FINAL DETERMINATION

Default Market Offer Prices 2019-20

April 2019

AUSTRALIAN ENERGY REGULATOR

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Contents

Shortened forms

Shortened form	Extended form
ACCC	Australian Competition and Consumer Commission
AEC	Australian Energy Council
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
ASX	Australian Securities Exchange
CARC	Customer acquisition and retention costs
CER	Clean Energy Regulator
CL	Controlled load
COAG Energy Council	Council of Australian Governments Energy Council
DMO	Default market offer
ECA	Energy Consumers Australia
EME	Energy Made Easy
ESCV	Essential Services Commission Victoria
EWOSA	Energy and Water Ombudsman South Australia
FiT	Feed-in tariff
ICRC	Independent Competition and Regulatory Commission
kW	Kilowatts
kWh	Kilowatt hours
kVa	Kilovolt amperes
LAR	Local area retailer
LRET	Large-scale Renewable Energy Target
MMO	Median market offer
MO	Market offer
MSO	Median standing offer
MWh	Megawatt hours
NEM	National Electricity Market
NER	National Electricity Rules
NERL	National Energy Retail Law
NERR	National Energy Retail Rules
NGL	National Gas Law

Shortened form	Extended form
NUOS	Network use of system
PIAC	Public Interest Advocacy Centre
PV	Photovoltaic system / solar power system
QCA	Queensland Competition Authority
REPI	Retail Electricity Pricing Inquiry
RET	Renewable Energy Target
RPP	Renewable power percentage
SAPN	SA Power Network
SME	Small and medium-sized business customers (enterprises)
SO	Standing offer
SRES	Small-scale Renewable Energy Scheme
STP	Small-scale technology percentage
TOU	Time of use
TUOS	Transmission use of system
UTP	(Queensland) Uniform tariff policy
VDO	Victorian Default Offer

1 Summary

This is our Final Determination for retail electricity default market offer (DMO) prices that will apply from 1 July 2019 to 30 June 2020 in network distribution zones where there is no retail price regulation.

In the final report of its Retail Electricity Pricing Inquiry (REPI), the Australian Competition and Consumer Commission (ACCC) noted that standing offers, which were originally intended as a default protection for consumers who were not engaged in the market, were unjustifiably high and have been used by retailers as a high priced benchmark from which their advertised market offers are derived. The ACCC found that the standing offer is no longer working as it was intended and is causing financial harm to consumers.

The ACCC recommended that, in non-price regulated jurisdictions, the standing offer and standard retail contract should be abolished and replaced with a default offer. Designated retailers, as defined in the National Energy Retail Law (NERL), should be required to supply electricity to consumers under a default offer on request, or in circumstances where the consumer otherwise does not take up a market offer.

The ACCC further recommended that the Australian Energy Regulator (AER) be given the power to set the maximum price for the default offer in each jurisdiction.

The ACCC noted that the default offer price will have two benefits:

- It will act as a cap on the price of default offers to limit the 'loyalty tax' that is levied on disengaged consumers
- It will be used to set a reference bill amount which all discounts must be calculated from.

On 22 October 2018, the Commonwealth Treasurer and Minister for Energy wrote to us requesting we develop a mechanism for DMO prices and a reference bill by 30 April 2019, in time for the Government to implement them by 1 July 2019.[1]

In developing DMO prices, we published a Position Paper in November 2018 and held a public forum in December 2018 to discuss the issues raised in the Position Paper. We subsequently published our Draft Determination in February 2019. We have had regard to the submissions we have received in response to our Position Paper and Draft Determination, as well as feedback provided at the public forum, in formulating this Final Determination.

[1] The Hon Josh Frydenberg, Treasurer, and the Hon Angus Taylor, Minister for Energy, *Letter to the AER*, 22 October 2018.

The legislative framework for determining DMO prices is contained in the *Competition and Consumer (Industry Code – Electricity Retail) Regulations* 2019 (the Regulations).[2]

Part 3 of the Regulations requires the AER to determine:

- how much electricity a broadly-representative small customer of a particular type in a particular distribution region would consume in a year, and the timing and pattern of that consumption[3] (the 'model annual usage')
- a reasonable total annual price for supplying electricity (in accordance with the model annual usage) to small customers of that type in that region (the DMO price).

We have made this Final Determination in accordance with the Regulations. The Legislative Instrument at **Appendix B** sets out our determination for each prescribed customer type, in each distribution region, as required under the Regulations.

In making this Final Determination we have had to carefully balance a number of important policy objectives. As a starting point, we have had regard to the need to reduce the unjustifiably high level of standing offer prices for consumers who are not engaged in the market. This is the key reason for the introduction of a DMO.

At the same time, we have sought to set DMO prices at a level that provides consumers and retailers with incentives to participate in the market, while allowing retailers to recover their efficient costs in servicing customers. The ACCC stated the default offer should not be the lowest price, or close to the lowest price in the market. Its purpose is to act as a fall-back for those not engaged in the market or for those that require its additional protections. We consider that these factors are important in facilitating competition, efficient investment, and innovation in retail markets. In a period where energy markets are undergoing significant technology and service transformation, we have been mindful of setting DMO prices in a manner that does not constrain innovation and the potential benefits of this to customers.

We have considered these policy objectives as enabled under s16(4)(d) of the Regulations.

We have used a price-based top-down approach for determining DMO prices. This method uses publicly available price information. We have also had regard to the forecast changes in key cost inputs, such as network charges and wholesale energy costs, for 2019-20.

Consistent with our Draft Determination position, we have determined that the DMO price for each distribution zone will be set at the mid-point (50th percentile) of the

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2 See: https://www.environment.gov.au/energy/electricity-code-consultation

3 The AER is not required to determine the pattern of consumption in the case of small business customers.

range between the median market offer and median standing offer, based on generally available offers in October 2018.

We consider this approach meets all the relevant policy objectives for the introduction of the DMO and criteria set out in the Regulations.

The resulting DMO prices are set out in Table 1 below. Chapter 3 sets out our annual price determination for DMO prices.[4]

Table 1: Final Determination DMO prices – 1 July 2019 (GST inclusive)

Distribution zone	Residential Flat rate	Residential Flat rate with controlled load (approx. 30% CL usage)	Small business Flat rate
Ausgrid	$1,467 for 3,900 kWh p.a.	$2,059 for 6,800 kWh p.a.	$7,371 for 20,000 kWh p.a.
Median saving#	$129	$200	$878
Endeavour Energy	$1,720 for 4,900 kWh p.a.	$2,166 for 7,400 kWh p.a.	$6,204 for 20,000 kWh p.a.
Median saving#	$175	$236	$579
Energex	$1,570 for 4,600 kWh p.a.	$1,927 for 6,300 kWh p.a.	$6,025 for 20,000 kWh p.a.
Median saving#	$118	$169	$457
Essential Energy	$1,957 for 4,600 kWh p.a.	$2,375 for 6,600 kWh p.a.	$8,045 for 20,000 kWh p.a.
Median saving#	$181	$231	$709
SA Power Networks	$1,941 for 4,000 kWh p.a.	$2,420 for 6,000 kWh p.a.	$9,120 for 20,000 kWh p.a.
Median saving#	$171	$219	$896

Median saving is the difference between the median standing offer price and the DMO price in that distribution zone, based on the model annual usage.

[4] Note that all prices in this Final Determination are GST inclusive, unless indicated.

We note that the Final Determination prices vary slightly (between -0.2 per cent and +1.8 per cent) from those in our Draft Determination due to minor updating to the standing and market offer data set. [5]

Our model annual usage determinations are outlined in Chapter 4. Consistent with the approach in our Draft Determination, our model annual usage levels for residential consumers in each distribution zone are derived from 2018 data provided by the network distribution businesses. The model annual usage for small businesses is based on research conducted by Energy Consumers Australia (ECA).

This Final Determination will lead to reductions in median standing offer prices in all distribution zones ranging between:

- $118 in Energex's zone and $181 in Essential Energy's zone for residential customers on a flat rate tariff.
- $169 in Energex's zone and $236 in Endeavour Energy's zone for residential customers on flat rate tariffs with controlled load (CL).
- $457 in Energex's zone and $896 in SA Power Network's (SAPN) zone for small business customers on a flat rate tariff.

We note that the DMO prices outlined above are indicative prices based on a set model annual usage level, and are not a 'maximum bill'. For an individual customer, their actual bill will vary depending on how much electricity they use, their distribution zone, and how their retailer has set the fixed and variable charges on their standing offer.

In accordance with the Regulations, we have specified DMO prices as annual price amounts, based on the model annual usage, rather than as fixed and variable charges. Under the Regulations, retailers must structure prices to not exceed the DMO annual price for the stated model annual usage level.

We consider that presenting the DMO price as an annual price is easier for customers to understand, and facilitates easier comparison than individual tariff components. It also provides retailers with some flexibility to translate the annual amount into different tariff structures. Different retailers will have different tariff components of supply charges and usage charges. However, our expectation is that retailers, in formulating tariffs that are consistent with the policy intent, will take reasonable steps to ensure that customers are not worse off under a DMO price tariff compared to what they are currently paying. In practice, we expect retailers should:

- maintain any relevant standing offer prices that are currently below the DMO price level at those levels

[5] These updates include changing the Ausgrid flat rate residential model annual usage from 3,800 kWh to 3,900 kWh; the exclusion of some further solar and green offers from the data set; the inclusion of some ongoing metering fees; and inclusion of three standing offers that were not in the EME data. See section 3.2.

- maintain any discounts offered to relevant standing offer customers where these result in a price lower than the DMO price.
- not increase relevant standing offer customers' fixed and variable tariff component prices from current levels.

We will use publicly available information to monitor changes to market and standing offer prices at a market-wide and individual retailer level. We consider this will be important to:

- assess whether the introduction of DMO prices is meeting the policy objectives
- inform our approach to future DMO price determinations.

In addition to setting DMO prices, the Minister and Treasurer's letter requested we develop a mechanism for a reference bill. A reference bill would function as a benchmark comparison point, against which consumers could compare the relative price of different offers.

Given that the DMO price will be specified as annual dollar amount, the DMO price for each distribution zone will also function as the reference bill price for that zone.

The code of conduct under Part 2 of the Regulations gives effect to the reference bill by requiring retailers to compare their market offers to the AER's total annual price (that is, the DMO price) for a distribution zone.[6]

As DMO prices and the reference bill are being implemented through an industry code under Part IVB of *the Competition and Consumer Act (2010)*, enforcement of its provisions will be the responsibility of the ACCC.

[6] Regulations, s 12, s 13.

Structure of this Final Determination

Chapters

Chapter 2 outlines the background and policy objectives for implementing DMO prices and legislative framework

Chapter 3 sets out our annual price determination for DMO prices

Chapter 4 sets out our model annual usage determination

Chapter 5 discusses other issues raised by stakeholders that are beyond the scope of this DMO price determination

Appendices

Appendix A – Ministerial letter requesting AER commence work to develop DMO prices

Appendix B – Model Annual Usage and Total Annual Prices determination, Legislative Instrument

Appendix C – Model Annual Usage and Total Annual Prices determination, Explanatory Statement

Appendix D – List of stakeholder submissions to the AER's Draft Determination

Appendix E – List of annual bill calculation assumptions

Appendix F – Standing and market offer analysis for each distribution zone

Appendix G – Forecast changes in cost components

Appendix H – Time of use and controlled load allocations

Appendix I – Inclusions, exclusions and assumptions for reference bill calculations

Appendix J – Sample reference bill calculation

Appendix K – Statement of compatibility with human rights

2 Background

The AER is the independent regulator for Australia's national energy market.

Our functions include regulating electricity networks and covered gas pipelines, in all jurisdictions except Western Australia. We enforce the laws for the National Electricity Market (NEM) and spot gas markets in southern and eastern Australia. We monitor and report on the conduct of market participants and the effectiveness of competition.

We protect the interests of household and small business consumers by enforcing the NERL. Our retail energy market functions cover New South Wales, South Australia, Tasmania, the ACT and Queensland.

Our goals include driving effective competition where this is feasible, providing effective regulation where competition is not feasible, and equipping consumers to participate effectively in the market.

This is our Final Determination for retail electricity default market offer (DMO) prices that will apply from 1 July 2019 to 30 June 2020 in network distribution zones where there is no retail price regulation. We have made this Final Determination in accordance with the requirements under Part 3 of the Regulations.

In meeting our legislative requirements we have also considered the policy intent as reflected in:

- The Treasurer and Minister for Energy's request in their 22 October 2018 letter to the AER (included as **Appendix A**)
- The ACCC's REPI final report, in particular recommendations 30, 32, 49 and 50, and the related commentary.

We have also had regard to:

- Submissions received in response to our Position Paper and Draft Determination. A list of submitters to the Draft Determination is included in **Appendix D**.
- Discussions and stakeholder feedback from our public forum. This was held in Sydney on 5 December 2018. Around 50 stakeholders attended, including retailers, consumer representatives, consultants and ombudsmen.
- Any other relevant information.

2.1 The Commonwealth Government's request

On 22 October 2018, the Commonwealth Treasurer and Minister for Energy requested that:[7]

> *…the AER commence work immediately on developing a mechanism for determining the price of the default market offer, consistent with the ACCC's recommendations. As part of this, we ask that the AER also develop a mechanism for determining a reference bill for each network distribution region, from which headline discounts can be calculated, in accordance with ACCC Recommendations 32 and 50.*
>
> *We ask that the AER's final determination for 1 July 2019 default offer prices and the reference bill be publicly released by 30 April 2019, to bring about price reductions for residential and small business consumers.*

The letter of request is included as **Appendix A** and also published on our website.[8]

2.2 What is the default market offer?

Currently, the NERL and the National Energy Retail Rules (NERR) include a framework under which all retailers are required to provide services to residential and small business customers under a standard retail contract if the small customer does not otherwise accept a market offer.[9] Retailers must publish, on their websites, a standard retail contract for all distribution zones in NEM regions that they operate in.[10] Retailers' standard retail contracts must adopt the model terms and conditions set out in the NERR.[11] As summarised in the ACCC's REPI final report:[12]

> *Governments retained standing offers after price regulation was removed to provide a safety net for consumers who had not engaged in the market, or for consumers who face barriers to accessing a market offer due to credit issues or other reasons. The standing offer was also used as a default offer for consumers who are switched following a retailer of last resort event. Given the role of a standing offer as a default safety net offer, the standard retail contract includes some additional consumer protections that are not required in all market retail contracts, such as access to paper billing, minimum periods before bill payment is due, a set period for reminder notices, and no more than one price change every six months. In non-price regulated jurisdictions, retailers are currently free to determine the prices of their standard offers subject to these terms and conditions.*

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7 The Hon Josh Frydenberg, Treasurer and the Hon Angus Taylor, Minister for Energy, *Letter to the AER*, 22 October 2018.

8 Available at: https://www.aer.gov.au/system/files/Letter%20to%20the%20AER%20Chair%20-%20dafault%20pricing.pdf

9 NERL, s. 22(1); NERR, r. 16.

10 NERL, s. 25(1).

11 NERL, s. 25.

12 ACCC, *Retail Electricity Pricing Inquiry - Final Report*, June 2018, p. 240.

The DMO is intended to be a service which all retailers in a non-price regulated distribution zone are obliged to offer customers that do not otherwise take up a market offer for the provision of electricity retail services. That is, it is to replace retailer-set standing offers.

The proposed July 2019 implementation of the DMO under the Regulations will incorporate the current standing offer framework in the NERL, including the standard retail contract. The new feature compared to the current standing offer framework is the introduction of a maximum price for relevant standing offers. We refer to the maximum price for standing offers as the 'DMO price'.

2.3 ACCC recommendations

In making its request to us, the Commonwealth Government referred specifically to recommendations 30, 32, 49 and 50 from the ACCC REPI final report. These recommendations are summarised in Table 2.

Table 2: ACCC recommendations

Number	Recommendation
30	In non-price regulated jurisdictions, the standing offer and standard retail contract should be abolished and replaced with a default market offer at or below the price set by the AER. • Designated retailers, as defined in the NERL, should be required to supply electricity to consumers under a default offer on request, or in circumstances where the consumer otherwise doesn't take up a market offer • The default offer should contain simple pricing, minimum payment periods, and access to bill smoothing and paper bills • The AER should be given the power to set the maximum price for the default offer in each jurisdiction. This price should be the efficient cost of operating in the region, including a reasonable margin as well as customer acquisition and retention costs. • The default offer should be used by retailers in all circumstances where a standing offer is currently used. This includes circumstances where a consumer has moved into a premises but has not contacted the retailer, where a consumer has not selected a market offer before the expiry of a market contract, and where a consumer is switched through a retailer of last resort event.
32	If a retailer chooses to advertise using a headline discount claim it must calculate the discount from the reference bill amount published by the AER. • The AER should publish a reference bill amount for each distribution zone using AER bill benchmarks for medium (2–3 person) households and the price set by the AER for default

	offers (recommendation 30). • Retailers must calculate all discounts off the reference bill, including win-back and retention offers that have discounts attached to them • Headline discounts in advertising must only include guaranteed (unconditional) discounts.
49	The ACCC's recommendation to abolish the standing offer and replace it with a 'default offer' at or below a price set by the AER (recommendation 30) should be extended to all generally available offers including offers for Small and Medium Enterprise customers.
50	The ACCC's recommendation that all discounts must be calculated from a reference bill amount set by the AER (recommendation 32) should be extended to all generally available offers including offers for SME customers. The AER should develop a process for determining a benchmark for representative usage levels for an average SME customer. Similarly, restricting conditional discounts to the reasonable savings that a retailer expects to make if a consumer satisfies the conditions (recommendation 33) should also apply to offers for small business.

Source: ACCC, Retail Electricity Pricing Inquiry- Final Report, June 2018, pp. xvii-xxv

These recommendations were designed to address two key issues, described in the ACCC's REPI final report as follows:

- In non-price regulated jurisdictions, the standing offer and standard retail contract are no longer fit for purpose. The standard retail contract is not operating as an effective default offer, nor is it delivering essential consumer protections that justify the high price of the offer.
- In recent times, standing offer prices have often been set at a high level to enable retailers to advertise high headline discounts for market offers.

2.4 ACCC commentary on the DMO price

The ACCC's REPI final report stated the DMO price should not be the lowest price in the market, but should reflect the operating costs of an efficient retailer, including a reasonable retail margin and customer acquisition and retention costs (CARC). It suggested DMO prices should fall somewhere between current standing offer prices and current market offers.

The ACCC was also clear to differentiate the purpose of a DMO price from retail price regulation in areas where there is limited retail competition:

> *The default offer should not exist to be a price accessed by most, if not all, consumers in the market. In NEM regions where there is little competition (that is, in Tasmania, regional Queensland and the ACT, and most consumers are on the standing offer) it is appropriate for the regulated price to include little or*

no CARC. In contrast, in NEM regions where the majority of consumers are on competitive market offers, the default offer price should be set at a higher level. To do otherwise would ignore the costs of customer acquisition being incurred by retailers and would discourage consumer participation and risk significantly increasing consumer disengagement.

It identified that:

…the ACCC considers that the AER should calculate the default offer price in each distribution zone based on the efficient costs of operating in each jurisdiction, including the costs of supplying an offer with additional consumer protections, such as paper billing and bill smoothing. This should include a reasonable margin as well as an allowance for CARC.[13]

2.5 Legislative requirements

The legislative framework for implementing DMO prices and the reference bill mechanism are contained in the Regulations.

Part 2 of the Regulations prescribes a mandatory industry code (the Code) for the purposes of Part IVB of *the Competition and Consumer Act 2010*. Under the Code:

- standing offer prices for small customers must not exceed a price determined by the AER[14]
- small customers must be told how a retailer's prices compare with the AER-determined annual price[15]
- the most prominent price-related feature in an advertisement must not be a conditional discount, and any conditions on other discounts must be clearly displayed.[16]

Part 3 of the Regulations confer price setting functions on the AER. Specifically, the AER is required to determine:

- how much electricity a broadly-representative small customer of a particular type in a particular distribution region would consume in a year and the pattern of that consumption[17] (the model annual usage)[18]
- a reasonable total annual price for supplying electricity (in accordance with the model annual usage) to small customers of that type in that region (the DMO price).[19]

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13 ACCC, *Retail Electricity Pricing Inquiry - Final Report*, June 2018, p. 249.

14 Regulations, s 10.

15 Regulations, s 12.

16 Regulations, s 14.

17 The AER is not required to determine the pattern of consumption in the case of small business customers.

18 Regulations, s 16(1)(a).

19 Regulations, s 16(1)(b).

The legislative instrument that sets out our DMO price and model annual usage determinations for 2019-20 is at **Appendix B**. An associated explanatory statement is at **Appendix C**.

As DMO prices and the reference bill are being implemented through an industry code under Part IVB of *the Competition and Consumer Act (2010)*, enforcement of the Code under Part 2 of the Regulations will be the responsibility of the ACCC.

2.6 Who will this affect?

The DMO price will affect residential and small business customers currently on standing offers in distribution zones where there is not already price regulation, and whose standing offer is of a tariff type for which we determine a DMO price.

Customers on standing offers

The DMO price will limit the prices charged to current and future standing offer customers but not to customers on market offers. The key policy objective of the DMO price is to mitigate the impact of unjustifiably high prices for standing offer customers while allowing scope for continued competition in market offers.

The majority of standing offer customers are customers of the 'Tier One' retailers – AGL, EnergyAustralia and Origin Energy.[20] More specifically, the local area retailer (LAR) in each distribution zone has the highest proportion of customers on standing offers.[21] The LAR (always a Tier One retailer) is the retailer that acquired the region's customer base at the time of retail market privatisation.[22]

Australian Energy Market Commission (AEMC) analysis of retailer data shows that on average in each distribution zone:

- 22 per cent of the LAR's customers are on standing offers
- Only 3 per cent of non-LAR customers are on standing offers, including other Tier One retailers.[23]

The AEMC and ACCC identified that customers on standing offers will be customers who:

- have not taken up a market offer since the introduction of retail competition in that jurisdiction – these will be customers of the LAR

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20 ACCC, *Retail Electricity Pricing Inquiry - Final Report*, June 2018, pp. 141, 241–242; AER, *Annual report on compliance and performance of the retail energy market 2017-18*, December 2018, pp. 29-30.

21 AEMC, *Advice to COAG Energy Council: Customer and competition impacts of a default offer*, 20 December 2018, pp. 14-15.

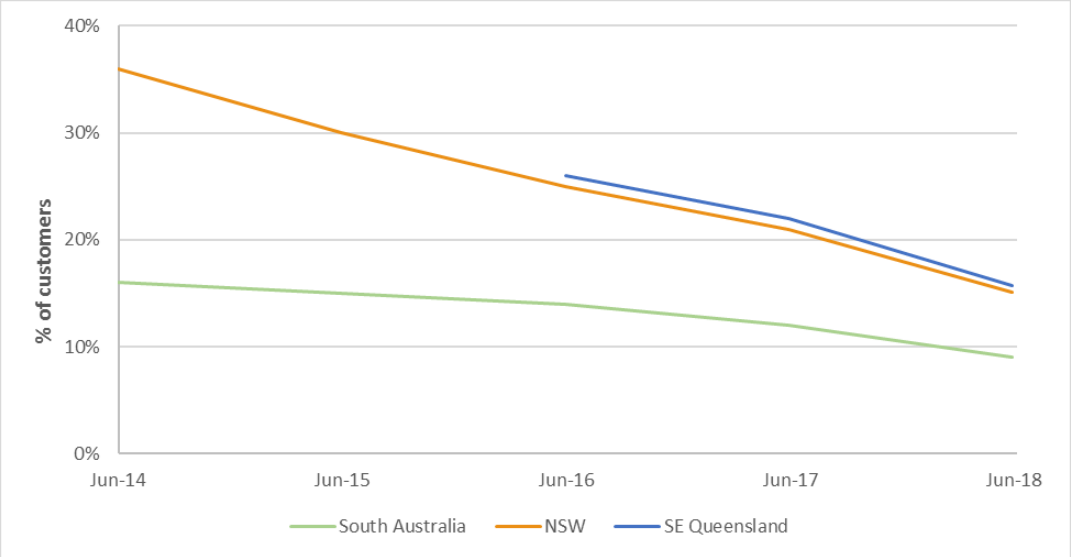
22 We note that while AGL and Origin acquired the Energex customer base, Origin is the formally designated LAR under the NERL.

23 AEMC, *Advice to COAG Energy Council: Customer and competition impacts of a default offer*, 20 December 2018, pp. 14-15.

- are supplied under a retailer's 'obligation to supply' obligations (for example, if a poor credit history means other retailers will not supply them)[24]
- have moved into a premises and receive supply from the existing retailer supplying the premises[25], but are yet to make contact with the retailer
- have defaulted to a standing offer following the expiry of a market contract.[26]

Figure 1 below sets out the trend and proportions of standing offer customers by state.

Figure 1: Standing offer customers by state



Source: ACCC, *Retail Electricity Pricing Inquiry- Final Report*, June 2018, p. 240; AER analysis

While the number of customers on standing offers has reduced over time, a significant proportion are still not accessing more competitive market offers. AEMC analysis of this inertia suggests that the reasons for not switching might depend on factors such as:[27]

- customer awareness of the different types of offers available to them and the ability to switch providers
- whether customers actively investigate offers, and how they behave once they have investigated offers

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24 Unlike other retailers, under s22 of the NERL LARs cannot refuse to supply customers.

25 AEMC, *Advice to COAG Energy Council: Customer and competition impacts of a default offer*, 20 December 2018, p. 15.

26 We note that under the Regulations the DMO price will not apply customers who are on 'evergreen' ongoing market contracts where discounts have expired, and who in practice are paying a retailer's standing offer prices.

27 AEMC, *2017 Retail Electricity Competition Review*, July 2017, p. 73.

- the ability of customers to compare offers given the information that is available to them through private and government websites.[28]

Under the NERL retailers are also able to switch a customer, without their explicit informed consent, to a standard retail contract in circumstances where the customer has not chosen a new market contract prior to the expiry of their current one, or is switched through a retailer of last resort event.[29]

Importantly, the ACCC noted there is a small cohort of customers who cannot access a market offer. This could be due to there being limited market offers where they live (for example in rural areas), or that retailers do not wish to serve them due to poor credit history.[30] The AEMC also highlighted that reasons for not switching may differ between customers and classes of customers.

The Code under Part 2 of the Regulations requires retailers not charge a standing offer customer more than the DMO price for their distribution zone and tariff type (based on the relevant annual model usage figure). In practice, this means retailers will have to reduce the prices of relevant existing standing offer customers who are paying more than the DMO price.

Customers in distribution zones with deregulated prices

DMO prices will apply in distribution zones that are not subject to retail price regulation by jurisdictional regulators.[31] These distribution zones are in the following areas:

- New South Wales
- South Australia
- South-East Queensland.

