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### Submission to the AER's Draft Determination on the Default Market Offer Prices 2023-24

Energy Consumers Australia welcomes the opportunity to comment on the Australian Energy Regulator's (AER) draft determination on the Default Market Offer (DMO) prices for 2023-24. The significant volatility occurring at present in the energy market has highlighted the need for robust consumer protections such as the DMO that safeguard consumers from unjustifiably high price increases.

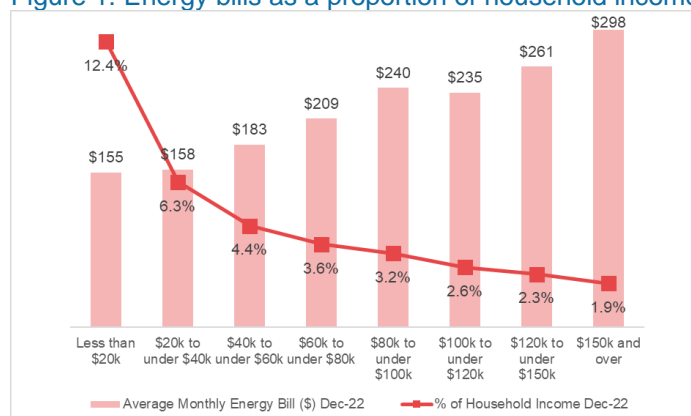
We acknowledge that unprecedented events in the wholesale energy market have had a significant impact on the DMO prices for 2023-24. The substantial increases announced by the AER, and the impact this will have on consumers already struggling with high cost-of-living pressures, only emphasises the need to ensure each component of the cost stack is achieving the DMO's objective around protecting consumers from unjustifiably high prices.

#### Consumers are already struggling with energy affordability

The AER's draft prices come on the back of significant increases to electricity bills experienced by consumers last year. Our most recent Energy Consumer Sentiment Survey<sup>1</sup> (ECSS) saw over half of residential consumers rank electricity bills as one of the top three bills they were concerned about. Over half were also worried that in the next three years energy will become unaffordable for them. Just under three quarters were concerned about energy becoming unaffordable for other Australians.

As evidenced by these findings, energy affordability is at the forefront of many Australians' minds. And the announcement that their electricity bill will increase by an expected 20% will only add to their concern. While price rises are unavoidable, there is no doubt that many consumers are in a position where they will find these rises incredibly difficult to absorb. We know from our ECSS that lower-income households will feel these increases disproportionately, with households on less than \$20,000 a year spending over 12% of their income on energy bills compared to 1.9% for households on over \$150,000 (Figure 1).

Figure 1: Energy bills as a proportion of household income



Source: ECA Energy Consumer Sentiment Survey December 2022

<sup>1</sup> Energy Consumers Australia, [Energy Consumer Sentiment Survey](#), December 2022

The AER has reported that in the past year, the average debt for hardship customers has increased alongside the amount of hardship customers that are holding debts greater than two years<sup>2</sup>. National Australia Bank's Consumer Insights Survey also found that 1 in 5 Australians had missed a bill in the last 3 months, with electricity being the most commonly missed bill<sup>3</sup>.

To cope, consumers are already making changes to their lifestyle. Our qualitative research<sup>4</sup> revealed customers are cutting down on heating and cooling, eating out and other expenses. One financially pressured respondent said:

*"I tell the kids to turn things off PCs laptops lights etc. These appear to make little impact on the bill though. So now I'm looking at additional income streams apart from my full time job."* – Male, NSW, 40-49 years.

These findings paint a grim picture of the position many Australians have already found themselves in, before they even feel the full impact of increasing electricity bills. With this in mind, it is unreasonable to expect consumers to bear the full brunt of an increasingly volatile energy market and instead believe all stakeholders have a role to play in keeping prices as low as they can be.

### **The Default Market Offer is a consumer protections tool**

The DMO plays an important role in ensuring consumers have access to an essential service at a reasonable price. The AER's draft determination, and previous determinations, sets out the DMO objectives to:

- reduce unjustifiably high prices and continue to protect consumers from unreasonable prices
- allow retailers to recover the efficient costs of providing services, including a reasonable retail margin and costs associated with customer acquisition and retention
- maintain incentives for competition, innovation and investment by retailers, and incentives for consumers to engage in the market.

While these objectives do reflect the recommendations given by the Australian Competition and Consumer Commission in the 2018 [Retail Electricity Pricing Inquiry](#), the original communication from the Commonwealth to the AER to develop the DMO<sup>5</sup> made no mention of the objectives and instead highlighted it as an important consumer protections tool that would aid in bringing down retail electricity prices.

We believe it is worthwhile remembering that at its core, the DMO was introduced with the intention of protecting consumers. Each objective, particularly those around competition and incentives to switch, is only desirable if it actually results in positive consumer outcomes.

This framing should inform the AER as they calculate each component of the DMO cost stack. While retailers do need to recover their costs and competition should be preserved, the increased risk retailers are facing should not be inflated. This is especially true if it comes at a cost to consumers who are facing equally difficult economic circumstances.

