National Seniors AUSTRALIA

7 December 2018

Mr Mark Feather
General Manager, Policy and Performance
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Mr Feather

Default Market Offer Price Position Paper

National Seniors welcomes the opportunity to respond to the Australian Energy Regulator's (AER) Default Market Offer Price Position Paper.

National Seniors is a not-for-profit organisation that gives voice to issues that affect older Australians. It is the largest membership organisation of its type in Australia.

National Seniors supports moves to introduce a Default Market Offer (DMO) with a regulated price for electricity as a replacement to standing offers. We have been calling for the reintroduction of price regulation for some time. We believe this is needed to protect vulnerable consumers, especially those unable to shop around for a better deal on electricity.

As an organisation that represents the interests of older Australians, we are acutely aware of the difficulties many older people face in negotiating complex and confusing markets for products and services. Older Australians generally have lower levels of digital literacy and may have difficulties engaging in markets for products where there is a reliance on engagement in digital platforms when choosing between products and services. The latest research from the Australian Bureau of Statistics shows that 2.6 million Australians do not use or have access to the internet, the majority of these are older Australians (ABS 2018).

It has been a great disappointment to older Australians that electricity prices have increased dramatically over the past 10 years coinciding with a period in which prices have been deregulated. The introduction of price deregulation for all its purported benefits has led to the emergence of an electricity market that is increasingly complex and confusing to consumers. While government continues to play a strong role in regulating electricity markets, this regulation has failed to curb behaviour that seeks to make it difficult to compare between the increasing volume of offers for electricity, albeit for a product that is both essential and largely homogenous.

Many older Australians believe that these complex offers are created to confuse them and profit at their expense.

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Older Australians should not be penalised by inflated prices for electricity because they find it difficult to engage with the market. Given the low-levels of digital literacy among older Australians it is important vulnerable older consumers have access to a DMO with a regulated price and consumer protections such as paper billing.

Provided below are responses to many of the specific questions raised in the AER Position Paper.

Should you require any further information please do not hesitate to contact Brendon Radford b.radford@nationalseniors.com.au or 07 3233 9125.

Yours sincerely

Ian Henschke
Chief Advocate

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Default Market Offer Price Position Paper: Responses to the position paper questions

To what extent and how should we take into account the QCA analysis for maximum prices for South-East Queensland standing offers in determining a DMO price in Energex's distribution zone?

The QCA cost analysis for maximum prices for South-East Queensland (SEQ) standing offers provides an opportunity to "test" the methodology proposed in the position paper. It would be beneficial to compare QCA with the approach proposed by the AER to assess if it provides a "realistic" methodology (at least in the SEQ context).

The QCA's bottom-up approach is likely to be more robust than the initial top-down approach proposed by the AER. Ultimately, a bottom-up approach should be used to set the DMO price.

For residential customers, what type of tariff structures should be subject to a DMO price?

The DMO should be applied to flat-rate and controlled load tariffs.

While retailers generally offer multiple standing offers with different tariff types, consumers on standing offers are more likely to be on flat rate or controlled load tariff types. Conversely, consumers who are more comfortable shopping around are more likely to use market offers with time-of-use or demand tariffs.

It would be beneficial to confirm the proportion of consumers on standing offers by tariff type, including the proportion of older consumers on standing offers by tariff type. This would give stronger evidence to support the proposal to only subject flat-rate and controlled load tariffs to a DMO price.

What if any other factors or risks should the AER consider in applying the proposed price-based top down approach for determining DMO prices?

Timing is a key issue. Setting the DMO for a 12-month period has significant implications for consumers who do not or cannot switch. Setting the DMO for the period of one year may have unintended consequences if there is significant price volatility. Under current legislation, standing offers can be changed every six months to account for changing energy production costs.

If the DMO price is set too high, consumers will be paying higher prices than they should. If prices are set too low, then retailers will not have adequate leverage to set discounts on market offers to promote competition and switching among those who can do this.

Risks could be exaggerated by the upcoming election and any change of government as this may herald further unforeseen policy and regulatory changes that impact on prices.

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For residential customers, are the proposed upper and lower thresholds reasonable, given the policy intent?