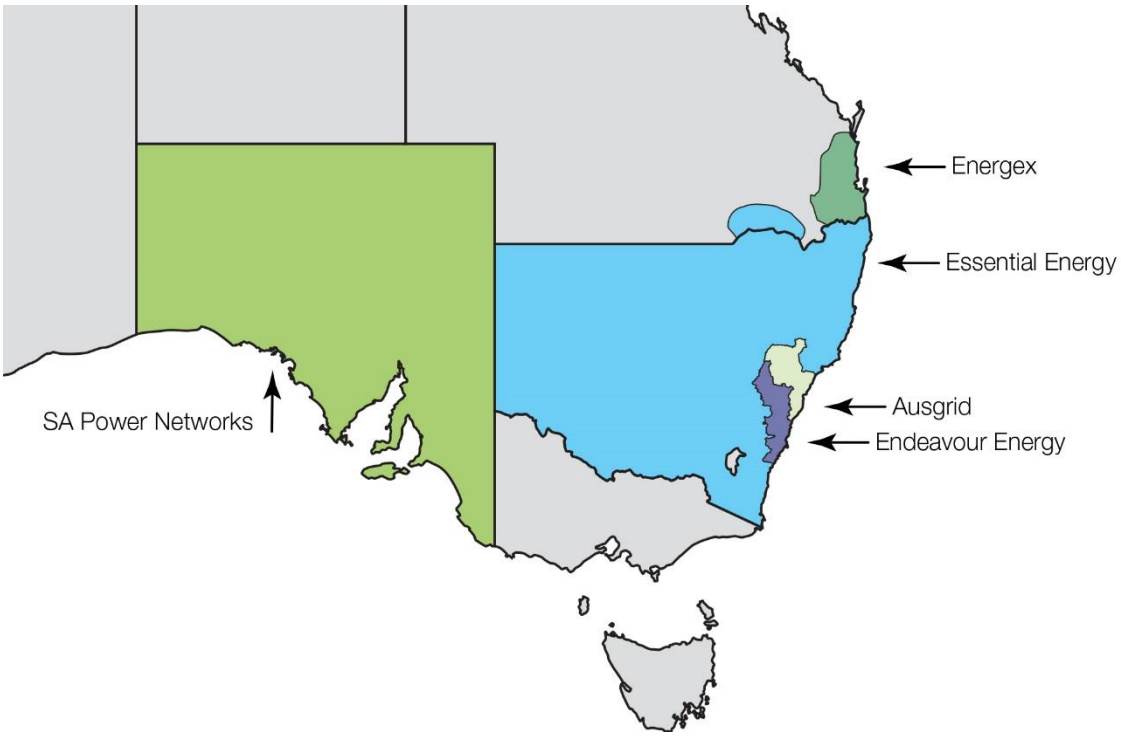
[28] The AER is undertaking a range of work to facilitate easier comparison of energy offers, including through improvements to its Energy Made Easy website, and the recent review of our Retail Pricing Information Guidelines.

[29] NERL, ss. 38(1), 54(2), 140(1).

[30] ACCC, *Retail Electricity Pricing Inquiry - Final Report*, June 2018, p. 247.

[31] Section 8 of the Regulations specifies that the instrument would not apply in a distribution region if any standing offer prices, or maximum standing office prices, for supplying electricity in the year in the region to a small customer are set by or under a law of a State or Territory.

Figure 2: Distribution zones with deregulated prices



Source: AER analysis

The jurisdictions where we will not determine a DMO price are:

- The Australian Capital Territory – The Independent Competition and Regulatory Commission (ICRC) currently regulates the price for the supply of electricity to small customers in the ACT purchased from ActewAGL Retail under regulated tariffs.[32]
- The Northern Territory – The Northern Territory Government regulates retail electricity tariffs and charges, via an Electricity Pricing Order issued by the Regulatory Minister. This pricing order applies to contestable customers using less than 750 megawatt hours (MWh) per annum.[33]
- Queensland (except for South-East Queensland) – Standing offer retail prices in Ergon's distribution zone are regulated under the Queensland Government's uniform tariff policy (UTP) by the Queensland Competition Authority (QCA).[34]
- Tasmania – The Tasmanian Economic Regulator approves the maximum prices that a Regulated Offer Retailer can charge its regulated customers.[35]

[32] See: https://www.icrc.act.gov.au/energy/electricity/
[33] See: http://www.utilicom.nt.gov.au/electricity/Pages/default.aspx
[34] See: https://www.dews.qld.gov.au/electricity/regulation
[35] See: https://www.economicregulator.tas.gov.au/electricity

- Western Australia – The Western Australian Government regulates Synergy's and Horizon Power's (main retailers) electricity prices through a UTP.[36]
- Victoria – The Essential Services Commission Victoria (ESCV) has released its Draft Advice to the Victorian Government on the Victorian Default Offer (VDO) for small electricity customers.[37] The VDO will be implemented from 1 July 2019.

2.5 Tariff types for which we determine a DMO price

As noted earlier, the NERL requires retailers to supply customers under a standing offer in certain circumstances. This requires that all retailers have at least one standing offer available in each distribution zone in which they participate. In practice, retailers typically offer numerous different standing offers for residential and small business customers within a distribution zone. The differences between these offers reflects the range of different tariff types, with retailers typically mirroring the network tariff structure applied to a customer.

Table 3 shows the different standing offer tariff types that a retailer in a particular distribution zone might offer residential customers.

Table 3: Tariff types

Tariff type	Description
Flat rate	A flat rate tariff includes a fixed daily supply charge, and a variable charge reflecting the volume (in kilowatt hours [kWh]) of electricity consumed. Usage charges do not vary by time of day, but may change based on overall consumption in a period (block tariffs) or the time of the year (seasonal tariffs).
Controlled load	A controlled load (CL) tariff is an additional charge element (potentially including both fixed and variable components) for a separately metered part of a customer's load (for appliances such as electric hot water storage systems or slab or underfloor heating). A CL tariff is generally a lower rate as these appliances operate during off-peak hours (usually overnight). Some tariffs incorporate multiple CL components.
Time of use (TOU)/Flexible	Time of use (TOU) pricing applies different charges to electricity usage (in kWh) at different times of the day (or week). Days are commonly split into peak and off-peak (and sometimes shoulder) periods. Peak periods are intended to correspond to the times the network faces high demand, but in practice are wide periods that

[36] See: https://www.treasury.wa.gov.au/Public-Utilities-Office/Household-energy-pricing/Electricity-pricing/

[37] See: https://www.esc.vic.gov.au/taxonomy/term/14

	cover much of the day. These tariffs also include a fixed daily supply charge. In the Regulations, TOU tariffs are referred to as 'Flexible Tariffs'.
Demand	In contrast to both flat rate and TOU pricing, which are based on kWh usage, a demand tariff differs in that it is based on the maximum point in time demand (in kilowatts [kW] or kilovolt amperes [kVa]) of a customer during pre-defined 'peak windows'. The windows are set by reference to the usual peak network demand. A customer's demand charge is reset after a defined period (for example, a month). Usage outside of the relevant pre-defined period does not contribute to the demand charge component (although usage charges and fixed charges may still apply).

Under the Regulations, we are required to determine DMO prices for: [38]

- residential customers on a flat rate usage tariff
- residential customers on a flat rate usage tariff with CL
- small business customers (less than 100 MWh per annum) on a flat rate usage tariff.

With respect to other tariff types, the explanatory statement to the Regulations notes:

> *No specific amount will be determined for residential customers with a flexible [TOU] tariff. Rather, the amounts applying to residential customers with a controlled load will cover both flat and flexible controlled load tariffs (and similarly for the amounts applying to residential customers without a controlled load). Similarly, upon commencement of section 11, no specific amount will be determined for residential customers who receive a feed-in tariff for a rooftop PV system. Instead the amounts applying to residential customers with a controlled load will cover both solar and non-solar tariffs (and similarly for the amounts applying to residential customers without a controlled load).*[39]

The Regulations are currently designed to apply to the most common supply arrangements and tariff types.[40] However, the Code provides for the capping requirements for standing offer prices to be extended to solar customers in the future, on a day to be fixed by the Minister by notifiable instrument.[41]

We discuss the interaction of the DMO with cost-reflective tariffs in Chapter 5.

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38 Regulations, s 6, s 16(1)(b).

39 Explanatory Statement - Competition and Consumer (Industry Code - Electricity Retail) Regulations 2019, p.11.

40 Regulations, s 6.

41 Regulations, s 2(2), s 11.

2.6 Consultation process

In making this Final Determination, we have undertaken a number of steps in consulting with affected stakeholders.

As the first step, we published a Position Paper in November 2018. This Position Paper outlined preliminary positions for how we would determine DMO prices and included a number of questions for stakeholder input. We received 31 submissions.

We also held a public forum in Sydney in December to discuss the issues raised in the Position Paper, with around 50 stakeholders attending, including retailers, consumer representatives, consultants and ombudsmen.

The key themes raised in submissions to the Position Paper were:

- Retailers generally opposed a 'hard cap' DMO, believing it would have significant impacts on competition and customer engagement. These parties noted that customers may think a government-set 'safety net' is a suitable option, which could dissuade them from taking up a market offer.
- There was general support for our use of a price-based top-down approach for setting the DMO price initially, particularly given the timeframes for the first DMO determination. However, many stakeholders considered that a bottom-up cost stack approach would more accurately capture retailers' various costs, and there was broad support for moving to this approach in future years. A number of stakeholders considered that we should have explicit regard to the QCA's methodology for setting the DMO price.
- Overall, retailers considered that the DMO price should be set around the standing offer range, to minimise risks to competition and customer engagement. In contrast, consumer submissions generally supported the DMO price being set in the market offer range.
- Some submissions considered that the proposal to only develop DMO prices for flat rate tariffs was inconsistent with broader moves to cost-reflective tariffs, and would become less relevant with greater levels of smart meter deployment. Whereas, other submissions considered that implementing the DMO for cost-reflective tariffs could increase consumer confusion and the potential for regulatory error.

We released our Draft Determination for consultation on 23 February 2019. We received 24 submissions. Key issues raised in submissions were:

- Overall, most stakeholders considered our proposed pricing approach appropriately balances the different policy objectives.
- The ACCC strongly supported the pricing methodology, and draft DMO price level, as meeting the objectives of its REPI recommendations.
- Some retailers considered the draft DMO prices do not recognise the risks faced by retailers, with some suggesting a higher-level DMO price, such as the

80th percentile of the median market offer/median standing offer range. In support of their position, retailers generally re-stated points made in response to our DMO prices Position Paper, including:

    - Market offers may be below a level where retailers can recover efficient costs, such that including these as an input into calculation of the DMO may lead to DMO prices that are too low.
    - Our approach does not adequately take into account increasing wholesale and other costs drivers. Retailers noted the uncertainties inherent in cost forecasting, as well as an increase in futures and spot prices. Retailers generally supported updating the wholesale costs in our Draft Determination. However, retailers supported our decision to not adjust the DMO price point for forecast changes in input costs for this determination.
    - The draft DMO price level is not high enough to provide an incentive for consumers to shop around for market offers. Therefore the DMO may negatively impact competition.

- In contrast, some consumer groups considered that the DMO price was too high, and should be based on a 'fair' price that only reflects efficient costs.
- Stakeholders sought further clarity on how we intend to determine DMO prices in future years.
- Stakeholders sought clarity on implementation and compliance issues such as the respective roles of the ACCC and AER and integration with the NERL and NERR.

We discuss these submissions in greater detail throughout this Final Determination document.

Our consultation documents and all public submissions to our process are available on our website at https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/retail-electricity-prices-review-determination-of-default-market-offer-prices.

3 Annual price determination

This chapter sets out our pricing methodology and reasoning for our Final Determination DMO prices for 2019-20. The DMO prices for customer types in each distribution zone are set out in Table 4 below.

Table 4: Default market offer prices – 1 July 2019 (GST inclusive)

Distribution region	Residential Annual Price without Controlled Load	Residential Annual Price with Controlled Load	Small business Annual Price
Ausgrid	$1,467 for 3,900 kWh p.a. *Median saving#* *$129*	$2,059 for 6,800 kWh p.a. *$200*	$7,371 for 20,000 kWh p.a. *$878*
Endeavour Energy	$1,720 for 4,900 kWh p.a. *Median saving#* *$175*	$2,166 for 7,400 kWh p.a. *$236*	$6,204 for 20,000 kWh p.a. *$579*
Energex	$1,570 for 4,600 kWh p.a. *Median saving#* *$118*	$1,927 for 6,300 kWh p.a. *$169*	$6,025 for 20,000 kWh p.a. *$457*
Essential Energy	$1,957 for 4,600 kWh p.a. *Median saving#* *$181*	$2,375 for 6,600 kWh p.a. *$231*	$8,045 for 20,000 kWh p.a. *$709*
SA Power Networks	$1,941 for 4,000 kWh p.a. *Median saving#* *$171*	$2,420 for 6,000 kWh p.a. *$219*	$9,120 for 20,000 kWh p.a. *$896*

Median saving is the difference between the median standing offer price and the DMO price in that distribution zone, based on the model annual usage.

We note that the DMO prices set out above are indicative prices based on a set model annual usage, and are not a 'maximum bill'. For an individual customer, their actual bill will vary depending on how much electricity they use, their distribution zone, and how their retailer has set the fixed and variable charges on their standing offer.

In accordance with the Regulations, we have specified DMO prices as annual prices, based on the model annual usage levels.[42] Under the Regulations, retailers must structure their tariffs to not exceed the DMO annual price for the model annual usage.[43] Our methodology for calculating these usage levels is discussed in detail in Chapter 4.

We consider that presenting the DMO price as an annual price is more accessible for customers, and facilitates easier comparison between offers than individual tariff components. It also provides retailers with some flexibility to translate the annual amount into different tariff structures. Different retailers will have different tariff components of supply charges and usage charges.

However, our expectation is that retailers will take reasonable steps to ensure that standing offer customers are not worse off under a DMO price, compared to what they are currently paying.

In most distribution zones, we observe that a few retailers' current standing offer prices are below the Final Determination DMO price (see **Appendix F**). As the DMO price is a maximum price, there is no basis or requirement for these standing offers prices to be increased to the DMO price level. Our expectation is that the DMO price would not impact these retailers' standing offer prices and their customers would continue to receive the current standing offer price levels.

Similar to the above point, there will be no constraint on retailers offering discounts off their DMO prices. As outlined in section 2.8 of our Draft Determination, a number of retailers introduced discounts on standing offer prices that took effect in January 2019. It has been reported that these discounts affect approximately half of existing standing offer customers. These discounted prices appear to reflect what the retailers consider are a fairer level of standing offer prices for this subset of customers. Our expectation is that standing offer customers who are currently benefitting from a retailer discount would continue to receive the discounted prices where they are lower than the DMO price, and not be disadvantaged by the introduction of the DMO price.

We expect no standing offer customer should be worse off under the implementation of DMO prices, irrespective of their consumption level. Where a retailer's fixed and variable cost structure remains broadly consistent over time, we expect that the introduction of the DMO would not increase the fixed or variable charge components of existing standing offer prices that are subject to the DMO. In transitioning to DMO prices we consider retailers should not increase the current levels of their fixed and variable components of each DMO tariff type. This approach will enable retailers to maintain their different tariff structures and still provide some flexibility to set their fixed and variable tariff components but, consistent with the policy intent, would safeguard against customers at different consumption levels being worse off with the introduction of the DMO price.

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42 Regulations, s 16(1).

43 The ACCC will be responsible for compliance and enforcement of the Regulations.

The above issues are matters that we intend to monitor following the implementation of the DMO price.

This rest of this chapter covers the following issues:

- The matters under the Regulations that we are required to have regard to in determining DMO prices
- Our selection of a price point for 2018-19, including our consideration of stakeholders' submissions on this issue
- Our consideration of forecast changes to cost inputs in 2019-20
- Our final determination of DMO prices for each of the relevant customer types in each network distribution zone.

3.1 Requirements under the Regulations

Under section 16(1)(b) of the Regulations we are required to determine what we consider is a reasonable total annual price for supplying electricity to customer types within a distribution region, for a model annual usage level.

In making this determination, we must have regard to the matters under section 16(4) and have used the relevant model annual usage amounts set out in Chapter 4. We have also had regard to the submissions made in response to our Position Paper, stakeholder feedback from our public forum and responses to our Draft Determination.

Table 5 summarises how we have had regard to each of the matters under section 16(4) in determining total annual prices.

Table 5: Matters the AER is required to consider in determining DMO prices

Regulations section 16(4)	AER considerations
(a) the prices electricity retailers charge for supplying electricity in the region to that type of small customer	We have used a sample of the generally available market offers and standing offers in each distribution region sourced from Energy Made Easy (EME) as part of our pricing methodology. We have had regard to the different levels and dispersion of available offers in each distribution region in determining DMO prices. We have also had regard to the retail offer prices for each customer type in each distribution zone.
(b) the principle that an electricity retailer should be able	We have used information on the generally available market offers and standing offers that are

to make a reasonable profit in relation to supplying electricity in the region	offered in each distribution region in determining DMO prices.[44] The observed standing and market offers (on a portfolio basis) will reflect a typical market participants' expectations about the efficient costs of providing retail services in particular distribution zones, including a reasonable profit margin. In addition we have set DMO prices above the observed median market offer in each distribution region to exclude any potential below cost prices/loss-leading offers that may not reflect a reasonable profit margin.
(c) the following costs: (i) the wholesale cost of electricity in the region; (ii) the cost of distributing and transmitting electricity in the region; (iii) the cost of complying with the laws of the Commonwealth and the relevant State or Territory in relation to supplying electricity in the region; (iv) if relevant to the region—the cost of acquiring and retaining small customers; (v) the cost of serving small customers;	Our pricing methodology takes account of these types of costs in two key ways. First, as noted above, we have used the generally available market offers and standing offers in a distribution region as part of our pricing methodology. The offers will reflect market participants' expectations about the costs of providing retail services in particular distribution zones, including the cost of acquiring and retaining small customers. Second, to account for any potential changes to costs in 2019-20, we have considered the likely direction and magnitude of changes for the main types of costs: • We have had regard to publicly available information on forecast changes in the wholesale energy costs for 2019-20. • We have had regard to the AER's pricing determinations for regulated transmission and distribution costs for 2019-20. • We have had regard to the forecast costs of complying with regulatory requirements such as the Large-scale Renewable Energy Target (LRET), the Small-scale Renewable Energy Scheme (SRES), jurisdictional schemes and feed-in tariff (FiT) schemes. • We have considered what changes in the

[44] This is discussed in sections 3.2

	retail costs component of charges – including those for costs to serve and customer acquisition and retention cost – is appropriate.[45]
(d) any other matter the AER considers relevant.	We have had regard to the policy intent for introducing a DMO price as outlined in the ACCC's REPI final report. This was to: • reduce unjustifiably high standing offer prices, and • provide a consistent base from which market offer discounts could be calculated. In recommending a DMO, the ACCC was explicit in its intention that the DMO price should be set at a level that allowed retailers to recover the efficient costs of servicing customers in each distribution zone, including costs for acquiring and retaining customers. The ACCC also noted that the DMO should be set at a level that did not dis-incentivise competition. In its submission to our Position Paper, the ACCC re-stated its position that the DMO should not be the lowest or near the lowest price level in the market.[46] Where available, we have had regard to relevant publicly available cost stack information such as the QCA's estimate of the efficient retail costs in South-East Queensland and the AEMC's 2018 Residential Electricity Price Trends Review.

Each aspect of our approach to determining DMO prices is discussed in detail below.

3.2 Selection of price point in 2018-19

Our Draft Determination position

In our Draft Determination, we set DMO prices in reference to observed and publicly available price data. We described this as a 'top-down' approach.

We considered that by having regard to both competitive market offers and standing offers in distribution zones with retail competition, and where most customers are on

[45] This is discussed in Section 3.3.

[46] ACCC, *Submission to AER on Default Market Offer - Position Paper*, 7 December 2018, p. 2.

market offers, this approach would capture market participants' expectations about the efficient costs of providing retail services.[47]

Given the policy objectives and the circumstances of this initial DMO price determination, including our short timeframe and limited access to retailer pricing information, we considered a 'top-down' approach was the most suitable approach. We noted that we would explore 'bottom-up' and other pricing methodologies in considering our approach in future years.

Our approach involved determining a range of prices in which the DMO should sit:

- *Lower bound* – The median of unique market offers across all retailers operating in each distribution zone. Our price analysis took into account all conditional and unconditional discounts. We considered that this provided a reasonable indication of the efficient costs of supplying a customer within the distribution zone and would mitigate the impact of any below-cost short-term pricing strategies.
- *Upper bound* – The median standing offer of all retailers in the distribution zone.[48]

These prices were based on standing offers and generally available market offers in EME in October 2018.

We considered that this range provided a reasonable starting point for determining a DMO price in 2019-20. Our Draft Determination was that the DMO price would be the mid-point (50th percentile) of this range in each distribution zone. We considered that this price achieved the key policy objectives of:

- *Reducing unjustifiably high standing offer prices for customers*. Given that the majority of standing offer customers are with the relevant local area retailer (LAR) in each distribution zone, we selected a draft DMO price that was lower than the LAR's standing offer in each distribution zone.
- *Allowing retailers to recover the efficient costs of providing services.* The draft DMO price was well above the median market offer in each distribution zone, which is a price point we considered provided an indication of retailers' efficient costs.
- *Not dis-incentivising competition and market participation by customers and retailers.* Our draft DMO price level was significantly higher than the lowest market offer in each distribution zone, meaning:
    - Customers on a DMO would have a strong incentive to shop around and switch.

[47] AER, *Default Market Offer - Draft Determination,* 23 February 2019, p. 34.

[48] AER, *Default Market Offer - Draft Determination,* 23 February 2019, pp. 34-37.

- There remained significant room for retailers to compete on price and discounts below the DMO price point.

Stakeholder submissions

Pricing methodology

Most stakeholders who commented on our pricing methodology considered that our approach of using the median market offer/median standing offer range as a basis for selecting DMO prices was reasonable, at least for our initial determination.[49] This support encompassed a wide range of retailer and consumer stakeholders.

ECA noted it:

> *…supported the pragmatic, market inquiry methodology the AER outlines in the Draft Determination, to re-establish the price safety net for consumers in a market where there are significant risks of paying more than necessary*.[50]

The Australian Energy Council (AEC) 'strongly supported' our use of a top-down approach for 2019-20.[51]

Some retailers re-stated concerns about aspects of our methodology, including the dataset of offers that formed our range, and the draft DMO price point. Generally, these stakeholders were concerned that our assumptions would result in a DMO price that is too low and would harm retailer viability and competition.

Simply Energy, Sumo and Meridian Energy/Powershop considered that pricing in the period of our offer set (October 2018) was likely to be based on outdated assumptions and was therefore not an appropriate starting point for determining 2019-20 prices.[52]

As noted in our Draft Determination, we consider that this period represents the best available information set for determining DMO prices under the current circumstances. This is because:

- These prices are close to the DMO determination period and therefore are more reflective of current price trends than prices across a longer period.

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[49] ECA, *Submission to AER on Default Market Offer - Draft Determination*, p. 1; AEC, *Submission to AER on Default Market Offer - Draft Determination*, p. 3; EnergyAustralia, *Submission to AER on Default Market Offer - Draft Determination*, p. 2; AGL, *Submission to AER on Default Market Offer - Draft Determination,* p. 2; Origin, *Submission to AER on Default Market Offer - Draft Determination*, p. 1; EWOSA, *Submission to AER on Default Market Offer - Draft Determination*, p. 1; ACCC, *Submission to AER on Default Market Offer - Draft Determination*, p. 1; Grattan, *Submission to AER on Default Market Offer - Draft Determination*, p. 2; Queensland Consumers Association, *Submission to AER on Default Market Offer - Draft Determination*, p. 1.

[50] ECA, Submission to AER on Default Market Offer - Draft Determination, p. 1.

[51] AEC, *Submission to AER on Default Market Offer - Draft Determination*, p. 3.

[52] Simply, *Submission to AER on Default Market Offer - Draft Determination*, p. 3.; Meridian/Powershop, *Submission to AER on Default Market Offer - Draft Determination*, pp. 2-3; Sumo, *Submission to AER on Default Market Offer - Draft Determination*, p. 1-3.

- These prices pre-date the release of our Position Paper and therefore could not be influenced by retailers' strategic behaviour in response to the proposed pricing approach.
- Our analysis shows no evidence that offers available in October 2018 are subject to any seasonal or other factors that would bias the observed prices.[53] We have undertaken some further analysis looking at March 2019 offers which further supports our assumption that the October 2018 offer set is reasonable sample for the purpose of setting DMO prices.

Some retailers considered our methodology did not take account of a range of future cost pressures that would increase retailers' costs, including retail costs (such as increasing bad debts), regulatory costs (for example, metering costs) and rising wholesale costs (underpinned by factors such as drought and political uncertainty).[54]

We have reviewed the most current information on forecast cost changes as part of this Final Determination. This is discussed in section 3.3.

A number of retailers considered some market offer prices were likely to be below the point at which a retailer could recover their efficient costs. Examples included pricing strategies that relied on customers missing conditional discounts[55] and the potential inclusion of below-cost promotional offers in our dataset, causing a downward skewing effect on our lower bound.[56]

These retailers proposed we weight these factors to ensure they did not unduly influence our analysis. For example, Alinta Energy (Alinta) considered that we should adjust market offer prices to reflect that not all customers achieved conditional discounts. It stated this would 'better reflect the AER's claim that the median market offer is indicative of an efficient price.'[57]

We accept that some retailers may take into account missed conditional discounts in their pricing strategies to recover their efficient costs, depending on their risk appetite. This issue was raised in response to our Position Paper and is one of the factors that we considered in setting the draft DMO prices at the relevant point within the specified range.[58]

In further assessing Alinta's submission, we examined the impact of upwardly adjusting the lower bound of the range based on the REPI final report finding that customers did

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53 AER, *Default Market Offer - Draft Determination,* pp. 39-40.

54 Sumo, *Submission to AER on Default Market Offer - Draft Determination,* p. 2; AEC, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-3.

55 Meridian/Powershop, *Submission to AER on Default Market Offer - Draft Determination*, pp. 2-3.; Alinta, *Submission to AER on Default Market Offer - Draft Determination,* pp. 4-5.

56 Origin, Submission to AER on Default Market Offer - Draft Determination, p. 2.; Meridian/Powershop, *Submission to AER on Default Market Offer - Draft Determination*, p. 2.; Alinta, AEC, *Submission to AER on Default Market Offer - Draft Determination*, pp. 4-5.

57 Alinta, *Submission to AER on Default Market Offer - Draft Determination*, p. 2.

58 AER, *Default Market Offer - Draft Determination,* p. 39.

not achieve all conditional discounts on 27 per cent of bills paid.[59] The ACCC's analysis did not identify a specific additional cost to consumers from missed conditional discounts. We undertook analysis on the basis that retailers expect customers to pay the full bill value for 27 per cent of bills that contain conditional discounts. This is likely to overstate the value to retailers of unmet conditions. Despite this, our analysis indicated that DMO prices calculated at the 50th percentile of this adjusted range were typically within 2 per cent of our proposed DMO prices.

Given the limited impact of this adjustment, the lack of clear data on the actual value of missed conditional discounts and the expectation that not all retailers price offers on the basis that they expect conditions to be missed, we have not adjusted the DMO price.

More generally, we accept that some retailer's pricing strategies may include below-cost offers. However, our use of the median market offer as the lower bound of our range excludes these from having an undue impact on our analysis.

Some stakeholders interpreted the ACCC REPI's final report recommendation 30 as meaning the DMO should be a 'fair' price option for all customers.[60] [61] These stakeholders generally did not support the use of a top-down approach based on price data. Instead, these submissions considered that a cost-stack/bottom-up approach was essential to establish retailers' cost elements and identify excessive retail costs.[62]

CHOICE, for example, noted that our approach of calculating DMO prices from 'inflated' market offer prices resulted in a DMO price that was above the efficient costs of providing an essential service.[63]

On this point, we note that the ACCC's submission emphasised that the DMO should not be an efficient cost-based price. Its submission noted:

> *…the DMO price should not be the lowest price, or close to the lowest price, nor should it be at an 'efficient' level. Rather, its purpose is to act as a reasonable fall-back position for those not engaged in the market for whatever reason or for those that required its additional protections, whilst also allowing scope for continued competition in retail offers.*[64]

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59 ACCC, *Retail Electricity Pricing Inquiry - Final Report*, June 2018, p. xii.

60 CHOICE, *Submission to AER on Default Market Offer - Draft Determination*, pp. 4-5; PIAC, *Submission to AER on Default Market Offer - Draft Determination*, p. 1.

61 Etrog Consulting recommended we clarify the role of efficient costs in the ACCC's recommendation. Etrog, Submission *to AER on Default Market Offer - Draft Determination*, p. 3.

62 CHOICE, *Submission to AER on Default Market Offer - Draft Determination*, p. 5; PIAC, *Submission to AER on Default Market Offer - Draft Determination*, p. 7; Active Utilities, *Submission to AER on Default Market Offer - Draft Determination*, p. 1.

