QCOSS Queensland Council of Social Service

Australian Energy Regulator
Email: DMO@aer.gov.au
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QCOSS Submission to the Australian Energy Regulator Position Paper on Default Market Offer

Queensland Council of Social Service (QCOSS) is the state-wide peak body representing the interests of individuals experiencing or at risk of experiencing poverty and disadvantage, and organisations working in the social and community service sector. For more than 59 years, QCOSS has been a leading force for social change to build social and economic wellbeing for all people and communities in this state.

Thank you for the opportunity to make a submission to the Australian Energy Regulator (AER) in response to your position paper on a default market offer (DMO) price. The position paper is the first step in the AER's process to develop a mechanism for determining:

- the price of the default market offer, consistent with the Australian Competition and Consumer Commission's (ACCC) recommendation 30 and 49; and
- a reference bill for each network distribution region, from which headline discounts can be calculated, in accordance with ACCC Recommendations 32 and 50.

We understand that the AER has been tasked by the COAG Ministers at their last meeting[1] to also consider a reference price or comparison rate.

QCOSS position

QCOSS supports the intent of a default market offer price, reference bill and reference price especially in that it aims to lower bills for many energy customers that are currently not on the best deal. This includes customers who are on standing offers, on market offers where the benefit period has expired, and those on pay on time discounts that can't pay on time. In developing the DMO price we ask the AER to consider:

- It is unconscionable that some customers are paying more than others due to complex market arrangements.
- Compared to the current standing offer, the DMO must be more affordable, reduce bill shock and be easier to understand.

QCOSS' view is that energy is an essential service and must be accessible and affordable to all customers and their households, not just those who are energy savvy and can engage with what has become a very complex market place.

Explanation

QCOSS acknowledges the Australian Competition and Consumer Commission (ACCC) Final Report[2] and supports the recommendations relating to reform in the retail energy market. Consequently, we are pleased that the Australian Government is seeking to adopt a number of these recommendations and that it has tasked[3]

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[1] COAG Energy Ministers Meeting 26 October 2018
[2] ACCC (2018), Inquiry into Retail Electricity Final Report (P240). Full report can be found at this link. https://www.accc.gov.au/system/files/Retail%20Electricity%20Pricing%20Inquiry%E2%80%94Final%20Report%20June%202018_0.pdf
[3] Letter from Treasurer and Minister for Energy to the AER (October 2018).

the Australian Energy Regulator (AER) to commence work on a mechanism to implement the ACCC recommendations:

- To abolish the standing offer and be replaced by the default market offer (DMO).
- That the AER set a maximum price in the DMO that will act as a cap for a default offer.
- That the DMO price be used to calculate a reference bill amount from which all advertised discounts must be taken (ACCC recommendation 32 in Chapter 13) including win-back and retention offers.

QCOSS agrees with the ACCC that there are many aspects of retail electricity competition that are not working and especially for low-income and vulnerable customers. We note the ACCC commentary[4]:

> 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.

QCOSS welcomes the ACCC commentary and recommendations as it has been concerned that the standing offer prices have been trending up since deregulation in 2016 in south east Queensland (SEQ). As retailer practice is to discount off the standing offers this acts as an incentive for retailers to set the highest possible standing offer prices to be able to advertise high percentage discounts and other incentives. Since deregulation the AEMC analysis set out in the ACCC Final Report[5] shows how the price differential has widened to about $273 in SEQ and significantly higher in some other States.

While the overall market is working for many customers retailers' discounting practices have resulted in three distinct groups of customers who are disadvantaged in the retail market; those on standing offers, on market offers where the benefit period has expired, and those on pay on time discounts that can't pay on time.

