Public Interest Advocacy Centre

Default market offer prices 2023-24 – Issues Paper

30 November 2022

Public Interest Advocacy Centre
ABN 77 002 773 524
www.piac.asn.au

Gadigal Country
Level 5, 175 Liverpool St
Sydney NSW 2000
Phone +61 2 8898 6500
Fax +61 2 8898 6555

About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is leading social justice law and policy centre. Established in 1982, we are an independent, non-profit organisation that works with people and communities who are marginalised and facing disadvantage.

PIAC builds a fairer, stronger society by helping to change laws, policies and practices that cause injustice and inequality. Our work combines:

- legal advice and representation, specialising in test cases and strategic casework;
- research, analysis and policy development; and
- advocacy for systems change and public interest outcomes.

Energy and Water Consumers’ Advocacy Program

The Energy and Water Consumers’ Advocacy Program works for better regulatory and policy outcomes so people’s needs are met by clean, resilient and efficient energy and water systems. We ensure consumer protections and assistance limit disadvantage, and people can make meaningful choices in effective markets without experiencing detriment if they cannot participate. PIAC receives input from a community-based reference group whose members include:

- Affiliated Residential Park Residents Association NSW;
- Anglicare;
- Combined Pensioners and Superannuants Association of NSW;
- Energy and Water Ombudsman NSW;
- Ethnic Communities Council NSW;
- Financial Counsellors Association of NSW;
- NSW Council of Social Service;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW;
- Salvation Army;
- Tenants Union NSW; and
- The Sydney Alliance.

Contact

Douglas McCloskey
Public Interest Advocacy Centre
Level 5, 175 Liverpool St
Sydney NSW 2000

T: 8898 6534
E: dmccloskey@piac.asn.au

Website: www.piac.asn.au

Public Interest Advocacy Centre

@PIACnews

The Public Interest Advocacy Centre office is located on the land of the Gadigal of the Eora Nation.

Contents

1. Introduction

PIAC welcomes the opportunity to respond to the *Default market offer prices 2023-24 issues paper* (the Paper). We strongly support default price protections for consumers and encourage the AER to take every possible step to ensure Direct Market Offer (DMO) 5 provides better protection for consumers during a time of cost-of-living pressure for households.

We understand the current process is not intended to re-evaluate the objectives, role, approach and application of the DMO. However, the current large retail energy bill increases, and extreme cost-of-living pressure justify a re-examination of the DMO and whether it remains fit-for-purpose and aligned with contemporary understanding of how consumer vulnerability should be addressed. PIAC considers a more widely applied, default protection reflecting efficient cost to serve is warranted. We recommend the AER consider the implications of the current and future energy market and how the DMO can be improved to offer better price protection to consumers, and discipline for the retail energy market.

The process setting DMO prices for 2023-24 should prioritise support for energy affordability. PIAC considers the AER has scope to alter aspects of its previous approach, particularly where it has intentionally 'balanced' the interests of consumers with an objective to provide additional headroom to retailers. Specifically, PIAC highlights opportunity to:

- Remove cost of customer acquisition and retention from inputs included in cost to serve
- Alter the calculation of retail 'allowance' so that it is expressed as a proportion of retail cost to serve, rather than a proportion of the entire cost stack
- Improve the accuracy of wholesale cost modelling, prioritising outcomes for consumers where there are trade-offs between accuracy and transparency.

In the remainder of this submission, we detail the case for substantive DMO reform beyond this process and provide input in response to key areas under consideration in this DMO process.

2. The need for DMO reform

DMO 5 should be regarded as an 'interim' step while more fundamental reforms of default pricing and retail market regulation are considered.

PIAC has consistently advocated for default pricing protections based on efficiency and wider application, to protect consumers more effectively and align retail market incentives with consumer expectations and preferences. We consider the case for such changes to be even more relevant now, where:

- Events during 2022 have demonstrated that the energy system transition will not be smooth. It is likely to involve significant shocks that impact energy costs for consumers over the medium term.
- Current circumstances in the energy market see consumers facing significant and ongoing rises in retail bills as part of wider cost of living pressures placing stress on households.
- The underlying assumption that consumers can 'shop around' for more efficient, reasonable retail offers is no longer reliable, if it ever was.

- The AER, through the release of ‘Towards energy equity’, has recognised a substantial proportion of energy consumers are unlikely to be able to engage with the retail market and get the best outcomes. The strategy seeks to address consumer vulnerability in the energy market and ensure the nature of the market does not contribute to consumer vulnerability.

Whether through the ‘Towards energy equity’ strategy itself, or other processes such as the ‘Game-changer’, PIAC recommends the AER initiate, recommend and/or support a process to reconsider the role of default pricing in providing effective protection for household consumers.