63 CHOICE, *Submission to AER on Default Market Offer - Draft Determination*, p. 4.

64 ACCC, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2.

The Public Interest Advocacy Centre (PIAC) considered it was 'manifestly inappropriate to use standing offers in the calculation of a default price in a process that explicitly recognises that standing offers represent unjustifiably high prices.'[65]

We note that using standing offers to establish the upper bound of our price range is one factor we have considered in determining DMO prices that meet the relevant policy objectives. In particular, we have had regard to the LAR's standing offer price in determining whether the DMO prices meet the policy intent of providing price relief to standing offer customers.[66] In addition, we have excluded the influence of high and low outliers on our analysis through our use of the median of standing offer.

AGL considered that we should use the QCA's price determination for Ergon as the DMO price in the Energex distribution zone.

Under the Queensland Government's UTP, the QCA determines price caps for standing offers in Ergon's (regional Queensland) distribution zone based on an estimate of the cost of supply in Energex's (South-East Queensland) distribution zone. As part of this process, the QCA undertakes an annual 'bottom-up' analysis to estimate the efficient retail costs in South-East Queensland.

We have liaised with the QCA throughout our process and have taken into account relevant information from that process in making this determination.

DMO price point

There was broad support for our Draft Determination position that DMO prices be at the mid-point of the range between the median market offer and median standing offer in each network distribution zone.

The ACCC strongly supported our approach as meeting the policy objective of its REPI recommendation. It noted we had:

> *…struck an appropriate balance in […] setting DMO prices at levels that are low enough to minimise the 'loyalty tax' currently levied on disengaged consumers, while not being so low that they would risk stifling competition or would not enable retailers to recover their efficient costs in servicing customers.*[67]

Similarly, the Energy and Water Ombudsman South Australia (EWOSA), Grattan Institute and ECA considered our Draft Determination appropriately balanced the various policy objectives.[68]

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65 PIAC, *Submission to AER on Default Market Offer - Draft Determination*, p. 7.

66 AER, *Default Market Offer - Draft Determination,* pp. 43-44.

67 ACCC, *Submission to AER on Default Market Offer - Draft Determination*, p. 2.

68 EWOSA, *Submission to AER on Default Market Offer - Draft Determination*, p. 1.

Simply Energy supported the policy intent that the DMO price be a 'safety net' set above the median market offer that provided retailers with sufficient margin to provide their customers with competitive offers.[69]

Origin Energy considered that the draft DMO price level was 'reasonable' and should not be changed in our Final Determination.[70]

However, a number of stakeholders noted the market risks of a DMO price that was too low – in particular reduced customer engagement and competition – and recommended various alternative price points to mitigate these risks.[71]

For example, while the Grattan Institute considered our draft DMO prices struck a 'sensible balance', it noted any form of price cap carried risks to competition.[72] It suggested the risks could be reduced by setting the DMO price at the higher point of our draft DMO price, or the 90th percentile of market offers. It noted that this approach would:

> *…reinforce the primary role of markets, rather than regulation, in setting retail electricity prices. In general, there is no obvious reason disengaged customers should receive prices lower than customers generally pay on market offers.*[73]

We have examined where our proposed DMO prices sit in terms of the range of market offers in each distribution zone. As highlighted in Table 6, our proposed DMO prices are between the 77th and 90th percentile of markets offers across the various distribution zones. This indicates that there are a significant number of market offers below the DMO price.

Table 6: Percentage and number of market offers below the DMO price

	Ausgrid	Endeavour	Energex	Essential	SAPN
Residential flat rate					
% MO below DMO	84%	84%	89%	82%	81%
# MO below DMO	*41*	*42*	*42*	*37*	*35*

69 Simply, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2.

70 Origin, *Submission to AER on Default Market Offer - Draft Determination*, p. 2.

71 AEC, *Submission to AER on Default Market Offer - Draft Determination*, p. 3; AGL, *Submission to AER on Default Market Offer - Draft Determination*, p. 2; Meridian/Powershop, *Submission to AER on Default Market Offer - Draft Determination*, p. 2; Sumo, *Submission to AER on Default Market Offer - Draft Determination*, p. 1; Simply, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2; SA Government, *Submission to AER on Default Market Offer - Draft Determination,* pp. 1-2; ACCC, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2.

72 Grattan, *Submission to AER on Default Market Offer - Draft Determination*, p. 4.

73 Grattan, *Submission to AER on Default Market Offer - Draft Determination*, p. 1.

Residential flat rate with CL					
% MO below DMO	85%	89%	86%	87%	85%
# MO below DMO	*85*	*91*	*84*	*78*	*39*
Small business flat rate					
% MO below DMO	90%	77%	84%	82%	79%
# MO below DMO	*43*	*37*	*32*	*36*	*31*

Note: Number of unique market offers. See Attachment E for criteria.

A DMO price set at the 90th percentile of market offers would provide a marginally higher gap above the lowest market offers, and may therefore marginally decrease perceived risks to customer engagement.

Table 7 to Table 9 below compare this option against our proposed DMO prices and the LAR's standing offer price in each distribution zone. They show that a DMO price based on the 90th percentile of markets offers would be above the LAR's standing offer price for some residential and small business customers. On this basis, a DMO price set at this level would not meet the key policy objective of providing price relief for standing offer customers.[74]

Table 7: Comparison of DMO price with 90th percentile of market offers, residential flat rate offers

	Ausgrid	Endeavour	Energex	Essential	SAPN
DMO = 50th percentile MMO/MSO range	$1,467	$1,720	$1,570	$1,957	$1,941
LAR SO	$1,597	$1,793	$1,677	$2,007	$1,996
DMO = 90th percentile all market offers	$1,562	$1,796	$1,569	$2,026	$1,997
Saving from LAR SO	$35	*-$3*	$108	*-$20*	*-$1*

Notes: MMO is the median market offer. MSO is the median standing offer. LAR SO is the local area retailer standing offer.

[74] All prices throughout this document are GST inclusive unless indicated. The figures in the below tables may not fully reconcile due to rounding.

Table 8: Comparison of DMO price with 90th percentile of market offers, residential flat rate offers with CL

	Ausgrid	Endeavour	Energex	Essential	SAPN
DMO = 50th percentile MMO/MSO range	$2,059	$2,166	$1,927	$2,375	$2,420
LAR SO	$2,296	$2,314	$2,057	$2,512	$2,513
DMO = 90th percentile all market offers	$2,139	$2,182	$1,939	$2,396	$2,494
Saving from LAR SO	$157	$133	$119	$116	$19

Notes: MMO is the median market offer. MSO is the median standing offer. LAR SO is the local area retailer standing offer.

Table 9: Comparison of DMO price with 90th percentile of market offers, small business flat rate offers

	Ausgrid	Endeavour	Energex	Essential	SAPN
DMO = 50th percentile MMO/MSO range	$7,371	$6,204	$6,025	$8,045	$9,120
LAR SO	$7,915	$6,701	$6,349	$8,681	$9,803
DMO = 90th percentile all market offers	$7,340	$6,712	$6,249	$8,363	$9,358
Saving from LAR SO	$575	*-$10*	$100	$318	$446

Notes: MMO is the median market offer. MSO is the median standing offer. LAR SO is the local area retailer standing offer.

Meridian Energy/Powershop and Sumo considered that our DMO price would have a negative impact on competition and customer engagement. Both businesses suggested that a DMO price set at the 80th percentile of the median market offer/median standing offer range was the appropriate price point to mitigate these risks.[75]

Table 10 to Table 12 below compare this price point against our proposed DMO prices and the LAR's standing offer price in each distribution zone. They illustrate that this

[75] Meridian/Powershop, *Submission to AER on Default Market Offer - Draft Determination*, p. 3; Sumo, *Submission to AER on Default Market Offer - Draft Determination*, p. 1.

option would lead to a DMO price that is above the LAR's standing offer price for residential customers in some distribution zones. On this basis, setting the DMO at the 80th percentile of the median market offer and median standing offer range would not meet the key policy objective of providing price relief for standing offer customers.

Table 10: Comparison of DMO price with 80th percentile of MMO/MSO range, residential flat rate offers

	Ausgrid	Endeavour	Energex	Essential	SAPN
DMO = 50th percentile MMO/MSO range	$1,467	$1,720	$1,570	$1,957	$1,941
LAR SO	$1,597	$1,793	$1,677	$2,007	$1,996
DMO = 80th percentile MMO/MSO range	$1,544	$1,825	$1,641	$2,066	$2,044
Saving from LAR SO	$52	*-$32*	$37	*-$59*	*-$47*

Notes: MMO is the median market offer. MSO is the median standing offer. LAR SO is the local area retailer standing offer.

Table 11: Comparison of DMO price with 80th percentile of MMO/MSO range, residential flat rate offers with CL

	Ausgrid	Endeavour	Energex	Essential	SAPN
DMO = 50th percentile MMO/MSO range	$2,059	$2,166	$1,927	$2,375	$2,420
LAR SO	$2,296	$2,314	$2,057	$2,512	$2,513
DMO = 80th percentile MMO/MSO range	$2,179	$2,308	$2,028	$2,514	$2,551
Saving from LAR SO	$117	$7	$29	*-$1*	*-$38*

Notes: MMO is the median market offer. MSO is the median standing offer. LAR SO is the local area retailer standing offer.

Table 12: Comparison of DMO price with 80th percentile of MMO/MSO range, small business flat rate offers

	Ausgrid	Endeavour	Energex	Essential	SAPN
DMO = 50th percentile MMO/MSO range	$7,371	$6,204	$6,025	$8,045	$9,120
LAR SO	$7,915	$6,701	$6,349	$8,681	$9,803

	Ausgrid	Endeavour	Energex	Essential	SAPN
DMO = 80th percentile MMO/MSO range	$7,898	$6,551	$6,299	$8,470	$9,658
Saving from LAR SO	$17	$150	$50	$211	$146

Notes: MMO is the median market offer. MSO is the median standing offer. LAR SO is the local area retailer standing offer.

In contrast to concerns about the impacts of low DMO prices, some stakeholders considered that our draft DMO prices were set too high, and would not provide an appropriate level of relief to standing offer customers.

PIAC considered that the policy intent of the DMO was to develop a fair offer reflecting retailers' efficient costs. It considered that this could be achieved by setting the DMO price at the level of the median market offer.[76]

While a DMO price set at this level would provide significant price relief for standing offer customers, it would narrow the gap between the DMO and the lowest price market offer (as shown in Table 13). The savings from switching from PIAC's proposed DMO price to the lowest market offer would be:

- 45 to 57 per cent less than what would be available under our proposed DMO for residential flat rate customers, depending on their distribution zone
- 40 to 55 per cent less for residential flat rate customers with CL
- 32 to 50 per cent less for small business flat rate customers.

We consider this lower level of available savings would reduce the incentive for customers to search for better deals, and would reduce the scope for retailers to compete on price and discounts. On this basis, the DMO would not function as a 'fall-back' offer and would increase potential risks for competition and customer engagement.

Minimising the impact of the DMO on competition and customer engagement, while providing price relief to standing offer customers, has been a primary consideration for us. Table 13 shows the gap between the proposed DMO price and the lowest market offers in each distribution zone, as well as the level of discount of these offers below the DMO price (presented as a percentage). This indicates that most retailers had market offers in October 2018 that are substantially below the DMO price.

Our analysis shows that the available savings for switching from the DMO to a market offer for a customer are sizeable. When expressed as a discount, the difference between the DMO price and lowest market is around 20 per cent. These potential

[76] PIAC, *Submission to AER on Default Market Offer - Draft Determination,* p. 7.

savings should maintain incentives for customers who are on the DMO to search for better deals.

Table 13: Margins between DMO and median and lowest market offers

Distribution zone	Customer type	Margin – DMO and median market offer	Margin – DMO and average of each retailer's lowest market offer	Margin – DMO and lowest market offer
Ausgrid	Residential – flat rate	$129	$139 *9%*	$266 *18%*
	Residential – flat rate with CL	$200	$236 *11%*	$470 *23%*
	Small business – flat rate	$878	$1,106 *15%*	$1,747 *24%*
Endeavour	Residential – flat rate	$175	$186 *11%*	$321 *19%*
	Residential – flat rate with CL	$236	$282 *13%*	$514 *24%*
	Small business – flat rate	$579	$721 *12%*	$1,325 *21%*
Energex	Residential – flat rate	$118	$155 *10%*	$255 *16%*
	Residential – flat rate with CL	$169	$229 *12%*	$424 *22%*
	Small business – flat rate	$457	$509 *8%*	$1,023 *17%*
Essential	Residential – flat rate	$181	$160 *8%*	$398 *20%*
	Residential – flat rate with CL	$231	$219 *9%*	$522 *22%*
	Small business – flat rate	$709	$792 *10%*	$2,226 *28%*

SAPN	Residential – flat rate	$171	$191 *10%*	$299 *15%*
	Residential – flat rate with CL	$219	$212 *9%*	$398 *16%*
	Small business – flat rate	$896	$973 *11%*	$1,829 *20%*

In terms of specific markets, Alinta considered that our draft DMO prices in the New South Wales and South Australian markets were so low that they would have a significant impact on retail competition.[77] It suggested that these risks could be reduced by setting the DMO price closer to the median standing offer.

EnergyAustralia noted that:

> *Due to the volatile nature of the SA energy market, only retailers with generation assets would be able to offer highly competitive offers, causing some retailers to exit the market.*[78]

We note that there are a number of competitive market offers available from retailers without generation assets in these jurisdictions – see **Appendix F**. As outlined above, we have set the DMO price at a level above these market offers that we consider should not dis-incentivise competition in these markets. We acknowledge there are differing retail market structures and dynamics across the different states. We will be monitoring the movement of prices following the introduction of DMO prices, to identify and consider any market impacts as part of our role in setting prices for future years.

EnergyAustralia also considered it important that our methodology allow material cost changes to be addressed between annual DMO determinations, such as through allowing pass-throughs or re-opening the Determination.[79] We note that the Regulations do not make provisions for pass-throughs or re-openers.

Controlled load

EnergyAustralia considered that our approach of setting a single DMO price for CL tariffs may leave some customers worse off.[80]

It noted retailers would have to split CL tariffs across a fixed amount of consumption. Due to the different pricing of CL1 and CL2 elements, it considered that our approach could result in retailers setting certain CL rates for their default offers that were higher than what some customers were currently paying.

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77 Alinta, *Submission to AER on Default Market Offer - Draft Determination*, p. 2.

78 EnergyAustralia, *Submission to AER on Default Market Offer - Draft Determination*, p. 3.

79 Ibid.

80 EnergyAustralia, *Submission to AER on Default Market Offer - Draft Determination*, p. 5.

Our Draft Determination approach to calculating DMO prices for CL tariffs was to set an overall DMO CL price cap at the total bill level, which would apply to all CL customers.

We considered this was appropriate given the legislative requirements, policy objectives and the available information at this time. In particular, determining a separate DMO price for each CL configuration was counter to having a clear and easily understandable safety net and reference bill for comparison purposes (as per the ACCC's REPI final report recommendation 32).

In terms of price relief for standing offer customers, our analysis indicates that in almost all cases, the DMO CL price cap will lead to price reductions on the total annual bill for standing offer customers on all types of CL tariffs at the model annual usage level. We recognise that these reductions will differ based on CL type and location.

We also consider that setting a DMO price based on the total bill enables retailers to recover their efficient costs of supplying customers for all CL types. In particular, we note the DMO CL price cap is set at a level above the median market offer for all CL types, which we consider should provide a good indication of the efficient costs of serving retail customers. Additionally, the total bill approach provides retailers with scope to recover costs through adjustments to non-CL tariff components.

As discussed above, our expectation is that retailers will take reasonable steps to ensure that standing offer customers are not worse off under a DMO price, compared to what they are currently paying, including those customers with CL.

Our Final Determination

Our Final Determination position is that the DMO price point in 2018-19 for each distribution zone will be the mid-point (50th percentile) of the range between the median market offer and median standing offer, based on generally available offers in EME in October 2018.

We consider that this approach achieves a reasonable balance of the different policy objectives we are trying achieve and is consistent with the requirements under the Regulations.

In coming to this position, we have carefully considered stakeholders' submissions on our proposed pricing methodology and price point in 2018-19 in response to our Draft Determination. In addition, we have assessed the alternative DMO price point proposals put forward by stakeholders, having regard to the policy objectives.

We have chosen this price level based on the observed price ranges in each distribution zone having particular regard to the following factors:

- This price point would result in lower standing offer prices and provide price relief for affected customers, which is the key policy objective for introducing DMO prices. This price point is below the respective LAR's standing offer prices and would lead to reductions from the median standing offer level of between:

- $118 in Energex's zone and $181 in Essential Energy's zone for residential customers on a flat rate tariff.
- $169 in Energex's zone and $236 in Endeavour Energy's zone for residential customers on flat rate tariffs with CL.
- $457 in Energex's zone and $896 in SA Power Network's zone for small business customers on a flat rate tariff.

- We consider this price point provides sufficient margin between the DMO price and more competitively priced market offer prices in each distribution zone such that there are still benefits for customers seeking out market offers that best meet their needs. It also provides a margin above the median market offer price to enable retailers to continue their current practice of competing on discounts. In a period where energy markets are undergoing significant technology and service transformation, we have been mindful of setting retail prices in a manner that does not constrain innovation and the potential benefits of this to customers.
- While we consider that the median market offer of our dataset represents a price point at which a retailer is able to recover its efficient costs, setting the DMO at the mid-point between the median market offer and median standing offer also provides for additional margin to address some of the potential issues raised in stakeholder submissions around future cost pressures.

In validating our dataset for this Final Determination, we have made a small number of minor adjustments that have resulted in changes to the figures in our Draft Determination (ranging from -0.2 per cent to +1.8 per cent). Specifically, we have:

- adjusted the model annual usage for residential flat rate tariffs in Ausgrid's network distribution zone (see Chapter 4)
- included recurring metering charges in the calculation of annual bills. This affected a small number of small business offers.
- included three standing offers that were not published on EME and excluded a small number solar-only or green market offers.

The key assumptions we have used in calculating the annual price ranges are outlined in **Appendix E**.

The annual price ranges in each distribution zone are illustrated in charts in **Appendix F**.

3.3 Forecast changes in cost inputs in 2019-20

Observed prices in October 2018 will reflect retailers' views on the underlying costs and competitive conditions at that time. In determining DMO prices for 2019-20, we have taken account of forecast changes in input costs for 2019-20 (such as networks charges, wholesale costs and environmental costs).

Our Draft Determination position

Our Draft Determination stated that we would take account of forecast changes in input costs for 2019-20 as a factor in selecting a price point within the relevant range of the observed October 2018 prices. We stated that we would rely on publicly available information for the purpose of assessing the overall magnitude and direction of changes in costs.

In the Draft Determination, we found that:

- Wholesale costs in relevant distribution zones for 2019-20 were expected to decrease relative to costs in 2018-19. We based our forecasts of wholesale costs on the AEMC's 2018 Residential Electricity Price Trends (AEMC Price Trends) Review. We stated that these wholesale cost forecasts would be updated to take into account market information, as well as any relevant information in the QCA Regulated Retail Prices for 2019-20 Draft Determination (QCA 2019-20 Price Determination) for Ergon's distribution zone.
- Network costs in the relevant distribution zones are expected to increase at low nominal levels (at or below CPI) between 2018-19 and 2019-20. We based our network cost forecasts on the relevant AER distribution and transmission revenue determinations.
- Changes in environmental cost components between 2018-19 and 2019-20 vary:
    - Large-scale Renewable Energy Target (LRET) costs are forecast to decline marginally.
    - Small-scale Renewable Energy Scheme (SRES) costs are forecast to increase moderately.
    - Changes in the cost of meeting jurisdictional schemes are likely to be negligible.

  We based our forecasts for these environmental cost components on the AEMC Price Trends Review.
- We adjusted the underlying costs components of retail costs for inflation between 2018-19 and 2019-20.

Based on the information available at the time, we found that forecast changes in key input cost components between 2018-19 and 2019-20 would lead to a moderate decline in retail prices (between 4 to 8 per cent across the various distribution zones).

Our Draft Determination was not to adjust the proposed DMO price point in 2018-19 for expected changes in costs between 2018-19 and 2019-20. We considered this was a reasonable approach given the DMO price point selected in 2018-19, the relatively modest forecast changes in the retail prices, and the provision of some margin of error in terms of any potential cost increases that are not part of our cost forecast.

Since the publication of the Draft Determination, additional information has become publicly available that is relevant to our assessment of 2019-20 cost forecasts. This includes:

- The update of the AEMC Price Trends Review wholesale cost forecasts to factor in recent changes in contract strike prices (contract prices).
- The QCA 2019-20 Price Determination in Ergon's Distribution zone for 2019-20.
- The AER final network revenue determinations for the 2019-24 regulatory control period for New South Wales distribution zones.
- The Clean Energy Regulator's (CER) revised Renewable Energy Target (RET) figures for 2019.

Stakeholder submissions

In response to the Draft Determination we received a number of stakeholder submissions on how we had assessed the forecast changes in costs for each cost component for 2019-20 and how we had applied these forecast changes to the selected 2018-19 price point. Set out below is an outline of these submissions and our consideration of the issues raised. Where relevant we have also included a discussion of any new publicly available information that is relevant to our cost forecasts.

Forecasting approach

Origin Energy and AGL agreed with our decision not to adjust the price point.[81] Origin Energy submitted that a more robust assessment framework would be needed for us to consider a price point adjustment.[82]

Conversely EWOSA stated that all forecast reductions in retail electricity prices should be applied to the DMO prices. EWOSA noted that in the case where some of these cost reductions are likely to be passed on to electricity customers on market contracts, there is no justification not to pass these savings on to standing offer customers as well.[83]

While EnergyAustralia supported the overall top-down pricing methodology, it noted that there needs to be further transparency in how the methodology accounts for cost changes in setting DMO values. EnergyAustralia noted that this is particularly important if the top-down methodology carries over to future DMO determinations and if there are re-openers during the DMO determination period.

While EnergyAustralia did not support a mechanistic approach to linking underlying cost changes to the DMO, it submitted that stakeholders are not readily able to discern

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81 AGL, *Submission to AER on Default Market Offer - Draft Determination*, 20 March 2019, p. 2; Origin, *Submission to AER on Default Market Offer - Draft Determination*, 20 March, p. 2.

82 Origin, *Submission to AER on Default Market Offer - Draft Determination*, 20 March 2019, p. 2.

83 EWOSA, *Submission to AER on Default Market Offer - Draft Determination*, 20 March 2019 p. 1.

how changes in the Draft Determination cost forecasts may affect our Final Determination.[84] To this end, it suggested that we should consult on the revised changes in cost forecasts prior to the making the Final Determination.[85]

EnergyAustralia also suggested that we examine retail market offers to identify any systemic changes that correspond to cost trends.[86]

As outlined in the Draft Determination, our proposed approach is to have regard to forecasts changes in key input costs as a factor in selecting a price point within the relevant range of the observed October 2018 price data. We consider that incorporating forecast cost changes in this way would be fit-for-purpose and well aligned with our proposed top-down pricing methodology.

In terms of EnergyAustralia's concern regarding how we would apply the updated forecasts in the Final Determination, we did not think further interim consultation on this aspect of our Final Determination was necessary in the current circumstances. First, we have relied on information that was publicly available at the time of our Draft Determination and updated this merely to incorporate recent market information, such as contract prices. The methodology and assumptions that underlie the cost forecasts remain the same. Second, given that the updated costs forecasts would lead to moderate changes in retail prices, we are not proposing to adjust the DMO price point. Therefore, we are not proposing to change from our position as outlined in our Draft Determination.

A number of stakeholders also raised concerns with how we will forecast costs in subsequent DMO determinations and how these forecasts will be applied. These are matters for further consultation with stakeholders as part of future determinations, as discussed in Chapter 5.

The application of the AEMC Price Trends Review

Some retailers raised concerns with the use of the AEMC Price Trends Review to assess forecast changes in retail tariffs. Origin Energy and AGL noted that the AEMC Price Trends Review is not intended to forecast future retail prices. More generally, EnergyAustralia and AGL stated that we should be mindful of the limitations of modelling retailer costs.

AGL raised concerns with the lack of consultation on the forecasting methodology for the purposes of the DMO. AGL noted that the wholesale and environmental cost modelling in the AMEC Price Trends Review consultant (EY) report are predicated on a number of assumptions and methodologies that are yet to be appropriately explored and tested for the purposes of the DMO.[87]

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84 EnergyAustralia, *Submission to AER on Default Market Offer - Draft Determination*, 20 March 2019, p. 3.

85 Ibid.

86 Ibid.

87 AGL, *Submission to AER on Default Market Offer Draft Determination*, 20 March 2019, p. 2.

We are mindful that the purpose of the AEMC Price Trends Review is to assess changes in retail cost for a representative customer in each state, rather than changes in costs for particular customer consumption types.

The AEMC Price Trends Review states that it does not provide forecasts of future prices, including those which are set by jurisdictional regulators and governments. With this in mind this report still provides guidance of three key aspects relevant to our assessment; the proportion of each cost component, the forecast changes in wholesale costs, and the forecast changes in environmental costs. Further, we consider the report is the best publicly available information source that covers all distribution zones under assessment.

In addition to the AEMC Price Trends Review, we have had regard to concurrent regulatory retail price assessments being undertaken by the QCA, the ESCV and the ACT Independent Competition and Regulatory Commission, where relevant.

Wholesale cost forecasts

Some retailers raised specific issues about how we assessed wholesale costs. Meridian Energy/Powershop considered that the cost assessment should capture the period of time that appropriately reflects when retailers incur hedging costs. To this end, it submitted that we should assess hedging costs from May 2018 to May 2019. Origin Energy also noted that the calculation of volume weighing contract strike prices (contract prices) in the AEMC Price Trends Review is based on the 12/24 month hedge book build-up curve, rather than actual trade volumes. It stated that this approach, in conjunction with the absence of actual trades from October 2018 onwards, would likely not reflect the recent uplift in contract prices.

Several retailers highlighted the uplift in 2019-20 contract prices since October 2018. EnergyAustralia, Origin Energy, Sumo, Alinta and Simply Energy all provided examples of the sustained increase of baseload swap contracts, most notably in New South Wales. Sumo also noted that when comparing the Q1 2020 New South Wales baseload contract price with the Q1 2019 equivalent, the Q1 2020 contract is now $10 more expensive when comparing the contracts 12 months before delivery. Sumo noted the increase in contract prices reflects the continued upward pressure on prices caused by market fundamentals. It submitted that the October 2018 retail prices are unlikely to have completely passed through these cost to retail customers.

As outlined in the Draft Determination, the analysis in the AEMC Price Trends Review is based on observed contract prices and volumes up to October 2018. In the Draft Determination we proposed that we would update the AEMC wholesale cost estimate to take into account the actual contract price and volume information for 2019-20 contracts publicly available by the end of March 2019.

There has been a notable increase of 2019-20 contract prices since October 2018. As we are comparing the changes in costs from 2018-19 to 2019-20 we must therefore compare the prices of 2019-20 contracts with 2018-19 contracts over an equivalent time period (based on an assumed hedging strategy). In this case, we have applied the

AEMC approach of the period leading up to the month of March prior to the commencement of the financial year.

As shown in the Table 14 below we have calculated the price of Australian Securities Exchange (ASX) baseload swap contracts for New South Wales, South Australia and Queensland. The table compares both the 12 month trade volume weighted price and the AEMC small retailer book build weighted price.

