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AER POSITION PAPER: DEFAULT MARKET OFFER PRICES 2020-21

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the Council of Australian Governments (COAG) Energy Council in 2015, our objective is to promote the long-term interests of energy consumers with respect to price, quality, reliability, safety and security of supply.

We appreciate the opportunity to make a submission on the Australian Energy Regulator's (AER) Default Market Offer Price 2020-21 Position Paper.

There is significant information asymmetry risk in AER pricing decision which have, in the past, been passed through to consumers through higher prices. We believe that the onus should be on the energy companies to offer further reductions in their Default Market Offer (DMO) prices. The role of the AER should be to robustly test the underlying assumptions in these proposed DMO prices. We have seen assurances from the Federal Minister, the Australian Energy Market Commission (AEMC) and the Australian Competition and Consumer Commission (ACCC) that energy prices are trending down. We anticipate several substantive changes will occur in the market during the 2020-21 period, to further drive down the underlying costs of energy, including the retail costs. The AER's 2020-21 DMO process should provide further assurance to consumers that the downward trend will continue.

How did we get here?

In the 2018 Retail Electricity Pricing Inquiry (REPI), the ACCC identified significant problems across the entire supply chain that are contributing to what the report said is a "market that is not working for consumers" and made a package of recommendations which together would help secure 20-25 per cent bill savings or around $400 off the average bill for consumers. The introduction of the DMO was a significant recommendation of this report.

The ACCC found that the standing offer, which was intended to be the safety-net for consumers, was often the highest priced offer in the market. Disengaged customers tended to be paying higher prices (a 'loyalty tax') as there was no incentive for retailers to reduce their prices for these 'sticky' customers. The ACCC found one of the key issues with the standing offer was that the high price of standing offer bills outweighs the benefit of having access to a default offer with additional essential consumer protections. Further, the difference between the standing offer and the lowest priced market offer was substantial. The ACCC considered "that the standing offer [was] no longer working as it was intended and [was] causing financial harm to consumers."[1]

In response, they recommended that the AER should be given the power to set the maximum price for the safety-net offer in each jurisdiction (the DMO). The price should be set at the efficient cost of operating in the region, including a reasonable margin and customer acquisition and retention costs.

[1] ACCC, Retail Electricity Pricing Inquiry – Final Report, p.246.

The standing offer (and therefore the DMO) has an important role to play in the electricity market, providing a safety net for consumers who have not engaged in the market, or for those who require its additional protections. It is therefore important to set the price right.

What happened in the first year?

Twelve months after the ACCC published this recommendation, the DMO was implemented. In the four months since its introduction, we are already seeing some positive outcomes for consumers.

Standing offer prices in 2019-20 appear to be generally lower than the 2018-19 prices. The recent St Vincent de Paul Society Tariff Tracking reports for Queensland, NSW and South Australia found that in each jurisdiction, the DMO price was lower than the standing offer offered by the incumbent retailers in 2018-19, meaning customers on these offers were paying lower bills (by 7%, 2-8% and 3-4% respectively).[2] The recent ACCC report, *Inquiry into the National Electricity Market Report – August 2019* also found that the majority of standing offers had reduced.

Retailers may be also reducing their market offer prices, though this is less clear. St Vincent de Paul Society also found that the average market offer in each of the relevant jurisdictions had decreased, by between 0.5% in Ausgrid's network area and 4% in Energex's network area. However, the ACCC found that while the number of market offers above the DMO had decreased, the spread of market offers had remained relatively unchanged or reduced.[3]

While the 2019-20 DMO appears to have been a good first step in improving consumer outcomes, there is room to go further. Energy prices are still not affordable for many consumers. Evidence from the recent AER report, *Affordability in Retail Energy Markets* was that while energy affordability improved marginally for households in most regions in 2019, it remains an issue for many households. Low income households continue to spend a significant portion of their disposable income on energy.[4]

The report also noted that only a small number of customers are on standing offers but, to the extent that these are low income households, these will be the most affected by affordability issues.[5] For example, the difference between annual electricity bills on the median market offer relative to the median standing offer is $532 for a low income household in South Australia, or around 2.3% of their disposable income in 2019.[6]

We see the same results in the Energy Consumer Sentiment Survey where consumers continue to tell us that energy services are not affordable, do not represent value for money and they do not have confidence that the sector is working in their long-term interests.[7]

The price of energy has nearly doubled for many households and small businesses in the past 10-15 years and this is a root cause of this dissatisfaction. Simply delivering lower, or (in the case of some market offer customers) flat prices in one year will not be sufficient to reduce the pressure on households and rebuild consumer confidence. The determination of the 2020-21 DMO provides an important opportunity to consolidate, and build on, the better outcomes of the 2019-20 DMO.

