

# Submission to default market offer prices 24-25 Issues Paper

9<sup>th</sup> November 2023

Co-signed by:



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## About the Public Interest Advocacy Centre

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

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

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

## Energy and Water Consumers' Advocacy Program

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

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

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

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## 1. Introduction

PIAC, ACOSS and SACOSS welcome the opportunity to respond to the *Default market offer prices 2024-25 issues paper* (the Paper). We strongly support effective default price protections for consumers and encourage the AER to take every available opportunity to ensure Default Market Offer (DMO) 6 meaningfully supports and protects consumers during a time of extreme cost-of-living pressure for households.

We understand this process is not currently intended to re-evaluate the objectives, role, approach and application of the DMO. However, such a re-evaluation is necessary and we strongly encourage the AER to use this process to support such a re-evaluation being undertaken. Substantial retail energy bill increases, changes in the energy market and extreme cost-of-living pressure make the need for re-examination of the DMO extremely timely. It is necessary to consider whether it remains fit-for-purpose and aligned with contemporary understanding of how consumer vulnerability should be addressed, particularly as the energy market transforms. PIAC considers a simplified, more widely applied, default protection reflecting efficient cost to serve is required.

Our organisations, alongside other consumer and community stakeholders, have written to Energy Ministers recommending an Energy Equity and Inclusion workstream to be added to the National Energy Transformation Partnership. This includes a key recommendation that Energy Ministers provide more effective retail market protection through reform of retail regulation, pricing and tariffs – including reform of the DMO. We recommend the AER support our request for an Energy Equity and Inclusion workstream to be added to the National Energy Transformation Partnership. DMO 6 should be regarded as an ‘interim’ step while more fundamental reforms of default pricing and retail market regulation are considered by Energy Ministers and the AER.

The process setting DMO prices for 2024-25 should prioritise support for energy affordability. Our organisations consider the AER has scope to alter aspects of its previous approach, and reassess how it has ‘balanced’ the interests of consumers with an objective to incentivise retail competition and consumer engagement in the market.

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

## 2. DMO Reform

PIAC has consistently advocated for more effective default pricing protections. This advocacy focuses on the need for wider, more consistent application in conjunction with a tighter focus on efficiency. We consider this would ensure retail market incentives are better aligned with consumer expectations and preferences. It has never been more apparent that the DMO is no longer fit-for-purpose and requires re-examination and meaningful reform, given:

- Current circumstances in the energy market see consumers facing significant and sustained rises in retail bills as part of wider cost of living pressures placing stress on households.
- Experience over recent years has demonstrated that the energy system transition will not be smooth. It is likely to involve significant shocks that impact energy costs for consumers over the medium term.

- In a recent national survey of people on low incomes, 97% indicated they are struggling to afford their energy bills and are running out of options. People reported taking drastic measures like not heating their home in winter, turning fridges off overnight, limiting showers, not having visitors, and going without food or medicine to afford their bills.<sup>1</sup> Some people are turning to credit products such as Buy Now Pay Later to pay for energy bills,<sup>2</sup> further increasing their costs of energy. People are being made ill and risking their health because they cannot afford to heat their homes in winter and cool them in summer.<sup>3</sup>
- Complaints to EWON are up 22% from last year, with the majority of complaints being about high electricity bills.<sup>4</sup>
- The fundamental assumption that consumers can 'shop around' for more efficient, reasonable retail offers is no longer reasonable advice where, increasingly, market offers are priced at or above the level of the DMO.
- Through 'Towards Energy Equity', 'Gamechanger' and in the most recent State of the Market 2023 report, the AER has recognised that existing energy market arrangements fail to adequately support consumers experiencing disadvantage and are contributing to increased consumer vulnerability:

for a range of reasons, many consumers face barriers to actively participate in the market and secure the best offer for their situation. This can exacerbate existing structural inequalities, whereby those who can least afford it are paying higher energy rates.<sup>5</sup>

Alongside other consumer and social organisations, our organisations have written to Energy Ministers recommending the addition of an Energy Equity and Inclusion workstream to the National Energy Transformation Partnership. This workstream should consider whether 'active participation in the market' is an appropriate objective for the delivery of an essential service. As part of this effort, we have requested that Energy Ministers,

**Provide greater retail protection through reform of retail regulation, pricing and tariffs.**

In 2018 the ACCC argued that the energy market and retail competition were failing consumers.<sup>6</sup> Little has changed following the report and indeed increases in energy prices have arguably seen a deterioration in outcomes for most energy consumers.

Regulated default offers or price caps of some form have been introduced by regulators in all jurisdictions. However, they are not all sufficient to address the issues identified by the ACCC and are not able to deliver acceptable outcomes for energy consumers. The Default Market Offer (DMO) is ineffective because it intentionally does not provide consumers with the

<sup>1</sup> ACOSS (2023) [Energy and Cost of living snapshot](#)

<sup>2</sup> Financial Counselling Australia (2021), '[It's credit, it's causing harm and it needs better safeguards](#),' p 5 and, p 9; CHOICE Consumer Pulse survey September 2022 found 1 in 4 BNPL users used this credit product to pay for essential products or services.