Table 14: Baseload swap contracts 2019-20 and 2018-19

		2019–20 pricing period		2018–19 pricing period	
	Calendar Year - Quarter	**12 month trade weighted price ($/MWh)**	**AEMC weighted price ($/MWh)**	**12 month trade weighted price ($/MWh)**	**AEMC weighted price ($/MWh)**
Qld	Q3	68.80	70.72	72.29	70.58
	Q4	63.56	65.10	70.37	69.61
	Q1	80.00	83.14	85.88	83.93
	Q2	58.83	61.75	63.88	62.68
NSW	Q3	80.94	84.72	89.63	87.75
	Q4	71.00	75.81	79.42	77.82
	Q1	88.54	94.32	89.56	88.61
	Q2	71.63	75.16	80.43	78.98
South Australia	Q3	86.68	89.13	111.29	107.3
	Q4	77.30	80.37	95.23	93.67
	Q1	111.15	115.38	127.47	120.49
	Q2	73.01	80.58	101.09	93.09

Source: ASX Energy and the AEMC Price Trends Review

The above table indicates that when comparing the 2018-19 baseload contract prices with 2019-20 baseload contract prices, the 2018-19 prices are marginally more expensive.

As set out in Table 15 below, and in the consultant report, EY has updated the original wholesale energy cost forecasts to include the changes in the relevant contract prices.[88]

Table 15: Updated wholesale energy cost forecasts

	Wholesale energy cost ($/MWh)		Change (%)
Distribution zone	**2018-19**	**2019-20**	**Year-on-year**
Energex	$83.09	$72.93	-12.2%
Essential	$100.91	$91.56	-9.3%
Endeavour	$108.13	$103.10	-4.7%
Ausgrid	$108.99	$99.45	-8.8%
SAPN	$149.28	$138.44	-7.3%

Source: EY consultant report, April 2019.

The updated figures still forecasts a reduction in 2019-20 wholesale energy costs when compared to 2018-19 energy costs. As outlined in the consultant report, this is despite the recent increase in the 2019-20 contract prices and the subsequent increased cost of hedging.

The overall retail price stack in **Appendix G** has been revised to reflect the updated wholesale cost estimates.

Alinta also submitted that we should consider the implications of the wholesale market price volatility and policy uncertainty. We consider this is likely an ongoing characteristic of the energy market rather than an emerging factor. Given this feature of the market is a continuation from the 2018-19 pricing period, we would expect that retail prices in October 2018 will already include any pricing in of these factors. To the extent that these factors have materially changed from the previous year, wholesale market modelling should capture any changes in the cost arising from these issues.

[88] These forecasts do not include other wholesale energy costs such as NEM fees, ancillary service charges, and loss factors. In accordance with the AEMC Price Trends Review methodology, we have incorporated these additional costs in the final wholesale costs forecasts set out in the summary table at the end of this section and in **Appendix G**.

QCA draft determination for regulated retail prices in 2019-20

In the Draft Determination we noted that we would have regard to the costs estimated in the QCA 2019-20 Price Determination for the Ergon distribution zone as an additional layer of information to assess how costs have changed in the Energex distribution zone.

QCA published the Draft 2019-20 Price Determination in February 2019.

QCA undertakes a 'bottom-up' estimate of efficient retail costs in the Energex distribution zone as part of the determination of regulated retail electricity prices (notified prices) in the Ergon Energy distribution zone. Under the methodology, the wholesale, environmental and retail costs are determined by QCA in conjunction with its consultant ACIL Allen.

The QCA Draft 2019-20 Price Determination outlined several key differences between ACIL Allen's and EY's methodologies to forecast wholesale costs in the Energex zone.[89]

A fundamental difference is the purpose of each forecast methodology.

As outlined above, the purpose of the AEMC Price Trends Review is to provide an overall assessment of retail price trends for a representative customer for each region. EY's methodology is therefore designed to consolidate cost estimates across a broad range of tariff types.

The ACIL Allen forecasting methodology has been developed for the purpose of QCA's bottom-up assessment. This methodology has been formulated to capture the relevant factors that are required to assess the cost components for each regulated tariff. In particular we note ACIL Allen uses an ex-ante hedged book build approach based on set hedging requirements. This approach is designed to reflect a risk averse retailer's hedging approach. Furthermore, different load profiles are applied for different retail tariff types (flat rate and CL) when modelling wholesale costs.

Other than these factors, there are the following differences in the assumptions under the two approaches.

- *Weights for hedged book build:* ACIL Allen uses a trade-weighted average of ASX Energy daily settlement prices for base, peak and cap contracts. It considers all the contracts traded back to the first trade recorded in the ASX Energy database for a given hedging product. EY uses observable futures contract prices that retailers use to build up their hedge contract book over time.
- *Different hedging time horizon for small and large retailers:* EY assumes a two-year book build profile for large retailers and a one-year book build profile for small retailers, and weights the hedge outcomes by the market share of small

[89] QCA, *Regulated retail electricity prices for 2019–20 - Draft Determination*, February 2019, p. 32.

and large retailers in each jurisdiction. ACIL Allen does not distinguish between small and large retailers.[90]

- *Forecasting spot prices:* EY uses in-house modelling (2-4-C®) to assess the wholesale market outcome for multiple simulations, which is an estimate of the lowest cost generation mix capable of meeting customer demand in all 30 minute trading intervals for the reporting period.[91] It also requires the generator to meet a net revenue test, where the generation revenue is equal to its operating costs and annualised capital cost repayments.[92] ACIL Allen uses its proprietary electricity model (Powermark) to estimate the wholesale spot prices for multiple simulations.[93]

- *Tariff type:* While the AEMC considers that the representative customer is on a residential flat rate with CL 2 tariff type, the QCA determines the tariffs for all single rate and CL tariffs separately.[94]

We note that these key differences between the two methodologies will impact the wholesale cost estimates made by EY for AEMC and ACIL Allen for QCA. Nevertheless, both forecasts indicate a reduction in wholesale costs in 2019-20 over 2018-19. In the case of the EY update, the revised forecast is an 11.8 per cent reduction (this includes the additional wholesale costs such as NEM fees). The QCA Draft 2019-20 Price Determination has forecast an 8.9 per cent reduction in wholesale energy costs for residential flat rate with CL 2 tariffs.

Given each tariff type is assessed separately, the QCA 2019-20 Price Determination forecasts provide a more granular and detailed assessment of expected changes in wholesale costs in South East Queensland. We have therefore incorporated these forecasts when assessing cost changes in the Energex zone. We have applied the QCA wholesale cost forecast for flat rate with CL 2 [95] for the Energex distribution zone.

Derived from the draft QCA 2019-20 Price Determination, Table 16 sets out the forecast change from 2018-19 of the wholesale costs for the tariffs relevant to the DMO.

Table 16: Change in wholesale cost estimates in 2019-20 from 2018-19

Tariff*	Change (%)
Residential and small business flat rate (FR)	-9.9%

[90] QCA, *Regulated retail electricity prices for 2019–20 - Draft Determination*, February 2019.

[91] EY, *Residential Electricity Price Trends – Wholesale Market Costs Modelling 2018*, 18 December 2018.

[92] Ibid.

[93] ACIL Allen, *Estimated Energy Costs - 2019/20 Retail Tariffs,* 19 February 2019.

[94] AEMC, *2018 Residential Electricity Price Trends Methodology Report*, 21 December 2018.

[95] Consistent with the AEMC price trend review the 'flat rate controlled load 2' tariff type was applied for SEQ

Tariff*	Change (%)
Residential flat rate with controlled load 1 (CL1)	-3.8%
Residential flat rate with controlled load 2 (CL2)	-8.9%

Source: QCA 2019-20 Price Determination

* Only the tariffs relevant to the DMO are listed

Note: Ancillary services and NEM market fees are added to the wholesale costs as per the methodology used in AEMC Price Trends Review

Environmental cost forecasts

Meridian Energy/Powershop submitted that the assumptions for estimating environmental costs will need to be updated to reflect the recently published renewable power percentage (RPP) and the small-scale technology percentage (STP).

The RPP and STP for 2019 were published by the Commonwealth Minister for Energy on the CER website in March 2019.[96] Since the information was not available when the AEMC Price Trends Review was published, the RPP and STP for 2019 used by AEMC in forecasting the 2019-20 environmental costs were estimated by its consultant EY.

Based on the methodology used by the AEMC, we recalculated the RPP and STP for FY 2018-19 and FY 2019-20 using the percentages published by the CER. The RPP and STP values using both these approaches are compared with the original AEMC forecast values in Table 17 below.

Table 17: AEMC-CER comparison for RPP and STP for FY 2018-19 and FY 2019-20

Period	Particulars	RPP	STP
CY 2019	AEMC	17.90%	19.59%
	Published on CER website	18.60%	21.73%
FY 2018-19#	AEMC	16.52%	17.71%
	Recalculated using CER figures	16.70%	18.24%

[96] Meridian/Powershop, *Submission to AER on Default Market Offer - Draft Determination*, 20 March 2019, p. 2.

Period	Particulars	RPP	STP
	Difference between AEMC and recalculated figures	**0.18%**	**0.53%**
FY 2019-20#	AEMC	18.32%	19.37%
	Recalculated using CER figures	18.85%	20.98%
	Difference between AEMC and recalculated figures	**0.53%**	**1.61%**

Source: AEMC 2018 Residential Electricity Price Trends Methodology Report; CER website

AEMC Price Trends Review applies a ratio of 75:25 on two consecutive calendar years to calculate RPP and STP for a financial year. For example, FY 2019-20 RPP = 75% of CY 2019 RPP + 25% of CY 2020 RPP.

The comparison indicates a minor difference between the values estimated in the AEMC Price Trends Review and the recalculated values based on the percentages published by CER. Based on the methodology used by the AEMC, we do not consider using recalculated RPP and STP will have a material impact on the change in environmental costs across the 2018-19 to 2019-20 period. Therefore, we have not adjusted the forecast cost change for the RPP and STP published on the CER website in March 2019.

Meridian Energy/Powershop also noted that the forecast changes in costs does not include an assessment of the impact following the non-surrender and under-surrender of LGCs for the 2018 calendar year.[97] We note that the implications of this shortfall will depend on how a retailer carries forward the liability in subsequent years. Nonetheless, in calculating the RPP, the CER does not require a retailer to make up the shortfall of non-surrender of certificates by other entities. On balance, we do not consider this recent under-surrender of certificates should alter our assessment of forecast cost changes in the RET obligations.

Retail cost forecasts

Regulatory reforms

Several retailers raised the cost implications of ongoing regulatory reform and energy affordability, in terms of both servicing customer debt and meeting hardship policy reform.

Meridian Energy/Powershop and Sumo[98] noted that with the increases in the underlying cost of providing electricity there is an increase in 'bad debt', which

97 Meridian/Powershop, *Submission to AER on Default Market Offer - Draft Determination*, 20 March 2019, p. 2.

98 Sumo, *Submission to AER on Default Market Offer Draft Determination*, 20 March 2019, p. 2.

ultimately incurs a cost on the retailer. Further, Meridian Energy/Powershop noted that the recent introduction of the AER Customer Hardship Policy Guidelines along with forecast negative economic conditions, will place an increased requirement for retailers to manage these debts until such time that the customer is able to meet the liability.[99]

In the AER's Compliance and Performance of the Retail Energy Market 2018 report, we noted that between 2016-17 and 2017-18 the average debt of non-hardship customers rose significantly, while across all jurisdictions the proportion of customers in debt decreased.[100] On balance this indicates that electricity has become less affordable for some customers and it is likely that retailers would have had a greater cost burden due to bad debt over this period.

Over the same period energy prices were increasing and hence bills were becoming less affordable for customers, which is a likely driver of increasing bad debt cost. However, as highlighted in this determination, underlying costs are not expected to lead to an increase in retail bills when compared to 2018-19 electricity prices. Given these factors, we would expect that, holding everything else constant, the cost of servicing bad debt is unlikely to increase materially.

In responding to the issue of increased costs stemming from our new Customer Hardship Policy Guideline, we refer to the AEMC Strengthening Protections for Customers in Hardship rule change 2018:

> *As noted throughout this determination, the Commission's view is that the final rule does not provide the AER with any additional powers. Rather, the rule creates a more efficient and consistent approach for the AER to exercise its powers. Therefore, the Commission finds that any costs associated with the outcomes of the Hardship Guidelines are costs that relate to retailers giving effect to their requirements under the NERL. The Commission considers there would be minimal cost impacts for those retailers who already comply with the NERL and who provide adequate support for customers facing payment difficulties due to hardship.*[101]

Therefore, we do not consider the new Customer Hardship Policy Guideline will cause a material change in the cost of managing debts.

Power of choice

Sumo and Meridian Energy/Powershop stated that the Power of Choice reforms[102] mean that retailers are facing increasing costs of meeting these obligations as more customers require new meters.

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99 Meridian/Powershop, *Submission to AER on Default Market Offer Draft Determination*, 20 March 2019, p. 2.

100 AER, *Annual report on compliance and performance of the retail energy market 2017–18*, December 2018, pp. 51-53.

101 AEMC rule change, *National Energy Retail Amendment (Strengthening Protections for Customers in Hardship) Rule 2018*, p. 28.

102 For further information see: https://www.aer.gov.au/consumers/my-energy-service/smart-meters#power-of-choice reforms

We agree that there are costs that would have been incurred as a result of the implementation of the Power of Choice package of reforms. However, most of these costs would have already been incurred to meet the compliance framework requirements. Since the Power of Choice reforms were introduced in December 2017, the AEMC has made a further amendment to the framework to require metering installations within a set timeframe. We consider this change is likely a relatively moderate adjustment of a retailer's established systems and operations along with an amendment of the contractual arrangements with the relevant metering coordinator. However, these costs are unlikely to have a material impact on overall tariffs.

In terms of retailers incurring higher costs as a result of the uptake of smart meters, we note that they are able to pass the costs on to customers by charging a fee either as a lump sum or over time, or by incorporating the cost as part of the electricity supply charges or other type of on-going charge. Under the Regulations, it is only the latter type of charges that we may consider for the purposes of the DMO price.[103] Given this factor and the relatively modest level in smart meter take-up growth, we do not consider this is a material cost that should be adjusted for in our retail cost forecast.

Retail costs for customer initiatives

AGL and Meridian Energy/Powershop contended that we should have regard to ensuring customer benefit initiatives and product innovation are not stifled by the DMO price. AGL stated that in recent half-year results, AGL's net operating cost per customer increased by 7 per cent. AGL submitted that the DMO should not penalise retailers that have invested in these initiatives.[104]

Meridian Energy/Powershop also stated that its retail business has consistently incurred costs for innovation and development to improve customer experience, service standards and product options.[105] Meridian Energy/Powershop contended that these costs are especially important during the ongoing energy transformation to an increased reliance on renewable energy and decentralised participation.

We agree with AGL and Meridian Energy/Powershop that these types of initiatives should continue and not be discouraged by the DMO. However we do not consider the retail cost component should be adjusted for this reason due to the following factors:

1. Given the DMO price point selected, we do not consider the DMO price curtails the ability of a retailer to improve customer benefit initiatives. To the extent that retailers in a competitive market would already be undertaking these type of initiatives, these costs should already be reflected in the October 2018 tariffs.
2. The introduction of the DMO price and advertising requirements under the Regulations will mean that the value of these features of a retail business will likely become better identified by customers when comparing offers.

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[103] Power of Choice Regulations, s 5.

[104] AGL, *Submission to AER on Default Market Offer Draft Determination*, 20 March 2019, p. 3.

[105] Meridian/Powershop, *Submission to AER on Default Market Offer Draft Determination*, 20 March 2019, p. 3.

3. Standing offer customers only account for around 14 per cent of customers across the NEM, therefore it's unlikely that a reduction in revenue from these customers would materially affect retailers' ability to innovate. We expect that in a competitive retail market these types of retailer led initiatives will continue for the primary purpose of improving a retail business's competitive edge over other retailers.

Five minute settlement

Alinta submitted that the costs of the five minute settlement systems upgrades should be included in our assessment of the changes in costs.[106] The five minute settlement rule change is designed to align settlement periods with the five minute dispatch price. Currently settlement prices are calculated on a 30 minute basis. The transitionary period to five minute settlement is three years and seven months, commencing on 1 July 2021. To meet this milestone the industry will need to adjust how metering data is collected and shared and ultimately the operation of the settlement framework. In addition, these changes will impact how retailers and generators manage hedging requirements. We note that the Australian Energy Market Operator (AEMO) is currently implementing these preparatory measures in conjunction with industry.[107]

Alinta stated that this preparatory stage of the reform will be substantial and will potentially span a lengthy time period. Costs will be reflected through both AEMO implementation costs, which will be reflected in increased market participant fees, and the internal implementation costs for market participants. Alinta submitted that the DMO should account for the costs associated with designing, building, testing and operationalising the necessary IT systems upgrades.[108]

We note that the AEMC Price Trends Review has taken into account the increase in NEM fees. In so far as these AEMO costs are being passed on to retailers, the costs have been included in the overall assessment of wholesale cost forecasts.

With regard to industry costs, at this preparatory stage, we expect these will be primarily associated with market generators and the replacement of meters. In the event that these costs are passed on, the retailer will incur the costs through increased wholesale and/or network costs. Given these costs are already included in our cost forecast, we do not propose to further adjust our forecast retail costs. However we will need to consider the implications of this reform from when it comes into effect on 1 July 2021 in future determinations.

Network cost forecasts

As outlined in the Draft Determination, we consider that the change in annual revenue, as set out in the relevant regulatory determinations, provides the best indicator for how network costs will change in 2019-20. This is referred to as the 'X factor' in our revenue determinations.

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106 Alinta Energy, *Submission to AER on Default Market Offer Draft Determination*, 21 March 2019, p. 5.

107 See: https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Five-Minute-Settlement

108 Alinta Energy, *Submission to AER on Default Market Offer Draft Determination*, 21 March 2019, p. 5.

In the Draft Determination, we relied on the respective draft network revenue determinations for the 2019-24 regulatory control period (published in November 2018) for forecasting network cost forecasts for the New South Wales distribution zones. In this Final Determination, we have used the final network revenue determinations published by us in April 2019 to forecast the change in network costs in the Essential Energy, Endeavour Energy and Ausgrid distribution zones in 2019-20.

The revised forecast change in the network costs for our Final Determination is outlined in Table 18 below.

Table 18: Comparison of change in network costs in New South Wales in 2019-20 from 2018-19 between Draft Determination and Final Determination

	Draft Determination	Final Determination
Essential	1.8%	0.7%
Endeavour	1.3%	-0.9%
Ausgrid	-0.6%	-16.3%

Source: AER analysis

We note that there is a sizeable change in forecast network costs in the Ausgrid distribution zone for 2019-20.

Ausgrid submitted that the forecast change in its network component between 2018-19 and 2019-20 in our DMO Draft Determination does not accurately represent the expected reduction in the transmission component of Ausgrid's network charges (network use of system charges, or NUOS).[109]

It noted that if its transmission revenue change is factored into the transmission use of system (TUOS) component for 2019-20, a residential customer on a flat tariff (EA010) would see a significant TUOS reduction from 2018-19 to 2019-20, rather than a small increase.[110]

We note that the final remittal decision for the Ausgrid 2014-19 electricity distribution determination was made in January 2019.[111] This decision resulted in an adjustment comprised of two parts:

- $41.1 million (nominal) at 30 June 2019 to be included in the total 2019-24 revenues for Ausgrid's distribution network.

[109] Ausgrid, *Submission to AER on Default Market Offer Draft Determination*, 20 March 2019, p. 2.

[110] A 38.1 per cent decrease in TUOS for 2019-20, rather than a 4.48 per cent increase.

[111] AER, *Final decision Ausgrid Adjustment Determination*, January 2019, p. 4.

- $352.0 million (nominal) at 30 June 2019 to be removed from the total 2019-24 revenues for Ausgrid's transmission network.

The net total of $310.9 million (nominal) at 30 June 2019 was proposed to be returned to customers over the 2019-24 regulatory control period.[112]

The final remittal decision for Ausgrid has been included in Ausgrid's final distribution and transmission network determination for 2019-24 (Ausgrid 2019-24 determination).

Given the above factors, we note that the forecast reduction in Ausgrid network costs in 2019-20 is a function of the unique circumstances of the 2014-19 remittal process. First, the Ausgrid forecast is based on the Ausgrid 2019-24 determination which involves transmission revenues being returned to customers from the 2014-19 period. The significant revenue reduction for 2019-20 is also a result of how we have adjusted revenues over the 2019-24 regulatory period. The Ausgrid 2019-24 determination forecasts an 83 per cent real reduction in Ausgrid's transmission revenue requirement in 2019-20 and then a 17 per cent per annum real increase in the revenue requirement in the subsequent four years.

Ultimately how this 2019-20 revenue reduction affects New South Wales customers will depend on the allocation of transmission charges for each New South Wales connection point. We have undertaken a conservative assessment of the customer impact by only applying the revenue change to Ausgrid customers and assuming that the majority of the transmission cost for Ausgrid customers is the Ausgrid transmission charges. We note that this approach may overstate the forecast price reduction for Ausgrid customers.

If we were to incorporate the Ausgrid network cost forecast for 2019-20 to adjust the DMO price point in 2018-19 without consideration of the above factors, it would lead to DMO prices in 2019-20 at levels consistent with current market offers. This would create risks of dis-incentivising competition and market participation by customers and retailers. This adjustment could also lead to price volatility in future years. On balance we consider that not adjusting the DMO price point in the circumstances is a reasonable approach.

Our Final Determination

Based on the information discussed above, we have found that:

- Wholesale costs in relevant distribution zones for 2019-20 are expected to decrease when compared to wholesale costs in 2018-19, despite the contract prices increasing between October 2018 and March 2019. We have based our wholesale costs forecasts on the underlying contract price and volume data analysed in the AEMC Price Trends Review, updated to 1 April 2019. For the Energex distribution zone, we have also had regard to the draft QCA 2019-20 Price Determination wholesale cost estimate by applying it in estimating retail price changes in Energex's distribution zone.

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[112] AER, *Final decision Ausgrid 2014–19 electricity distribution determination*, January 2019, p. 4.

- Aside from the Ausgrid distribution zone, network costs in the relevant distribution zones are forecast to increase at low nominal levels between 2018-19 and 2019-20. We have based our network costs forecasts on the relevant AER distribution and transmission revenue determinations.
    - Ausgrid will return excess revenue related to the Ausgrid transmission network recovered in 2014-19 regulatory period to its customers over the 2019-24 control period. With that adjustment, the network costs in Ausgrid's distribution zone are forecast to decrease moderately in 2019-20.
- Changes in the environmental costs components between 2018-19 and 2019-20 vary:
    - the LRET cost is forecast to decline moderately
    - the SRES cost is forecast to increase moderately
    - changes in the cost of meeting jurisdictional schemes are likely to be negligible.

    We have based our forecasts for these environmental cost components on the AEMC Price Trends Review as well as having regard to updated information from the CER.
- Based on our assessment of retail costs, we expect retail costs will remain constant. We have adjusted this cost component by changes in CPI.

Our forecasts of changes to the cost components between 2018-19 and 2019-20 and the forecast impact on retail prices in each distribution zone are set out in Table 19 below.

Table 19: Changes in cost components and overall impact for 2019-20 prices (nominal)

Distribution zone	Wholesale	Network	Environmental	Overall price impact#
Energex	8.9% reduction	1.7% reduction	9.4% reduction	3.3% reduction
Essential	9.5% reduction	0.7% increase	1.3% increase	2.4% reduction
Endeavour	4.7% reduction	0.9% reduction	1.3% increase	1.9% reduction
Ausgrid	8.7% reduction	16.3% reduction	1.3% increase	10.2% reduction
SAPN	7.9% reduction	3.2% increase	1.9% reduction	2.2% reduction

This includes adjusting the residual component of the price stack by inflation.

Source: AEMC Price Trends Review and AER Regulatory Determinations

Consistent with our Draft Determination, our proposed approach is to have regard to these forecasts as a factor in selecting a price point within the relevant range of the observed October 2018 price data.

In our Draft Determination we estimated overall retail price reductions of approximately 4 to 8 per cent across the various distribution zones. The update of wholesale cost forecasts has lowered the forecast price reductions to between 1.9 and 3.3 per cent, with the exception of Ausgrid's 10.2 per cent forecast reduction. Consistent with our Draft Determination, our approach is not to adjust the DMO price point derived from 2018-19 retail prices. We consider this is a reasonable approach given:

- The DMO price point in 2018-19 is the mid-point of the price range of the median market offer and median standing offer price in each distribution zone
- The relatively modest forecast changes in the overall retail prices across most distribution zones in the context of our task, which is to estimate the likely direction and magnitude of cost changes.
- In the case of Ausgrid, the unique underlying driver of the forecast reduction in network costs.
- This approach will provide some margin of error in terms of any potential cost increases that are not part of our cost forecast.

We will consider the impact of changes in key input costs annually as part of any future DMO price determination process.

3.4 DMO prices

Using the methodology described above, we have determined the following DMO prices for 2019-20.[113]

Residential flat rate tariffs

Table 20 lists the calculations for each distribution zone for residential flat rate tariffs. This shows the median standing offer, median market offer, DMO price and the savings from the median standing offer.

[113] Numbers in the tables may not fully reconcile due to rounding.

Table 20: Default market offer prices and savings from median standing offer – Residential flat rate tariffs (GST inclusive)

	Ausgrid	Endeavour	Energex	Essential	SAPN
Single load kWh p.a.	3,900	4,900	4,600	4,600	4,000
Median standing offer	$1,596	$1,895	$1,688	$2,138	$2,112
Median market offer	$1,338	$1,545	$1,451	$1,776	$1,770
DMO	**$1,467**	**$1,720**	**$1,570**	**$1,957**	**$1,941**
Saving from SO median	$129	$175	$118	$181	$171
DMO above MO median	$129	$175	$118	$181	$171
DMO above MO minimum	$266	$321	$255	$398	$299
DMO percentile within range	50%	50%	50%	50%	50%

Residential flat rate tariffs with controlled load

Table 21 lists the calculations for each distribution zone for residential flat rate tariffs with CL. This shows the median standing offer, median market offer, DMO price and the savings from the median standing offer.

Table 21: Default market offer prices and savings from median standing offer – Residential flat rate tariffs with controlled load (GST inclusive)

	Ausgrid	Endeavour	Energex	Essential	SAPN
Single load kWh p.a.	4,800	5,200	4,400	4,600	4,200
Controlled load kWh p.a.	2,000	2,200	1,900	2,000	1,800
Total load kWh p.a.	**6,800**	**7,400**	**6,300**	**6,600**	**6,000**
Median standing offer	$2,259	$2,402	$2,096	$2,606	$2,639
Median market offer	$1,859	$1,930	$1,757	$2,143	$2,201

DMO	**$2,059**	**$2,166**	**$1,927**	**$2,375**	**$2,420**
Saving from SO median	$200	$236	$169	$231	$219
DMO above MO median	$200	$236	$169	$231	$219
DMO above MO minimum	$470	$514	$424	$522	$398
DMO percentile within range	50%	50%	50%	50%	50%

Small business flat rate tariffs

Table 22 lists the calculations for each distribution zone for small business flat rate tariffs. This shows the median standing offer, median market offer, DMO price and the savings from the median standing offer.

Table 22: Default market offer prices – Small business flat rate tariffs (GST inclusive)

	Ausgrid	Endeavour	Energex	Essential	SAPN
Single load kWh p.a.	20,000	20,000	20,000	20,000	20,000
Median standing offer	$8,249	$6,783	$6,481	$8,754	$10,016
Median market offer	$6,493	$5,624	$5,568	$7,336	$8,224
DMO	**$7,371**	**$6,204**	**$6,025**	**$8,045**	**$9,120**
Saving from SO median	$878	$579	$457	$709	$896
DMO above MO median	$878	$579	$457	$709	$896
DMO above MO minimum	$1,747	$1,325	$1,023	$2,226	$1,829
DMO percentile within range	50%	50%	50%	50%	50%

4 Model annual usage determination

Under Part 3 of the Regulations, we are required to determine model annual usage amounts for residential and small business customer types in each distribution zone, from which a DMO price and reference bill can be calculated.[114]

Additionally, the Regulations require us to determine the 'timing and pattern' of supply for each region over a year, except in the case of small business customers.[115]

Our Draft Determination position

In our Draft Determination, we calculated the residential flat rate model annual usage per customer from the distribution business' annual pricing model for 2018-19. We considered that this information was appropriate as it:

- identified information specific to residential customers within a distribution zone
- was current and had been subject to quality assurance by the network businesses and assessed by the AER in the context of the annual pricing approval processes.

