

Regulation impact statement – the introduction of a Default Market Offer (DMO) price cap and reference bill on retail electricity prices

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GLOSSARY

ACCC	Australian Competition and Consumer Commission
ACOSS	Australian Council of Social Services
AEC	Australian Energy Council
AEMC	Australian Energy Market Competition
AER	Australian Energy Regulator
BSO	Basic Service Offer
CARC	Customer Acquisition and Retention Costs
DMO	Default Market Offer
ESCV	Essential Services Commission Victoria
NEM	National Electricity Market
PEMM Bill	<i>Treasury Amendment Laws Prohibiting Energy Market Misconduct (2018) Bill</i>
Thwaites Review	Independent Bipartisan Review of Electricity and Gas Retail Markets in Victoria
VDO	Victorian Default Offer

PART 1. THE PROBLEM

On 1 July 2018, the Australian Competition and Consumer Commission (ACCC) delivered the final report of their Retail Electricity Pricing Inquiry (the ACCC Inquiry) to the Treasurer.¹ The ACCC found that the current situation in Australia's electricity market was unacceptable and unsustainable.

As part of their report, the ACCC highlighted problems around the high prices paid by disengaged customers who were on standing offers and also how discounts are used in a manner that can be confusing and misleading and can confer considerable additional costs on some consumers. These problems were outlined in chapters 12 and 13 of the ACCC Inquiry and are summarised below.

- In the retail electricity market there are generally two types of offers customers can receive, a market offer and a standing offer.
 - Market offers are less regulated than standing offers and can include a range of features including discounts. Many customers benefit from being on market contracts due to generally lower prices and discounts offered.
 - Retailers are also required by law² to publish a standing offer. In Victoria, New South Wales, South Australia and South East Queensland, this offer includes a price set by the retailer, but is attached to a regulated standard retail contract which has additional consumer protections including limiting price changes to once every six months, paper bills, reminder notices, and a simple set of terms and conditions (with no conditional discounts or additional fees).
- The ACCC Inquiry found that standing offers tend to be set at the highest prices in the electricity market and these high prices do not reflect the cost the retailer incurs in providing the additional consumer protections provided under the standard retail contract. The ACCC found that this was the case for customers with relatively small usage including household and small to medium enterprises³.
- As price regulated retail markets in Western Australia, regional Queensland, Tasmania, the Northern Territory and the Australian Capital Territory already have a price ceiling the ACCC did not focus retail pricing issues in those markets.
- Following the Independent Bipartisan Review of Electricity and Gas Retail Markets in Victoria, headed by John Thwaites (the Thwaites Review)⁴, the Victorian Government has introduced legislation that allows the Essential Service Commission of Victoria to cap

¹ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018

² The National Energy Retail Law (2012) (NERL) requires authorised retailers to offer a standing offer contract in each network region they operate. The NERL applies in Australian Capital Territory, New South Wales, Queensland, South Australia and Tasmania. Other states and territories, where prices have or will have retail price regulation, apply their own legislative arrangements, Victoria has the *Electricity Industry Act* (2000) which requires licensees to offer a standing offer. Western Australia *Electricity Industry Act* (2004) which requires retailers to offer standard form contracts, and the Northern Territory's [Electricity Reform Act \(NT\)](#) sets similar arrangements for non-contestable customers.

³ Each state and territory government defines under the NERL or an equivalent legislative instrument the upper energy usage threshold for household and business customers. Under the NERL the usage threshold is 100 MWh although the figures applied vary by derogation or local application.

⁴ Engage Victoria, [Independent Bipartisan Review of Electricity and Gas Retail Markets](#), accessed Mar 2019

standing offer prices from 1 July 2019.^{5,6} This Victorian Default Offer (VDO) and other Victorian retail reforms, including a reference bill, are aimed to address similar concerns to those identified by the ACCC regarding excessive standing offer prices. Implementation issues associated with recent state government decisions are detailed in chapter seven of this statement.

- The ACCC noted in its report that price dispersion between the median standing offer and best market offer can be in the range \$273 and \$832 depending on the network region, and that high retailer standing offers can be attributed to:
 - retailers looking to cross subsidise the costs of customers on discounts or with low usage (solar);
 - being set as a high base price against which retailers offer discounts – offering a discount of a high base can create a false sense of benefit, or mislead consumers into believing they have a comparably better deal.
- Arguments have been made that high levels of price dispersion are a normal and efficient outcome of competitive markets.⁷ Consumers with a low willingness to pay, pay a price close to marginal cost, while those with a high willingness to pay, pay a higher price to cover a company's fixed costs.
- Other arguments have been put forward that such price dispersion is not applicable to the retail electricity market.⁸ The price that consumers pay is based, not on their willingness to pay, but on their level of engagement in a market that can be confusing. As a result, some consumers with a low willingness to pay end up paying the higher price.
- The latter argument was given credence by the ACCC which found that price dispersion in the National Electricity Market (NEM) is less a result of efficient price discrimination and more a function of retailers taking advantage of consumer confusion around pricing, barriers to engagement in the market and a lack of consumer awareness of the cost of being loyal.
- The ACCC describe customers who remain on standing offers as paying a 'loyalty tax'. Consumers who have never, or who have rarely engaged in the market – tend to be on standing offers, and tend to have remained with the same retailer for many years. The premium that is attached to standing offers has been described as a loyalty tax because it tends to apply to those customers who remain with a given retailer for a long period of time, rather than shopping around for a better deal.
- There are currently around 725,000 residential customers in deregulated NEM states who are on standing offers – around 14 per cent of all residential customers.⁹ The ACCC state that around a third of small businesses in New South Wales and South East Queensland are on standing offers, with just under 20 per cent of small businesses in Victoria and South Australia being on standing offers (see Figure 1).

