08 November 2019

Dr Paul Paterson
Chair
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop, Sydney NSW 1240

public interest
ADVOCACY CENTRE

Dear Dr Paterson

IPART 2018-19 Review of the performance and competitiveness of the NSW retail electricity market – Draft report

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon people who are marginalised and facing disadvantage. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training. The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers, developing policy and advocating in energy and water markets.

PIAC welcomes the opportunity to respond to IPARTs *Review of the performance and competitiveness of the NSW retail electricity market – draft report.*

PIAC supports IPARTs ongoing role in monitoring the performance and competitiveness of the NSW retail electricity market. In the Draft Report IPART recommends that their market monitoring role be discontinued on the basis that this function is effectively duplicated by other national market and regulatory bodies, such as the AEMC, AER and ACCC.

PIAC acknowledges there is duplication between IPART and national market and regulatory bodies, but contends that, with a remit in the National Energy Retail Law (NERL) to report on any other matters they think appropriate, IPART has the scope to go beyond those assessments with wider and more targeted analysis to better promote the interests of NSW households and other energy users.

IPART has a unique and important role as an expert, jurisdiction-specific regulator with a remit to monitor, assess and provide information and recommendations on the performance of the energy market.

PIAC recommends that IPART revise its previous approach to this review, in particular its assumptions regarding the intrinsic value of retail competition, and test aspects of the nature of competition and how it performs in relation to the actual impacts and outcomes for NSW households and other energy users. This would necessarily involve a more qualitative analysis than that currently undertaken.

IPART has the capacity to access and analyse additional NSW-specific information to enable more meaningful analysis than that by other agencies. For example, data collected by Service NSW and the Department of Planning, Industry and

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Environment through the NSW energy rebates summary report[1], in conjunction with information sources already used by IPART, could enable a much-needed view of lived experience of NSW households.

While existing monitoring uses median and average bill data as an indication of the performance of the market, this provides an incomplete and potentially misleading picture, and presumes general availability of these offers and high engagement. A more accurate and complete picture of the performance of the market and real outcomes for consumers would be achieved by also considering:

- What offers consumers are actually engaging with, including how many consumers are on the range of different price offers available.

- How much electricity consumers are using and what this costs on the various offers available. For instance, the recent NSW rebate summary indicated that rebate consumers on standard offers were generally consuming less energy than those on market offers[2]. This is important as it indicates the costs of some deals may result in consumers using less electricity than is necessary for their essential needs. The Energy Switch service operated by ServiceNSW represents a potential source of valuable data in relation to NSW consumers actual usage, and final bill costs.

- The observed switching and renewal behaviour of consumers. Current assessments look only at the total number of switches, in conjunction with the numbers on market and standing offers.

  PIAC notes that the recent NSW rebate summary report indicated that the actual switch rate for NSW rebate customers in 2017-18 was 20 percent lower than the rate assumed by the AEMC, whose data IPART presented in table 2.1 of the draft report. Analysis of the actual behaviour of consumers is important as total switching numbers are likely to be materially distorted by the small number of 'highly active' consumers who churn very regularly, and who's behaviour potentially adds costs that must be recouped from other consumers.

- The state of the market for innovative energy retail products and services, particularly those that households can generally only access via retailers, such as smart metering, online energy portals and apps, and demand response. This analysis could be supported by PIAC's own annual survey of NSW retail innovation, last undertaken in February 2019 and scheduled to be updated in February 2020.

PIAC considers that a number of the conclusions IPART draws in the draft report do not accurately represent the performance of the retail market in respect of the outcomes and impacts for NSW consumers. Accordingly, we note the following:

- IPART observes that retailers are competing on price, with a significant spread of offers available. IPART does not appear to consider whether (or how much) price variation is appropriate in the delivery of the essential service of electricity.

  While price dispersion is reasonable and expected in relation to differentiated products and those consumers can choose not to purchase, in a market with little variation between

1 NSW Government. 'NSW energy rebates summary report: analysis of program reporting data for the period July 2017 – June 2018.

2 Ibid.

sellers of a product and an objectively narrow-ranging cost to serve, PIAC regards a wide price spread as a sign of market failure.

It is possible to estimate what, it costs retailers to deliver services to consumers, including a reasonable margin. The Victorian Essential Services Commission (ESC) has done this analysis in relation to their own default offer. A market that delivers a range of products substantially above this price, and one many consumers are paying this excess for an essential service, should be regarded as performing poorly[3]. PIAC recommends that IPARTs analysis of the performance of the competitive market in NSW include analysis of the number of offers above the efficient cost of service, and how many consumers are impacted by excess cost offers.

- In observations on retail price trends for the period 2007-2019 in section 1.3.2, IPART comments on increasing network costs driving the significant rise in retail prices over the period 2007-13. Comments regarding the changes in subsequent periods link these to increases in wholesale costs. However, periods of decreasing retail prices appear to be attributed only to the operation of the competitive market, rather than reductions in these underlying costs.

  PIAC considers this an incomplete, potentially misleading analysis. An assessment of the relative performance of retail competition over time should present contributing factors consistently, tracking network and wholesale costs over time.

  PIAC considers the use of the 'median lowest market offer' in this analysis is misleading. Lowest market offers are, at best, only available to a small minority of consumers. These offers are often 'loss-leading' and likely to be below the efficient cost of operation for retailers. These offers are not indicative of the shape of the market, or a reasonable marker of the outcomes it is delivering for consumers. If this analysis is continued, PIAC recommends using the median market offer, rather than the median lowest market offer.

- In assumptions that price dispersion is a sign of a workably competitive market, retailers are assumed to need to be able to charge some consumers more, in order to make lower cost offers available for others. This assumes that the availability of lower cost offers demonstrates that consumers have access to efficient well priced services, and can get their essential services at a fair price. By this logic, an effectively performing retail market delivers better outcomes for consumers who engage and participate regularly and 'actively'.

  PIAC considers that this is based upon a number of assumptions that do not reflect consumer behaviour or best interests, which have implications for IPARTs assessment of market performance. Specifically:

  - Retailers are assumed to need to charge a significant proportion of consumers above an efficient price, to provide scope to offer other consumers lower prices, and to develop and employ innovative products. This assumes that retailers need a 'positive' incentive, so they benefit financially in advance of any action that is intended to be incentivised, and where they do not bear any direct cost or risk of not engaging in that behaviour.

    This entrenches inertia, as it allows retailers to 'benefit' from inefficient pricing, regardless of whether they innovate or compete. This leaves the potential for some

3 PIAC has attached submissions made to the AER in response to their determinations of the DMO, presenting arguments in relation to how a competitive market should work for consumers.

consumers to benefit (and the quantum of that benefit) up to retailers, with no transparent mechanism incentivising efficiency. PIAC regards this as inappropriate in the provision of an essential service, particularly one that is largely homogenous.