We also used the distribution business' annual pricing models for 2018-19 as a basis for calculating the flat rate with CL model annual usages.

To determine the model annual usage for CL customers, and the relative proportion of CL and non-CL usage, we undertook the following steps:

- Analysed data provided in each distribution business' annual pricing proposals for 2018-19 to determine the average CL consumption of customers with a CL.[116]

- Analysed residential consumption data collected by ACIL Allen during the 2017 Energy Consumption Benchmark project[117] to determine the proportion of total consumption of CL and non-CL. This analysis indicated that across the areas for which we are determining DMO prices, the proportion of CL usage was consistently close to 30 per cent of total usage. Given this outcome, we used the 30 per cent figure across all calculations.

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114 Regulations, s 16(1)(a)(i).

115 Regulations, s 16(1)(a)(ii).

116 The annual pricing proposals can be found on our website at: https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/pricing-proposals-tariffs?f%5B0%5D=type%3Aaccc_aer_pricing_proposal. Some of the annual pricing models are not published as they are commercial-in-confidence.

117 https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/electricity-and-gas-bill-benchmarks-for-residential-customers-2017

- We derived the total consumption by applying the 30 per cent figure to the CL consumption, eg:

  If CL (30%) is 1,900 kWh pa, non-CL consumption (70%) will be approximately 4,400 kWh pa

- The remainder of total residential usage not allocated to customers with CL was divided by the number of flat rate customers.

- In some cases, we could calculate the flat and CL usages directly from the model or alternatively we contacted the distribution business directly to clarify this data.

For offers with multiple CL components, we analysed distributor data to determine the average proportion of CL1 and CL2 usage in each distribution zone.[118]

Our Draft Determination was to adopt a model annual usage of 20,000 kWh for small business customers, consistent with that published by ECA.[119] We considered this was the best source of business consumption data available.

To provide a consistent source of assumptions for retailers to calculate annual bills for TOU (flexible pricing) tariffs for comparison with the DMO annual price, our Draft Determination included TOU profile information for each zone. These profiles were based on household usage data collected as part of our 2017 Energy Consumption Benchmark project.[120] We proposed that retailers use the EME algorithm to calculate annual bills.

Stakeholder submissions

A small number of stakeholders commented on our calculation of model annual usages.

Origin Energy supported our decision to calculate annual prices using the EME algorithm, but considered that we should provide more guidance about how the TOU profile data should be applied in practice.[121]

Active Utilities proposed that we provide timing profiles for the proposed TOU profiles as this would assist in generating more accurate bills for the purpose of comparing to a reference bill.[122]

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118 Some distribution zones have multiple controlled load options which have different times of operation. For example overnight only for a hot water heater and a set period during the day for pool pumps. Retailers may bundle these together in a retail offer of flat rate and controlled load, or have a retail offer with flat rate and two controlled loads.

119 Energy Consumers Australia, *SME Retail Tariff Tacker report*, June 2018. The 20,000 kWh figure is based on a rounded average consumption for small businesses in various NEM by Jacobs Australia for AEMO.

120 https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/electricity-and-gas-bill-benchmarks-for-residential-customers-2017

121 Origin, *Submission to AER on Default Market Offer - Draft Determination*, p. 3.

122 Active Utilities, *Submission to AER on Default Market Offer - Draft Determination*, p. 5.

Ausgrid noted that it had reviewed our methodology for calculating the residential flat rate model annual usage amounts. Its analysis noted that not all CL customers were on flat tariffs, and it proposed we modify our methodology to pro-rate CL customers. Based on its recalculation, it proposed that we revise the Ausgrid non-CL model annual usage amount from 3,800 kWh per year to 3,900 kWh (rounded to the nearest hundred).[123]

In relation to the TOU profiles, the purpose of these is to provide simplified assumptions that retailers can use to split annual consumption across different TOU tariff configurations. While a detailed timing profile, as proposed by Active Utilities, would allow more detailed price calculations, we consider the profiles provided are sufficient to meet the objective of providing a consistent set of assumptions for calculating annual bills.

We have reviewed Ausgrid's analysis and consider its methodology is reasonable. On this basis, we have determined to adjust the model annual usage for non-CL flat rate tariffs in Ausgrid's zone to 3,900 kWh per year.

It remains our view that it will be important for retailers to have a consistent set of assumptions from which to calculate annual bills. However, after further considering implementation issues, we consider that retailers should not use the EME algorithm to calculate annual bills. Instead, retailers should use their own systems to calculate annual bills.

Our reasons for this view are:

- Seasonality – the EME algorithm applies seasonal weightings to annual consumption. This is not consistent with the assumptions we have adopted in calculating DMO annual prices of flat consumption throughout the year
- Controlled load – the EME algorithm uses a simplified approach to CL costs and is not capable of calculating costs for multiple CL rates.

We have included an example of how retailers should treat different offer elements in calculating annual prices as **Appendix J.**

Our Final Determination

This section sets out our Final Determination for the annual usage amounts and the timing and pattern of supply, as required under the Regulations.

Model annual usage

With the exception of the adjustment based on Ausgrid's submission, our final model annual usage amounts are unchanged from our Draft Determination.

[123] Ausgrid, *Submission to AER on Default Market Offer - Draft Determination*, p. 3.

Table 23 sets out the per-customer model annual usage amounts for residential and small business customer types in each distribution zone.

Table 23: Model annual usages

Distribution Region	Residential Annual Usage without Controlled Load[#]	Residential Annual Usage with Controlled Load [++]		Small Business Annual Usage ^
		General Usage	Controlled Load Usage	
Ausgrid	3,900 kWh	4,800 kWh	2,000 kWh	20,000 kWh
Endeavour Energy	4,900 kWh	5,200 kWh	2,200 kWh	20,000 kWh
Energex	4,600 kWh	4,400 kWh	1,900 kWh	20,000 kWh
Essential Energy	4,600 kWh	4,600 kWh	2,000 kWh	20,000 kWh
SAPN	4,000 kWh	4,200 kWh	1,800 kWh	20,000 kWh

[#] Source: Network distribution businesses' annual pricing proposals

++ Source: Network distribution businesses' annual pricing proposals, with CL assumptions based on the AER's 2017 Energy Consumption Benchmarks

^ Source: Energy Consumers Australia, SME Retail tariff tracker

Our assumption of apportioning 30 per cent of total consumption as CL across all distribution zones is unchanged.

Our final position on how total CL usage should be allocated across tariffs with multiple CLs has not changed from our Draft Determination. The CL allocation proportions and annual consumption amounts for multiple CLs are set out in **Appendix H.**

Timing and pattern of supply

Our final position on the timing and pattern of supply remains unchanged from our Draft Determination.

Flat consumption

Daily consumption is assumed to be the same across the year with no adjustments for seasonality, or variation between weekday/weekend consumption.

Retailers should use the same assumption when calculating annual bills for comparison to the annual DMO price, as required under the Code.[124]

TOU (Flexible tariff) consumption allocations

While the Regulations do not require us to develop DMO prices for TOU offers, the Code requires retailers to compare the price of their offers to the reference bill in each network distribution zone.[125] To facilitate the consistent calculation of annual bills, we have determined TOU period usage allocations for all TOU configurations.

These allocations are included in **Appendix H**.

Our final position to allocate TOU usage based on the specified EME profiles for each distribution zone remains unchanged from the Draft Determination. These profiles are based on household usage data collected as part of our 2017 Energy Consumption Benchmark project. Consultants ACIL Allen analysed usage data from households with interval meters to determine the proportion of electricity typically used across peak, off-peak and shoulder periods in each climate zone.

We note however that we have simplified these figures from the Draft Determination by presenting average annual allocations, rather than seasonal proportions.

[124] Regulations, s 12(1).

[125] Regulations, s 12.

5 Other issues

Stakeholder submissions to our Draft Determination raised a number of issues that are beyond the scope of our current DMO annual price (and model annual usage) determination.

Future pricing approach

While most stakeholders agreed with our pricing methodology for this initial DMO price determination, several stakeholders noted that DMO prices will need to be set on a different basis in future years.[126] For example, Grattan Institute submitted that continuing with the same methodology would result in a 'ratchet' effect that would lead to standing offers converging towards the level of the median market offer.[127]

There were a range of different methodologies proposed by stakeholders, including:

- A 'bottom-up' approach using a cost stack[128]
- Indexing the DMO prices based on observable market trends[129]
- Setting the DMO based solely on upper-bound market offers. For example, at the 90th percentile of all market offers with adjustments based on known regulatory cost changes from year to year.[130]

Stakeholders also emphasised that a clearly stated process and methodology is necessary for changing a DMO price for future years, as well as an adequate consultation process.[131] The AEC submitted that predictability is an essential requirement for businesses to be able to invest and not stifle investment and innovation.[132]

We are mindful of the need to consult with stakeholders and provide certainty on the DMO process for future years. We intend to publish a position paper in mid to late

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126 Simply, *Submission to AER on Default Market Offer - Draft Determination,* pp. 2-3; AEC, *Submission to AER on Default Market Offer - Draft Determination* p. 3; AGL, *Submission to AER on Default Market Offer - Draft Determination,* pp. 4-5; Grattan, *Submission to AER on Default Market Offer - Draft Determination*, p. 6.

127 Grattan, *Submission to AER on Default Market Offer - Draft Determination*, p. 6.

128 CHOICE, *Submission to AER on Default Market Offer - Draft Determination*, p. 5; EWOSA, *Submission to AER on Default Market Offer - Draft Determination*, p. 1; Active Utilities, *Submission to AER on Default Market Offer - Draft Determination*, p. 1.

129 Simply, *Submission to AER on Default Market Offer - Draft Determination*, pp. 2-3; Active Utilities, *Submission to AER on Default Market Offer - Draft Determination*, p. 2; AEC, *Submission to AER on Default Market Offer - Draft Determination*, p. 3.

130 Grattan, *Submission to AER on Default Market Offer - Draft Determination*, p. 6.

131 Origin, *Submission to AER on Default Market Offer - Draft Determination*, p.4; Active Utilities, *Submission to AER on Default Market Offer - Draft Determination*, p. 2; AGL, *Submission to AER on Default Market Offer - Draft Determination*, pp. 4-5; Simply, *Submission to AER on Default Market Offer - Draft Determination;* pp. 2-3.

132 AEC, *Submission to AER on Default Market Offer - Draft Determination*, p. 3.

2019 outlining our assessment of the options for the future years of the DMO. As part of our process we will engage with stakeholders on the methodology, assumptions and approaches under consideration.

Communication

EnergyAustralia stated that we should give further thought to our communications on the introduction of the DMO and work with stakeholders in managing customer expectations around the impact of the DMO. EnergyAustralia submitted that it would be concerned if the DMO was promoted as something that delivers material and universal price reductions and discourages customers from seeking out market offers.[133]

We agree that the introduction of the DMO should not discourage customers from seeking out market offers. The DMO is designed to reduce high priced standing offers for those customers that are not engaged or unable to engage in the market. The DMO is not designed to be the cheapest offer in the market and customers should be better off on a market offer. We manage the Energy Made Easy website (www.energymadeeasy.gov.au) to help households and small businesses make informed choices about electricity and gas offers. As part of our communications we will provide information on DMO prices and how they affect customers through our website.

Nevertheless, we note that the primary responsibility for communicating changes to customers' tariffs lies with their retailer. This view is shared by ECA who submitted that this is consistent with the Energy Charter principles.[134]

Monitoring

Our Draft Determination stated our intention to monitor prices following the introduction of the DMO.[135]

A number of stakeholders supported us taking an active role in monitoring outcomes. Monitoring roles suggested for us included:

- Examining how average (customer-weighted) margins move over time.[136]
- Ensuring that customers will not be worse off under a DMO price tariff compared to what they are currently paying.[137]
    - SA Government and EWOSA noted that with the implementation of DMO prices is the potential for energy retailers to raise the tariff rates

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133 EnergyAustralia, *Submission to AER on Default Market Offer - Draft Determination*, p. 4.

134 ECA, *Submission to AER on Default Market Offer - Draft Determination*, p. 3.

135 AER, *Default Market Offer - Draft Determination*, February 2019, p. 10.

136 Grattan, *Submission to AER on Default Market Offer - Draft Determination*, pp. 4-5.

137 NFF, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2; Government of SA, *Submission to AER on Default Market Offer - Draft Determination*, p. 2; EWOSA, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2.

applied to small customers with low levels of electricity consumption (below the model annual usage levels), so that the maximum DMO price is reached.[138]

- Monitoring and publicly reporting on the impacts and effectiveness of DMO prices and the reference bill prices.[139]
- Assessing the market offers provided by electricity retailers to determine whether or not the effective discounts provided to customers already on market contracts are diluted by the introduction of DMO prices.[140]

In addition, stakeholders questioned how we could ensure customers would be no worse off under the DMO[141] and raised concerns with the market impacts of setting a cap too low, or too high.[142]

In implementing the DMO, we consider that we will have a key role in monitoring outcomes of the DMO. We will use publicly available information to monitor changes in retail prices in order to understand whether the DMO is achieving the intended policy objectives, as well as to inform our development of approaches for future DMO price determinations.

Similarly, in addition to its role of enforcing retailer compliance with the Code, the ACCC will monitor the competition and consumer impacts of the DMO as part of its broader under its new Electricity Monitoring Inquiry.[143]

We will work closely with the ACCC to ensure any regulatory burden on stakeholders from our different monitoring roles is minimised.

Interaction with cost-reflective pricing

Under the Regulations, we are required to determine DMO prices for:

- residential customers on a flat rate tariff

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138 Government of SA, *Submission to AER on Default Market Offer - Draft Determination*, p. 2; EWOSA, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2.

139 Queensland Consumers Association, *Submission to AER on Default Market Offer - Draft Determination*, p. 1.

140 EWOSA, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2.

141 Government of SA, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2; EnergyAustralia, *Submission to AER on Default Market Offer - Draft Determination*, pp. 4-5; Grattan, *Submission to AER on Default Market Offer - Draft Determination*, pp. 4-5; ACCC, *Submission to AER on Default Market Offer - Draft Determination*, p. 2.

142 AEC, *Submission to AER on Default Market Offer - Draft Determination*, p. 3; Meridian/Powershop, *Submission to AER on Default Market Offer - Draft Determination*, pp. 2-3; Grattan, *Submission to AER on Default Market Offer - Draft Determination*, p. 3; AGL, *Submission to AER on Default Market Offer - Draft Determination*, p. 2; CHOICE, *Submission to AER on Default Market Offer - Draft Determination*, p. 5.; Sumo, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-3; Australian Chamber of Commerce and Industry, *Submission to AER on Default Market Offer - Draft Determination* pp. 1-5; Government of SA, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2; Alinta, *Submission to AER on Default Market Offer - Draft Determination,* p. 2.

143 ACCC, *Submission to AER on Default Market Offer - Draft Determination*, p. 2.

- residential customers on a flat rate tariff with a CL[144]
- small business customers on a flat rate tariff.[145]

CHOICE submitted that it is concerned that TOU and demand tariff customers will miss out on accessing the benefits of a default offer. CHOICE also stated that we must ensure that the default price will deliver fair outcomes to households who use solar. It noted that, while there are challenges in estimating default offers and reference bills for different tariff structures, this should not mean that cohorts of customers are excluded from the benefits and protections that a default offer provides.[146] The National Farmers Federation (NFF) also supported the extension of the DMO price to TOU tariffs.[147]

Energy Networks Australia (ENA) submitted that while there is a necessary trade-off between simplicity and efficient price signals, the default market offer should retain the capability for cost-reflective tariffs to be implemented for the network component of the DMO.[148]

Network-level data indicates that most residential customers are on either flat rate or controlled-load network tariffs at the present time. The majority of small business customers are on also on flat rate network tariffs.[149] However, we note there is far greater heterogeneity in both tariff type and usage patterns for small business customers.

At present, a key barrier to the assignment of residential and small business customers to cost-reflective network tariffs is metering technology. Outside Victoria, most residential and small business customers currently have an accumulation meter that measures the total amount of consumption, but not when this consumption occurs. It is therefore not possible to implement cost-reflective network tariffs for customers with accumulation meters.

While the numbers of customers on cost-reflective network tariffs is currently limited, this will increase over time with on-going tariff reform and the roll-out of smart meters. The interrelationships between the DMO and tariff reform is a matter that we consider will become increasingly important over time. Under the Regulations, we note there is scope to extend the application of the DMO to both cost-reflective network and solar tariff customers. The types of tariffs that are covered by the DMO will need to be considered further as part of future determinations.

In response to the ENA's submission, we do not consider our DMO price determination will remove the capability for cost-reflective network tariffs to be implemented.

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144 Regulations, s 6, s 16.

145 Regulations, s 6, s 16.

146 CHOICE, *Submission to AER on Default Market Offer - Draft Determination*, p. 8.

147 NFF, *Submission to AER on Default Market Offer - Draft Determination*, pp. 1-2.

148 ENA, *Submission to AER on Default Market Offer - Draft Determination*, p. 2.

149 Colmar Brunton, *Australian Energy Market Commission: 2018 retail competition review—Small business*, June 2018, p. 66.

First, there is no obligation on a retailer with a cost-reflective network tariff to provide a customers with a DMO flat rate retail tariff.

Second, we have noted that retailers are in the best position to manage the risks of any mismatch between their offers to customers and the cost structures the retailer faces in terms of network costs.[150] In our view, this is also applicable to the DMO in the case where a retailer places a customer on a DMO flat rate retail tariff while facing a cost-reflective network tariff. We note that retailers are not restricted in making market offers available to standing offer customers. Retailers are also able to develop other solutions to manage any potential cost mismatch (such as, energy efficiency measures or using PV and batteries).

Further, in setting DMO prices we have been cognisant of setting the price at a level that does not dis-incentivise participation in the market and allows retailers to recover their efficient costs in servicing customers. To this end, we have set the DMO price above the majority of market offers and the median market offer observed, which we consider is a reasonable proxy for the efficient costs. Accordingly, we consider that the revenue risks for a retailer serving a DMO customer, while facing cost-reflective networks tariffs, are likely to be minimal.

[150] AER, *NSW distributors—Tariff Structure Statements—Final Decision 2017-19*, p. 22.

Appendices

A Letter requesting AER commence work on DMO

TREASURER

MINISTER FOR ENERGY

MS18-001177

Ms Paula Conboy
Chair
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3000

Dear Ms Conboy Paula

You would be aware that the Prime Minister recently confirmed the Australian Government will adopt a number of recommendations from the Australian Competition and Consumer Commission's (ACCC) Retail Electricity Pricing Inquiry.

The Australian Government is focussed on reducing retail electricity prices. A priority for the Government is the swift introduction of a default market offer for both residential and small business electricity consumers. This landmark reform will replace the standing offer for those customers who are not subject to state-based price regulation.

Consistent with the Inquiry recommendations 30 and 49, we consider the AER is the appropriate body for setting a maximum price for the default market offer in each network distribution region that does not have a regulated standing offer price.

Accordingly, we ask that the AER commence work immediately on developing a mechanism for determining the price of the default market offer, consistent with the ACCC's recommendations. As part of this, we ask that the AER also develop a mechanism for determining a reference bill amount for each network distribution region, from which headline discounts can be calculated, in accordance with ACCC Recommendations 32 and 50.

We ask that the AER's final determination for 1 July 2019 default offer prices and the reference bill be publicly released by 30 April 2019, to bring about price reductions for residential and small business consumers.

We recognise that introducing the default offer and reference bill will require legislative support. The Australian Government, intends to work closely in the first instance with state and territory governments to prepare the legislation to implement these changes. Should state and territory agreement not be forthcoming, the Australian Government will underpin the introduction of these reforms through Commonwealth legislation.

Following the introduction of legislative reforms supporting the default offer, the Australian Government intends to commence updating consumer protections and abolish the Standard Retail Contract, as recommended by the ACCC. This work will be undertaken in cooperation with the AER and state and territory governments, and informed by stakeholder consultation.

We ask that you work closely with officials from the Treasury and the Department of the Environment and Energy throughout this process, and undertake consultation as appropriate. As this is a priority for the Australian Government, we ask the AER provide a fortnightly update on the progress of the work.

Yours sincerely

JOSH FRYDENBERG
Treasurer

ANGUS TAYLOR
Minister for Energy

CC: The Hon Scott Morrison MP, Prime Minister of Australia

B Model Annual Usage and Total Annual Prices Determination, Legislative Instrument

Competition and Consumer (Industry Code – Electricity Retail) (Model Annual Usage and Total Annual Prices) Determination 2019

The Australian Energy Regulator makes the following determination.

Dated 30 April 2019

Australian Energy Regulator

1. Name

This instrument is the *Competition and Consumer (Industry Code – Electricity Retail) (Model Annual Usage and Total Annual Prices) Determination 2019.*

2. Commencement

This instrument commences on 1 July 2019.

3. Authority

This instrument is made under section 16(1) of the *Competition and Consumer (Industry Code – Electricity Retail) Regulations 2019* (the Regulations).

4. Definitions

In this Determination:

a) ***Regulations*** means the *Competition and Consumer (Industry Code – Electricity Retail) Regulations 2019*; and

b) ***Residential Annual Usage without Controlled Load*** applies to the type of small customer considered in s 6(2)(b) of the Regulations; and

c) ***Residential Annual Price without Controlled Load*** applies to the type of small customer considered in s 6(2)(b) of the Regulations; and

d) ***Residential Annual Usage with Controlled Load*** applies to the type of small customer considered in s 6(2)(a) of the Regulations; and

e) ***Residential Annual Price with Controlled Load*** applies to the type of small customer considered in s 6(2)(a) of the Regulations; and

f) ***Small Business Annual Usage*** applies to the type of small customer considered in s 6(2)(c) of the Regulations; and

g) ***Small Business Annual Price*** applies to the type of small customer considered in s 6(2)(c) of the Regulations; and

h) ***General Usage*** means the non-controlled load usage of a small customer under s 6(2)(a) of the Regulations; and

i) ***Controlled Load Usage*** means the controlled load usage of a small customer under s 6(2)(a) of the Regulations.

j) Terms defined in the Regulations have the same meaning in this instrument.

5. Per-customer usage determination

In accordance with s 16(1)(a)(i) of the Regulations, the AER determines the per-customer amount of electricity supplied in specified distribution regions to small customers of the following types:

Per-customer annual usage determination

Distribution region	Residential Annual Usage without Controlled Load	Residential Annual Usage with Controlled Load		Small Business Annual Usage
		General Usage	*Controlled Load Usage*	
Ausgrid	3,900 kWh	4,800 kWh	2,000 kWh	20,000 kWh
Endeavour Energy	4,900 kWh	5,200 kWh	2,200 kWh	20,000 kWh
Energex	4,600 kWh	4,400 kWh	1,900 kWh	20,000 kWh
Essential Energy	4,600 kWh	4,600 kWh	2,000 kWh	20,000 kWh
SA Power Networks	4,000 kWh	4,200 kWh	1,800 kWh	20,000 kWh

6. Timing or pattern of supply determination

In accordance with s 16(1)(a)(ii) of the Regulations, the AER determines the timing or pattern of the supply of electricity in specified distribution regions to small customers:

a) Seasonality assumptions, all tariff and customer types

For all tariff and customer types, consumption has no seasonal weighting. That is, kilowatt hours consumed are assumed to be the same on each day of the year.

b) Annual period usage allocations for Flexible Tariffs (Time of Use tariffs) –Residential Annual Usage without Controlled Load and Residential Annual Usage with Controlled Load

i. Ausgrid distribution region

Flexible Tariff (Time of Use tariff) period usage allocations

	Period	Usage allocation per period	Residential Annual Usage without Controlled Load (kWh/yr)	General Usage - Residential Annual Usage with Controlled Load (kWh/yr)
		(1.000)	**3,900**	**4,800**
2 period	**Peak**	0.656	2,558.4	3,148.8
	Off-peak	0.344	1,341.6	1,651.2
3 period	**Peak**	0.319	1,244.1	1,531.2
	Shoulder	0.395	1,540.5	1,896.0
	Off-peak	0.286	1,115.4	1,372.8
4 period	**Peak**	0.319	1,244.1	1,531.2
	Shoulder 1	0.271	1,056.9	1,300.8
	Shoulder 2	0.124	483.6	595.2
	Off-peak	0.286	1,115.4	1,372.8

Controlled Load (CL) annual usage allocations (kWh/year)

CL1 only	CL2 only	CL 1 and 2	
		CL1 (0.67)	CL2 (0.33)
2,000	2,000	1,340	660

ii. Endeavour Energy distribution region

Flexible Tariff (Time of Use tariff) period usage allocations

	Period	Usage allocation per period	Residential Annual Usage without Controlled Load (kWh/yr)	General Usage - Residential Annual Usage with Controlled Load (kWh/yr)
		(1.000)	**4,900**	**5,200**
2 period	**Peak**	0.668	3,273.2	3,473.6
	Off-peak	0.332	1,626.8	1,726.4

3 period	**Peak**	0.336	1,646.4	1,747.2
	Shoulder	0.391	1,915.9	2,033.2
	Off-peak	0.273	1,337.7	1,419.6
4 period	**Peak**	0.336	1,646.4	1,747.2
	Shoulder 1	0.268	1,313.2	1,393.6
	Shoulder 2	0.123	602.7	639.6
	Off-peak	0.273	1,337.7	1,419.6

Controlled Load (CL) annual usage allocations (kWh/year)

CL 1 only	**CL 2 only**	**CL 1 and 2**	
		CL 1 (0.67)	CL 2 (0.33)
2,200	2,200	1,474	726

iii. Energex distribution region

Flexible Tariff (Time of Use tariff) period usage allocations

	Period	**Usage allocation per period**	**Residential Annual Usage without Controlled Load (kWh/yr)**	**General Usage - Residential Annual Usage with Controlled Load (kWh/yr)**
		(1.000)	**4,600**	**4,400**
2 period	**Peak**	0.680	3,128.0	2,992.0
	Off-peak	0.320	1,472.0	1,408.0
3 period	**Peak**	0.341	1,568.6	1,500.4
	Shoulder	0.393	1,807.8	1,729.2
	Off-peak	0.266	1,223.6	1,170.4
4 period	**Peak**	0.341	1,568.6	1,500.4
	Shoulder 1	0.275	1,265.0	1,210.0
	Shoulder 2	0.118	542.8	519.2
	Off-peak	0.266	1,223.6	1,170.4

Controlled Load (CL) annual usage allocations (kWh/year)

CL 1 only	CL 2 only	CL 1 and 2	
		CL 1 (0.29)	CL 2 (0.71)
1,900	1,900	551	1,349

iv. Essential Energy distribution region

Flexible Tariff (Time of Use tariff) period usage allocations

	Block	Usage allocation per period	Residential Annual Usage without Controlled Load (kWh/yr)	General Usage - Residential Annual Usage with Controlled Load (kWh/yr)
		(1.000)	**4,600**	**4,600**
2 period	**Peak**	0.668	3,072.8	3072.8
	Off-peak	0.332	1,527.2	1,527.2
3 period	**Peak**	0.338	1,554.8	1,554.8
	Shoulder	0.388	1,784.8	1,784.8
	Off-peak	0.274	1,260.4	1,260.4
4 period	**Peak**	0.338	1,554.8	1,554.8
	Shoulder 1	0.263	1,209.8	1,209.8
	Shoulder 2	0.125	575.0	575.0
	Off-peak	0.274	1,260.4	1,260.4

Controlled Load (CL) annual usage allocations (kWh/year)

CL 1 only	CL 2 only	CL 1 and 2	
		CL 1 (0.77)	CL 2 (0.23)
2,000	2,000	1,540	460

v. South Australian Power Networks distribution region

Flexible Tariff (Time of Use) period usage allocations

	Period	Usage allocation per period	Residential Annual Usage without Controlled Load (kWh/yr)	General Usage - Residential Annual Usage with Controlled Load (kWh/yr)
		(1.000)	**4,000**	**4,200**
2 period	**Peak**	0.634	2,536.0	2,662.8
	Off-peak	0.366	1,464.0	1,537.2
3 period	**Peak**	0.313	1,252.0	1,314.6
	Shoulder	0.388	1,552.0	1,629.6
	Off-peak	0.299	1,196.0	1,255.8
4 period	**Peak**	0.313	1,252.0	1,314.6
	Shoulder 1	0.249	996.0	1,045.8
	Shoulder 2	0.139	556.0	583.8
	Off-peak	0.299	1,196.0	1,255.8

Controlled Load (CL) annual usage allocations (kWh/year)

CL 1 only	CL 2 only	CL 1 and 2
1,800	NA	NA

c) Small business customers – Flexible Tariff (Time of Use tariff) and Controlled Load usage

Under s 16(2) of the Regulations the AER is not required to determine the timing and pattern of supply for small business customers.