<sup>3</sup> <https://www.acoss.org.au/wp-content/uploads/2023/02/ACOSS-Plus-Submission-to-National-Energy-Performance-Strategy-Consultation-paper-07022023.pdf>

<sup>4</sup> Energy and Water Ombudsman NSW (2023) [Annual Report 2022-2023](#)

<sup>5</sup> Australian Energy Regulator (AER) (2023) [State of the energy market 2023](#), p.248.

<sup>6</sup> ACCC (2018) Restoring Electricity Affordability and Australia's Competitive Advantage, Retail Electricity Pricing Enquiry, Final Report.

protection of a genuinely fair default. People are burdened with unreasonable wholesale and retail costs that don't reflect an efficient cost to serve.<sup>7</sup> Many people are on contracts with expired benefits which may be higher than the 'regulated or default' standing offer, meaning people need to continuously renegotiate or switch market contracts simply to avoid paying unreasonable prices.<sup>8</sup>

We encourage the AER to actively support the recommendation for an Equity and Inclusion workstream, and to work with Energy Ministers to implement meaningful reform of the DMO. We note that as part of the 'Gamechanger' the AER intends to support the inclusion of a 'vulnerability' workstream in the partnership to further progress recommendations. The AER could consider supporting a single additional workstream which encompasses the purposes of addressing vulnerability, equity and inclusion work. In any case our organisations encourage the AER to support our joint recommendation as a means to re-examine the DMO.

We recommend a re-evaluation of the DMO with the scope to consider a range of issues related to consumer protection and effective operation of the retail market, including:

- The role of robust, efficient default price protection in alleviating consumer vulnerability resulting from interaction with an essential service (energy).
- The circumstances where default price protection should apply to ensure consumers are protected by a fair/efficient default in all circumstances where they have not explicitly consented to retail offer conditions.
- How consumer preferences regarding 'postage stamp pricing' (consistently revealed in distribution network consumer engagement) can be reflected in the structure of default pricing protections.
- How environmental costs can be removed from the cost stack of bills and instead recovered through government revenue and taxation to ensure vulnerable consumers are not carrying a disproportionate cost burden of transition costs.
- The role of a reformed DMO as part of the introduction of an obligation on retailers to offer a flat-price option to consumers.
- The role of efficient, widely applied default pricing in incentivising retailers to understand consumer preferences and create alternative products that demonstrate value to consumers and genuine choice of products.
- The role of network tariff reform and cost-reflective network tariffs in enabling opportunities for retailers to offer genuine product choice to consumers, rather than simply passing signals through to consumers.
- How our changing energy system is providing more meaningful opportunity for retail competition than retail allowance in the DMO. Retailers are increasingly able to innovate offers that meet consumer needs and preferences including time-of-use tariffs, solar-soakers, EV tariffs, bundling with renewable asset purchases and other green energy products.

### **Recommendation 1**

*That the AER support the addition of an Energy Equity and Inclusion workstream into the National Energy Transformation Partnership, including the recommendation that Energy Ministers provide greater retail protection through reform of retail regulation, pricing, and tariffs.*

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<sup>7</sup> <https://piac.asn.au/wp-content/uploads/2022/11/22-30-11-Submission-to-AER-DMO-issues-paper-2023-24.pdf>

<sup>8</sup> <https://www.aer.gov.au/system/files/State%20of%20the%20energy%20market%202023%20-%20Full%20report.pdf>

## **Recommendation 2**

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*That the AER work with Energy Ministers to re-evaluate the DMO, considering the role of robust, efficient default price protection and the circumstances where default price protection should apply.*

### **3. Response to DMO 6**

DMO 6 should be regarded as an ‘interim’ step while more fundamental reforms of default pricing and retail market regulation are considered by the AER and Energy Ministers. The process setting DMO prices for 2024-25 should prioritise support for energy affordability. The objective to reduce unjustifiably high standing offer prices and protect consumers from unreasonable prices should be the guiding objective. ‘Unjustifiably high’ and ‘unreasonable prices’ should be defined from the perspective of the consumers, who the energy system is ultimately in service of.

#### **3.1 Competition indicators and retail offers**

A report commissioned by PIAC found significant issues related to retailer behaviour, particularly as regards the availability (or lack thereof) of retail offers.<sup>9</sup> Researchers found considerable discrepancy between offers publicly listed on EnergyMadeEasy and those that were actually available to consumers upon contacting the retailer. PIAC has been witness to and involved in multiple discussions within the energy regulatory space where the practical accessibility of offers on EnergyMadeEasy has been highlighted as a problem.

The DMO methodology currently relies on offers available on EnergyMadeEasy to conduct the market offer analysis, which impacts on both the evaluation of previous DMO determinations and on the calculation of future DMO determinations. The AER should collect and analyse actual consumer bills to allow greater rigour of methodology, analysis and determination of DMO 6 (and other regulatory processes that rely on EnergyMadeEasy).