- Consumers are considered to want to mitigate losses. It is assumed they will become more active in the market if they face penalties for not being so. This is predicated on two faulty assumptions:

    - Consumers are driven by 'negative incentives' based on a guaranteed penalty and the possibility of a future benefit if the desired behaviour is undertaken. PIAC considers this is not appropriate in the delivery of an essential service such as electricity, where consumers do not have the option not to purchase, and do not have knowledge of the 'fair value' of retail services[4]

    - Participation enables consumers to secure a better priced deal through navigating the competitive market. Research undertaken by the Victoria Energy Policy Centre illustrates that this is not the case. Examining nearly 50,000 actual bills, the research demonstrated that the price difference for consumers who switched recently and those who did not, was negligible[5]. The conclusion drawn was that consumers are not able to effectively mitigate their losses or impose efficiency on retailers through participation in the market.

On this basis, PIAC considers that IPART undertake further examination of the operation of the retail market and its interaction with consumers. It is imperative that assessment of market performance critically examines how effectively retail competition is driving efficiency in retail operation, and the delivery of affordable essential electricity services to all consumers.

Continued engagement

PIAC would welcome the opportunity to meet with IPART and other stakeholders to discuss these issues in more depth.

Yours sincerely,

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4 The attached responses to the AER in relation to the DMO process provide further context and explanation in relation to the need for an effective value indicator for consumers

5 Victoria Energy Policy Centre. 'Do Victoria's households leave less money on the table when they switch electricity retailers?' September 2019.

18 October, 2019

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

Dear Mr. Feather

Default Market Offer (DMO) Price 2020-21 Position Paper

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon people who are marginalised and facing disadvantage. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training. The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers, developing policy and advocating in energy and water markets.

PIAC welcomes the opportunity to respond to the Australian Energy Regulators (AER) position paper on the Default Market Offer Price 2020-21.

PIAC disagrees with the AERs assertion in the Position Paper (the Paper) that the initial iteration of the DMO achieved its intended objectives. We contend that the DMO has failed to deliver its intent, and is based on a number of flawed assumptions that have ensured the retail market does not operate in the interests of consumers. This has left many consumers still being charged too much for an essential service.

PIAC is concerned that if DMO2 is built upon the flawed foundation of the initial DMO it will compound existing failures and lock inefficiency into retail pricing. We strongly recommend the AER reconsider the proposed option for calculating DMO2, reassess the intent of default pricing, and look at ways the stated objectives can be better realised in the long-term interests of consumers. PIAC considers Option 3 – a cost-based approach to determining DMO2 – is preferable.

Recommendation

PIAC recommends that the AER undertake a more thorough re-assessment of the intent and objectives of the DMO, including a more detailed examination of the impact of the DMO on actual retail bills, as part of a DMO2 determination process utilising a cost-based approach.

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Assessment against DMO objectives

The Paper asserts that the initial DMO (DMO1) achieved its objectives. PIAC disagrees and contends that in determining DMO2, the AER should undertake a comprehensive reassessment of the intent and objectives of the DMO.

Defining Unjustifiable

A key objective, and arguably the fundamental intent, of the DMO is to prevent the charging of 'unjustifiably high' standing offer prices. Where standing offers operate as a form of default and crucial reference price, PIAC strongly supports this objective. However, we disagree that this intent has been correctly applied in the development of the DMO, and do not consider that the Paper has sufficiently assessed the impact of DMO1 against the intent and objectives.

As we argued in our submissions to the initial DMO consultation process, 'unjustifiable' is a subjective term. Accordingly, it is crucial that the DMO process commences with a clearer 'problem definition' and an explicit statement of the reasoning behind what the AER regards as unjustifiable standing offer prices.

Without this, it is impossible to assess the performance of the DMO, and conclude that the objective of preventing 'unjustifiable standing offer prices' has been achieved. PIAC strongly recommends the AER adopt an approach similar to that used by the Victorian Essential Services Commission (ESC) to calculate the Victorian Default Offer (VDO). The VDO methodology uses efficient costs as a reasonable, objective and transparent indicator for unjustifiable standing offer prices. PIAC regards this as particularly important where the DMO also serves as the basis for the reference price, and is a crucial element of information for consumer choice.

Regardless of whether the AER agrees with this particular perspective on what is unjustifiable, transparent monitoring and assessment requires an explicit definition and reasoning to be stated as part of the DMO setting process.

The application and extent of efficiency

Efficiency is a key measure of the 'long term interests of consumers' and PIAC strongly supports embedding efficient cost recovery into each link in the energy supply chain. Accordingly, PIAC supports the objective that a DMO allow the recovery of efficient retail costs including reasonable retail margins. However, this objective was not achieved by the initial DMO formulation. In fact, in its final determination of DMO1, the AER was explicit that the DMO would intentionally not represent an efficient retail price[1].

We consider that the objective was formulated to guarantee that retailers recover 'at least' their efficient costs, and when read in conjunction with the first objective – to prevent unjustifiably high standing offer prices – this objective should lead to a DMO set at a level of efficient cost recovery. PIAC regards the decision to set DMO1 above the level of efficient cost recovery as a failure. Accordingly, we consider that DMO1 did not achieve either of the first two policy objectives.

The VDO, implemented in parallel to the DMO, used a formula that includes 'efficient costs'. This incorporated a reasonable allowance for benchmarked retail costs, benchmarked Customer acquisition and retention costs (CARC) and retail margin. It was not intended to

1 AER '*Default Market Offer 2019-20: Final Determination.* April 2019, 30.

indicate a 'lowest cost' price, and it left considerable room for lower cost offers. The VDO has achieved much greater standing offer reductions than the AER's DMO. PIAC contends that this difference is a reasonable indicator of the unreasonable premium above efficient costs allowed by the DMO.

This indicates that the DMO has not met its objective to allow for the recovery of 'efficient costs', and as the basis of the reference price, does not serve as a meaningful market indicator for consumers.

Incentives and market participation

Active, meaningful competition and the ability for consumers to engage effectively in the market is a priority for the retail energy market. PIAC supports the objective that the DMO not negatively impact incentives for retailers or consumers to participate effectively in the retail electricity market, for the benefit of consumers. However, we reiterate our disagreement with the application of this principle in the AER's formulation of the DMO.

Throughout the determination of DMO1, the AER applied an assumption that retailers must have 'positive incentives' and consumers must have 'negative incentives' to act. PIAC considers these assumptions to be flawed and inappropriate. Specifically:

- Incentives for retailers are assumed to require retailers to be able to charge a significant proportion of consumers above an efficient price, on the basis that this provides scope for them to offer other consumers lower prices, and to develop and employ innovative products. This assumes that retailers need a 'positive' incentive, where they benefit financially in advance of any action that is intended to be incentivised, and where they do not bear any direct cost or risk of not engaging in that behaviour.

  PIAC contends this assumption entrenches inertia, as it allows retailers to 'benefit' from inefficient pricing, regardless of whether they innovate or compete. This leaves the potential for some consumers to benefit (and the quantum of that benefit) up to retailers, with no transparent mechanism incentivising efficiency. We regard this as inappropriate in the provision of an essential service, particularly one that is largely homogenous.

- Consumers are considered to be incentivised by a requirement to mitigate losses. It is assumed they will become more active in the market if they face penalties for not doing so. This is predicated on the following two faulty assumptions:

  - Consumers are driven by 'negative incentives' based on a guaranteed penalty and the possibility of a future benefit if the desired behaviour is undertaken. PIAC considers this is inappropriate in the delivery of an essential service such as electricity, where consumers do not have the option not to purchase, and do not have an effective indicator of the 'fair value' of retail services.