Accordingly, the AER has not determined Flexible Tariffs (Time of Use tariffs) and Controlled Load allocations for small business customers.

7. Per-customer annual price determination

In accordance with s 16(1)(b) of the Regulations, the AER determines what it considers the reasonable per-customer annual price for supplying electricity in specified distribution regions to small customers of the following types:

Per-customer annual price determination (all prices GST-inclusive)			
Distribution region	**Residential Annual Price without Controlled Load**	**Residential Annual Price with Controlled Load**	**Small Business Annual Price**
Ausgrid	$1,467	$2,059	$7,371
Endeavour Energy	$1,720	$2,166	$6,204
Energex	$1,570	$1,927	$6,025
Essential Energy	$1,957	$2,375	$8,045
SA Power Networks	$1,941	$2,420	$9,120

DATED THIS 30TH DAY OF APRIL 2019

Australian Energy Regulator

C Model Annual Usage and Total Annual Prices Determination, Explanatory Statement

EXPLANATORY STATEMENT

Competition and Consumer Act 2010

Competition and Consumer (Industry Code – Electricity Retail) Regulations 2019

Competition and Consumer (Industry Code – Electricity Retail) (Model Annual Usage and Total Annual Prices) Determination 2019

Issued by authority of the Australian Energy Regulator

Purpose and operation

The Australian Competition and Consumer Commission (ACCC) recommended the Australian Energy Regulator (AER) be given power to set maximum standing offer prices for electricity supplied to small customers. It also recommended electricity retailers be required to discount all their offers from a reference price set by the AER. The *Competition and Consumer (Industry Code – Electricity Retail) Regulations 2019* (the Regulations) give effect to these recommendations.

Part 2 of the Regulations prescribes a mandatory industry code for the purposes of Part IVB of the *Competition and Consumer Act 2010*. Under the code:

- standing offer prices for small customers must not exceed a price determined by the AER
- small customers must be told how a retailer's prices compare with the AER-determined annual price
- the most prominent price-related feature in an advertisement must not be a conditional discount, and any conditions on other discounts must be clearly displayed.

Part 3 of the Regulations confer price setting functions to the AER. Specifically, the AER is required to determine:

- how much electricity a broadly-representative small customer of a particular type in a particular distribution region would consume in a year and the pattern of that consumption (the model annual usage)
- a reasonable total annual price for supplying electricity (in accordance with the model annual usage) to small customers of that type in that region (the DMO price).

This Legislative Instrument sets out the AER's determinations under Part 3 of the Regulations:

- Clause 5 sets out the AER determined per-customer amount of electricity supplied in specified distribution regions to small customers.
- Clause 6 sets out the AER determined timing or pattern of the supply of electricity in specified distribution regions to small customers.

- Clause 7 sets out the AER determined reasonable per-customer annual price for supplying electricity in specified distribution regions to small customers.

The determinations made by the AER under the Legislative Instrument commence on 1 July 2019.

Background

In the final report of its Retail Electricity Pricing Inquiry (REPI), the ACCC noted that standing offers, which were originally intended as a default protection for customers who were not engaged in the market, were unjustifiably high and have been used by retailers as a high priced benchmark from which their advertised market offers are derived. The ACCC found that the standing offer is no longer working as it was intended and is causing financial harm to customers.

The ACCC recommended that, in non-price regulated jurisdictions, the standing offer and standard retail contract should be abolished and replaced with a default offer. Designated retailers, as defined in the National Energy Retail Law (NERL), should be required to supply electricity to customers under a default offer on request, or in circumstances where the customer otherwise does not take up a market offer.

The ACCC further recommended that the AER be given the power to set the maximum price for the default offer in each jurisdiction.

The ACCC noted that the default offer price will have two benefits:

- It will act as a cap on the price of default offers to limit the 'loyalty tax' that is levied on disengaged customers.
- It will be used to set a reference bill amount, which all discounts must be calculated from.

On 22 October 2018, the Commonwealth Treasurer and Minister for Energy wrote to the AER requesting it to develop a mechanism for default market offer (DMO) prices and a reference bill by 30 April 2019, for implementation by 1 July 2019.

Consultation

In making this this Legislative Instrument, the AER has undertaken a number of steps in consulting with affected stakeholders.

As the first step, the AER published a Position Paper in November 2018. This Position Paper outlined preliminary positions for how the AER would determine DMO prices and included a number of questions for stakeholder input. The AER received 31 submissions from industry stakeholders including retailers, consumer representatives, ombudsmen and members of the public.

The AER also held a public forum in Sydney in December 2018 to discuss the issues raised in the Position Paper, with around 50 stakeholders attending, including retailers, consumer representatives, consultants and ombudsmen.

As a next step, the AER released a Draft Determination for consultation in February 2019. The AER received 24 submissions, from industry stakeholders including retailers, consumer representatives, consultants, ombudsmen and network distribution businesses

The consultation documents and all public submissions to this process are available on the AER's website at https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/retail-electricity-prices-review-determination-of-default-market-offer-prices

Statement of Compatibility with Human Rights

This Legislative Instrument has been prepared in accordance with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*: see **Appendix K**.

D List of submitters to Draft Determination

1. Government of South Australia
2. Energy Consumers Australia
3. Grattan Institute
4. Etrog Consulting
5. National Farmers Federation
6. Active Utilities
7. Energy Networks Australia
8. Australian Competition Consumer Commission
9. Energy & Water Ombudsman South Australia
10. AGL
11. Simply Energy
12. Ausgrid
13. EnergyAustralia
14. Origin Energy
15. Public Interest Advocacy Centre
16. Alinta Energy
17. Australian Energy Council
18. Meridian Energy Australia and Powershop Australia
19. 1st Energy (confidential)
20. SUMO
21. Queensland Consumers Association
22. Australian Chamber of Commerce and Industry
23. CHOICE
24. Red/Lumo (confidential)

E List of annual bill calculation assumptions

Subject	Specifications
Raw data	All available data from Energy Made Easy (EME) for October 2018.
Unique data set	For offers to be considered unique, the following criteria are used: Contract type (standing, market) Retailer Total annual bill (unconditional, conditional) Fixed component (unconditional, conditional) Usage component (unconditional, conditional) CL fixed component (unconditional, conditional) CL usage component (unconditional, conditional).
GST	Annual bill includes GST.
Demand component to flat tariff	Offers with a demand component to the flat tariff are removed from the data.
Usage profile	Assumption of uniform consumption throughout the year to calculate the annual bill. Hence the daily consumption is consistent across the year with no adjustments for seasonality.
Days per year, days per quarter	365 days per year. Quarter calculated by daily charge times 365 days then divided by 4. No further adjustment made for leap years, as the contract start date will vary depending on the customer.
Controlled loads CL1 & CL2	When CL1 and CL2 are listed in the raw data, we have apportioned the total CL usage depending on the distribution area. This represents the customer being on a retail offer with flat, CL1 and CL2. When the EME raw data only has CL1, this could represent CL1 or CL2 in a retailer's offer. Hence the customer is on a flat with CL1 offer or a flat with CL2 offer.
Standing offer with controlled load	Some retailers offer three standing offers with CL – flat rate with CL1, flat rate with CL2 or flat rate with CL1 and CL2. We have used the highest standing offer for each retailer in calculating the median standing offer. This is

	usually CL2.
Discounts	Discounts on unconditional and conditional offers are applied to usage and supply as per each offer (percentage or dollar amount) as applied in EME.
Fees	Most fees are excluded for the calculation of the annual bill as they are one-off payments or dependent on the customer's payment. These include connection fees, disconnection fees, late payment fees, direct debit dishonour payment fee, credit card processing fee, credit card merchant service fee, direct debit payments fee, establishment fee, and other fees.
Membership fees	This annual fee is effectively a supply charge, hence are included in the calculation of the annual bill.
Metering fees	Ongoing metering fees are included in the calculation of the annual bill. Up front metering charges are excluded, as there is no set scenario that would apply to most customers.
Bundling	No bundling included, such as gas, phone, internet, mobile, pool services.
Green charges	Assumption of no additional payment for green schemes to calculate the annual bill. Offers including green supply are removed from the data.
PV / Solar feed in tariffs	Assumption of zero PV solar exported. Offers with 'solar', 'FiT' and 'FI' are removed from data.

F Standing and market offer analysis for each distribution zone

These charts are GST inclusive.

Figure F-1: Standing and market offers – Ausgrid – Residential flat rate tariffs

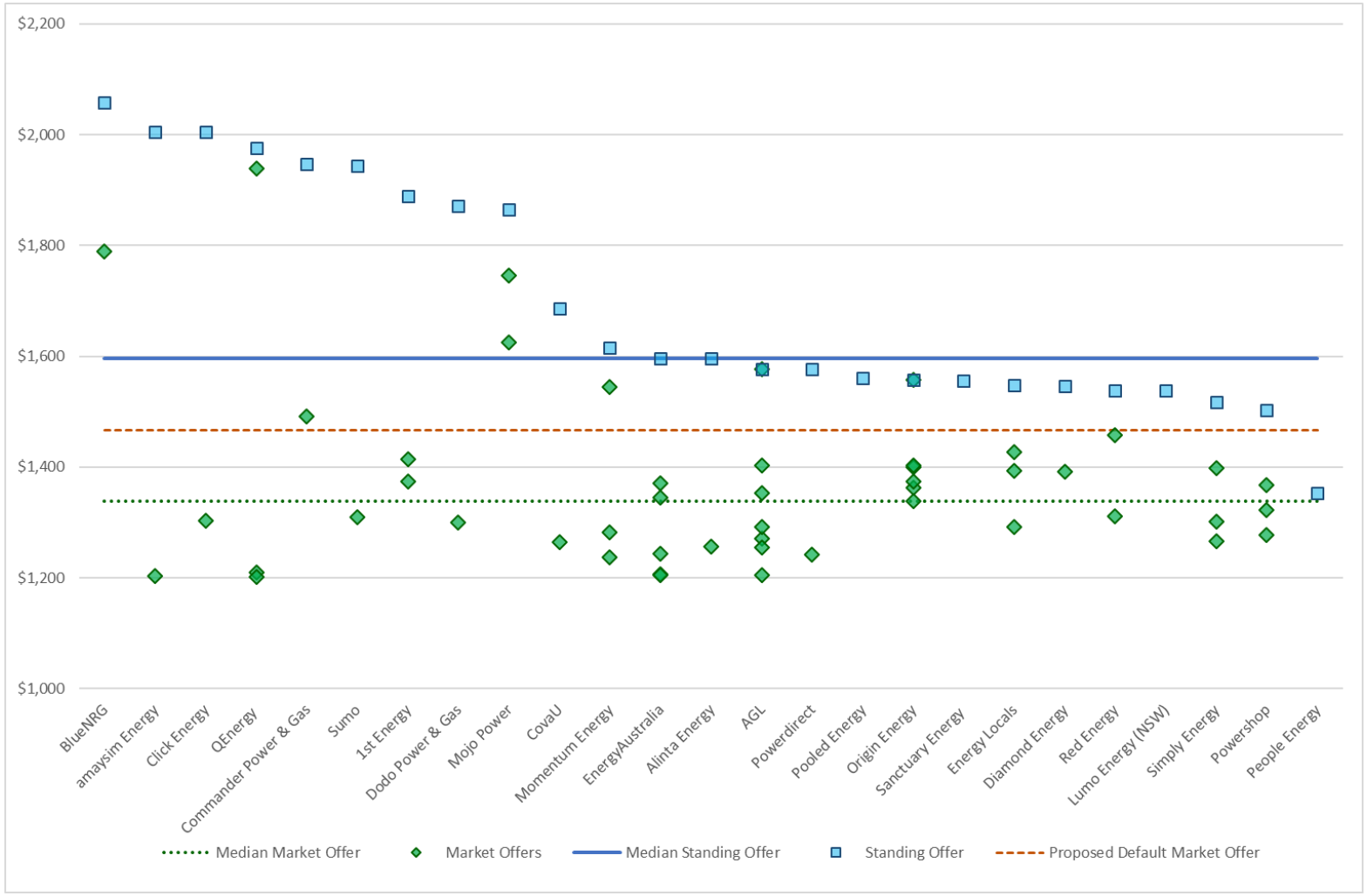


Figure F-2: Standing and market offers – Ausgrid – Residential flat rate tariffs with controlled load

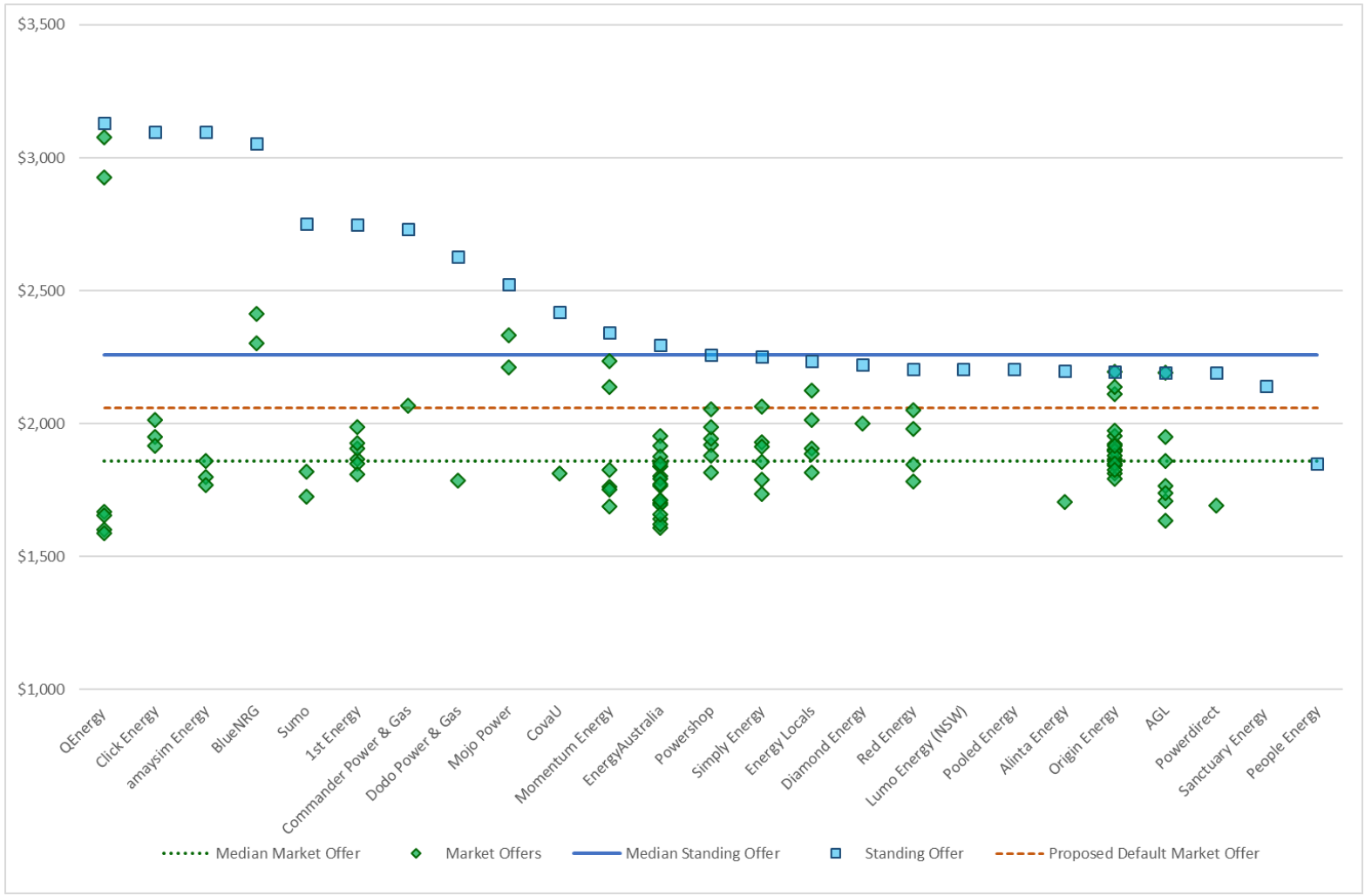


Figure F-3: Standing and market offers – Ausgrid – Small business flat rate tariffs

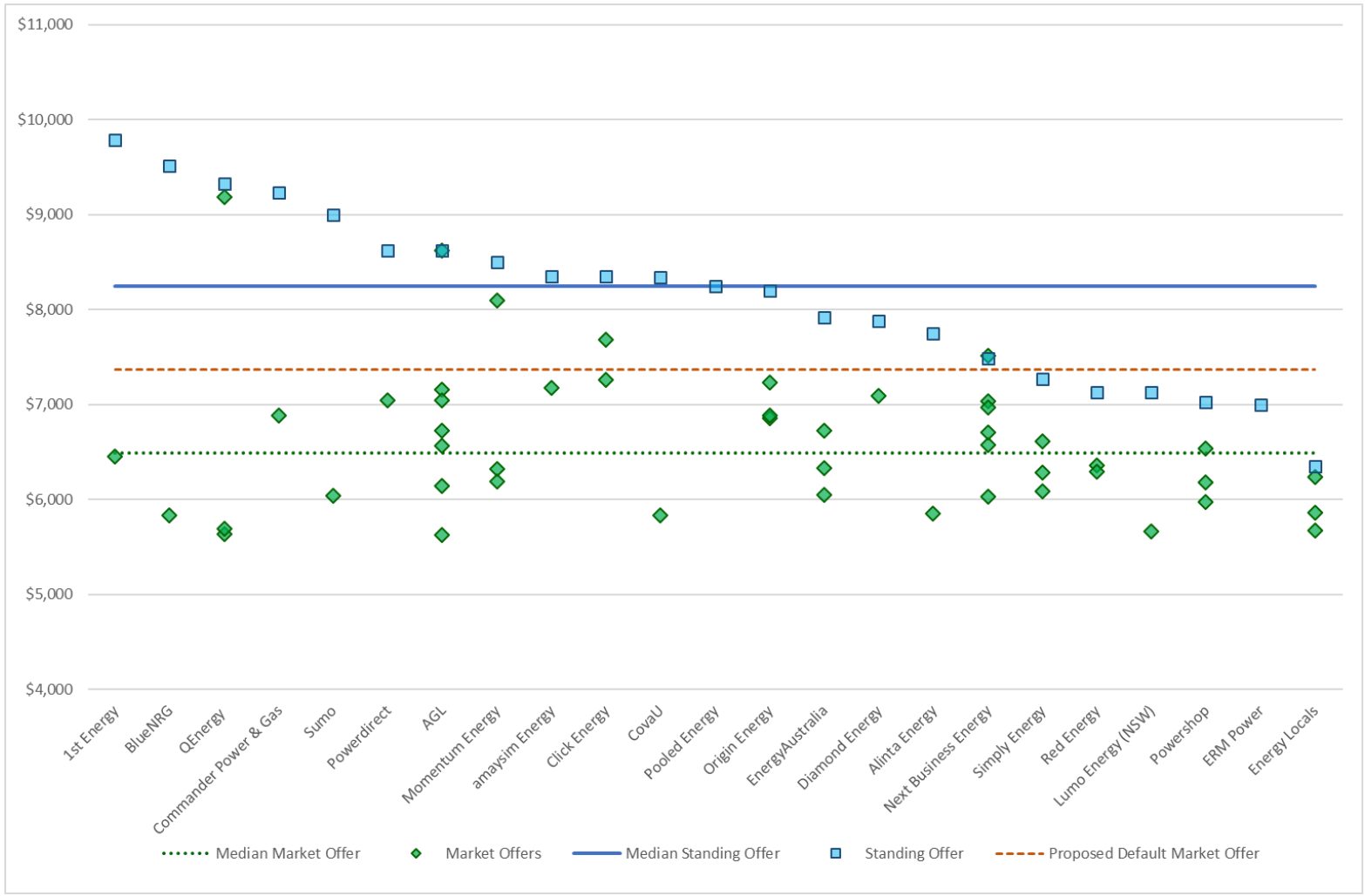


Figure F-4: Standing and market offers – Endeavour – Residential flat rate tariffs

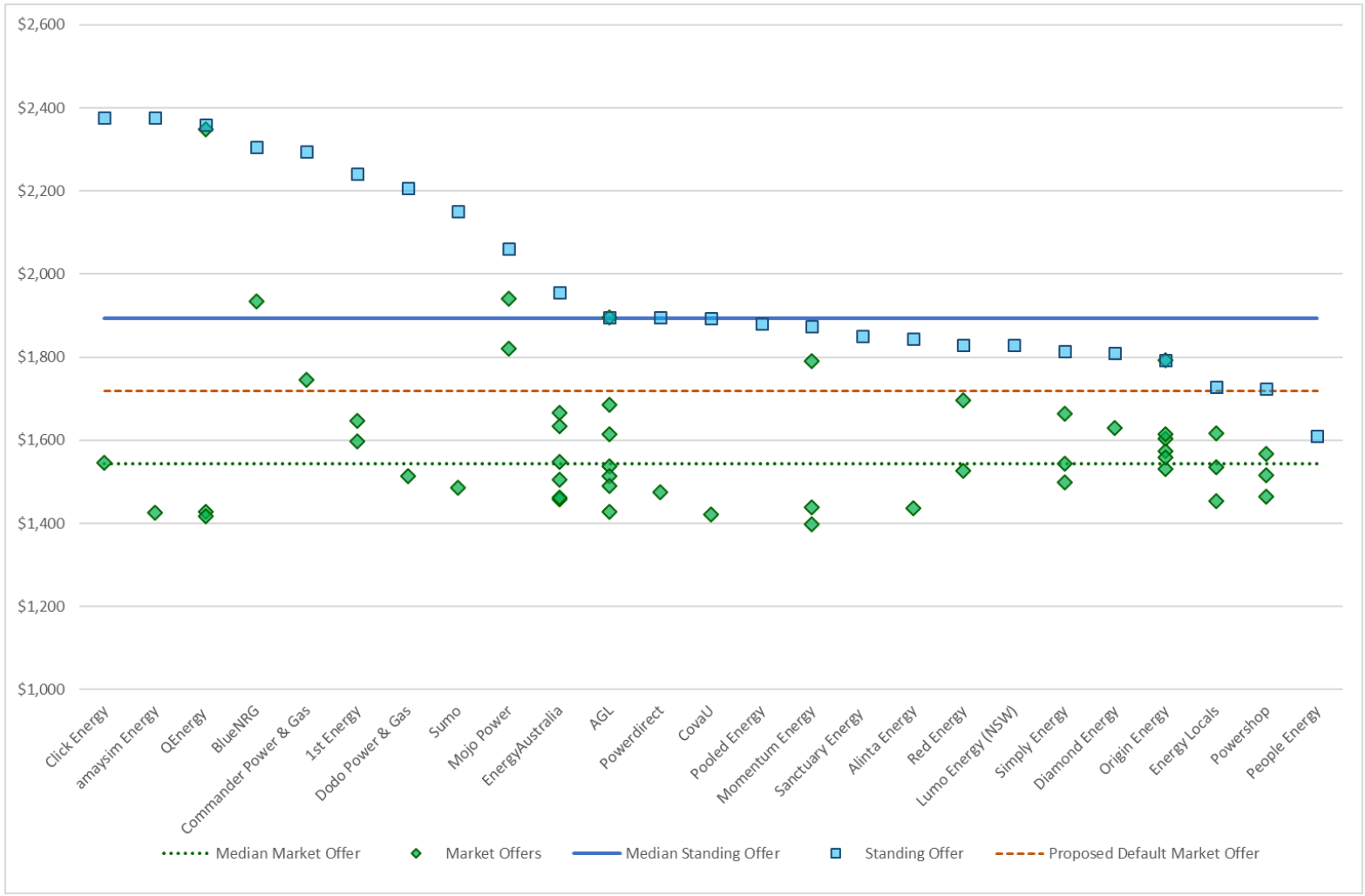


Figure F-5: Standing and market offers – Endeavour – Residential flat rate tariffs with controlled load

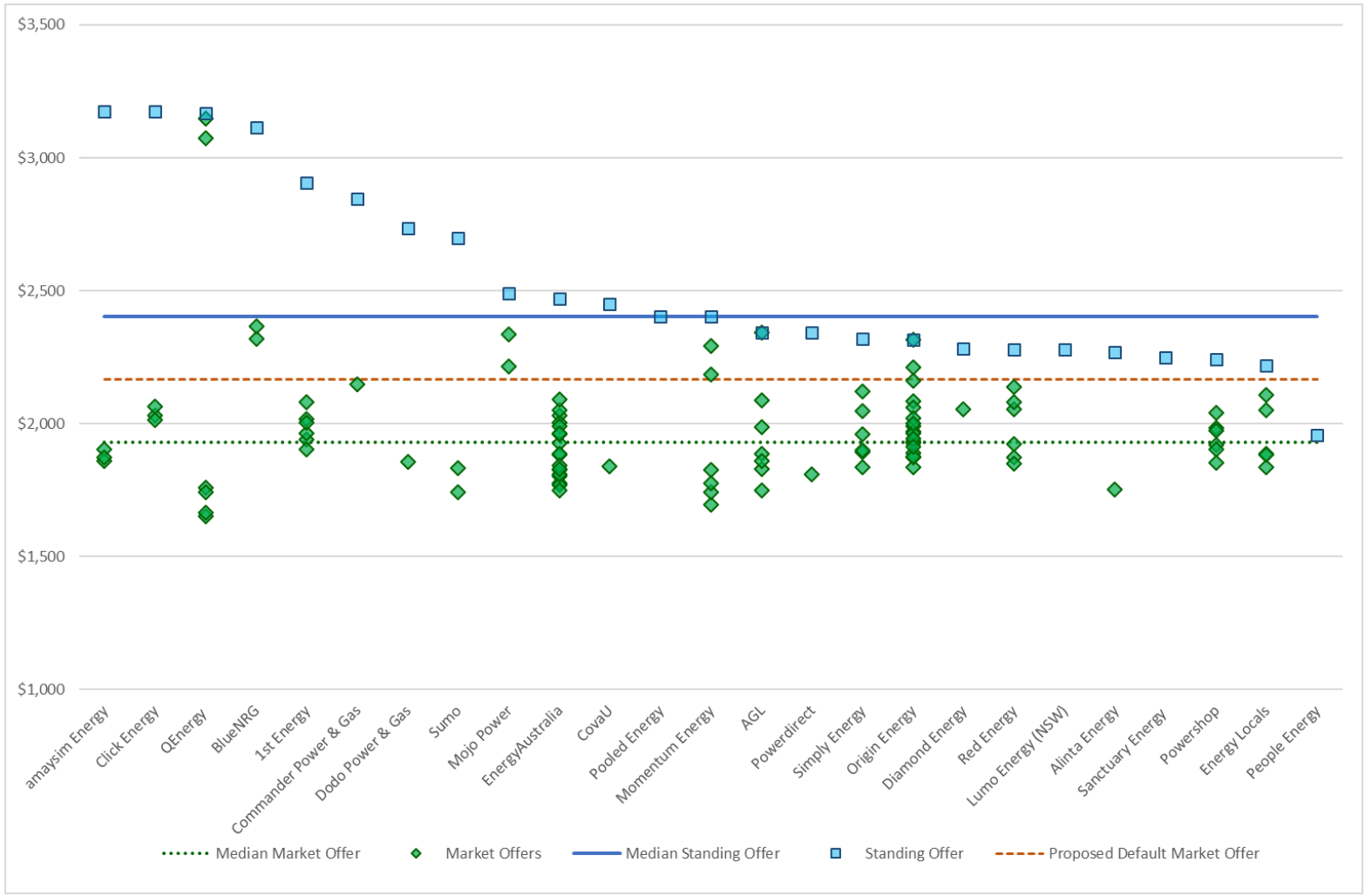


Figure F-6: Standing and market offers – Endeavour – Small business flat rate tariffs