Using medians of market offers and standing offers to set the lower and upper thresholds appears reasonable, however we suspect that the difficulty will be in getting agreement about where within this range the DMO price is set.

Using a top-down methodology to set a DMO price based on existing pricing is not ideal, however given the time constraints it appears reasonable to use this methodology to determine the range.

As suggested above, the reasonableness of this approach could be tested in the SEQ region where the QCA undertakes more robust analysis of efficient costs (as it is proposed will be done in the future).

If a more targeted upper threshold was used, which retailers standing offers should be included?

If a more targeted approach to calculating the upper threshold were used it should include a large enough proportion of standing offers to accurately reflect reality. It may be pertinent to remove outliers if these are substantially skewing the midpoint, however the use of median over mean likely minimises the impact of any outliers.

Are there any offers or categories of offers that we should not include as inputs into our proposed methodology?

No.

Should the range be the same in each distribution zone?

The methodology used to generate the range should be consistent across all distribution zones.

For residential customers, on what basis should we set the consumption benchmark as part of our proposed methodology?

This depends on how the DMO price works in operation.

The position paper has indicated that the DMO price will be adjusted proportionally to match individual household consumption such that households with lower consumption would pay a price for electricity that reflects specific household consumption. If this is the case, then an average would be suitable as a benchmark.

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Given defined upper and lower bounds, at what point within the range should the DMO price be set? What factors should we take into account in determining this point?

The DMO price should be set at the midpoint between the upper and lower threshold.

This appears to be consistent with the intention of the ACCC to mitigate the impact of unjustifiably high prices for standing offers while also providing reasonable margins and allowances for customer acquisition and retention costs (CARC).

Setting the DMO price any higher than the midpoint will unfairly punish those on existing standing offers which are set low. As the example range in Figure 3 for Ausgrid demonstrates, setting the DMO price at the upper threshold (median standing offer) would increase the price for consumers on standing offers with 10 of the 25 retailers listed (40 per cent), whereas setting the price at the midpoint would only increase standing offers for customers with one of the retailers listed.

Furthermore, Figure 3 also shows that 18 of the 25 retailers (72 per cent) have market offers with ranges extending below the midpoint, 15 of these (60 per cent) with offers below the lower threshold (a majority of which extend over $100 below the market offer median).

Clearly there is ample room to discount below the midpoint if this was the DMO price.

There is only one retailer that has the potential to be negatively impacted by setting the price higher than the midpoint in the Ausgrid example (Pooled Energy) because it does not have any variance between the range and the standing offer, however this retailer is providing a unique product quite different from most other electricity retailers.

What type (and sources) of information should the AER have regard to in considering the likely direction and magnitude of any forecast changes in the main input cost for 2019-20 in setting a DMO price?

Ultimately, it would be preferable to increase frequency of review to avoid the need to forecast changes when there is the risk of uncertainty and unpredictability.

How should the DMO price be specified?

Ideally, annual amounts should be used to specify the DMO price. This will be less confusing for consumers. Annual amounts are what are currently used on the Energy Made Easy site. The Energy Made Easy website and price fact sheets should clearly state the annual cost of electricity for a DMO.

However, there is a fundamental question about how the DMO price will work in practice given the tradition of charging a fixed and variable component in electricity bills. Daily charges have been growing as a proportion of the overall bill as a means of ensuring customers with low use are contributing adequately to the cost of maintaining the supply of electricity.

While the position paper states that consumers should pay based on use, it is unclear how this will work in practice (so that consumers pay an amount equivalent to consumption) without specifying a consistent fixed and variable rate within a distribution zone. It is potentially problematic if retailers have the discretion to set the fixed and variable charges independently as this might mean a customer on one retailers DMO would pay a different amount with a different retailer even though they had the same consumption. This needs further consideration.

What should be the duration of the AER's DMO price determination? To what extent and under what circumstances should there be scope to reopen the AER's determination?

Ideally the price determination should be reviewed within six months with changes timed to coincide with incidences in which major cost drivers occur.

As soon as practical there should be a shift to a bottom-up approach in which the AER estimates the efficient costs that retailers incur in supplying services to consumers in each distribution zone.

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