

Submission to the Draft Determination on the Default Market Offer Price 2020-21

3 March 2020

About QCROSS

We are Queensland's peak body for the social service sector. Our vision is to achieve equality, opportunity and wellbeing for every person, in every community.

QCROSS believes that everyone in Queensland should be able to access affordable energy as an essential service. However, people on low incomes pay proportionately more for energy services due to the complexity of the market (Australian Council of Social Service (ACOSS) (2019)). This has resulted in a system that further entrenches thousands of people into poverty and disadvantage, which is unacceptable for delivery of an essential service. For example, in 2018-19 there were 35,587 Queensland households repaying energy debt, 35,605 Queenslanders on electricity payment plans and 19,070 consumers on hardship programs (Australian Energy Regulator (AER) (2019a)).

QCROSS' Position

QCROSS welcomes the opportunity to provide input to the Australian Energy Regulator's (AER) Draft Determination on the Default Market Offer Price 2020-21 (AER, 2020). This is the second Default Market Offer consultation and is referred to as DMO 2. Our response to the AER's draft determination builds on our previous submissions namely:

- Submission to the Australian Energy Regulator Position Paper on Default Market Offer 2019-20 (QCROSS 2018).
- Submission to the AER's Position Paper - Default Market Offer Price 2020-21 (QCROSS, 2019); and

This submission has been informed by engagement with Queensland consumers and the community services sector including:

- individual consultations (with staff from Queensland Consumers Association and Council on the Aging);
- through our Essential Services Consultative Group (ESCG);¹
- engagement with other consumer organisations; and
- the stories we hear directly from people with lived experience.

We have engaged Etrog Consulting to provide detailed technical advice on the DMO 2 (attached). We also engaged directly with the AER.

QCROSS supports the intent of a Default Market Offer (DMO) price to lower bills for consumers who have been unable to obtain affordable and transparent prices in the market. QCROSS is satisfied the DMO has supported progress towards an energy market that is easier and more

¹ The ESCG meets four times a year to discuss energy and water issues, and includes representatives from Legal Aid QLD, Australian Pensioners & Superannuants League QLD, Carers QLD, Uniting VT, Uniting Care Qld, Queensland Consumers Association, Tenants Queensland, Laidley Neighbourhood Centre, Good Shepherd Microfinance, Caxton Legal Centre, Council On The Ageing, St Vincent de Paul Society and Multilink.

transparent for people to navigate. Nonetheless, we see opportunities for the DMO to further improve outcomes for consumers. Our recommendations are: Our recommendations are:

- **Broader application of the DMO:** The DMO price should be extended to cover all consumers who would be better off, rather than just those on standing offers. This should include consumers on market contracts who are paying standing offer prices where the benefit period has expired, and consumers on pay-on-time discount offers who are unable to pay on time, and thereby find themselves paying for their electricity at a price that is higher than the DMO price.
- **Set DMO to reflect efficient costs:** To protect consumers from high prices, the DMO should only allow retailers to recover efficient costs – and no more. The AER should not set the DMO 2 price above median market offers.
- **Rigorous, bottom-up price modelling:** The AER should undertake a more bottom-up approach for calculating the DMO (Option 3 as described on page 19 of the Position Paper).¹ QCOSS does not support the use of indexing to Consumer Price Index (CPI) alone and advocates more rigour in calculating the DMO, including accurate modelling of retail costs, rather than indexing “residual costs” from DMO 1.
- **Invest in consumer engagement and literacy:** The AER should support the Australian Competition and Consumer Commission’s (ACCC) recommendation to resource community organisations to provide effective information and support targeted at those who face additional barriers to participating effectively in the market. This should be a fundamental pillar of the DMO.
- **Underrepresentation of consumer voice:** The consumer voice is underrepresented in the Draft Determination report and in the DMO process at large. Therefore, the proportion of supportive submissions should not be considered a proxy for the level of support from the community for the AER’s determination.

The real purpose of the DMO is to protect consumers from high prices. Regulators often prioritise competition and the AER sets out a policy objective is to “*incentivise competition, consumer engagement, innovation and investment*” (AER, 2020). QCOSS’ position is that competition should not be an objective in and of itself, but rather the pathway through which affordable and transparent prices are achieved. Unfair competition, poorly designed incentives, lack of or poor engagement with consumers, poorly targeted innovation and inefficient investment, risks increasing the vulnerability created by the energy market. As an essential service, consumers should not be expected to continually shop around in order to achieve affordable prices.

Issues

Broader application of the DMO

The DMO is an effective measure for consumers who are on standing offers. It has also been effective for consumers on new market offers who are now benefitting from prices comparable to or lower than the DMO prices since introduction of the DMO in July 2019 (AER, 2020).