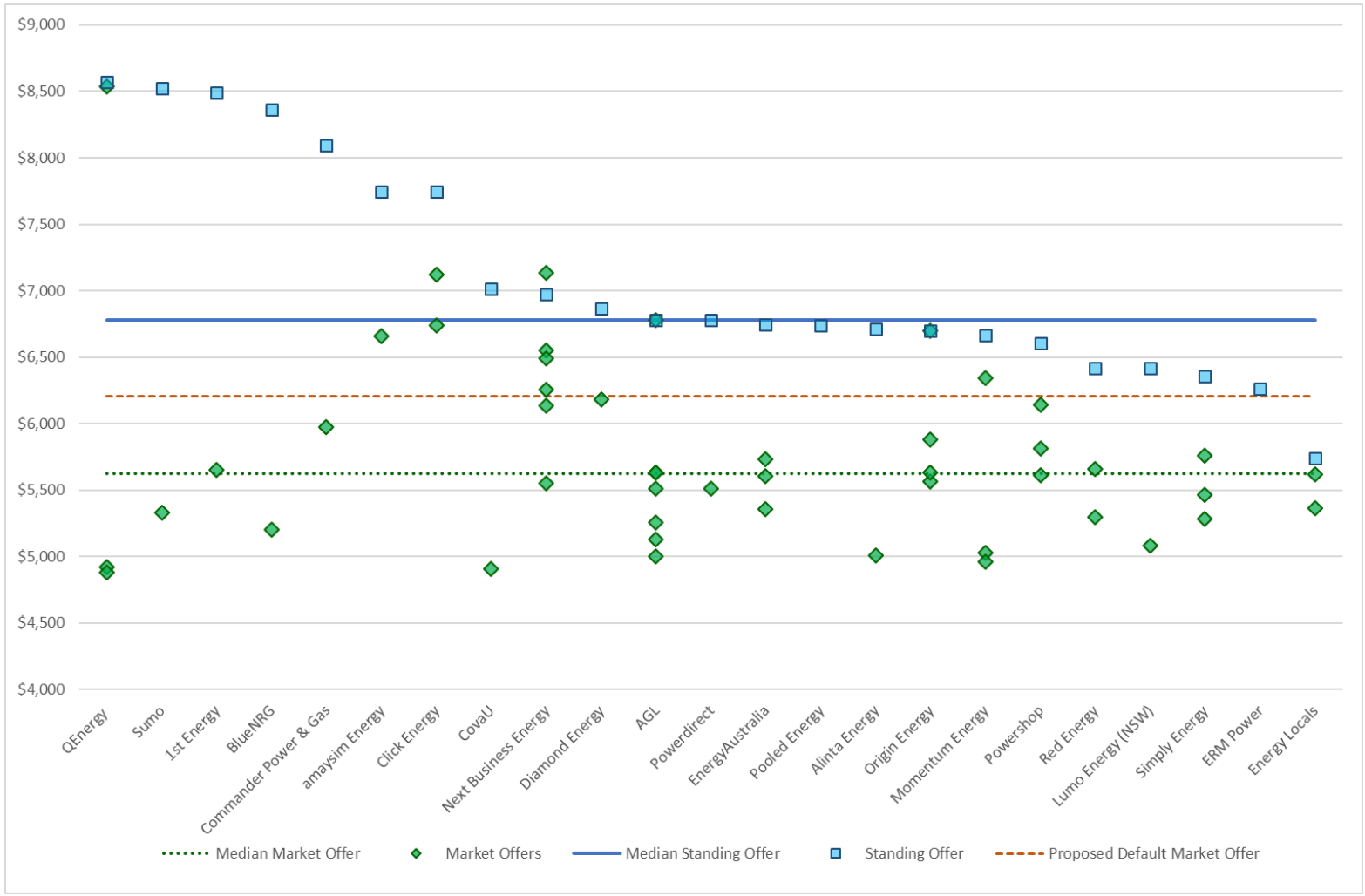


Figure F-7: Standing and market offers – Energex – Residential flat rate tariffs

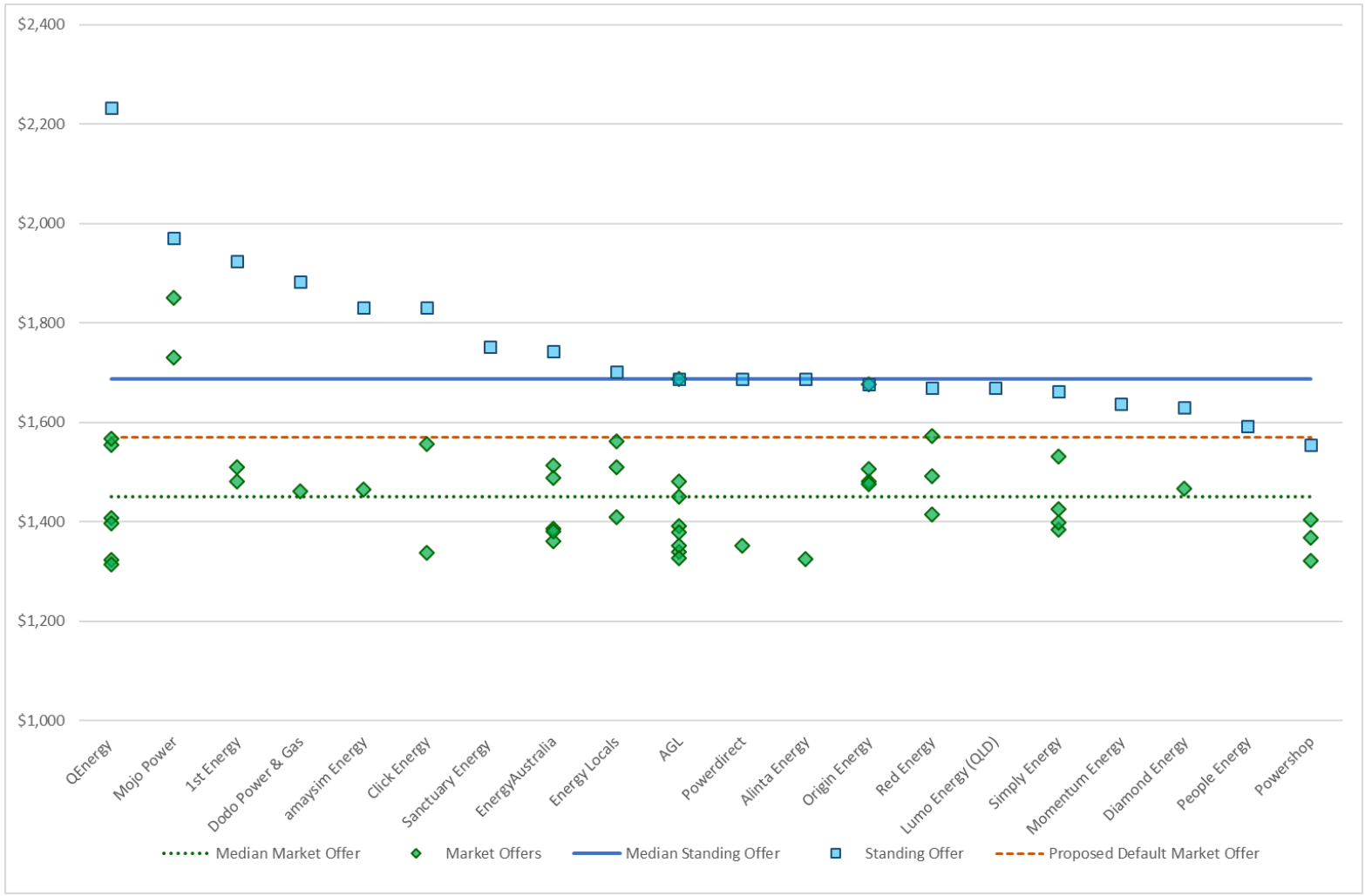


Figure F-8: Standing and market offers – Energex – Residential flat rate tariffs with controlled load

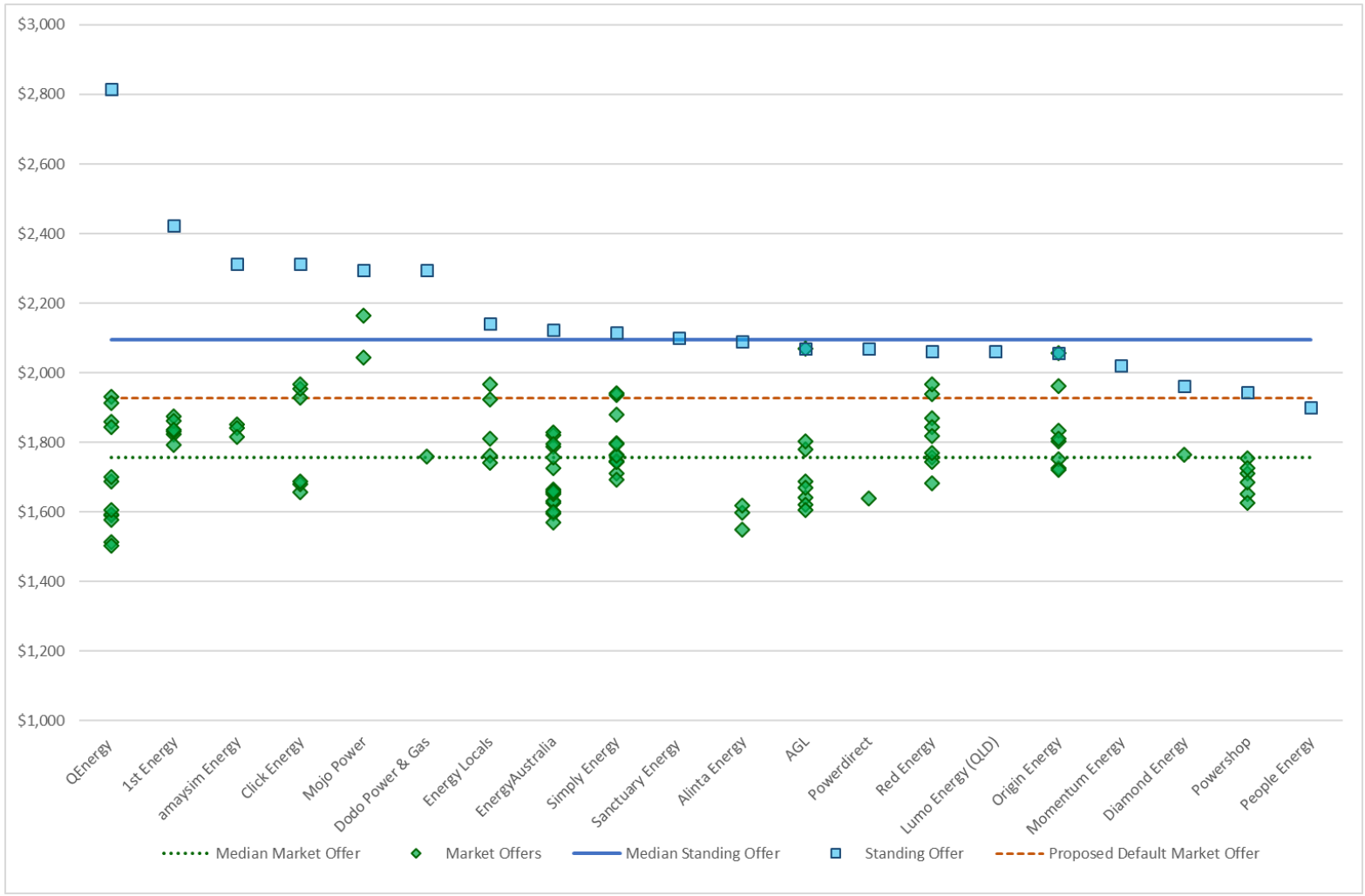


Figure F-9: Standing and market offers – Energex – Small business flat rate tariffs

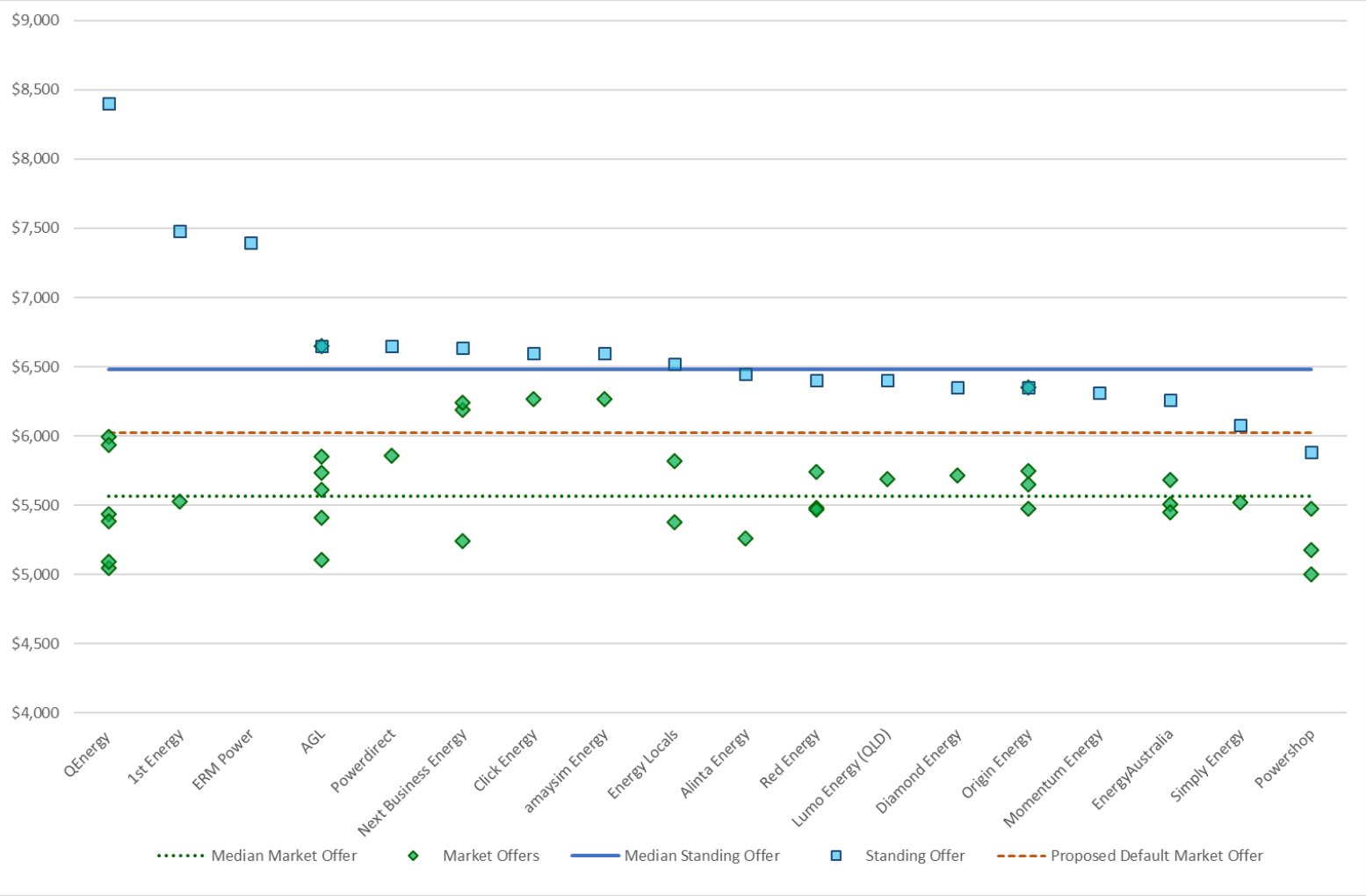


Figure F-10: Standing and market offers – Essential – Residential flat rate tariffs

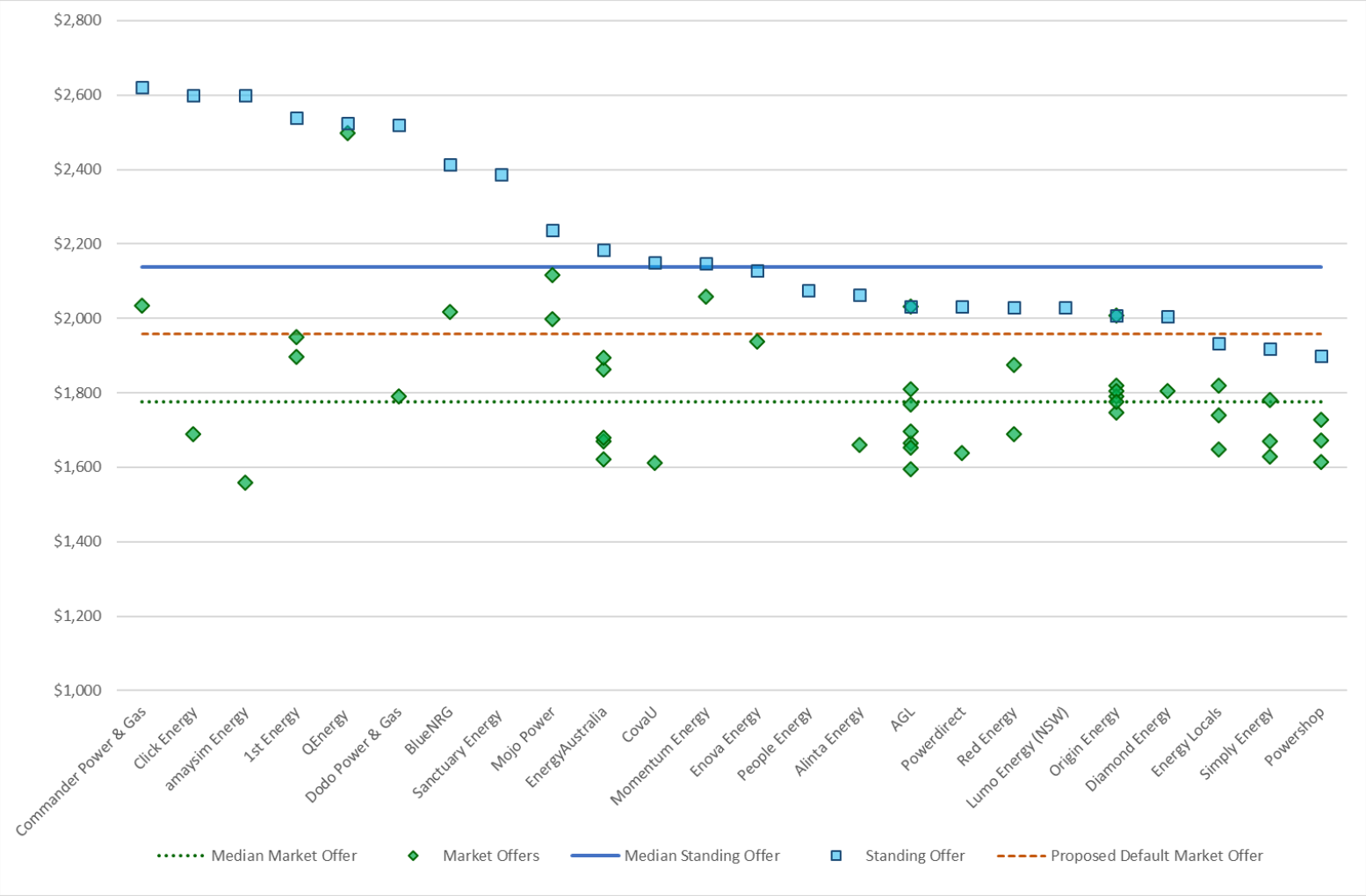


Figure F-11: Standing and market offers – Essential – Residential flat rate tariffs with controlled load

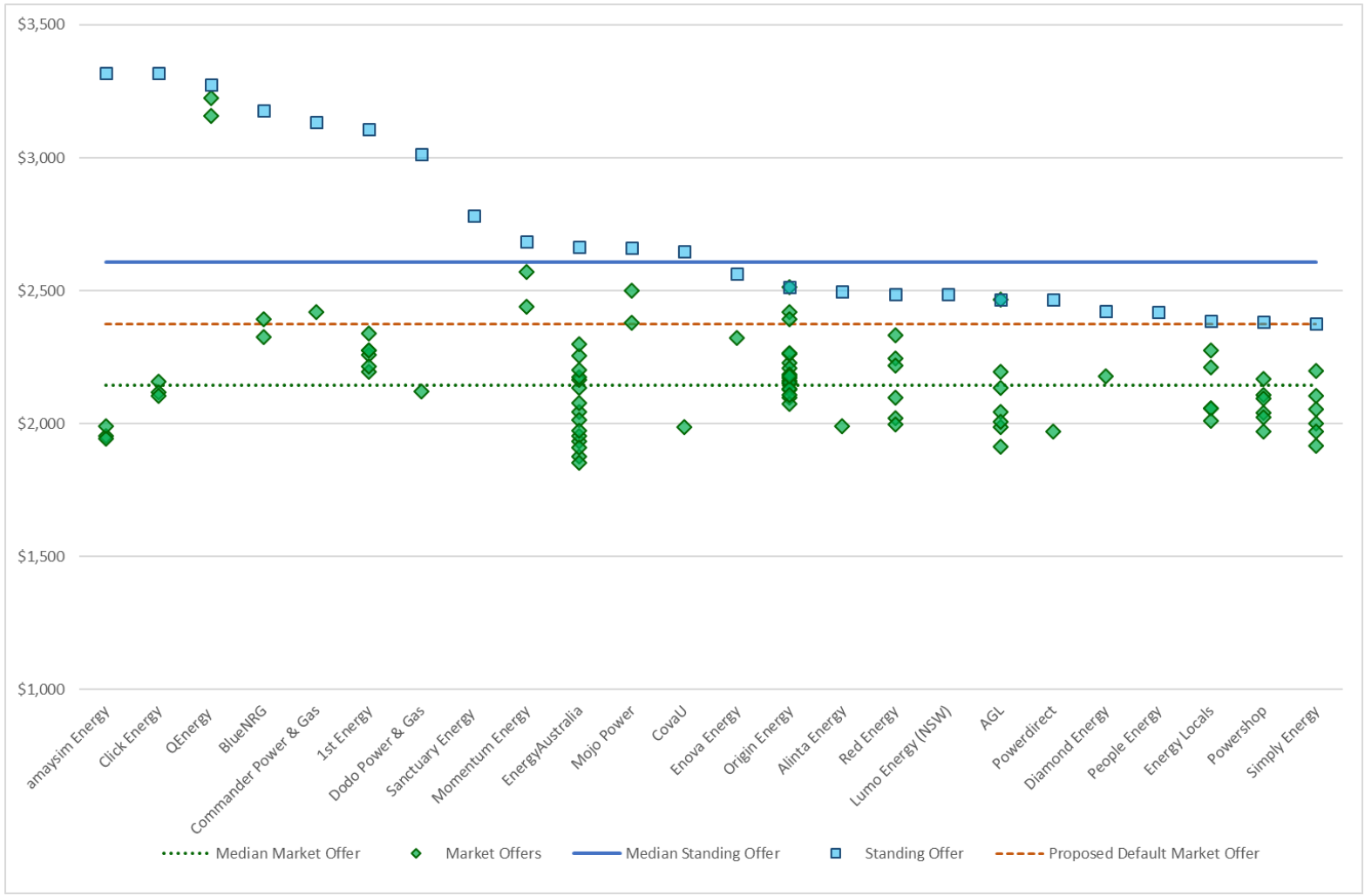


Figure F-12: Standing and market offers – Essential – Small business flat rate tariffs

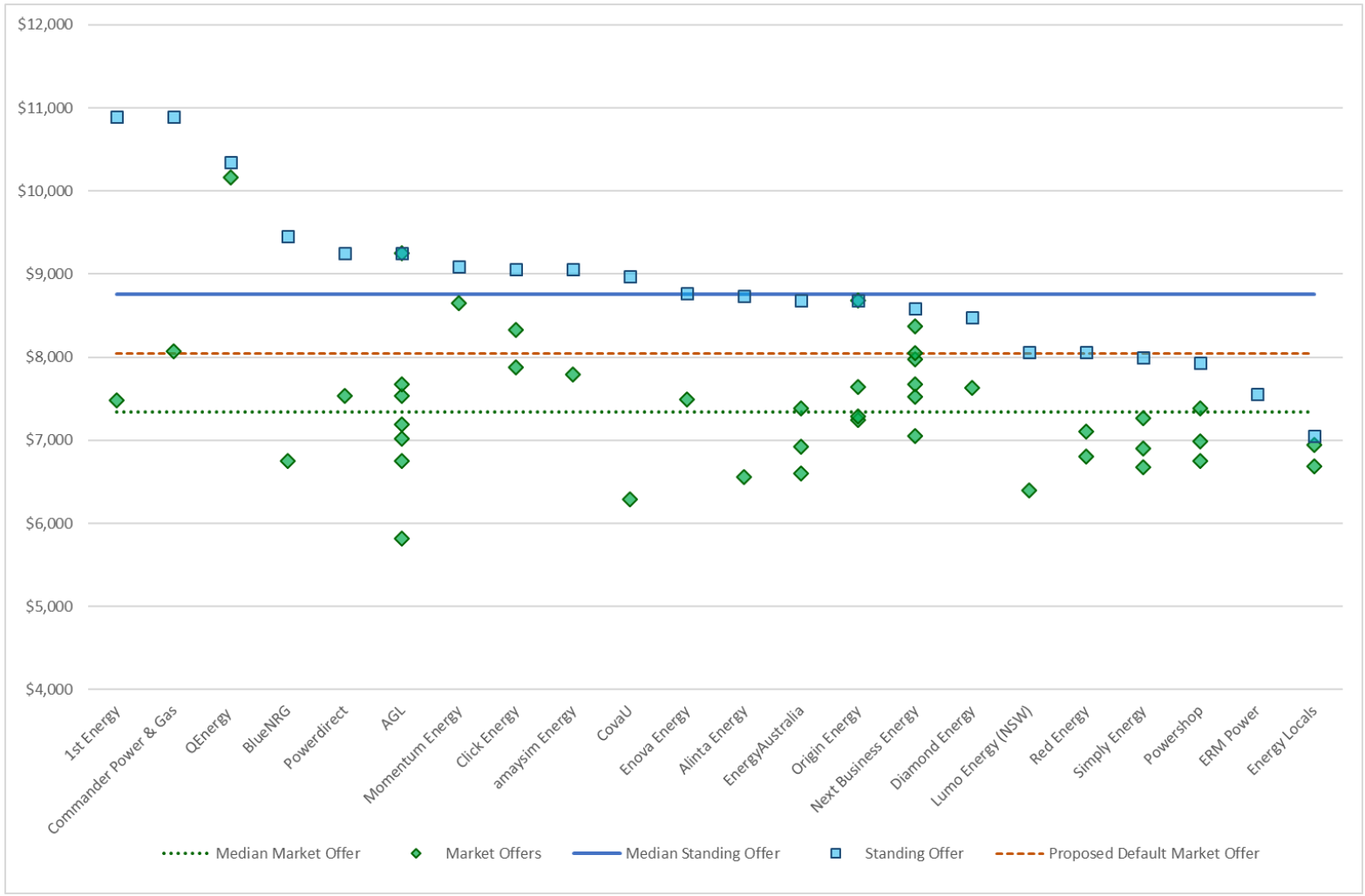


Figure F-13: Standing and market offers – SAPN – Residential flat rate tariffs

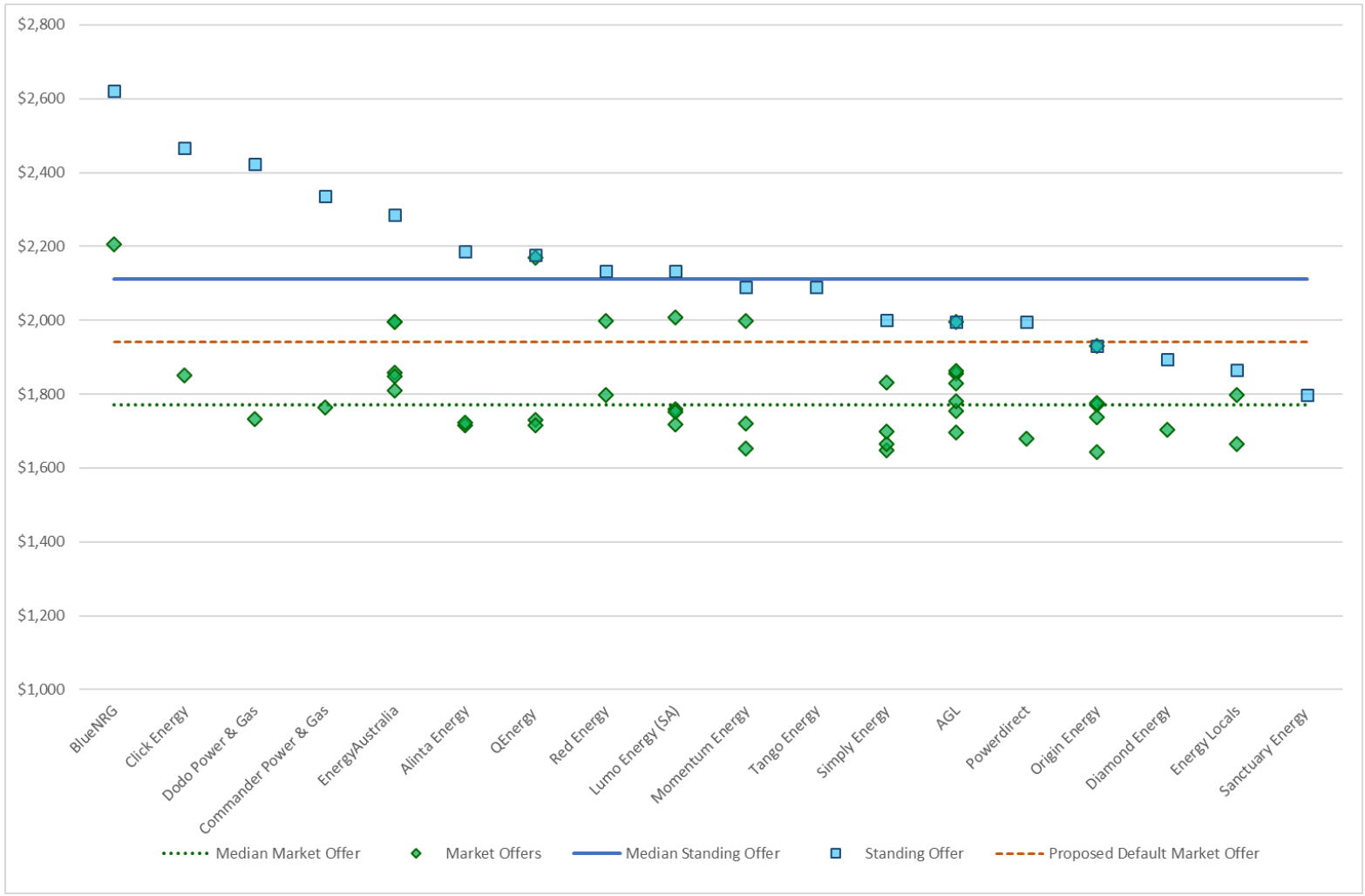


Figure F-14: Standing and market offers – SAPN – Residential flat rate tariffs with controlled load