  - Participation enables consumers to secure a better priced deal through navigating the competitive market. Research undertaken by the Victoria Energy Policy Centre illustrates that this is not the case. Examining nearly 50,000 actual bills, the research demonstrated that the price difference for consumers who switched recently and those who did not, was negligible[2]. The conclusion drawn was that consumers are

[2] Victoria Energy Policy Centre. 'Do Victoria's households leave less money on the table when they switch electricity retailers?' September 2019.

not able to effectively mitigate their losses or impose efficiency on retailers through participation in the market.

On this basis, PIAC considers that the current DMO has not fulfilled its objective to maintain effective incentives. The result is that consumers bear the bulk of the cost and 'risk' of ineffective market competition. They are penalised for not 'participating', while unable to consistently impose competitive efficiency when they do.

PIAC reiterates that a DMO reflecting the efficient cost of retail services operates as a more 'symmetrical' market incentive for both consumers and retailers. Such a DMO would more clearly signal retail cost efficiency, and better align the interests of retailers with the long-term interests of consumers. An efficient cost based DMO would:

- Give retailers an incentive to improve the efficiency of all of their service offerings. Under an efficient cost DMO retailers are discouraged from 'loss-leading' price discounting, a behaviour that has been shown to be demonstrably inequitable, inefficient and one that loads unproductive costs into retail operations. In an environment where 'price only' competition is less viable, retailers are incentivised to develop new service offerings to entice consumers. An efficient price DMO leaves a productive margin for retailers and aligns improved retail business growth and profitability with improved efficiency. Importantly, it introduces an ongoing mechanism for improved productivity and efficiency and does not reward inefficient pricing or business practice.

- Incentivise consumers to choose the market participation that best suits their needs. With a clearer understanding of the efficient cost of retail electricity services through the DMO, consumers are better able to choose between offers. Crucially, it becomes a 'positive incentive', ensuring that consumers pay a 'fair' price, and can exercise choice where it is in their interests to do so. This may include choosing premium price offers where retailers demonstrate the additional value to consumers.

PIAC strongly recommends that the AER re-evaluate the role of the DMO in aligning effective competition incentives in the retail electricity market, and implement a DMO2 that more closely represents the efficient cost of retail services.

Recommended approach to DMO2

The AER has proposed an approach that 'updates' DMO1 with adjustments to retail cost inputs. PIAC strongly disagrees with this approach. As outlined above, we consider DMO1 to have failed, and to be fundamentally flawed. The AER's preferred approach to DMO2 proposes only to 'adjust' for changes in retail input costs, not to re-evaluate costs as a whole. We regard this as a 'worst of both worlds' option.

PIAC sees the review processes being undertaken concurrently by the Victorian ESC and the AER as an opportunity to address flaws in the initial DMO mechanism. The results outlined by the ESC support PIAC's view that an efficient cost-based formulation of a default price more effectively delivers good consumer outcomes. PIAC contends the ESC VDO more effectively meets the stated objectives and intent of the DMO, and addresses the flaws and concerns we have raised in this submission and our previous submissions to the initial DMO process. Adopting an approach more consistent with the ESC would improve consistency across the retail electricity market, and improve transparency and simplicity for retailers operating in multiple jurisdictions. PIAC recommends Option 3 in the Paper be pursued, with an explicit objective to align with the VDO to the greatest extent possible.

Continued engagement

PIAC would welcome the opportunity to meet with the AER and other stakeholders to provide further input and discuss these issues in more depth.

Yours sincerely,

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20 March 2019

public interest
ADVOCACY CENTRE

Mark Feather
General Manager, Policy and Performance
Australian Energy Regulator

By email: [redacted]

Dear Mr Feather,

Submission to Default Market Offer Price Draft Determination

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon people who are marginalised and facing disadvantage. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training. The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers, developing policy and advocating in energy and water markets.

PIAC welcomes the opportunity to respond to the AER's Draft Determination on the development of a Default Market Offer price (DMO) for retail electricity. While PIAC strongly supports the principle of a Default Price mechanism, we are concerned that the draft determination departs from the initial intent of the ACCC's recommendations which informed this process. More importantly, we are concerned that the draft determination contains assumptions that do not appropriately recognise fundamental disfunctions of the retail electricity market that have resulted in unacceptable consumer outcomes in the delivery of an essential service.

PIAC contends that a properly constituted default mechanism should ensure that consumers would have access to an essential service at a 'fair' price and provide much needed discipline to the market, incentivising competition that delivers more innovation, better consumer outcomes and the more efficient delivery of electricity as an essential service.

The recent release of the Victorian Essential Services Commission Draft Victorian Default Offer (VDO) presents a timely example, with which the AER could align its own default mechanism to ensure more consistent consumer outcomes across all jurisdictions. PIAC considers that the VDO more appropriately reflects the intent of a properly constituted default pricing mechanism, and is more likely to achieve the intended outcomes for consumers and the retail market more broadly. We strongly recommend that the AER align their Default Market Offer mechanism with the draft VDO, as far as is practicable.

The remainder of this submission addresses concerns with the underlying assumptions and principles put forward in the draft determination and the application of these principles and assumptions in the proposed DMO.

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The implications for consumers of considering electricity as an essential service

Electricity is an essential service. While this is, at least conceptually, accepted by all stakeholders involved in the National Electricity Market, there is a fundamental misunderstanding of its implications for the competitive retail electricity market, and how it must work for consumers.

As an essential service, electricity is not a product or service that consumers have the option not to consume or purchase (a choice that is normally an intrinsic tool of competitive market discipline). Access to energy is an essential requirement for a basic, acceptable and healthy standard of living, and for the ability to access social and economic opportunities. Where a consumer cannot afford the electricity they need, they do not have the option not to purchase. This is a crucial, foundational fact, which determines that the key interest for consumers is access to electricity as an essential service. It also determines that it is in consumers interests that essential access is provided affordably at a 'fair' value.

It is informative to refer to the National Energy Objective (NEO) and the National Energy Retail Objective (NERO), which places this interest at the centre of consideration for the rules in the NEM:

> "to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy."

Crucially, this objective makes no distinction between different groups of consumers, such as those who are engaged or those who are not, and those who are 'able' versus those who are not. This is an implicit statement of equality of the interests of all consumers.

Additionally, the NEO and NERO make no mention of the 'interests of the market' or the 'interests of competition'. This is an implicit recognition that competition, engagement and the market generally, are intended as mechanisms through which the interests of consumers and efficient energy services, may be promoted. These are not ends or objectives in and of themselves, which require explicit consideration except when they promote or facilitate the interests of consumers.

PIAC considers these principles fundamental to discussions regarding a potential DMO mechanism, and contends that the Draft Determination is predicated on assumptions and arguments that do not recognise the implications of regarding electricity as an essential service, and of accurately applying the principles expressed in the NERO and NEO to the operation of the retail market.

Issues with the assumptions and principles in the draft determination

There are a number of overlapping concerns with some of the terminology, assumptions, and principles expressed in the draft determination, which form the basis of how the AER proposes to apply a DMO mechanism. Specifically, those concerns include:

- The draft determination cites avoiding 'unjustifiably high' prices as a key purpose of the DMO. PIAC disagrees with this terminology and the fundamental assumption and rationale that it expresses.