However, the DMO is of little value for consumers who remain on legacy market offers where the benefit period has expired, or to consumers on pay-on-time discount offers who are unable to pay on time.

We understand that some retailers have voluntarily applied the DMO price to some consumers on market contract. However, this is inconsistent across retailers. We recommend that the AER require retailers to apply the DMO price to all consumers that would be better off.

DMO should reflect efficient costs

The AER should maintain the original intention of recommendation 30 of ACCC (2018) and allow retailers only to recover efficient costs. In its current proposal, the AER assumes the median market offer represents a retailer's efficient costs, but then states that the DMO 1 price is well above the median market offer (AER, 2020). It therefore clearly demonstrates that DMO 1 was set well above efficient costs. This is a failure of the DMO policy objective “*of preventing unjustifiably high standing offer prices*” (p.11, AER, 2020). We expect that DMO 2 will similarly fail to meet its objectives under the current methodology. If the AER does use the pricing methodology as currently proposed (and not the bottom-up pricing we recommend below), it should just use the median market offer price, as the AER itself states this is “*a reasonable indication of the efficient costs of supplying a customer in each region*” (AER, 2020).

Rigorous, bottom-up price modelling

In developing the DMO price, we urge the AER to ensure that the DMO is more affordable, fairer, and easier to understand than the current standing offers. As an essential service, energy must be accessible and affordable to all, not just those who can understand and engage in what is an increasingly complex marketplace.

To achieve this, QCOSS maintains our recommendation that the AER use the more bottom-up approach proposed as Option 3 in AER (2019b). Detailed reasoning for our recommendation is outlined in the **attached** report from Etrog Consulting.

In summary, the current proposed approach builds the DMO price from four cost inputs. These are network, energy, environmental and residual costs. The first three of these inputs are calculated based on cost forecasts. They are transparently calculated and can lead to increases or decreases year to year.

The ‘residual’ amount, which represents all retailer costs, is not calculated with equivalent rigor. It also seems the residual price can only go up. Consumers deserve transparency and the opportunity for lower costs. The calculation of residual costs should be clearer, forward-looking and able to decrease, not just increase. Retailers should be incentivised to improve efficiency and productivity (and therefore lower costs), and this is missing in this calculation method.

QCOSS opposed the inclusion of customer acquisition and retention costs (CARC) in the DMO price, noting that the DMO was designed to be a safety net for those consumers not shopping around – and therefore not requiring any active recruitment and or retention strategies. However, we note that the ACCC (2018) recommendation 30 explicitly stated that CARC should be included in the DMO calculation. Given that, we strongly recommend that any margin or adjustment for CARC be minimised to the greatest extent possible.

In its Draft Determination, the AER acknowledges the views from our submission to the Position Paper (AER, 2020), but does not address them. The AER must consider this in finalising its approach, as it does in the network business determinations. We encourage the AER to consider building in an efficiency factor or complementary arrangements such as regular efficiency reviews or specific incentives to promote efficiency gains.

Invest in consumer engagement and literacy

Addressing the experience of people made most vulnerable by the system requires more effective information and support to people with diverse needs. The AER has produced resources. However, these will not reach many vulnerable consumers, who will continue to miss out on the benefits of these reforms. A well-resourced and targeted information and support program is required to reach those who face additional barriers to participating effectively in the market. QCOSS strongly believes that funding must be made available for community organisations to deliver this support, as per Recommendation 38 of the ACCC

(2018), which recommended funding to the value of \$43 million for a grant scheme modelled on QCOSS's *Switched on Communities* program.

Underrepresentation of consumer voice

QCOSS and the Public Interest Advocacy Centre (PIAC) are the only consumer advocates that have submitted to the Position Paper (AER, 2019b), with many advocacy organisations unable to make submissions due to lack of resources. We caution the AER against assuming that the quantity of supportive submissions is a fair indication of widespread support for certain positions. It should be acknowledged that consumer organisations are underrepresented compared to other stakeholders.

References

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AER (2019a) *AER Payment difficulties and hardship data by jurisdiction 2018-19*, <https://www.aer.gov.au/retail-markets/performance-reporting/annual-retail-markets-report-2018-19>

AER (2019b) *Position Paper: Default Market Offer Price 2020-21*, <https://www.aer.gov.au/system/files/D19-146139%20AER%20-%20Default%20Market%20Offer%20-%20price%20determination%202020-21%20Position%20Paper%20-%2019%20September.PDF>

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QCOSS (2018) *QCOSS Submission to the Australian Energy Regulator Position Paper on Default Market Offer*, <https://www.qcoss.org.au/publication/qcoss-submission-to-australian-energy-regulators-position-paper-on-default-market-offer-price/>

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