PIAC recommends a re-evaluation with the scope to consider a range of issues related to retail price regulation, including:

- The role of robust, efficient default price protection in alleviating the impact of essential energy access on consumer vulnerability.
- The circumstances where default price protection should apply to ensure that where consumers have not explicitly consented to retail offer conditions, they are protected by a fair and efficient default.
- How consumer preferences regarding ‘postage stamp pricing’ (consistently revealed in distribution network consumer engagement) can be reflected in the structure of default pricing protections.
- The role of efficient, widely applied default pricing in incentivising retailers to understand consumer preferences and create products that demonstrate value and genuine choice.
- The role of network tariff reform and mandatory cost-reflective network tariffs in helping to provide incentive (and scope) to retailers to offer genuine product choice to consumers.

Recommendation 1

That the AER initiate, recommend or otherwise support a review of the role of default pricing in protecting consumers and ensuring an effective retail market operates in their interests.

3. Issues to consider for DMO 5

Wholesale costs

PIAC considers accurate wholesale cost estimation to be a priority for the DMO in its current form. This is particularly true in this DMO process, where all efforts should be taken to ensure consumers are paying no more than is necessary. We understand that more accurate wholesale cost estimation may involve processes which compromise the transparency of wholesale cost inputs. While transparency is important, accuracy, as the determinant of actual impact/outcomes for consumers, should be prioritised. In making this trade-off, the AER will must ensure it retains a focus on outcomes that are in the interests of consumers.

Similarly, while stable pricing for consumers is a priority, it is price stability within a DMO period that is most relevant to consumers. Price stability between DMO periods has less impact, particularly where market retail prices are already adjusted during a DMO period.

Accordingly, PIAC recommends the AER adopt wholesale estimation methodology that improves accuracy in the DMO 5 process, even where this may result in less transparent wholesale cost inputs, or may result in greater volatility of DMO prices between periods.

Recommendation 2

That the AER adopt wholesale estimation methodology that improves accuracy in the DMO 5 process, even where this may result in reduced transparency of wholesale cost inputs or may result in greater volatility of DMO prices between periods.

Retail costs and allowances

Retail costs

PIAC reiterates our strong disagreement with the explicit inclusion of retail costs to acquire and retain customers (CARC) in the calculation of retail costs to serve in the DMO. CARC has no benefit to consumers, and is subject to no productivity or efficiency incentive. CARC costs are more appropriately seen as a ‘retail expenditure’ and can be allowed for as part of the retail margin rather than accounted for explicitly. This is particularly important where the DMO methodology allows for retail costs, margin and an extra ‘head room’ 'allowance.

Smart meter costs should not be explicitly included in retail cost calculations either, unless there is greater transparency around how retailers are incurring and recovering those costs. If retailers are recovering the smart meter costs directly from the customer, offsetting those costs through sale of data, or engaging in any other activity that may alter the impact of the metering costs on the retailer, this must be assessed fully. PIAC sees merit in a regulated schedule of costs for smart meter installation and operation, including guidelines regarding how costs may be recovered from consumers.

Retail allowance

PIAC strongly disagrees that headroom allowance – over and above retail cost and retail profit margin - is required to 'meet the objectives of the DMO', or that this is an effective means of incentivising retail innovation or competition in the market. In the current energy market circumstances this approach intentionally disadvantages consumers. Where the DMO continues to apply to less than 15% of consumers, and consumers are restricted in their ability to access the DMO, retaining an extra allowance is likely to reduce any incentive for retailers to innovate as it inflates consumers’ reference for what constitutes a reasonable or acceptable price.

The Paper outlines issues with the current approach to calculating retail ‘headroom’, noting that using a proportion of the entire cost stack would result in a higher DMO price increase due to rises in wholesale and network cost elements of the stack. The current method also leads to unreasonable additional price increases for consumers and does not appear to be grounded in strong rationale. Where the AER considers it necessary for retailers to have additional headroom beyond their cost to serve and profit margin, this allowance should be calculated as a proportion of their own cost to serve, rather than as a proportion of the cost stack.

PIAC recommends calculating the retail allowance as a percentage of the retail cost to serve only, and that this cost to serve not include CARC or profit. This would ensure the calculation of allowance (or headroom) can be more transparently assessed on its merit as an additional allowance ‘for competition’, while ensuring that no additional unreasonable costs are born by consumers.

Recommendation 3

That the AER adopt calculate the retail allowance as a percentage of the retail cost to serve only, and that this cost to serve not include CARC or profit.

4. Continued engagement

PIAC welcomes the opportunity to meet with the AER and other stakeholders to discuss these issues in more depth.