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Submission to the AER on the Default Market Offer Prices 2023-24 Issues Paper

Energy Consumers Australia thanks the Australian Energy Regulator (AER) for the opportunity to comment on the 2023-24 Default Market Offer (DMO) issues paper (the Issues Paper). As the AER rightfully acknowledges, the current market has only amplified the significance of the DMO as a tool to protect consumers from unreasonably high prices. For this reason we are pleased to see the AER highlighting potential changes in approach which could see the DMO best fulfil this function, in the current environment.

In our response to the Issues Paper we submit that:

- the AER should prioritise transparency, stability, and certainty for consumers in its calculation of wholesale costs for the next DMO (DMO 5);
- the retail allowance of 10% for residential and 15% for small business set in the last DMO (DMO 4) is unjustifiably high, especially given expected increases to the overall DMO cost-stack;
- there should be no difference in retail allowance for residential and small business; and
- embedded networks served by authorised retailers should be covered by DMO protections with safeguards against double-charging of network costs.

Wholesale costs and methodology

We support the AER reviewing the methodology used to set the wholesale cost component of the DMO. We agree that the AER should prioritise a methodology that ensures transparency, stability and certainty for consumers. Unless proposed changes offer an improvement in these aspects, we see no urgent need to make large-scale amendments to the methodology.

Our specific comments in relation to the proposed changes are as follows.

- In seeking to better understand how the net system load profiles may be changing, and therefore the hedging costs of the modelled retailer using access to anonymised smart meter data, the AER could also undertake analysis of how the net system load profile is no longer representative of any particular customer segment, and the “internal” hedging that may be available from consumers who have less peaky profiles.
- We see value in an approach that more accurately assesses risk management practices, and costs. However, care would need to be taken in how this could impact stability from setting one DMO to the next.

We do acknowledge that significant movements in the wholesale energy market over the past year will see this component of the overall cost-stack increase substantially. While we agree that these costs must be included in the final DMO price, we are also mindful that this will increase pressure on households and small businesses already struggling with rising energy bills and broader cost-of-living pressures.

Our most recent Energy Consumer Sentiment Survey (ECSS) found 85% of respondents were concerned energy could become unaffordable for them in the next three years, and 95% said they were concerned it would become affordable for other Australians[1]. In light of this, any increases must be justifiable and reasonable, and scrutiny should be placed on all elements of the cost-stack to ensure consumers are not paying any more than needed.

Retail allowance

In our submission to the AER's consultation on DMO 4, we contended that a retail allowance of 10% for residential and 15% for small business consumers was unreasonably high. We maintain this view. This is because:

- they are significantly higher than the retail margins used in other jurisdictions with regulated offers where effective competition continues to exist; and.
- we see little justification for differentiating between residential and small business consumers.

The DMO must protect disengaged consumers from unreasonable prices

Standing offers were originally intended as a default option for those consumers who were not engaged in the market (and to act as a reference price for comparing market offers)[2]. This remains a core objective, as there continues to exist a cohort of consumers who, for various reasons, are not shopping around and still rely on the protections offered by the DMO.

The AER's own *Towards Energy Equity Strategy* finds that 40-45% of consumers were unable to select the cheapest offer when presented with three options. Further, the same report found that 44% of Australians have literacy levels considered to be below what is required to fully participate in society[3].

With the numerous barriers to engagement that exist for Australian consumers, and the proven inability of many to adequately navigate the choice available, shopping around cannot be considered the sole way to protect consumers from high prices. Instead, emphasis should be placed on the DMO as a reasonably priced protection.

It is unfair that the retail allowance increases alongside rising wholesale and network costs

A fair price is unlikely to be achieved if the amount consumers pay for the retail allowance is linked to the anticipated rises in the overall DMO cost-stack. We agree with the AER that there is a risk of improper balance to the DMO objectives if the dollar value of the retail allowance increases for DMO 5, without any evidence of actual cost changes.