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<sup>2</sup> Australian Energy Regulator, [Quarterly retail performance report](#), October-December 2022

<sup>3</sup> National Australia Bank, [Quarter 4 consumer insights report](#), March 2023

<sup>4</sup> Energy Consumers Australia, [Consumers' Voice report](#), October 2022

<sup>5</sup> [Treasurer's and Minister for Energy's request to the AER to develop a DMO](#), October 2018

## **Rising prices will impact consumer trust**

When energy prices rise it risks further entrenching low levels of consumer trust. In the past year, we have seen the number of consumers who believe that the energy market is working in their long-term interests dip 11% to just 35%<sup>6</sup>. The large increases outlined in the AER's draft determination are unlikely to improve this figure.

Consumers need to be reassured their interests are being placed at the centre of key decisions such as the DMO determination. Simply directing consumers to shop around will not negate the impact of these price increases. Our previous submissions have highlighted the numerous barriers consumers face to engaging with the market and for those that are able to switch to the best offer, they are still likely to experience a jump in their electricity bill. St Vincent de Paul's Residential Tariff Tracker, for example, found the best available offer in the Ausgrid network in July 2022 for a household consuming 7,200kWh a year was still \$547 higher than it was in July 2021<sup>7</sup>. This is evidence that improving consumer engagement alone will not lead to good consumer outcomes. Suggesting that it will, could risk further denting consumer trust. One respondent in our qualitative research said:

*"At the moment I think the energy market is driven by greed. Gone are the days that if you stayed with a company you would get a loyalty discount. Unfortunately now us as the consumer need to be constantly on the ball trying to chase a better deal. This is what the company's count on, people being too lazy to check."* - Male, 40-49, general public<sup>8</sup>

The DMO is not the only mechanism needed to protect consumers from rising prices and improve consumer trust in the market and we appreciate that many of the solutions lie beyond the scope of this consultation. However, the DMO is an important tool and by framing the final determination around good consumer outcomes, the AER will ensure it remains so.

## **Wholesale costs**

The AER's calculations for the wholesale component of the cost-stack should reflect retailers' increased costs resulting from an unprecedented volatile wholesale market. However, we support the AER's statement that the estimate of these costs should not be overstated and agree that while retailers are able to minimise their risk in extreme circumstances through their hedging strategies, consumers are less well positioned to absorb dramatic increases in costs.

We support the AER's decision to maintain a shorter book build process which will allow for greater price stability in the face of such large increases to the DMO. We agree that consistency and stability are an important part of protecting consumers, particularly those who, for various reasons, are less engaged in the market.

## **Retail margin**

As advocated in previous submissions<sup>9</sup>, we maintain that a retail allowance of 10% for residential consumers and 15% for small businesses is unjustifiably high. We believe sufficient evidence is yet to be provided as to why a lower retail allowance would not achieve the objectives around incentives for competition and for consumers to engage in the market.

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<sup>6</sup> Energy Consumers Australia, [Energy Consumer Sentiment Survey](#), December 2022

<sup>7</sup> St Vincent de Paul, [NSW Energy Prices 2022](#), August 2022

<sup>8</sup> Energy Consumers Australia, [Consumers' Voice report](#), October 2022

<sup>9</sup> Energy Consumers Australia, [Submission to AER DMO 5 Issues Paper](#), November 2022; Energy Consumers Australia, [Submission to DMO 4 Draft Determination](#), March 2022

Our submission to the DMO 5 issues paper and to the DMO 4 consultation outlined that continued competition and consumer engagement in Victoria, where a lower retail margin is used, is evidence that the AER's margins are unjustifiably high.

The Essential Services Commission's approach to setting the Victorian Default Offer differs from that of the AER. Despite this, Victoria has more market offers available from both Tier 1 and non-Tier 1 retailers than any DMO jurisdiction. And in October last year, Victoria had the highest number of retailers with at least one market offer priced below the regulated standing offer<sup>10</sup>. As demonstrated in our previous submission, Victoria also continues to see consumer switching levels on par or higher than DMO jurisdictions.

As part of their calculation of the retail allowance, we understand that the AER has undertaken analysis of the effective margins needed to ensure costs faced by retailers of differing sizes are adequately accounted for. Additional allowance should only be given when it is indeed required to ensure good consumer outcomes. For example, we question whether analysing the additional allowance needed for Tier 1 retailers to recover depreciation costs is needed considering they experience lower costs elsewhere in the cost stack.

The AER has stated in their draft determination that they will not be adjusting the retail margin to avoid consumers paying a higher margin in dollar terms. Given wholesale electricity costs are likely to remain elevated over the coming years, we hope the AER will continue to monitor market conditions to assess whether any increases to the retail margin in dollar terms threaten the DMO objective to protect standing offer customers from unjustifiably high prices.

We look forward to continuing to engage with the AER throughout this consultation. For any further questions please contact [alice.g@energyconsumersaustralia.com.au](mailto:alice.g@energyconsumersaustralia.com.au).

Yours sincerely



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<sup>10</sup> Australian Competition and Consumer Commission, [Inquiry into the National Electricity Market](#), November 2022, pg. 88.