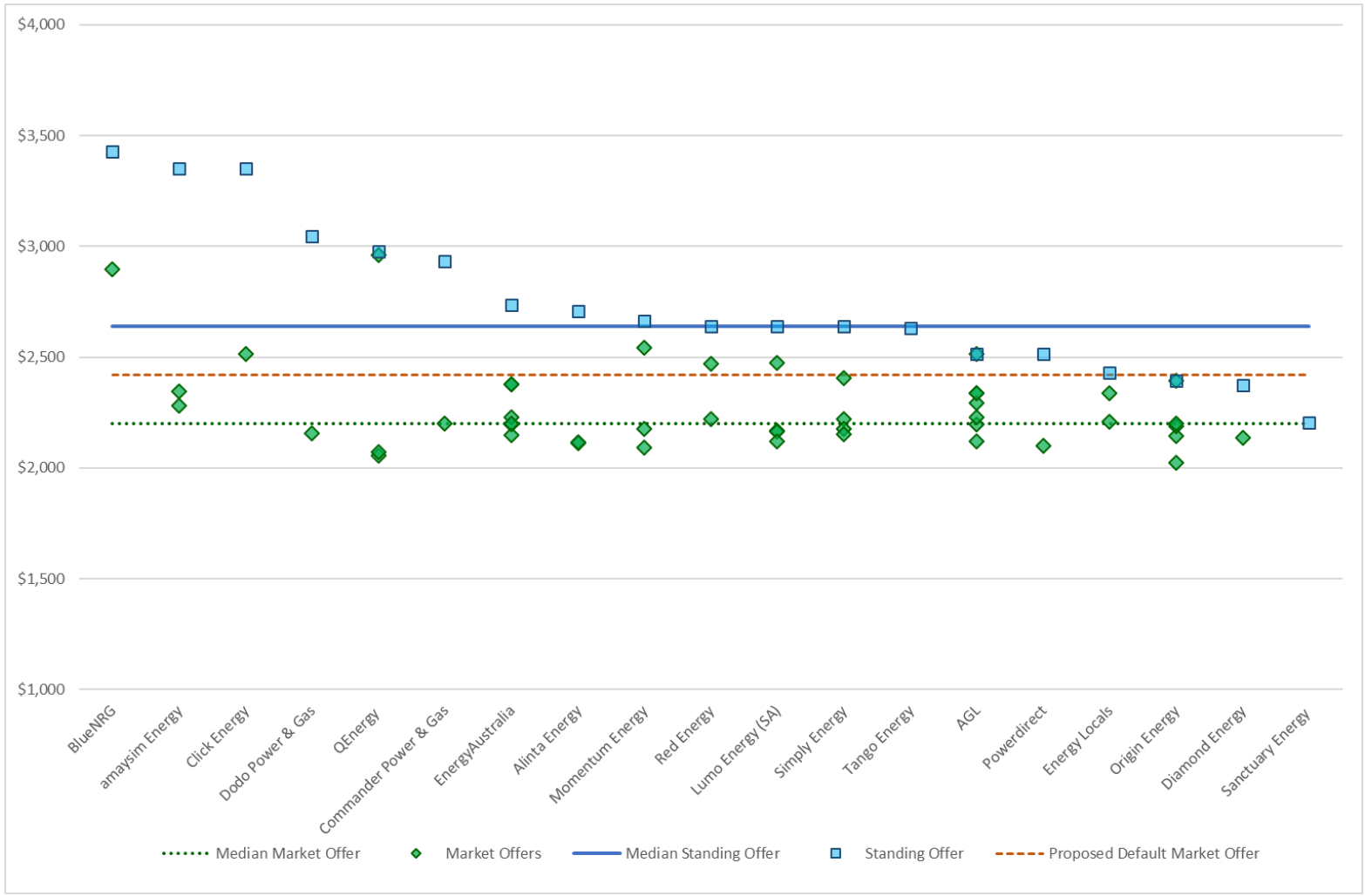
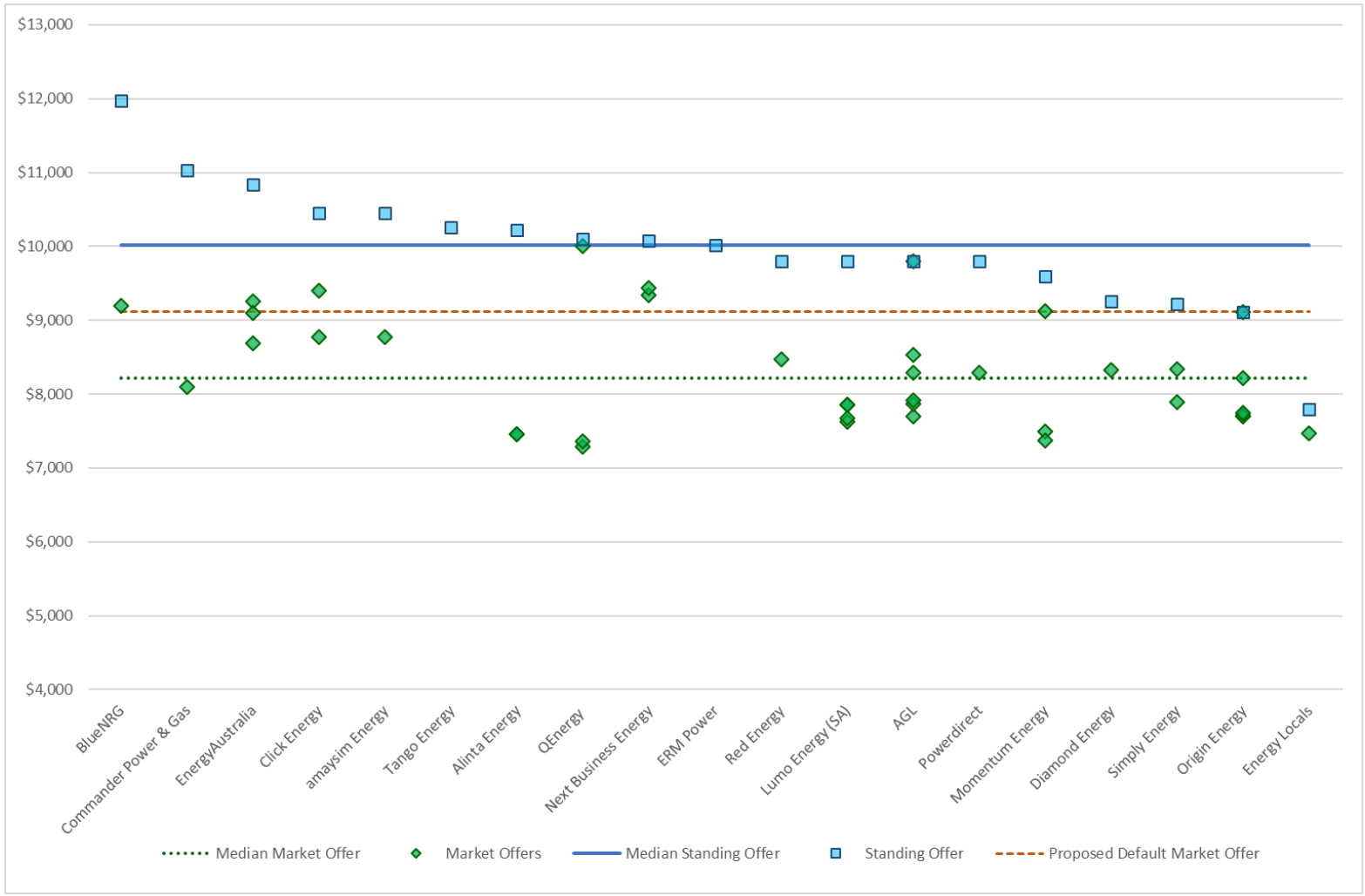


Figure F-15: Standing and market offers – SAPN – Small business flat rate tariffs



G Forecast changes in cost components

As outlined in Chapter 3, we have sourced all relevant standing offers and market offers as reported in the Energy Made Easy (EME) website. This sample is based on the offers available to new customers in October 2018.

Based on the AEMC Price Trends Review and further discussions with industry representatives, we consider that retailers generally formulate these offers based on the underlying costs as at the commencement of 2018-19.

Based on this information we consider the underlying 2018-19 costs, as determined at the commencement of this period, will be reflected in 2018-19 tariffs.

How is the cost stack determined?

In practice the ratio of the cost components will depend, among other things, on the tariff under assessment and the consumer's consumption profile.

The AEMC Price Trends Review has determined the percentage of each of the cost components by first estimating the cost of each component in terms of kWh price and then, using a set consumption amount, calculated the percentage of the cost component relative to a representative tariff. In the AEMC Price Trends Review, this representative tariff is based on the best market offers for the relevant state.

Furthermore, as the cost components change over time, the proportion of each of the components to the overall price will also change. We note that in the AEMC Price Trends Review, the cost stack is based on 2017-18 costs, however information was also provided to estimate the 2018-19 cost stack.

With these two features in mind, we have used the AEMC price stack information subject to few adjustments;

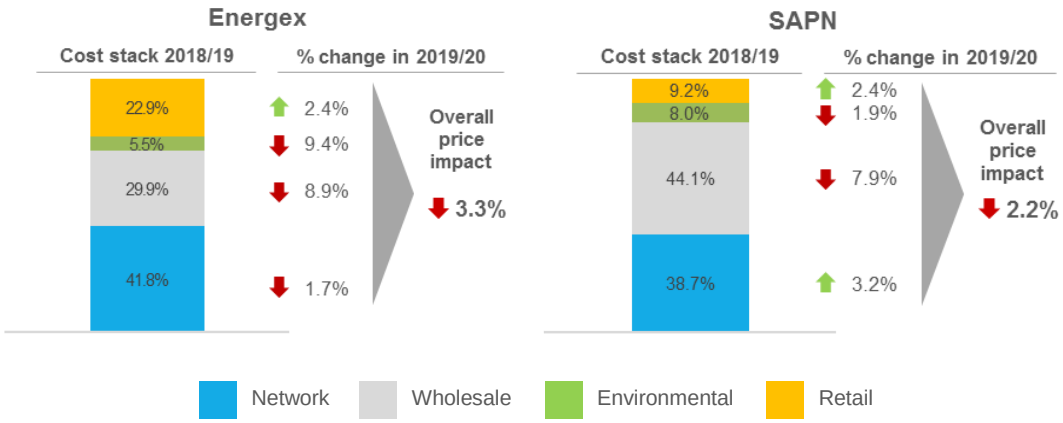
1. Based on the additional AEMC's data book[151] we have used the representative median market offer.
2. We have used the AEMC Price Trends Review cost stack for the 2018-19 financial year.
3. We have adjusted the residual component of the 2018-19 price stack for inflation.
4. We have adjusted the change in wholesale costs for updated underlying contract price and volume data from October 2018 until 1 April 2019, along with relevant NEM fees, ancillary charges and loss factors.
5. As outlined in Section 3.3, in the New South Wales distribution zones we have adjusted the network costs for the X factors from the final 2019-24 distribution network determinations in 2019-20 published by us in April 2019.

[151] See AMEC website: https://www.aemc.gov.au/sites/default/files/2018-12/Databook%20-%202018%20Residential%20Electricity%20Price%20Trends.XLSX

6. As outlined in Section 3.3, in the Energex distribution zone we have adjusted the wholesale costs to reflect the QCA wholesale cost estimates.

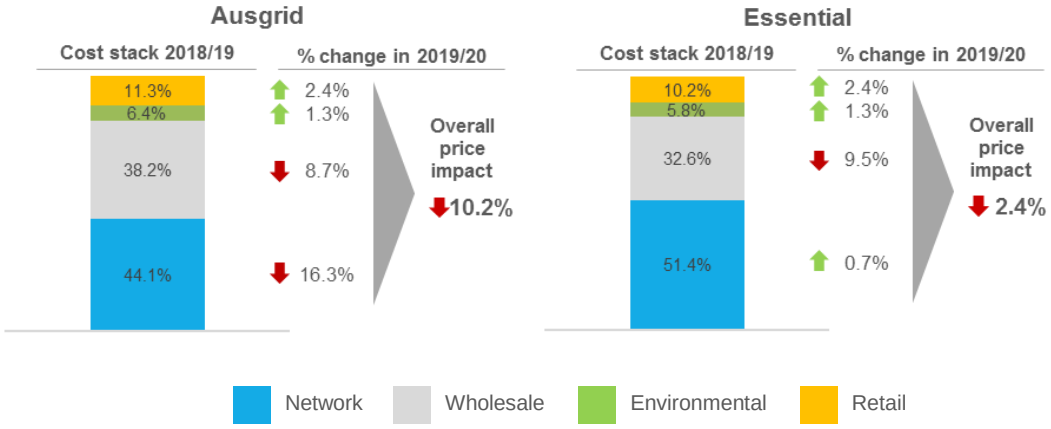
The AEMC Price Trends Review provides cost stack information for each state rather than each distribution network. Whilst this is not an issue for South Australia and South East Queensland, the New South Wales cost stack was also adjusted to reflect the three network areas in New South Wales. Based on the respective network and wholesale costs we have therefore modified the New South Wales cost stack keeping all other components the same.

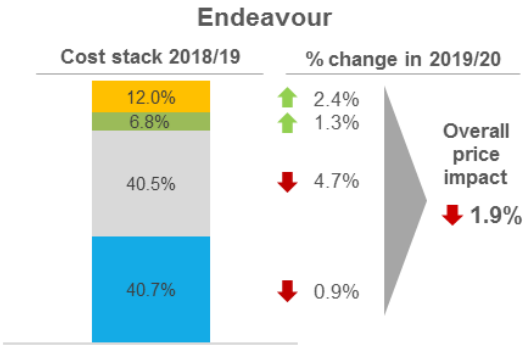
South East Queensland **South Australia**



New South Wales

As outlined above, the New South Wales cost stacks have been separated into each distribution zone to reflect the different network and wholesale costs for each zone. For environmental costs, we applied the same change for all the distribution regions.




Endeavour
Cost stack 2018/19
% change in 2019/20
12.0%
6.8%
40.5%
40.7%
2.4%
1.3%
4.7%
0.9%
Overall price impact
1.9%

H Time of use (flexible tariff) and Controlled Load annual usage allocations

Ausgrid

Table H-1: Flexible Tariff (Time of Use tariff) period usage allocations– Ausgrid

	Period	Usage allocation per period	Residential annual usage without Controlled Load (kWh/yr)	General Usage - Residential annual usage with Controlled Load (kWh/yr)
		(1.000)	**3,900**	**4,800**
2 period	**Peak**	0.656	2,558.4	3,148.8
	Off-peak	0.344	1,341.6	1,651.2
3 period	**Peak**	0.319	1,244.1	1,531.2
	Shoulder	0.395	1,540.5	1,896.0
	Off-peak	0.286	1,115.4	1,372.8
4 period	**Peak**	0.319	1,244.1	1,531.2
	Shoulder 1	0.271	1,056.9	1,300.8
	Shoulder 2	0.124	483.6	595.2
	Off-peak	0.286	1,115.4	1,372.8

Table H-2: CL annual usage allocations (kWh/year) – Ausgrid

CL1 only	CL2 only	CL 1 and 2	
		CL1 (0.67)	CL2 (0.33)
2,000	2,000	1,340	660

Endeavour Energy

Table H-3: Flexible Tariff (Time of Use tariff) period usage allocations– Endeavour

	Period	Usage allocation per period	Residential annual usage without Controlled Load (kWh/yr)	General Usage - Residential annual usage with Controlled Load (kWh/yr)
		(1.000)	**4,900**	**5,200**
2 period	**Peak**	0.668	3,273.2	3,473.6
	Off-peak	0.332	1,626.8	1,726.4
3 period	**Peak**	0.336	1,646.4	1,747.2
	Shoulder	0.391	1,915.9	2,033.2
	Off-peak	0.273	1,337.7	1,419.6
4 period	**Peak**	0.336	1,646.4	1,747.2
	Shoulder 1	0.268	1,313.2	1,393.6
	Shoulder 2	0.123	602.7	639.6
	Off-peak	0.273	1,337.7	1,419.6

Table H-4: CL annual usage allocations (kWh/yr) – Endeavour

CL 1 only	CL 2 only	CL 1 and 2	
		CL 1 (0.67)	CL 2 (0.33)
2,200	2,200	1,474	726

Energex

Table H-5: Flexible Tariff (Time of Use tariff) period usage allocations– Energex

	Period	Usage allocation per period	Residential annual usage without Controlled Load (kWh/yr)	General Usage - Residential annual usage with Controlled Load (kWh/yr)
		1.000	**4,600**	**4,400**
2 period	**Peak**	0.680	3,128.0	2,992.0
	Off-peak	0.320	1,472.0	1,408.0
3 period	**Peak**	0.341	1,568.6	1,500.4
	Shoulder	0.393	1,807.8	1,729.2
	Off-peak	0.266	1,223.6	1,170.4
4 period	**Peak**	0.341	1,568.6	1,500.4
	Shoulder 1	0.275	1,265.0	1,210.0
	Shoulder 2	0.118	542.8	519.2
	Off-peak	0.266	1,223.6	1,170.4

Table H-6: CL annual usage allocations (kWh/yr) – Energex

CL 1 only	CL 2 only	CL 1 and 2	
		CL 1 (0.29)	CL 2 (0.71)
1,900	1,900	551	1,349

Essential Energy

Table H-7: Flexible Tariff (Time of Use tariff) period usage allocations– Essential Energy

	Period	Usage allocation per period	Residential annual usage without Controlled Load (kWh/yr)	General Usage - Residential annual usage with Controlled Load (kWh/yr)
		(1.000)	**4,600**	**4,600**
2 period	**Peak**	0.668	3,072.8	3,072.8
	Off-peak	0.332	1,527.2	1,527.2
3 period	**Peak**	0.338	1,554.8	1,554.8
	Shoulder	0.388	1,784.8	1,784.8
	Off-peak	0.274	1,260.4	1,260.4
4 period	**Peak**	0.338	1,554.8	1,554.8
	Shoulder 1	0.263	1,209.8	1,209.8
	Shoulder 2	0.125	575.0	575.0
	Off-peak	0.274	1,260.4	1,260.4

Table H-8: CL annual usage allocations (kWh/yr) – Essential Energy

CL 1 only	CL 2 only	CL 1 and 2	
		CL 1 (0.77)	CL 2 (0.23)
2,000	2,000	1,540	460

SAPN

Table H-9: Flexible Tariff (Time of Use tariff) period usage allocations– SAPN

	Period	Usage allocation per period	Residential annual usage without Controlled Load (kWh/yr)	General Usage - Residential annual usage with Controlled Load (kWh/yr)
		(1.000)	**4,000**	**4,200**
2 period	**Peak**	0.634	2,536.0	2,662.8
	Off-peak	0.366	1,464.0	1,537.2
3 period	**Peak**	0.313	1,252.0	1,314.6
	Shoulder	0.388	1,552.0	1,629.6
	Off-peak	0.299	1,196.0	1,255.8
4 period	**Peak**	0.313	1,252.0	1,314.6
	Shoulder 1	0.249	996.0	1,045.8
	Shoulder 2	0.139	556.0	583.8
	Off-peak	0.299	1,196.0	1,255.8

Table H-10: CL annual usage allocations (kWh/yr) – SAPN

CL 1 only	CL 2 only	CL 1 and 2
1,800	NA	NA

I Inclusions, exclusions and assumptions for reference bill calculations

Offer element	Notes
Model annual usage	Use model annual usage for each distribution zone in Table 23. For TOU/flexible tariffs, use the TOU period allocations in Appendix H to assign consumption to different periods. Note that for TOU bills with no CL, the model annual usage is the same as Flat Rate with no CL. Similarly, for TOU bills with CL, the model annual usage is the same as Flat Rate with CL.
Controlled load	Use CL model annual usage in Table 23. Use the multiple CL usage amounts in Appendix H.
Seasonal usage profile	Assume flat consumption across every day of the year.
Days per year	365
Tariff seasons/periods	For tariff rates that apply to a season (or any period less than a year), multiply daily consumption by number of days in the tariff season/period to calculate usage for the period.
Four-period TOU/Shoulder 2	An offer with a single shoulder period rate that applies in a season is considered a three-period TOU offer (even if the price applies at different times). An offer with two shoulder period rates that apply in a season is considered a four-period TOU offer.
Guaranteed discounts	Include in bill calculation.
Conditional discounts	Include in bill calculation.
Annual/recurring fees – e.g. Membership and contribution fees	Include in bill calculation.
GST	Include in bill calculation.
Up front/one-off fees	Do not include in bill calculation.
Up-front/one-off metering charges	Do not include in bill calculation.
Recurring metering charges	Include in bill calculation. Note: Where the metering charge has a range, the upper end charges are included in the estimate. For example, if a plan has a metering charge that ranges from $15 to $30 per month, prices should be calculated using the $30 figure is calculated.

Green charges	Do not include in bill calculation.
PV/Solar FiT	Do not include in bill calculation.
Concessions	Do not include in bill calculation.
Incentives – including upfront bonuses, rebates or cashbacks	Do not include in bill calculation.

J Sample reference bill calculation

Table J-1: – 'Super Saver TOU with CL' offer details (all prices GST inc)

	Summer (1 Dec – 28 Feb)	Non-summer (1 Mar – 30 Nov)
Peak Mon-Fri 1400-1959	58 c/kWh	52 c/kWh
Shoulder Mon-Fri 0700-1359 & 2000-2159 Sat-Sun 0700-2159	26 c/kWh	28 c/kWh
Off-peak Mon-Fri, Sat-Sun 2200-0659	15 c/kWh	17 c/kWh
Daily supply charge	$1.02 c/day	$1.05 c/day
CL 1 – Block 1	First 5 kWh/day – 8.1 c/kWh	First 5 kWh/day – 8.5 c/kWh
CL 1 – Block 2	Remaining CL/day – 8.9 c/kWh	Remaining CL/day – 9.1 c/kWh
Metering charge	$15 monthly meter service charge	
Discount	Guaranteed 5% on GST inclusive usage charges	

Table J-2: Super Saver TOU with CL, Ausgrid – worked example

	Annual kWh	Summer usage (kWh) (90 days)	Rate ($)	Price ($)	Non-summer usage (kWh) (275 days)	Rate ($)	Price ($)	Annual total ($)
General usage – 4800 kWh/year								
P	*1531.2*	377.56	0.58	218.98	1153.64	0.52	599.89	818.87
Sh	*1896.0*	467.51	0.26	121.55	1428.49	0.28	399.98	521.53
OP	*1372.8*	338.50	0.15	50.78	1034.30	0.17	175.83	226.61
CL usage – 2000 kwh/year								
CL 1 – block 1	*1825.0*	450.00	0.081	36.45	1375.00	0.085	116.88	153.33
CL 1 – block 2	*175.0*	43.15	0.089	3.84	131.85	0.091	12.00	15.84
Daily charges	-	-	1.02	91.80	-	1.05	288.75	380.55
Metering service charge	-	-	15.00	44.38	-	15.00	135.62	180.00
Sub-total								2296.73
Disc.								– 86.81
Total annual price								**2,209.92**

K Statement of compatibility with human rights

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Competition and Consumer (Industry Code – Electricity Retail) (Model Annual Usage and Total Annual Prices) Determination 2019

The Determination is compatible with the human rights and freedom recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of legislative instrument

This Legislative Instrument sets out the AER's determinations under Part 3 of the *Competition and Consumer (Industry Code – Electricity Retail Regulations 2019* (the Regulations). Specifically:

- Clause 5 sets out the AER determined per-customer amount of electricity supplied in specified distribution regions to small customers.
- Clause 6 sets out the AER determined timing or pattern of the supply of electricity in specified distribution regions to small customers.
- Clause 7 sets out the AER determined reasonable per-customer annual price for supplying electricity in specified distribution regions to small customers.

The determinations made by the AER under the Legislative Instrument commence on 1 July 2019.

The Regulations confer price setting functions on the AER.

Human rights implications

The Legislative Instrument is prepared under the Regulations. The Regulations regulate business conduct and do not engage any of the applicable rights or freedoms.

Conclusion

The Legislative Instrument is compatible with human rights as it does not raise any human rights issues.