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[1] ECA, Energy Consumer Sentiment Survey, December 2022, available: https://ecss.energyconsumersaustralia.com.au/

[2] ACCC, Retail Electricity Pricing Inquiry – Final Report, available: https://www.accc.gov.au/system/files/Retail%20Electricity%20Pricing%20Inquiry%E2%80%94Final%20Report%20June%202018_Exec%20summary.pdf

[3] AER, Towards energy equity – A strategy for an inclusive energy market, October 2022, available: https://www.aer.gov.au/system/files/AER%20-%20Towards%20energy%20equity%20strategy%20-%20October%202022.pdf

In our previous submission we drew attention to the Independent Competition and Regulatory Commission in the Australian Capital Territory (ACT) who decreased their retail margin to 5.3% in 2017 following large increases in energy purchasing costs. This was to ensure the “dollar value of the retail margin would not increase at a rate that exceeded what was necessary for a reasonable profit margin”[4]. We would suggest the AER consider a similar approach.

The current retail allowances are too high to be considered reasonable

In its options paper on the DMO 4, the AER referred to the retail margins used in Victoria, ACT and Tasmania which range from 5.3% to 5.7%.

We believe sufficient reasoning has not been given as to why a 10% and 15% retail margin, significantly above those used in these jurisdictions, is considered “reasonable”.

We recognise that the objectives of the DMO differ from other jurisdictions such as Victoria in that the AER explicitly includes headroom in its retail allowance to maintain competition and incentivise switching. However we believe that there is evidence to suggest competition exists at an equal level in Victoria compared to the DMO jurisdictions, suggesting the AER does not need a retail allowance as high above other jurisdictions to fulfil this objective.

We agree with the AER’s statement that an increase in the number of RoLR events in recent months is not a result of the current retail allowance and is instead related to increased volatility in the wholesale market. Therefore, there is nothing to suggest the retail allowance is failing to support the DMO objectives around competition. We believe this is also supported by the fact that, in jurisdictions where a lower retail allowance is used, there remains adequate competition.

At the peak of the energy crisis in Victoria, where a retail operating margin of 5.7% is used, the decline in the number of retailers with published residential market offers was not dissimilar from declines witnessed in the DMO’s jurisdictions[5]. And in August 2022, Victoria was the region with the greatest number of retailers with published market offers. There was little difference for small businesses, with Victoria experiencing a less dramatic drop than DMO jurisdictions in the number of retailers offering small business market offers[6].

Consumers are incentivised to engage with a lower retail allowance

We maintain our view from our submission to DMO 4 that, for those consumers who are capable, there is sufficient incentive for consumers to switch even with a lower retail allowance. The Australian Energy Market Operator’s data on customer transfers shows that, at the peak of the ‘energy crisis’ in June and July this year, Victoria had the highest number of customer transfers compared to jurisdictions where the DMO is in place[7]. At this time, we also saw an uptick in the amount of customer transfers, the most significant of which occurred in Victoria and NSW (Chart 1).

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[4] ICRC, Retail electricity price investigation 2020-24 Final Report, June 2022, p. 49, available: https://www.icrc.act.gov.au/__data/assets/pdf_file/0010/1556182/Electricity-Final-Report.pdf

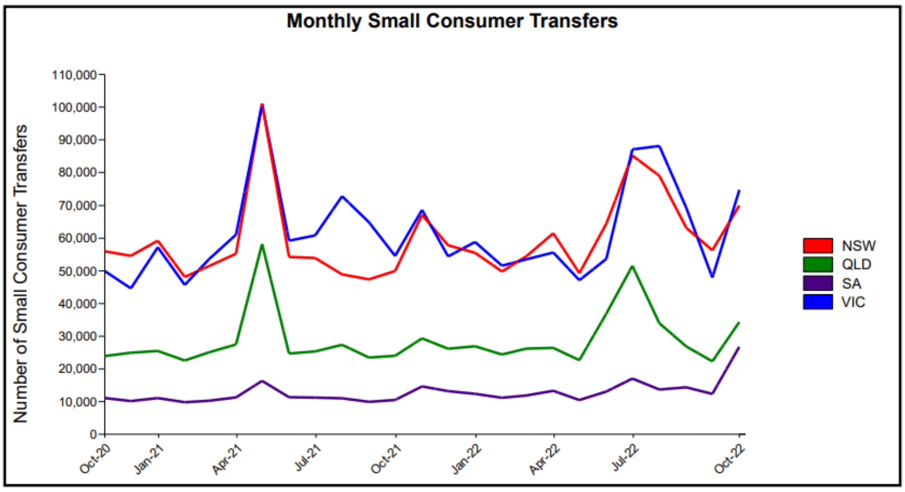
[5] St Vincent de Paul, Observations from the Vinnies’ Tariff-Tracking Project, October 2022, available: https://www.vinnies.org.au/icms_docs/334622_2022_National_Energy_Market_-_Volatile_prices_vanishing_retailers_and_vulnerable_consumers.pdf