  Electricity is an essential service, and at the level of essential service provision (i.e. where the service is effectively homogenous, qualitatively indistinguishable and where purchase is unavoidable) there is little rational justification for price dispersion or, arguably, any price above the efficient cost of provision. This is particularly true where the efficient cost is not revealed (i.e. where the intrinsic value of the service is not able to be known by the consumer to serve as a basis for choice).

Therefore, in relation to the provision of electricity as an essential service, the role of an effective default price mechanism for consumers is two-fold:

- To ensure that all consumers (as referred to in the NERO and NEO) have equal and fair access to an essential service, provided at a cost that is efficient.
- To serve as a value indicator for both consumers and the market as a whole, providing transparent information regarding the value of electricity as an essential service, by indicating the efficient cost of its provision. This essential service 'value anchor' provides a necessary basis for the creation and pricing of innovative service offerings, including those which may be priced at a premium.

PIAC does not advocate for homogeneity of pricing for all electricity services, merely that the starting point for default pricing should be recognition that all consumers should have equal access to it at an efficient, 'fair' price. With this as a foundation, consumers are free to engage in the market as a choice, when it is in their interests, potentially choosing premium services that deliver qualitative difference in service (beyond price).

- Efficiency has apparently been removed as the primary principle informing the development of the DMO price. The original ACCC recommendation 30 which has formed the basis for the current DMO process, explicitly referred to the need for the AER to set the price point for the default at the 'efficient cost' of service provision in a distribution zone.

  Efficiency has, inexplicably, been removed from consideration, with the draft determination appearing to intentionally set the DMO price well above the 'efficient cost' in order to provide 'room' for discount price competition to continue. The draft determination cites the ACCC's own submission contending that the DMO should not be a 'viable alternative'[1] and that to facilitate effective competition retailers would need room to discount 'well below the DMO'[2]. PIAC strongly disagrees with these statements and the assumptions that underpin them, specifically:

  - As outlined earlier, the DMO can (and should) represent an efficient cost for service that is a viable alternative for any consumer, in whose long term interests the retail market must operate, and to which they can default in any circumstances where they have not expressed an explicit choice.
  - A DMO that represents an efficient cost is not, and does not need to be, the lowest priced product to be effective. A DMO which is priced to cover the efficient costs of the provision of electricity as an essential service (including allowance for a benchmarked, reasonable margin) serves as a proxy for the intrinsic or 'fair' value of that essential service, provided in the interests of consumers. Crucially, being 'efficient' it also operates in the interests of the NEM as a whole in that in representing the efficient cost of the service, it accounts for constituent costs (including retail margin) while retaining a market discipline for long term efficiency – something which is absent in the current operation of the retail market.
  - A DMO that represents an efficient cost may reduce the scope for discount based, price-only competition in the form that it currently operates. However, it is untrue that loss-leading discounts particularly, and price-based competition generally, are the only (or even most preferable) form of competition. A default mechanism that provided consumers with an efficient cost option (and efficient cost indicator) would provide added incentive for retailers to develop innovative product and service offerings (potentially for a price premium), and demonstrate their value to consumers. In this way a DMO should serve as an incentive for competition that

1 ACCC. Letter of submission to the AER Default Market Offer Price: consultation Paper, December 2018. P.2
2 Ibid

more effectively serves consumers' interests by delivering competition on 'quality' and difference of service, not merely price.

- PIAC strongly disagrees with the narrow focus upon standing offers as the only issue in need of redress in relation to retail pricing, behaviour and consumer impacts. Standing offers are, as recognised in the original REPI recommendations, not working in the interests of consumers, and are worthy of abolition. However, focusing only on those with the 'standing offer' label, fails to recognise that these poor outcomes are also being experienced by many consumers who are currently on market offers, because:
    - While they are technically still on market offers, the headline benefits (such as the discounts which theoretically differentiate standing offers from market offers) have expired while their contract or 'market offer' has not (that is, they have not defaulted to a standing offer). Where 'benefit periods' typically have a 6-12 month duration, market contract periods are increasingly 'evergreen' meaning that a consumer does not revert to a standing offer, but does lose the headline benefits of their market offer. This means that any consumer who has not 'switched' within a 12-month period, is likely to be experiencing conditions which are functionally equivalent to a standing offer[3].
    - They are on market offers that involve conditional discounts for paying on time that they do not, and are not able to, realise (which is the case for many vulnerable consumers). The REPI report demonstrates that between 10-50% of consumers on market offers (with an average of nearly 30%)[4] are not meeting the conditions of their offer and not receiving their discount. Accordingly, these consumers are effectively standing offer customers. They are often worse off than standing offer customers when lost discounts and accrued penalties are incurred.

  In PIAC's view, the focus must be on the outcomes for all consumers, regardless of the label attached to the offer that they are currently on. The opacity of actual costs involved in all offers (both market and standing offers) is a fundamental problem that not only delivers poor outcomes that are not in the interest of consumers, but it allows distorted competition that facilitates widespread inefficiency, and acts as a disincentive for qualitative innovation.

  For example, anecdotal evidence suggests that tier 1 and 2 retailers intentionally target their largest 'loss leading' discounts at high-churn consumers in a deliberate attempt to 'strip' value out of these consumers. Knowing that these consumers churn regularly to chase the lowest prices, these retailers target them with the biggest discounts (often not publicly available) in the knowledge that they are unlikely to remain as customers, and that if and when they churn to another retailer, they will represent a significant cost to that retailer. This practice is facilitated by the opacity of retail costs (across both market and standing offers), and a system which enables internal cross subsidy by the majority of consumers (in excess of 70%) who switch less than once every 12 months. PIAC does not consider this form of competition to be sustainable, in the interests of consumers, or delivering appropriate outcomes in the market.

  A properly functioning default offer that represented an efficient price for all consumers would ensure that consumers would default to a 'fair' priced offer that represented efficient costs. Such a mechanism would significantly reduce the scope and incentive for practices such as that outlined above, and would provide an incentive for retailers to operate more efficiently, and develop innovative and qualitatively different service offerings for consumers.

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3 Even in Victoria, the jurisdiction with the highest switching or 'churn' rates, this represents some 74% of consumers based on information from the REPI

4 ACCC, Retail Electricity Price Inquiry: Final Report. June 2018. Pp230-280

That is, it would better align retailer incentives to compete with the interests of consumers and the NEM as a whole.

- PIAC strongly disagrees with the rationale, outlined in the draft determination[5], that a default must not be priced efficiently, because such a 'fair value' price would remove the incentive for consumers to engage in the market. This argument is based on fundamentally flawed assumptions:
    - That engagement is an intrinsic good in and of itself, that needs to be maximised by effectively ensuring that some (or most) consumers are structurally disadvantaged by paying prices for an essential service that are in excess of the efficient cost, and indeed in excess of those paid by other consumers.
    - That the potential for monetary benefit is an effective motivator of consumer behaviour and engagement in the retail market. The recent (ongoing) Victorian program offering Victorian consumers $50 to visit the energy compare site has much less impact than expected, not only on the number of consumers switching, but on the number of consumers even visiting the site. That is, the potential for monetary benefit is not effective in overcoming consumers structural assumptions and behaviours in relation to the retail energy market.