- About 18 per cent of households in SEQ are on standing offers. This is the highest in any jurisdiction where the market has been deregulated. Some of these customers may be price inelastic but -others are likely to be in hardship and/or have some barrier to switching such as medical issues, lack of proficiency or lack of confidence in decision making that prohibits them from participating in the competitive market. There is clearly inertia given that a plethora of marketing activity in SEQ for more than 10 years has not enticed them to switch.
- People who are on market offers and their contract benefit period has expired who have not signed up to another plan. In Queensland these people get reminders when the benefit period is almost finished and most recently this has been extended to the rest of the National Energy Market (NEM). Nonetheless there are likely to be a number (and this may be relatively large) who do not continue to shop around. When the benefit period has expired these customers will be put on their offers' "reference" prices, some of which are the same as the standing offer or in some cases higher than the standing offer.
- People on market offers who are struggling to pay their bills on time. The ACCC analysis[6] indicates that people who are on low incomes may be more likely to shop around to secure the best price they can get, so those customers in hardship who are struggling to pay their bills may be more likely to be on a market offer. We note this is only one indicator of vulnerability, and there are potentially many vulnerable consumers that are not on payment plans or in retailer hardship schemes.

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[4] ACCC (2018), Inquiry into Electricity Retail Price, FInal Report.
[5] ACCC (2018), Inquiry into Electricity Retail Price, Final Report P241, Figure 12.1, it is noted that in jurisdictions with longer period of retail competition that the gap is much wider. This suggests that as the market matures that retail competition produces even great differentials between standing offer and market offers.
[6] ACCC (2018), Inquiry into Electricity Retail Price, Final Report, P245, Figure 12.5.

This group are especially vulnerable to retailers' practice of inflating the standing offer prices so as to appear to offer a higher discount. This means that people who remain on standing offers, where benefit has expired or people who cannot meet the requirement to pay on time will end up paying these inflated prices.

The ACCC analysis[7] indicates that these groups are missing out on the lowest energy deals. For example, based on retailer data obtained by the ACCC, while 73 per cent of all residential customers in SEQ, NSW, Vic and SA achieved conditional discounts, only 41 per cent of hardship consumers did, and only 56 per cent of consumers on payment plans did. These findings are concerning, as these consumers are more likely to be experiencing payment difficulties already and their exposure to penalties in the form of forgone discounts is adding further unnecessary burden.

Approach

The AER has been tasked to implement ACCCs recommendation to set a DMO price to replace the current high inflated standing offer (which retailers set) and a reference bill for households and small and medium business. The ACCC recommended a bottom up approach where the DMO price would include a reasonable retail margin, the costs of additional customer protections (paper bills and bill smoothing) and include costs of customer acquisition and retention costs (CARC). The AER however in their Position Paper proposes in the first year (2019-2020) to use a "top down" approach to determine the DMO in each distribution area. It proposes to use publicly available data of market and standing offers from the energy made easy website, to determine the median price of these offers and then estimate an 'efficient' price somewhere between the market and standing offers.

QCOSS has significant experience advocating for fair and efficient regulated prices as there was a regulated price in SEQ determined by the Queensland Competition Authority (QCA) up to 2016. There are still regulated "notified prices" in regional Queensland. The approach is a bottom up, cost-stack based price determination. Notified prices in regional Queensland under the uniform tariff policy (UTP) are based on standing offer prices in SEQ.

We recognise that the AER process for determining the DMO is a different process to that of the QCA in regional Queensland and may produce different outcomes. We note that aligning the methodological approach between notified prices and the DMO would reduce the likelihood of the regulated price in SEQ being significantly different to that in regional Queensland. How this aligns with the UTP and how notified prices sit alongside the DMO remains to be seen. QCOSS will consult with Queensland Government and the regulators on these matters and will raise any concerns that may become apparent. Draft notified prices will be available in March 2019. The final notified prices will be released at the end of May 2019.

Bottom up approach

In principle, QCOSS strongly supports the bottom up approach as it is a more rigorous approach and is a tried and tested method to determine the efficient costs of supplying electricity. It is also not dependent on revealed prices for a point in time (such as the top down approach) in the year and therefore not exposed to any volatility in the market at that time. This may increase the risk of greater changes in prices from year to year which in turn may lead to greater bill instability and bill shock.

