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RE: Position Paper: Default Market Offer Price

The Australian Energy Council (the Energy Council) welcomes the opportunity to make a submission to the Australian Energy Regulators (AER) Position Paper on the *Default Market Offer Price*. The AEC is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

Notwithstanding that the AER has merely been tasked with determining the appropriate price for the Default Market Offer (DMO), with no scope for considering policy, the AEC consider that it is incumbent on the AER in undertaking this work to highlight the fundamental flaws in the Default Market Offer proposal.

The DMO is clearly price regulation, however it appears to the AEC as utilising an untested implementation mechanism. Its impact on the market and ultimately consumers is unknown. Setting a price cap in any form cannot come without risks. The consequences of this consultation are of grave importance, a fact that should be stated by the AER.

Implementing the default tariff is not the same as implementing the reference bill. While we support a reference bill that simplifies energy offers, we consider that as one of many tools with which a customer will engage with in entering a new market retail contract, the risks of an overly simplistic reference bill causing significant customer detriment are low. A simple tool will allow a greater number of customers to benefit, with retailers then able to explain the limitations when engaging with the customer directly. This is not the case for DMO customers. Standing offer customers will be told they will be protected from paying too much, encouraging them to disengage. As highlighted below, this suggestion clearly puts customers at risk of receiving a poor outcome.

The outcomes of price regulation

Customers in competitive jurisdictions are engaging in the market in increasing numbers. The ACCC highlighted that the number of standing offer customers decreases year on year. While this policy might benefit standing offer customers who will *never* engage, it is detrimental to those customers who would engage under a business as usual scenario.

It is extremely likely that the presence of a regulated 'reasonable price' that customers will be automatically shifted onto will discourage customers who would otherwise have switched to a cheaper market offer from doing so. This will result in a net loss to the community. In states where price deregulation is relatively immature, the percentage of customers still on standing offers is high. As shown in Victoria, and highlighted by ACCC projections, the vast majority of these customers would switch to a market offer in time.

International evidence shows that in jurisdictions where price regulation is present, switching rates decline rapidly. For that reason, if any customer is dissuaded from seeking a market offer at some time in the future due to the presence of the 'reasonable' DMO, then that customer would pay more for their energy than they otherwise would have.

This issue exacerbates the risk for the AER in setting the DMO. The ACCC appeared to suggest in the REPI that the Default Offer would be a no risk method of ensuring standing offer customers did not pay a 'loyalty tax'. They would merely pay the lower tariff until the point they switched to a market offer. Following the political rhetoric surrounding this policy, we do not consider this assumption to be correct. Customers are being told engagement in the market is too complicated, that they will need to spend hours *haggling* with their retailer to get a better deal. These factors will all lead to customers choosing to disengage given the presence of the DMO.

The AEC consider other mechanisms can achieve the policy objectives without the need for inherently risky price regulation. Customers need to be encouraged to engage in the market, and for that reason the AEC strongly supports the introduction of a comparison rate utilising a reference bill to be implemented as soon as possible.

This will mean that setting the DMO too high will mean these already sticky customers continue to pay more than they need. Conversely, setting it too low, will risk sending smaller retailers out of business and decreasing competition.

The practical implications of the proposal

The AEC welcomes the desire for the AER to make the DMO as simple as possible, mitigating retailers as much as possible from the risk of poor regulatory decisions. However, the manner in which the AER proposes to determine the DMO is untested and given it is likely to encourage customers to disengage, may result in unintended consequences. The AER suggests that an annual amount (or price cap) should be determined for each network area, for a representative flat tariff and a representative controlled load tariff. Retailers would then be empowered by the AER to develop their own pricing structures, provided the annual cost for the representative customer is below the price cap.

This comes with its own difficulties. The price cap will in effect only be meaningful for the representative customer based on average consumption. No customer will be average. Depending on the structure of the retailer's tariff, either customers consuming more or less than the average will be worse off. The AEC is not aware of any jurisdiction where a price regulation model such as this is currently operating successfully.