      These results are not outliers, and mirror similar experiences in the UK, other international markets and markets for other consumer goods and services, demonstrating that monetary benefit or penalty is not sufficient to overcome entrenched consumer behaviour patterns and assumptions regarding the essential service nature of electricity.

      In this context, ensuring that some (or indeed most) consumers will pay a higher price for an essential service, in an attempt to leave room for them to benefit by engaging, amounts to ensuring that some (or indeed most) consumers will pay more than they need to. PIAC regards this as entrenching inefficient retail pricing, with the burden of this inefficiency borne wholly by consumers, and is contrary to the NERO.
    - The assumption that consumers should have to 'engage' by regular switching, merely to have the potential to receive a 'fair' price for their essential electricity service (even though they are unlikely to know that the price they are receiving is fair, should they receive it). Where the interests of consumers and outcomes for consumers are the priority, and can be achieved through a mechanism that guarantees a fair price by default, engagement is a secondary consideration.
- PIAC does not accept the assertion in the draft determination that the DMO must be priced at a higher than efficient level so as not to have a negative impact upon competition. This rationale appears to be based upon the inherent (and incorrect) assumption in the draft determination that the health of competition in the market is measured by the number of retail participants and the number of offers available in the market.

  Competition is a mechanism, with outcomes for consumers the ultimate measure of its health and effectiveness. Referring back to the NERO and NEO, and 'interests of consumers', where the operation of the retail market demonstrates that the nature of competition is not in the interests of consumers, with respect to price and quality, then there is a strong argument that the market and the nature of competition should be reshaped, not the behaviour of the consumer. In this respect, should a DMO based upon efficient costs of an essential service result in a reduction in the quantity of offers and retail participants, but

5 Page 33 of the AER draft determination

result in improvement of the 'quality' of options available and deliver better outcomes for consumers, then it can be said to have improved competition.

PIAC contends that a strong default based upon efficient costs will ensure that a significant proportion of consumers are able to access essential electricity services at a 'fair' price, that also provides a reasonable margin to the retailers supplying it to them. A DMO based on efficient costs would also provide necessary information to consumers regarding the intrinsic value of that efficient service, which would serve as a basis for more informed and confident choices in their wider engagement with the retail market. For instance, they would then be aware that any discounts from this price were a 'low cost offer', and any deals offered at a premium should involve a qualitatively better or different service. This would place the retail electricity market on a similar footing to effectively competitive markets.

PIAC contends this would also provide retailers with a greater incentive to offer innovative products and services, by ensuring that they bear more of the risks of not doing so (where consumers currently bear all the risks in relation to engagement with the retail market).

- PIAC strongly disagrees with the argument, perpetuated in the draft determination, that a DMO should only operate as a 'safety net' for an undefined (but small) minority of people deemed unable to get satisfactory outcomes from the market. This argument is based upon faulty premises:
    - That the number of consumers getting poor outcomes from the market is small, and in any case a minority. As outlined in relation to the errors in focussing on standing offers, a majority of consumers are likely to be paying above an efficient or fair price for their essential access to electricity.
    - That regardless of the number affected, a significant (opaque) price dispersion in the delivery of a largely homogenous essential service, is not only acceptable but desirable.
    - That the consumer is inherently responsible for ensuring that the retail market operates in their interests, by delivering a service that is efficiently and fairly priced. Further, that if they fail to be able to engage effectively according to the terms set by retailers, then any excess costs that they incur above the efficient price of the retail service, is reasonable.

  In this context the problem is not one of mitigating the impacts upon a small number of the vulnerable, but of addressing the fundamental failure of the retail market to deliver affordable, fair outcomes in the interests of all consumers and their access to an essential service. The DMO is not merely a safety net or back-stop, but a necessary guarantee of a fair price option for all consumers, who have an equal right to access to services that are provided efficiently in their interests.

Response to the proposed DMO

PIAC considers that the issues we have raised with the assumptions and principles expressed in the draft determination require a re-assessment of the function, framework and implementation of default pricing. We strongly recommend that the AER commit to undertake a full review of the principles, purpose and mechanism of default pricing as part of the scheduled review of the DMO within the next 12 months.

In relation to the DMO proposed in the draft determination, PIAC contends that the issues of principle that we have raised in this submission also present immediate opportunities for redress, notwithstanding the time imperatives, and we recommend that the AER undertake to make the following amendments to the proposed DMO approach:

Calculation of the DMO

The draft determination proposes to set the default price at the median point between the median standing offer and the median market offers. PIAC strongly disagrees with this approach, and considers that it results in a price that is well in excess of the efficient cost of the provision of essential electricity services.

While PIAC considers that, in the long term, a bottom up approach is required to set and maintain an efficiently priced default price, the recently released Victorian Essential Services Commission (ESC) draft VDO[6] highlights the potential to amend the top down approach proposed by the AER, to ensure that the price set more appropriately represents the efficient (not lowest) cost of essential service provision.

Specifically, on page iv of the draft VDO advice the ESC note that although their proposed (bottom up) approach results in a default price that is $200 lower than that arrived at by the AER, when the ESC tested their approach with the addition of an allowance of retail 'headroom' a similar default price was arrived at. We note that in the AERs draft determination a default that was simply the median of available market offers would reduce the resulting default price by $200, to a level equivalent to proposed VDO

In its initial recommendations in the REPI, while noting that the final decision was up to the AER, the ACCC advised that the default price should be 'closer to the median market offer than the median standing offer'. Further, PIAC considers it manifestly inappropriate to utilise standing offers in the calculation of a default price in a process that explicitly recognises that standing offers represent 'unjustifiably high' prices[7].

Accordingly, PIAC recommends that the AER re-evaluate their top-down approach by removing consideration of the median standing offers, as the upper bound for the DMO calculation, and simply utilise the median of available market offers.

Expressing the DMO

PIAC has a number of concerns with the way the AER proposes to express the DMO, for the purposes of market and consumer information and comparison.

- The AER proposes only to express the DMO as an indicative dollar bill amount, based upon benchmark usage. However, as a number of stakeholders have commented, this can create a number of unintended and misleading consequences for consumers when it interacts with different usage levels. PIAC recommends, that the AER also calculate and publish the DMO as an indicative c/kwh value to provide a more flexible basis for relating actual household usage to the AERs benchmark household usage
- It is unclear or how retailers will be required to formulate and advertise their 'default offer', in response to the AER specified DMO, and how the default and reference functions of the DMO will interact. The consultation paper on the proposed draft code[8] suggests that, contrary to ACCC recommendation 30, standing offers will not be abolished, but retained and 'capped' as the new 'default', with the AER setting this DMO and retailers being required to ensure their standing offers are at or below the level of the DMO, and that their other market offerings are expressed in relation to the AER DMO.

  PIAC recommends that the AER clarify the terminology that retailers will be required to use in relation to their default offers, ideally referring to their own 'default market offer'. Further, PIAC recommends that the AER refer to the DMO, when published, as the DMO reference price, ensuring a consistent framework of terminology and information.