The AER state that for the first year, given the time imperative that it is not possible to achieve a bottom up approach and hence a top down approach is necessary. However, QCOSS encourages the AER to adopt a more rigorous approach after the first year and potentially the top down approach could act as a check to determine if the DMO price is broadly in line with the revealed prices in the market.

In determining the costs for inclusion in the DMO price, QCOSS would like the AER to consider the following factors when determining DMO prices.

- Valuing the protections of the DMO
- Customer acquisition and retention costs (CARC)

[7] ACCC (2018), Inquiry into Electricity Retail Price, Final Report, P264, Figure13.7.

- Premium Feed-in-Tariff Schemes
- Load control tariffs

QCOSS believes customer protections, offering paper bills and bill smoothing should be considered standard and not an additional cost. This is a position we have consistently taken in our advocacy to the QCA and Queensland Government as part of the setting of notified prices which is set with regard to the Queensland Government's uniform tariff policy (UTP). The UTP is set out in a delegation from the Queensland Government to the QCA and is given effect by a cost stack approach with an additional adjustment for the differential between standing offer and market offer in SEQ. This is in recognition that there are additional protections for consumers on standing offers. For the last few years the delegation has specified that this adjustment approximate about five per cent of the total costs.

For our submission to the QCA in 2018, QCOSS presented some preliminary analysis[8] that shows that a simple comparison between market offer and standing offer contract terms and conditions brings into question the extent to which there is a measurable benefit to standing offers over market offers. QCOSS asks that the AER take into account the particular protections under the derogations for Queensland including that there are no late fees on the standing offer and they are capped at $20 for market offers.

QCOSS' view is that customer acquisition and retention costs (CARC) should not be included in the DMO price. The DMO price is a cap on what is essentially the standing offer and is regarded as a safety net then CARC should not be included as there is no need to actively recruit and retain customer to a default offer. It is these customers' prerogative not to engage in the market and therefore they should not have to pay the costs of others who choose to engage with the market. People on standing offers and who do not shop around do not get the benefit of the activities relating to these costs.

On 31 May 2017, the Queensland Government directed Energy Queensland (Energex and Ergon Energy) to remove the costs of the Solar Bonus Scheme from their network tariffs until 2020. The effect was to reduce the notified prices for 2017-18, and this will continue until 2020. The Solar Bonus Scheme was implemented as a Queensland Government policy rather than a network business requirement.

QCOSS supports the exclusion of the costs of the Queensland Government's Solar Bonus Scheme (premium solar feed in tariff scheme) from network tariffs and that the exclusion should be continued for the life of the Scheme which ends in 2028. From July 2020, unless the Queensland Government extends its current policy, the costs of the Scheme will be included in prices. Should the DMO price not include the Scheme then it is likely that the Scheme costs will be recovered from non DMO customers. This is not an acceptable situation and QCOSS will strongly advocate to the Queensland Government to continue funding the scheme. In the absence of the Queensland Government not funding there may be no option but to include the scheme in the DMO price.

The AER has not addressed in its Position Paper how controlled load tariffs will be determined using the bottom up approach. This is an especially important issue for SEQ as there are many households with load control tariffs. QCOSS notes with some concern the increase in energy costs for customers on load control in recent years due to night-time costs of energy increasing in Queensland. The load control tariffs are marketed as a way for customers to reduce the cost of the electricity they use, while at the same time they contribute to reducing peak demand by shifting usage away from peak times when wholesale energy costs and network costs are highest, and the strain on the system is highest. QCOSS asks that anything that reduces the benefits of load control tariffs should be avoided in the short term in developing the DMO price for load control households.