Case study:

The AER determines the flat tariff DMO in the Ausgrid network to be \$2000 for a 5000 kWh per annum customer.

Retailer 1 prices their offer at \$1.50 per day, and 29c per kWh. Retailer 2 prices their offer at \$1 per day, and 33c per kWh. The below table highlights the impacts this will have on customers with varying consumption. The low consumer is significantly better off with Retailer 2, and the high consumer significantly better off with retailer 1.

	Retailer 1	Retailer 2
1500kwh	\$982.50	\$855.50
5000kWh	\$1,997.50	\$2,000.00
8000kWh	\$2,867.50	\$2,981.00

The risk here, given the empirical evidence suggests that customers switch less in jurisdictions with price regulation, is that customers could be locked into being better or worse off in the long term based purely on their consumption profile.

All customers, other than those with the average consumption profile, will assume the 'safety net' is protecting them from paying too much when this is clearly not the case.

The AER does not give a view as to whether customers could 'opt out' of the competitive market, but the model proposed seems to encourage gaming. As highlighted in the below example, particular energy consumption profiles will be benefitted by the DMO, irrespective of how the retailer chooses to set it. This may result in customers (likely aided by comparison services) choosing to take up the DMO rather than continuing to engage in the competitive market. We do not expect this is the intent of the policy.

We are particularly concerned about the impact of the retail DMO tariff, and how it interacts with the customer's network tariff. We agree with the AER that the vast majority of residential customers today are either on flat or controlled load tariffs, but this will not be the case after July 2019. In their draft tariff structure statements due to apply from 1 July 2019, NSW distribution networks and Energex have suggested that any new customers will increasingly be placed onto more cost reflective (CR) network tariffs. This raises the question about how the DMO will apply for these customers. This issue will result in three possible implementation options, none of which appear to meet the intent of the policy.

1. A customer on a CR network tariff would be billed on a flat DMO tariff
2. A customer on a CR network tariff would be billed on a CR DMO, calibrated to be equivalent to the flat DMO for the average customer
3. A customer on a CR network tariff would not receive the DMO at all

The AEC is keen for the AER and other stakeholders to work through these issues to ensure the policy achieves its long term objectives.

Small business customers

The issues above are all relevant for small business customers, albeit exponentially more complicated than for residential customers. Almost 50% of small business customers are on cost reflective network tariffs, and this number will only increase following the implementation of new Tariff Structure Statements on 1 July 2019. Small business customers also have vastly greater consumption differences to residential customers. While a small residential user might use 2MWh per annum, and a large residential user might use 10MWh per annum, the difference in small business usage could range from 2 MWh to 150 MWh per annum.

Both of these factors will result in some customers being better off, and others worse off purely due to their consumption and site profile. For this reason, we consider a regulated DMO to be extremely unlikely to deliver benefits across the range of small business energy customers.

Conclusion

The AEC understands that the AER has been tasked with determining a DMO amount, with no role investigating the merits of the proposal. That being said, we do not consider the issues paper gives enough clarity on the practical implementation of the DMO to allow us to be able to give substantive comments on the appropriate value of the offer. The value of the offer can only be understood once all factors have been clarified. If retailers are expected to bear consumption and network tariff risk, then the DMO value needs to be high enough to account for this. These risks cannot be expected to fall on the customer, just as customers cannot be expected to pay more than they need to because of a poor regulatory model.

We strongly recommend the AER undertakes significantly more consultation on these critical implementation factors in the coming weeks to ensure stakeholders are able to make an informed decision on the questions raised in the approach paper.

For any questions about our submission please contact Ben Barnes by email at Ben.Barnes@energycouncil.com.au or on (03) 9205 3115.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'B. Barnes', written in a cursive style.

Ben Barnes
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Australian Energy Council