6 Victorian ESC Victorian Default Offer to apply from 1 July: draft advice
7 AER. Page 17 of default market offer draft determination
8 Commonwealth Department of Energy & Environment. Competition and Consumer (industry code- electricity retail) regulations 2019

- Requiring retailers to express market offers as a percentage discount in relation to the DMO (which is based upon a benchmarked usage level) and their own 'default offer', potentially results in misleading information to consumers where retailers utilise different combinations of fixed and usage-based tariffs[9].

  Accordingly, PIAC recommends that the AER publish the DMO as an indicative c/kwh, as well as an indicative annual dollar bill amount (based upon benchmark usage). Further PIAC recommend that retailers be required to advertise their other market offers (in addition to their own default offer), not as a percentage variance from the DMO, but as a dollar amount above or below the DMO. Percentages are not well understood as basis for relative consumer information, where consumers are able to clearly understand and choose between offers expressed as a relative bill saving or premium[10].

Continued engagement

PIAC would welcome the opportunity to continue to engage with the AER and other stakeholders to discuss these issues in more depth, and looks forward to providing further detail on the issues explored in this submission. For further engagement please contact Douglas McCloskey.

Yours sincerely,

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9 Etrog Consulting submission to Competition and Consumer (industry Code – Electricity Retail) regulations 2019. 12 March, 2019. p 2-4.

10 The current NSW government energy switch service utilises AER Energy Made Easy information to compare available offers to a consumers current offer as a $ saving or premium.

10 December 2018

Mark Feather
General Manager, Policy and Performance
Australian Energy Regulator

By email: [redacted]

Dear Mr Feather,

Submission to Default Market Offer Price position paper

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon people who are marginalised and facing disadvantage. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training. The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers, developing policy and advocating in energy and water markets.

PIAC welcomes the opportunity to respond to the AER's position paper on the development of a Default Market Offer (DMO) price for retail electricity. PIAC strongly supports the need for significant reform to default retail pricing, and welcomes the recognition that, as it stands, the retail electricity market does not operate in the interests of consumers. The introduction of a DMO mechanism represents an opportunity to reshape the operation of the market to support better and more equitable outcomes for consumers in the delivery of an essential service.

The market implications of considering electricity as an essential service

Electricity is an essential service. The recent Thwaites review presented a guiding principle which should frame any considerations of the shape and structure of the retail electricity market, namely:

> 'Energy is an essential service and underpins our health and wellbeing, and our economic participation. As an essential service, consumers must purchase energy and must participate in the retail market even if they are not interested in the product and regardless of continued price rises. Energy must be accessible, affordable and reliable for all.
> Consumers are entitled to obtain easily understandable energy offers and enter into energy contracts that provide value for money and don't contain negative surprises.' [1]

Getting a fair deal in the current energy market relies upon a high degree of consumer understanding and engagement. Consumers are required to remain informed about the available choices in the market, regularly assess those choices and 'switch' within or between retailers on a regular basis. The failures of the market are well documented, with most consumers are paying above the lowest price for energy and many are paying above an efficient price.

1 Thwaites, *Independent review into electricity and gas markets in Victoria*, page 51.

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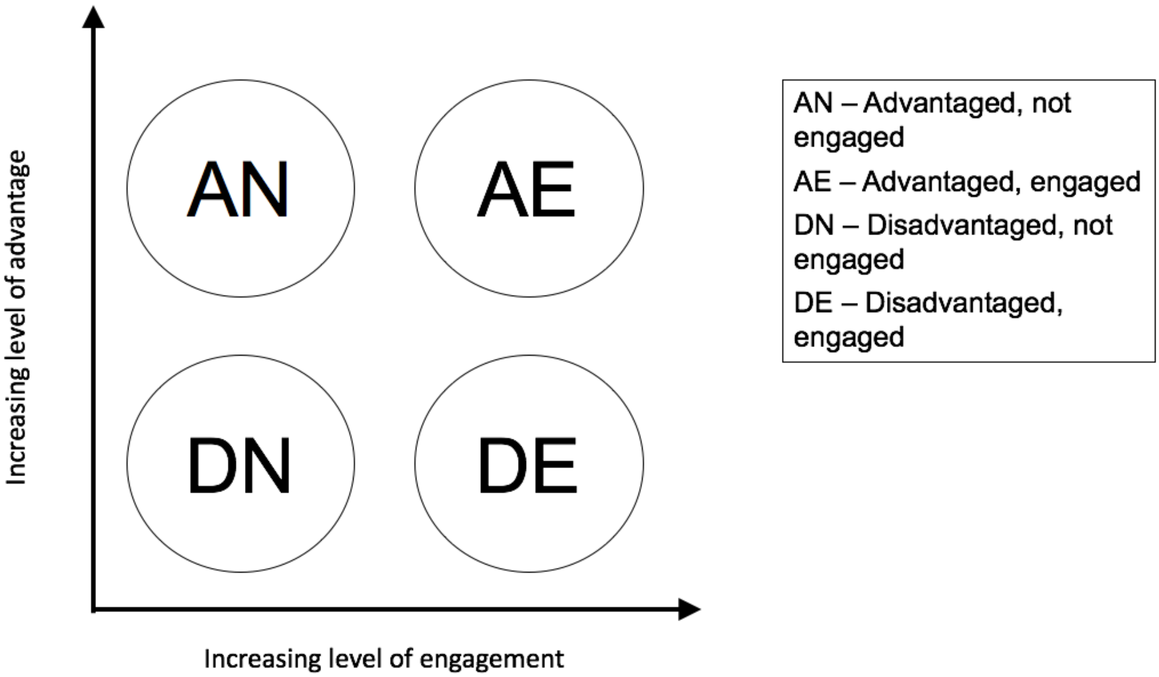

In this context PIAC considers that the current 'outcomes' for consumers are a function of the interaction between their level of engagement and their level of potential 'advantage', which can be expressed in 4 broad categories.

Advantaged/able, not engaged (AN)
This consumer cohort is disengaged from the energy market. While they do experience higher bills through suboptimal retail contracts, their potential socio-economic advantage means that they are often ignored in discussions regarding the operation of the competitive market and consumer outcomes, as they are considered to be able to be capable of dealing with the impacts of their lack of engagement. Increasingly however, evidence is showing that even consumers in middle incomes, are struggling with the cost of energy and are experiencing negative impacts as a result of their lack of engagement with the market[2]. PIAC considers the structure of the market framework and consumer protections are still relevant to this cohort, notwithstanding their current level of socio-economic advantage.

Disadvantaged/vulnerable, not engaged (DN)
This consumer cohort, who most closely match those often referred to as 'vulnerable consumers', consistently have the worst outcomes. The combination of energy market disengagement and relative socio-economic disadvantage means that these consumers are unable to take advantage of better market contracts from energy retailers. Market frameworks should support them having the opportunity to benefit from engagement where possible, but it is critical that supporting frameworks must not require them to be engaged in order to pay a fair price for access to an essential service. Most importantly, the goal should be to improve the relative level of 'advantage' (that is move people from the DN cohort to the AN cohort), while giving them the opportunity to move to the AE cohort but not obliging them to do so.

