidence from the operation of the DMO to date supports PIAC's position.

In its most recent monitoring report[1], the NSW Independent Pricing and Regulatory Tribunal (IPART) made a number of observations regarding the impact of the DMO on the retail electricity market, including:

- 2019-20 saw continued entry of new retailers with 33 (38 brands) operating in NSW.
- The market share of smaller retailers increased to 20%.
- The market share of the three largest retailers continued to fall.
- 2019-20 saw a continued increase in the number of NSW consumers on market offers.
- Standing offer, median market offer, and overall prices decreased.
- Product differentiation and other competition not exclusively based on price increased.

These observations, which are also reflected in the DMO position paper, indicate the DMO delivered improved consumer outcomes while business activity increased in the retail market. They suggest focusing on better consumer outcomes need not come at the expense of retail competition.

PIAC recommends in setting the DMO prices for 2021-22, the AER prioritise creating more effective competition that delivers positive outcomes for all consumers, and recognises the potential for an efficiency-focused DMO to better achieve this.

Responses to Position Paper questions

1. Do you agree with the principles that forecasts and assumptions from previous DMO determinations should not be retrospectively amended to reflect actual information?

Re-assessment of forecasts and assumptions is necessary to ensure the DMO is an effective reference point and protection for consumers. PIAC maintains the current AER approach to formulating the DMO results in unnecessarily high overall prices.

In PIAC's view, the AER's approach does not provide a transparent and objective restriction on 'unjustifiable' standing offer prices because it does not consider the efficient costs of supplying energy, calculated regularly. The current approach becomes increasingly disconnected over time from actual costs incurred by retailers, making it harder to have confidence that the resulting price is not 'unjustifiable'. This undermines trust in the DMO, making the DMO a less worthwhile reference price and less effective price protection for consumers. A transparent re-assessment of forecasts and assumptions against actual information would help address this.

If the AER intends to persist with this approach for DMO 3, PIAC accepts a review of indexation and the potential role of adjustments should be undertaken after the proposed review of the regulations by the Department of Industry, Science, Environment and Resources (DISER).

PIAC recommends the AER commit to a review of the DMO approach regardless of the findings of the DISER review. This review should prioritise the role of the DMO as an ongoing reflection of efficient cost to serve (including reasonable retail margin).

1 IPART 'Monitoring the electricity retail market 2019-20: draft report' September 2020.

9. Is it reasonable to apply a productivity factor to the DMO? What is the evidence retailers' costs are decreasing or increasing?

PIAC recommends a DMO formulation based upon an assessment of actual and benchmarked retail costs, representing an efficient cost to serve with reasonable margin. We consider this to be the most effective means of ensuring an ongoing incentive for retail cost efficiency, and refer the AER to our previous submission.

Where the AER persists with the current approach, PIAC supports the application of a productivity factor to the DMO. The current approach intentionally sets the DMO well above any estimation of efficient cost to serve (including retail margin), and indexes in line with the CPI. Without the application of a productivity factor, there is no ongoing incentive to evaluate retail costs and improve the efficiency of retail offers. A productivity factor would help ensure any benefits of lower costs are not narrowly restricted to customers on specific deals, but delivered to all consumers. As outlined earlier in this submission, PIAC considers an assessment of benefits of the DMO must include impacts on prices overall, not merely the availability of low prices to some consumers.

PIAC recommends the AER give greater consideration to the application of a productivity factor to the DMO until a new formulation method for the DMO is implemented.

11 Do you agree with our proposed approach to continue using the DMO2 step change framework?

We note the retail component of the DMO is effectively formulated by mixing 'assumed' cost levels with considerations for 'actual' cost drivers. The flaws in this approach include the inability to assess when and how to adjust for external circumstances that may have material impact upon retail operations. PIAC contends a more consistent, cost-based approach, focussed on efficiency, would make such assessments more practical.

PIAC accepts under the current approach to the DMO it is necessary to have a framework to adjust for material external changes. As such, we support the criteria for assessing costs that may require a step change adjustment.

The current formulation of the DMO, set well above efficient costs, means the threshold for costs to be considered outside the scope of reasonable risk management and good business practice must be high. We do not consider the implementation of the Consumer Data Right (CDR) or dealing with the impacts of COVID-19 meet this assessment. Specifically:

- CDR obligations will not involve significant capability to keep additional data, but changes to its access, tracking and treatment. While the likely costs are not currently known and will depend on the final details of the scheme, all estimates indicate it will not have a material impact upon business costs compared to the significant headroom afforded by the current DMO setting.
- There is no indication that costs specifically attributable to the impacts of COVID-19 are material. Retailer responses to COVID-19 do not demonstrate a systemic change in retail behaviour that would indicate material impacts of the pandemic. The behaviour of 'prudent'

retailers has not materially changed, indicating external circumstances have not required changes which impose material costs. Refer also to our response to question 12 below.

12. What will be the impact of COVID-19 on retailer costs in 2021-22? Are any retailers costs decreasing due to COVID-19?

PIAC contends the impacts of COVID-19 should be excluded from the step change framework. No consistent evidence has emerged of a substantial change in retailer behaviour, or any changes that have resulted in unavoidable or unmitigable increased costs. We highlight the following in support of this position:

- While average debt has increased, the AER's monitoring of retail debt has not shown a material increase in customers with debt of 90 days or over.
- The actual costs to retailers of increased bad or doubtful debt provisions is not known. The Victorian Essential Service Commission (ESC) review of the Victorian Default Offer (VDO) highlighted evidence from AGL and Origin indicating these increases are not a material proportion of revenue[2].
- An ESC review of 2019-20 financial results indicated many retailers have realised significant ongoing reduction in cost to serve that exceeds any indications of potential temporary cost increases due to COVID-19[3].
- AER monitoring has not shown a material increase in the numbers of customers being supported on payment plans or hardship programs, suggesting there have not been material cost increases in such programs as a result of COVID-19.
- A range of government support and other measures, including arrangements to defer network charges, have provided scope for payments to recommence and alleviated immediate debt risk issues for retailers.
- As well as being required to, prudent retailers should implement early support measures to avoid customer debt and disconnection. PIAC expects numbers of customers supported by payment plans and hardship programs to be an early indicator of potential future debt costs. If retailers are not making material changes to process, or increasing support through payment plans and hardship measures, PIAC does not consider the costs of any debt that may result to be 'unavoidable'.

PIAC recommends the AER not consider COVID-19 impacts as a valid trigger for a step change adjustment.

14. What impact will meeting CDR obligations have on retailer costs in 2021-22? What is the basis for estimating any cost impacts? Please provide relevant cost information to assist with estimating cost changes associated with CDR.

PIAC does not consider meeting the CDR obligations to be a relevant consideration under the step change framework.

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2 Essential Services Commission. 'Victorian Default Offer 2021: draft decision' September 2020, 24-30.

3 Ibid.