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Paula Conboy
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Sent electronically

Dear Paula

AER Position Paper Default Market Offer Price – position paper

The ACCC refers to the AER's position paper on the default market offer, released on 7 November 2018, and the invitation to provide input to the development of the Default Market Offer (**DMO**).

The ACCC's interest in the process is to ensure that the DMO is implemented in a way that achieves the goals set out in the ACCC's 2018 Retail Electricity Pricing Inquiry final report (**REPI**), which recommended the introduction of the DMO. In this submission, the ACCC makes comments relevant to the question of what factors the AER should take into account in determining the level of the DMO.

As you would be aware, the ACCC proposed the DMO in a series of interrelated recommendations in REPI. The recommendations can be summarised as:

- Recommendation 30: in the relevant jurisdictions, the existing 'standing offer' or standard retail contract should be abolished and replaced with the DMO, which provides similar consumer protections as standing offers, and for which the AER sets a maximum price
- Recommendation 32: in jurisdictions with a DMO, any retail offers that involve a headline discount must be calculated as a discount compared to the DMO
- Recommendations 49 and 50: ensure the above two recommendations also apply to small business customers.

The ACCC made these recommendations to address two broad issues observed in retail electricity markets in the National Electricity Market. Firstly, that standing offers are priced significantly above market offers, which imposes unreasonably high costs on consumers that are unable to effectively engage in the electricity market. And secondly, that the marketing of retail offers has become focused on headline discounts, but that these discounts are not off the same base price, which means that consumers cannot effectively compare offers.

As set out in REPI, the ACCC's intention for these recommendations is that the DMO will act as a cap for the price of default offers to limit the 'loyalty tax' that is levied on disengaged consumers, while also being used to create a common reference bill amount from which the majority of market retail offers can be compared against. In effecting these changes, it is intended that consumers currently on standing offers will receive a reduction in the cost of their electricity, and that consumers who shop around for their electricity deal will be better able to compare offers. This will clearly bring about more effective competition in market offers and so help all consumers.

The ACCC acknowledges that there is potentially some tension between these two goals. A DMO that is set very low will result in greater savings for customers currently on a standing offer, but a very low DMO may also attract customers that would otherwise engage in the market and shop around for a better deal. The level at which the DMO is set is critical in ensuring that these measures work to improve competition, rather than risk stifling it.

The ACCC does not want the DMO to become a viable alternative for engaged consumers that can find good deals. Engaged consumers drive efficiency and innovation in the electricity sector by responding to new offerings from retailers. Losing this engagement would result in less effective retail competition and is unlikely to be in the long-term interest of consumers.

As stated in REPI, the DMO should not be the lowest price, or close to the lowest price, in the market. It is a fallback offer for those that are disengaged or require its additional protections. Ideally, it should only be used by a small number of consumers.

The ACCC does not, therefore, consider that the DMO should be determined using a cost-based, building block methodology that is traditionally used in setting prices in those jurisdictions where prices are regulated.

The ACCC does not consider that the AER should determine the efficient cost of supply in each jurisdiction or distribution zone, or that the AER should set the DMO at an 'efficient' level. The ACCC considers that inefficiencies in the supply of electricity are better tackled by facilitating effective competition between retailers that drives prices down towards efficient costs. In the recent dynamic of advertising large headline discounts, facilitating competition between retailers will involve giving retailers room to discount well below the DMO.

The ACCC therefore strongly supports the AER's proposal to apply a 'top-down' approach.

The ACCC does not have set views on what criteria should be used to determine the DMO in each region. Setting the DMO with reference to the distribution of existing market and standing offers, however, seems appropriate. Subsequent DMOs could use other criteria, taking into account the spread of prices below the DMO (ceiling) price.

The criteria for setting the DMO will also need to have regard to any perverse incentives it may create for retailers. For example, if the distribution of market offers are used as the basis for setting the DMO, this may impact retailer decisions in how they set their prices. In this respect, a degree of flexibility in how the AER sets the DMO in future years is desirable.

Flexibility will also allow the AER to respond to the effect of the DMO over time. The initial DMO will likely reduce standing offer prices substantially and also result in significant recalibration of advertised discounts. Subsequent changes to the level of

the DMO may have less impact on retail market dynamics, but may give rise to new strategies by retailers seeking to differentiate their products.

The ACCC will continue to engage with the AER in the development and implementation of the DMO.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Rod Sims". The signature is stylized and cursive.

Rod Sims

Chair