[6] ECA, Analysis of small business retail energy bills in Australia, November 2022, available: https://energyconsumersaustralia.com.au/projects/retail-tariff-tracker

[7] AEMO, National Electricity Market Monthly Retail Transfer Statistics, October 2022, available: https://www.aemo.com.au/-/media/files/electricity/nem/data/metering/mrts/2022/nem-monthly-retail-transfer-statistics-202210.pdf?la=en

Our own data from our December Energy Consumer Sentiment Survey (ECSS) tells us that 31% of consumers in Victoria said they had switched energy company, plan or both in the past 12 months, while in South-East Queensland, NSW and South Australia between 21% and 26% of respondents said they had switched[8].

Chart 1: Number of monthly small consumer transfers in the National Energy Market (October 2020 to October 2022)



Source: Australian Energy Market Operator data on NEM monthly retail transfers – October 2022

The retail allowance should not be higher for small businesses

The AER also strays from the approaches of these jurisdictions by differentiating between small businesses and residential customers when determining a retail margin. We see no reason for this to be the case.

In our previous submission we noted small businesses were more likely to be on standing offers than residential customers and the tendency for small businesses to be less engaged is reflected in the higher retail margins they experience NEM-wide[9]. However, while the AER points to this as a justification for a higher retail allowance[10], in reality it raises a point of concern and demonstrates that the DMO's purpose to protect disengaged consumers is emphasised for small business consumers.

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[8] ECA, Energy Consumer Sentiment Survey, December 2022, available: https://ecss.energyconsumersaustralia.com.au/

[9] ACCC, Inquiry into the National Electricity Market, November 2021, available: https://www.accc.gov.au/system/files/Inquiry%20into%20the%20National%20Electricity%20Market%20-%20November%202021%20report%20-%20Copy.pdf

[10] AER, Default market offer prices 2022-23 Final determination, May 2022, p. 45, available: https://www.aer.gov.au/system/files/AER%20-%20Default%20Market%20Offer-%20Price%20determination%202022-23%20-%20Final%20Determination%20-%2026%20May%202022.pdf

Embedded Networks

We commend the AER's efforts to ensure consumers in embedded networks have access to energy at an affordable price. Most embedded network customers cannot simply switch energy company if they are unhappy with the price and so the importance of a price cap on what they are charged is particularly important. For this reason, we support extending DMO pricing protections to embedded networks served by authorised sellers as well as exempt sellers. We also agree that the AER should seek to avoid any circumstance where these customers may be 'double-charged' for network costs.

We note that, as embedded network customers generally do not have choice over their energy retailer or plan, the DMO objectives around incentives to switch and incentives for retailers to compete do not apply. A residential retail allowance of 10% therefore seems particularly unreasonable in the context of embedded networks. We ask that the AER consider whether the same retail allowance for embedded networks is necessary.

Once again, we thank the AER for the opportunity to provide comment on their review of the DMO. The AER has demonstrated in the Issues Paper the importance of the DMO as a consumer protections tool. We commend this sentiment and would hope that it underpin any potential changes the AER is considering undertaking in their approach to setting each component of the cost-stack. While we agree that unprecedented changes underway in the energy market must be captured in the DMO determination, we also expect that consumers will not find themselves paying more than what is needed to ensure a functioning energy market.

If you have any questions about our comments in this submission, or require further detail, please contact Alice Gordon at alice.g@energyconsumersaustralia.com.au.

Yours sincerely,

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