Advantaged/able, engaged (AE)
This energy consumer cohort are the only consumers able to operate as the current framework intends, and therefore only ones broadly getting good outcomes today. The combination of energy market engagement and relative socio-economic advantage means these consumers are more likely to be on favourable retail energy contracts, and choose (and can afford) to be adopters of energy technology such as solar PV, energy storage and demand management

2 Choice, *Consumer Pulse Report: July 2016*, page 8-9

systems. Competitive opportunities for these consumers should be encouraged, while recognising they are, by and large, the least at risk of disadvantage. PIAC considers all consumers should have the opportunity – but not an obligation – to move into this cohort. Importantly, the positive outcomes achieved by this cohort, are to some extent cross subsidised by the higher prices paid by those groups who are not engaged and able to negotiate better deals, particularly where 'loss-leading' contracts are involved.

Disadvantaged/vulnerable, engaged (DE)

While this cohort still requires similar support to the DN cohort, their potential and preference for engagement means that they are able to ameliorate some impacts of disadvantage through more active participation in the energy market. However, PIAC's recent report on disconnections demonstrates that the constant requirement to remain informed and engaged is a significant burden for a cohort that is often burdened by compounding and overlapping vulnerabilities[3]. Further, their potential disadvantage (even something as simple and fundamental as being a renter) means that the potential benefits of their engagement are limited. Accordingly, the goal for this group should be ensuring that the framework provides the same protections of access to a fair price, while giving them the choice and opportunities to benefit from competition in the same way that the AE cohort has. It is important that these consumers do not continue to be burdened with the risk of not engaging (and the ongoing cost of engagement), and that they have the protection of a fair price for an essential service.

The current, largely deregulated market framework operates upon the assumption that any negative consumer outcomes can be improved by facilitating greater consumer information and engagement. However, the independent review of electricity and gas in Victoria presented an alternative perspective, which reflects PIAC's own consumer framework, and suggests that the essential service nature of electricity requires another approach:

> 'the lack of consumer engagement in energy markets can be viewed as consumers simply acting as if energy was still a monopoly product. It is possible the essential service nature of energy is responsible for this: consumers cannot exit the energy market, they need to use energy, and the amount of energy they purchase stays the same no matter which retailer they are with.'[4]

This is fundamental to the consideration of a DMO, its intended role and the most suitable and efficient structure to fulfil that role. The key considerations in determining the role and objective of the DMO are that:

- electricity is an essential service, which all consumers have a right to access equitably and, for a fair price,
- overall benefit to consumers as a whole, be weighed against potential impacts for particularly consumer cohorts,
- competition is a mechanism intended to deliver consumer benefits, not an end in itself or an intrinsic good in and of itself,
- competition of any kind must be evaluated 'qualitatively' as well as quantitatively, and that a more effective competitive market may involve a smaller number of competitors, with the scope to compete on a range of service aspects instead of (and in addition to) price, and
- the 'choice to choose or not to choose', should be a fundamental right for consumers in an essential service market, such as electricity. Active participation should not be required to ensure a fair price.

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3 PIAC & UMR. Close to the Edge: A qualitative and quantitative study, November 2018. Pp 12-20

4 Thwaites, *Independent review into electricity and gas markets in Victoria*, page 38

PIAC accepts that any DMO that achieves such objectives will limit the ability of some retailers to continue with current business models, in particular those business models that today provide little or no discernible value for their customers. PIAC fundamentally rejects the notion that establishing a strong default mechanism that is designed to constrain consumer bills to a relatively efficient price is somehow anathema to market competition and innovation; to the contrary, a strong default mechanism places the incentive to innovate in a manner that will better serve customers though differentiation in service, rather than just price.

Establishing a Default Market Offer Price

In the context of the framework and objectives outlined above, the primary considerations to draw from the ACCC's recommendations relating to the DMO are:

- That the standing offer and standard retail contracts be abolished and replaced with a default market offer at or below the price set by the AER,
- That retailers are required to supply consumers under a DMO on request or where a consumer does not make an explicit choice of market offer,
- That the DMO price should be the *efficient*[5] cost of operating within the region, including a reasonable cost of customer acquisition and retention (CARC), and
- That AER should publish a reference bill amount for each distribution zone, using AER household benchmarks and the DMO price.

Customer Acquisition and Retention

In establishing a DMO mechanism for an essential service such as electricity, the consideration of what represents an 'efficient cost of operation' is fundamental. While the ACCC explicitly recommends that an allowance for 'reasonable CARC' be included in the formulation of a DMO, PIAC notes that there is no reliable means of determining a reasonable allowance for CARC that could be regarded as efficient. In its own final report, the ACCC sites a range of evidence to support this conclusion, including:

- That there is a positive correlation between 'switching rates' and an increase in CARC[6], suggesting that increased activity related to a small number of customers is simply loading more costs into retail businesses,
- That the retail cost to serve (CTS) and CARC have moved in opposite directions over the last 5 years, with average retail CTS per residential customer falling by $25 to $90, where the average CARC per customer has steadily increased by 20% to $48 over the same period[7]. While this seems a relatively small number, it is important to consider that this is averaged over all residential customers, and represents the cost of acquiring and retaining a relatively small proportion of 'desirable' customers who are churning (26% in Victoria and 19% in New South Wales),
- The difference between average CARC ($40 for 'big 3' retailers and $87 for other retailers) and CARC per acquired customer ($283 for 'big 3' retailers and $198 for other retailers)[8] illustrates the significant extent of effective cross subsidy as a result of costs imposed upon the majority of relatively static consumers for small number of 'acquired customers', and
- That retailers are engaging third party services that charge in excess of $200 per acquired customer[9]. This represents a substantial, unproductive cost added into the supply chain,

[5] Emphasis added
[6] ACCC, Retail Electrcity Pricing Inquiry- Final Report, June 2018, pg.229
[7] Ibid, pg.222
[8] Ibid, pg.230
[9] Ibid, pg.231

that is neither transparent, nor, because it can be smeared across the remaining customer base, subject to significant drivers of efficiency.

CARC are driven by decisions made by retailers making choices, for very opaque business-specific reasons, about which customers they believe to be desirable. It is difficult to argue this discretionary spending by retailers is a reasonable or efficient cost of business. PIAC contends that the only practical efficiency that could reasonably be applied to CARC, in the context of the formulation of a DMO, is to make no explicit allowance for it.

As an alternative, the formulation of an efficient price basis for the DMO should simply make allowance for efficient retail costs, and an additional 'fair' margin (which could be benchmarked and evenly applied across all jurisdictions). This would leave scope for the DMO price to allow retailer discretion to continue to 'spend' on CARC if they so choose, but not allow this to be unreasonably borne by consumers. More importantly it would introduce an efficiency incentive for any CARC incurred by retailers, something which does not currently exit. PIAC notes that this conclusion was supported by the ACT Independent Competition and Regulatory Commission[10], and the Independent Review into Victorian retail energy Markets.