Top down approach

The top down approach is a second-best option to establish the DMO price however it does give an indication of the revealed prices in the market. It will be important to provide confidence to stakeholders that the analysis for

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[8] QCOSS (2018), Submission to the draft Determination for Notified Prices 2019-2020 in Regional Queensland. The submission can be found by at this link: http://www.qca.org.au/getattachment/0ec7a74d-2ce7-4239-b917-6e8046630b21/QCOSS-submission-Draft-Determination-on-Regulat.aspx

the DMO price is robust and based on data that is validated by the market. In particular, it will be important to consider the following issues:

- What offers to include
- Consumption benchmark
- Load controlled tariffs

The AER has stated that it will source offers from Energy Made Easy (EME) and the Victorian Energy Compare site as at October 2018 for the DMO price for 2019-2020. The timing proposed is a good idea as this date has already passed and hence retailers cannot distort the market in advance. However, it is well known that not all offers are available on EME and particularly not all "best offers" are available. Further there is also a plethora of other incentives which are "gifts" and therefore also decrease costs for consumers as the consumer may otherwise have purchased those items themselves, but they do not directly impact on energy bills.

As the market has become more competitive there is evidence that the larger retailers are actively marketing to existing customers and offering them very good offers. These offers are not available on EME. The ACCC in its recent report actually cites the comments of a retailer's staff member which indicates that this is a growing practice:

> "*Another retailer's staff member commented in an internal email that: "[t]he big three retailers particularly, now have large and very active retention / winback teams that are offering high % discount rates and "stay" credits of $100 and on occasion up to $200, that appear to be lossmaking but they are often holding the customer. No doubt with the intention to grow the rate over the next year or so." This email noted that a particular retailer had "recently resorted to chasing a discount % with customers offering 24, 25, 26, 27% until they find the "sweet" spot with a customer and hold them.*"

The AER must also investigate how to take into account the plethora of non EME offers and incentive gifts. In particular it must attempt to estimate the significance of non EME offers and if they are material. If they are material an allowance should be made for them in determining the median market offer.

The AER will also calculate the annual bill amount for each available standing and market offer based on a consumption benchmark. This benchmark will be based on "average" data from the distributors' Benchmarking Regulatory Information Notices (EBRINS). We would assume that the "average" is based on the median measure to allow for low and large outliers.

For residential customers on load control tariffs (of which there are a very large number in SEQ), the same "average" consumption benchmark will be used with a proportion for total consumption allocated to load control based on assumptions used for EME. QCOSS is keen to understand better the assumptions underlying these benchmarks and the extent to which they are proxies for revealed consumption. With respect to load control consumption it will be very important in establishing the benchmarks for SEQ that every effort is made to calculate a robust proxy. As already flagged above the use of EME to estimate the consumption benchmark for load control may be misleading.

We recommend that AER contact Energy Queensland to get a better understanding of the extent of the usage for load control. Relying on assumptions in EME may be problematic as many people do not use their own bills to generate offer comparisons. These at best are guesstimates and therefore may not be reliable.

How should DMO prices be specified?

In specifying the DMO prices the AER's preliminary view is to "specify the DMO price as an annual bill amount, which standing offer tariffs applied to the representative user's expected usage, cannot exceed". This can be represented in terms of annual $, daily $ or c/kWh and discounting can be off any of these measures. This is opposed to a fully specified tariff including caps on the fixed and variable components. Crucial to both approaches is that the specification is based on the representative customer's usage and hence the actual bill for a customer may be greater or less depending on usage relative to the representative user's usage.

QCOSS strongly supports making discounting easier to understand and so consumers must have easy to use and useful information to facilitate comparison of different electricity offers. A good starting point is that all retailers operating in the same jurisdiction will use the same consumption level assumptions when providing mandated comparison/reference/rates/costs. It is crucial that whatever way the reference bill/reference price is specified people understand that it is indicative only and used for comparison purpose so they can easily determine the magnitude of difference between the offers. That is they can compare “apples with apples” and then work out which one is truly a better offer. It is important for them to understand that the reference bill does not relate to their own consumption.