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[2] St Vincent de Paul Society, Queensland Energy Prices July 2019: An update report on the Queensland Tariff-Tracking Project, p.2; NSW Energy Prices July 2019: An update report on the NSW Tariff Tracking Project, p.4; South Australian Energy Prices July 2019: An update report on the South Australia Tariff-Tracking Project, p.2.
[3] ACCC, Inquiry into the National Electricity Market – August 2019 Report, p.55.
[4] AER, Affordability in Retail Energy Markets, September 2019, p.13.
[5] Ibid.
[6] AER, Affordability in Retail Energy Markets, September 2019, p.4
[7] Energy Consumers Australia, Energy Consumer Sentiment Survey June 2019

Looking forward to 2020-21

Improving affordability and increasing consumer confidence in the sector needs to be a priority. For governments, implementing the intent of the 56 ACCC REPI recommendations would be a good first step in delivering better consumer outcomes, delivering savings of around $400 for a consumer.

However, the sector also has a clear role to play in structuring energy services to deliver affordable outcomes and many industry stakeholders have made public commitments to improve consumer outcomes. Under The Energy Charter, the CEOs of 18 energy companies have committed to a major strategic and cultural re-orientation of their businesses and the sector, based on five principles:

1. We will put customers at the centre of our business and the energy system.
2. We will improve energy affordability for customers.
3. We will provide energy safely, sustainably and reliably.
4. We will improve customer experience.
5. We will support customers facing vulnerable circumstances.

The Energy Charter initiative provides an opportunity for industry to demonstrate their commitment to improving affordability and re-establishing trust. The recent Disclosures from the signatories, and the Report from the Independent Accountability Panel (due in November), will help to set a new baseline for business conduct and performance.

In this context of high energy prices and low consumer trust, the DMO also has an important role to play, re-establishing both the safety net for consumers on the standing offer (who were previously on some of the highest offers in the market) and facilitating better comparisons by acting as the reference price for marketing. To that end, we support the objectives identified by the AER in the Position Paper:

- To prevent unjustifiably high standing offer prices;
- To allow recovery of efficient costs; and
- To maintain incentives for competition, innovation and market participation.

The AER has indicated the preferred approach to determining the 2020-21 DMO is through a price-based approach using DMO1. That is, by assessing the changes to the underlying wholesale, environmental and network costs and indexing the remaining “retail” costs.

We believe the onus should be on the energy companies to offer further reductions in their DMO price based on their detailed knowledge of the implications for their company of future price downward trends. The Federal Minister, the AEMC through its Price Trends report and the ACCC have already provided supply side assurance to consumers that prices are trending down. Consumers, as has been explained earlier, have no appetite or capability for more expensive electricity prices. The regulatory process supervised by the AER should provide further assurance to energy consumers that prices will continue a downward trend for 2020-21.

The role of the AER should be to robustly test with companies the assumptions underlying their proposed DMO prices, rather than to second guess cost stack elements top down to bottom or bottom up. These processes in the past have revealed significant information asymmetry risk in AER decisions which has been passed to consumers in the form of rising prices. For future rounds of DMO price setting, we would hope the Sunshine Rule Change being developed by ECA would provide the AER with full information gathering powers to avoid information asymmetry risk or compliance gaming. Moreover, we hope through the promising Energy Charter work to see an industry culture of focus on consumer outcomes that can be consistently relied on by consumers, enabling fewer detailed regulatory processes.

Overall, we see the development and implementation of the 2020-21 DMO as an important opportunity to build on the good steps that have already been taken to improve consumer outcomes. It provides an opportunity for retailers and networks to work together to meet consumer expectations on affordability and to rebuild trust in the sector. In particular, for those businesses who have signed on to the Energy Charter, this is a chance to demonstrate that commitment.

If you have any questions about our comments in this submission, or require further detail, please contact Jacqueline Crawshaw, Associate Director, by phone on 02 9220 5520 or by email at jacqueline.crawshaw@energyconsumersaustralia.com.au.

Yours sincerely,

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