#### **3.2 Wholesale costs**

While we consider the principles of transparency and accuracy to be equally important to the development of a robust and effective default, where there is any conflict we recommend that accuracy be prioritised. In this case we understand that a more accurate modelling of the actual wholesale costs for retailers is required and support load profiles being updated to account for more accurate data. We note this will involve the use of non-transparent data and a modelling process which may not be able to be fully revealed. We strongly recommend that the AER provide as much information regarding the methodology underpinning the creation of more accurate load profiles and how they are then applied to assess wholesale costs.

#### **3.3 Retail costs**

##### **3.3.1 Costs to acquire & retain customers**

Our organisations reiterate our strong disagreement with the explicit inclusion of retail costs to acquire and retain customers (CARC) in the calculation of retail costs to serve in the DMO. CARC

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<sup>9</sup> Miller, Lisa and Miller, Kelly, [‘Save4Good: Insights into Retailer Practices’](#) (2022)

has no benefit to consumers, and is subject to no productivity or efficiency incentive. CARC costs are more appropriately seen as a 'retail expenditure' and can be allowed for as part of the retail margin rather than accounted for explicitly. This is particularly important where the DMO methodology allows for retail costs, inefficient margin and an extra retail allowance.

### **3.3.2 Metering costs**

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

We do not consider projected advanced meter installations to be a reasonable data set for calculating any metering costs incurred by retailers. The most contemporary period of smart meter installations is a more appropriate input.

## **3.4 Retail allowances**

Our organisations consider that the current DMO methodology does not protect consumers from unreasonable or 'unjustifiable' prices. DMO 6 should make every possible effort to prioritise consumer outcomes and energy affordability, particularly in the calculation of retail 'allowance' or margin, where there is the clearest scope to reduce costs for consumers

We strongly disagree that retail allowance (headroom) – over and above efficient retail cost and reasonable, benchmarked retail profit margin - is required to 'meet the objectives of the DMO'. We further disagree that this approach constitutes an effective means of incentivising retail innovation or competition in the market that benefits consumers. The current energy market circumstances render this approach increasingly unjustifiable and unfit for the fundamental purpose of protecting consumers. The DMO applies directly to less than 15% of consumers. However, the DMO is most important as a market reference for consumers in determining what a 'fair' offer is. Retaining excess allowance reduces any incentive for retailers to innovate as it inflates consumers' reference for what constitutes a reasonable or acceptable price and is likely to result in all market offers becoming unnecessarily higher.

Our changing energy system provides more meaningful opportunity for retail competition with the right incentives and regulation. Retailers have increasing scope to develop genuinely innovative product offers that meet consumer needs and preferences including by:

- Re-packaging network tariffs to create useful consumer energy products e.g.time-of-use retail tariffs, solar-soakers retail tariffs, EV retail tariffs, simple and predictable flat-tariff options and energy rebates.
- Bundling with renewable asset purchases
- Other green energy products

The changing landscape and growing scope to offer genuinely different products mitigates the (already unnecessary) focus on price differentiation as an indicator or objective of competition. It

then further makes obsolete the existing DMO policy requirement to build in retail allowance to promote competition in the energy retail market.

We reiterate our strong disagreement that excess retail allowance is a reasonable or meaningful incentive for people to 'engage' with the energy retail market. This fundamentally misunderstands the implied value of 'competition'. That is that competition drives more efficient service provision, cheaper and superior products. Ensuring inefficiency and higher prices to drive behaviour that might lower prices is fundamentally flawed logic that leaves consumers bearing the cost of the market's failure to deliver on expectations. This approach further entrenches consumer vulnerability and disadvantage.

While we do not support retention of the approach to the retail margin and allowance, where the AER considers it necessary for retailers to have additional headroom beyond their cost to serve and profit margin, this allowance should be calculated as a proportion of their own cost to serve, rather than as a proportion of the entire cost stack. PIAC recommends calculating the retail allowance as a percentage of the retail cost to serve only, and that this cost to serve not include CARC or profit. This would ensure the calculation of allowance (or headroom) can be more transparently assessed on its merit as an additional allowance 'for competition', while ensuring that no additional unreasonable costs are born by consumers.

In relation to specific issues posed in the Issues Paper, PIAC considers that differences in the allowance for small businesses and residential customers to be arbitrary. If such an approach is to be retained the AER should present clear reasoning why this is justified. Further where a fixed allowance for retail margin is retained (regardless of the level it is set at) it should include a structural incentive for efficiency (for instance by being applied as a proportion of cost to serve or being capped at a dollar amount) and should clearly indicate the difference between an efficient or reasonable margin and the allowance being applied. For instance, the Issues Paper notes that other regulators allow for between 3-5% margin and that the ACCC's most recent monitoring report indicated actual margins were around 2-2.5%. The AER could apply a decision more in line with common regulatory practice and ensure that any additional allowance applied in the DMO was clearly labelled as 'competition/innovation headroom' allowing decision-makers and consumers to clearly understand and quantify the additional 'cost of competition' the AER regards as justifiable.

## **4. Continued engagement**

We welcome the opportunity to meet with the AER and other stakeholders to discuss these issues in more depth. Please contact Alana West at [awest@piac.asn.au](mailto:awest@piac.asn.au) regarding any further engagement.