Furthermore, QCOSS’ view is that presenting the reference bill as a quarterly or monthly dollar amount may be a better basis for comparison than a fully specified tariff or specification based on an annual, daily or c/kWh for a number of reasons[9]:

- While an annual amount is very useful as it provides a quantum of the likely impact on their overall budgets, QCOSS’ view is that an amount based on the bill period is the most understandable for consumers as the amounts are most likely to align with their own bills.
- A “reference rate” which expresses all costs in terms of a daily cost or cents per kWh is unlikely to be beneficial for consumers as it will not be well understood, will result in a very small figure that consumers will disregard, and will be confused with the kWh rate in tariffs.
- It is a known consumer behaviour that the size of the unit of measure used to indicate price/cost influences perception of value. For example, 30c per 100g is considered cheaper than $3 per kg even though they are identical numerically, and a saving of $3 per kg is regarded as being worth more than 30c per 100g. Therefore, it is recommended that the unit cost used for any comparison/reference prices should be large enough for consumers to consider significant, that is $ rather than c.

It is crucial that consumers understand the purpose of the DMO Price otherwise this will lead to more confusion. Consistent language across the retailers is important here and we highlight a recommendation from the Queensland Consumers Association to the Issues Paper for the AER’s Retail Pricing Information Guidelines which stated that:

> *It is important to agree on and mandate the use of one set or words to describe what figure/value is eventually decided on. For example, if an annual estimated cost for a specific level of consumption is adopted the Association suggests that this be only called either the “comparison cost” or the “cost indicator”.*

Implementation

How the DMO is implemented will be a key factor in its success. We note that implementation issues have not been discussed in the Position Paper and so it is expected that in the draft determination the AER will consider how the DMO price and the Reference bill are implemented and importantly if there will be a communications strategy?

We ask that the AER consider the following issues at the next stage of DMO price development:

- Until the standing offer are abolished the AER must clarify if discounting for new offers are off the DMO and not the standing offer. This must be for all new offers available not just those that are “generally available” offers and include offers where the base price is at the standing offer or above and those that are not publicly available.
- To set out very clearly what (if any) are retailers’ obligations to nonstanding offer customers with respect to the DMO price? Of special concern to QCOSS is those customers where the benefit period has already expired (before 1 July 2019), they have received the relevant notification and they have not taken up a new offer. This group will not have the opportunity of finding out about the DMO price or the reference bill as they have already got the notification.

Funding should be made available to community organisations as part of an energy literacy and efficiency community awareness and education program which could include an understanding of the DMO price and reference bill and how to shop around. Collateral should be made available for distribution to community

[9] QCOSS refers to these reason from analysis by the Queensland Consumers Association work in uniting pricing and submissions to the AER’s Retail Pricing Information Guidelines Issues Paper in November 2017.

organisations. In this context the Federal Government should commence the ACCC recommendation (Recommendation 38) to provide funding for community groups to provide targeted assistance to vulnerable consumers.

QCOSS encourages the AER to also put in place a strong monitoring regime to assess the customer impacts of the DMO. The analysis should aim to assess the impact on different customers groups (especially those previously on a standing offer where the benefit period has expired; and those who cannot pay their bills on time), as well as what is the impact on prices and bill shock for these customers. These are the customers who are not benefiting from the competitive market so if the DMO is to be a success then it must be benefit these groups.

The impacts and trends on the overall market also need to be monitored. It will be important to understand how retailers are likely to behave and what will be the impact on the overall market in terms of market concentration, prices in market offers, number of customers on market offers and trends in discounts. It may well be the case that the level of activity reduces in terms of market offers, discounts and number of retailers in the market. This needs to be assessed and understood against the benefits of a DMO price regime which brings benefits to customers who are currently disadvantaged by the market,