Pricing approach

The AER proposes to apply a 'top down' approach to the formulation of the DMO price in each distribution zone, utilising the median market offers and median standing offers for benchmark household consumption, and selecting some point between these as an indication of an efficient price. PIAC appreciates that there are a number of pragmatic considerations, including short externally imposed timeframes and difficulty accessing sufficiently detailed and accurate market information, behind the decision to employ a top-down approach in this initial process. However, we have significant concerns with the intended approach and the assumptions underpinning it. Specifically:

- It is well established that standing offers are significantly 'overpriced' and, as such, do not bear any relationship to efficient costs. Utilising even the 'median' point of standing offers as an upper boundary for calculation of a proxy for an efficient price is likely to significantly over-estimate and inflate the resulting price. PIAC recommends that as this process will involve abolishing them, standing offers not be part of the consideration of an efficient price.
- The position paper assumes that available market offers in 'competitive markets' are likely to reflect retailers' efficient costs, and be a practical proxy for them. This assumption is flawed because:
    - it does not recognise the significant (and largely intentional) price dispersion that retailers create across their offers, often specifically to manipulate comparison tools (that is, offering multiple deals across a wide range that differ by a small and immaterial amount (such as $1) that would qualify as 'unique offers' under the proposed framework),
    - It depends on data that is not available, on how many consumers are on each deal. Retailers create a spread of offers, which range from significantly above efficient costs, to potentially below efficient costs. The efficiency of any particular offer, then, is not discrete and depends upon how many customers remain on a given deal relative to others that retailers offer, and
    - It does not recognise that market offers are expressed as inclusive of discounts. These offers are mostly dependent upon conditions that may or may not be met by consumers (particularly consumers experiencing various forms of payment difficulty who have trouble paying on time). This undermines the value of these 'headline'

[10] Independent Competition and Regulatory Commission (ICRC) 2017, Standing offer process for the supply of electricity to small customers from 1 July 2017, Report 6 of 2017, Final Report June 2017, p.28

prices as they are not necessarily a reflection of what consumers are actually paying. Additionally, the ACCC report and Independent report into Victorian retail markets also recognised that the quantum of the discounts that these deals involve do not relate to the efficient costs of meeting (or failing to meet) those conditions; for example, a 30% on-time payment discount is not related to the costs borne by the retailer should the customer not pay on time.

PIAC accepts that there is a time imperative in relation to the current process that is likely to make a 'top down' approach a matter of pragmatic necessity. However, bearing in mind the concerns raised, PIAC recommends that the flaws of this approach be explicitly recognised as part of this process, and that an initial 'top down' method be augmented by the following:

- That standing offers not be part of the top-down consideration at all,
- That market offers be utilised as the only basis for calculation of an indicative 'efficient price',
- That the market offers used be expressed including all discounts, and
- That the resulting median of all available market offers (including all discounts) be tested against a desktop estimation of an efficient or fair price (such as that proposed in the ACOSS submission to this process), that could be calculated by adding:
    - Wholesale energy costs – this can be calculated by applying the premium of wholesale energy costs over wholesale spot prices that was observed in the AEMC's most recent price trends reports to a forecast of wholesale spot prices for 2018/19 that is based on ASXEnergy swap prices for 2018/19.
    - Costs of complying the Large-scale Renewable Energy Target (LRET) and Small-scale Renewable Energy Scheme (SRES) – which can be based on retailer's percentage obligations for 2018/19 and observed prices for Large-scale Generation Certificates (LGCs) and Small-scale Technology Certificates (STCs).
    - Network tariffs – which can be based on published network use of system (NUOS) tariffs for each distribution area in the NEM.
    - Network losses - based on published loss factors.
    - Market fees, ancillary services costs and costs of complying with any relevant jurisdictional schemes - based on the AEMC's most recent prices trends reports.
    - Retail operating costs, and the retail margin, can be based on recent regulatory allowances.
        - The allowance for retail operating costs based on retail operating costs from IPART's 2013 review of regulated retail prices for 2013 to 2016, or ACIL Allen's analysis for the Queensland Competition Authority for 2015/6, or similar work, adjusting for inflation to 2018/19.
        - The allowance for the retail margin: This retail margin is from IPART's 2013 review of regulated retail prices for 2013 to 2016; it reflects a regulated allowance rather than an estimate of the retail margin that retailers are actually earning (as reported by the ACCC[11]).
        - No specific allowance for CARC, and
- That this process involves an explicit commitment that subsequent processes for determining the DMO price will be carried out using a 'bottom up' approach, that has more scope for accuracy.

Specifying the DMO

[11] ACCC, Retail Electricity Pricing Inquiry- Final Report, June 2018, pp.145-147

PIAC recommends that the DMO and reference bill be expressed in both dollar terms for bill and as a c/kWh.

Expressing the DMO as a quarterly or annual bill (based on a single, or ideally several benchmark consumption points) will enable people to compare between offers.

Expressing the DMO also in c/kwh, may also provide a means for consumers to better estimate what their total bill might be at different times of the year (depending on their climate zone), and also to adjust for any potential differences in the way that different retail offers may split between fixed and usage charges.

Addressing the risks

Critics of a default offer mechanism often cite the risk that such a mechanism will encourage consumer inertia. PIAC agrees that there is a likelihood that a significant proportion of consumers (any of the vast majority who regard electricity as an essential service for which they simply want to pay a fair price) may be encouraged to remain on the default offer. As set out in our framework for understanding consumers, PIAC contends that should be regarded as a positive outcome for all consumers if:

- The default price is set as close to an efficient price as possible, to ensure that those consumers who remain on it, do so in the knowledge that they are paying a 'fair' price for their essential access to electricity.

  PIAC recommends against regarding only to protect against the most egregious price impacts. Such an approach would have limited impact upon the large number of consumers who regard energy as an essential service, and would see many of them potentially remain on a default offer under the false assumption that they were being protected by a fair price. Such an approach would still allow for the continuation of a significant 'opaque' internal cross-subsidy between retail customers and would do little to address the significant detrimental impacts currently being experienced by many consumers.

- There is recognition that it is not merely 'standing offers' which are currently problematic, and that many consumers who currently appear to be on 'market offers' may still be on contracts which are priced significantly beyond any reasonable point of efficiency. The common retail practice of long or 'evergreen' retail contracts, in combination with 'benefit' periods which expire within the term of the contract, means that many consumers who appear to be, or assume they are on, a market offer, may be subject to conditions similar to those of a standing offer (without actually defaulting to a standing offer and being captured in those figures).

  Accordingly, the provisions of any DMO should explicitly state that the DMO applies not only in all conditions where a consumer currently defaults to a standing offer, but in all conditions where the benefits of the offer that a consumer explicitly consented to, expire. This would address the significant confusion currently experienced by many consumers, while providing retailers with a further incentive to engage their customers.

- The choice to engage in the competitive market is genuinely retained as a choice, rather than a requirement. Where consumers are guaranteed a 'fair' price for electricity, they are able to engage in the retail market as and when they choose (similar to any other competitive market). This provides retailers with a strong incentive to innovate and create services and offers which are likely to draw consumers attention.

  Because 'fair' price is guaranteed, it is true that there may be more limited scope for price-only competition, though it will still be possible (with below cost honeymoon offers, 'all-you-can-eat' deals, bundling, peak demand rebate deals, etc). Importantly, the burden of risk and cost for engagement will be more evenly shared between consumers and retailers.

Continued engagement

PIAC would welcome the opportunity to meet with the AER and other stakeholders to discuss these issues in more depth, and looks forward to providing further detail on the issues explored in this submission. For further engagement please contact Douglas McCloskey.

Yours sincerely,

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