⁵ [Victorian Premier's media release of introduction of a default offer](#), 19 Feb 2019

⁶ Victoria's [Energy Legislation Amendment \(Victorian Default Offer\) Bill 2019](#) as it was introduced into Parliament

⁷ Simshauser, [Price discrimination in Australia's retail electricity markets](#), 2017

⁸ Wood & Blowers, [Price shock](#), 2017

⁹ Departmental analysis based on AER, [Annual Report on Compliance and Performance of the Retail Energy Market 2017-18](#), 2018. Figures excludes Victorian standing offer customer numbers.

Figure 1 – Small and Medium Enterprise customers by offer type and region as at 30 June 2017

Figure 18.4: SME customers by offer type and region as at 30 June 2017



Source: ACCC analysis of retailer data.

Note: NEM figure excludes Tasmania and regional Queensland.

- The ACCC also noted that consumers least able to pay could be found on standing offers.
 - Eight per cent of hardship and payment plan customers are on standing offers.¹⁰
 - According to a survey undertaken on behalf of the ACCC, nine per cent of non-solar customers with an income of less than \$25,000 a year are on standing offers, compared to seven per cent of all non-solar customers surveyed.¹¹
- The existence of consumers on low incomes paying the highest prices in the market supports the proposition there is a disconnect between the price that customers actually pay and the customers willingness or ability to pay.
- While those customers may have made a conscious choice to remain on high-priced standing offers, this would be surprising given they are on the lowest incomes. Alternative explanations could be:
 - Consumers are disengaged from the market as they find it confusing and difficult to compare offers and have low levels of energy market literacy.¹²
 - Some customers will be placed on a standing offer because they have failed to switch retailer when moving house and/or have allowed their existing deal to expire.
 - Some consumers may have limited access to market offers owing to where they live or that retailers do not wish to supply them because they have a poor credit history.¹³
- There is likely to be a group of higher income customers that pay standing offer prices because they are not willing to expend the time and effort to identify a better deal. These customers do not suffer from a market failure as they have made a conscious decision to not engage in the market and do not care about the price they pay.

¹⁰ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p245.

¹¹ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p245.

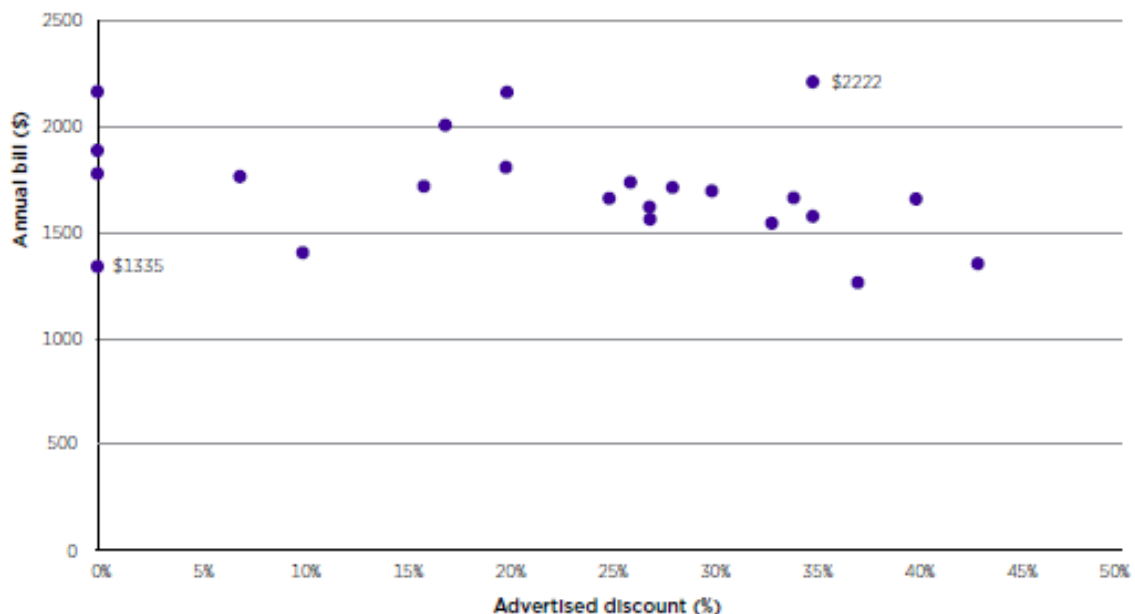
¹² AEMC, [2018 Retail Energy Competition Review](#), 2018, p. 94

¹³ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p247.

- The high price of standing offers highlights a further issue identified by the ACCC regarding customers who are active in the market and are not on standing offers: that advertising using headline discounts does not give the consumer the ability to easily compare offers, or estimate how much they are likely to pay.
- Many retailers discount off their standing offers and market their offers on the basis of the discount rather than the price.
- But there are significant differences in the underlying standing offer price offered by different retailers – the ACCC found that for a medium household in Adelaide, Brisbane and Sydney there was a difference of over \$500 between the lowest and highest priced standing offers.
- As a result, marketing based on discounts is confusing for consumers and means that currently offers with any kind of discount cannot be easily compared given their different base. This has been described as the ‘discount off what?’ problem.
- Analysis by the ACCC into offers in the Victorian distribution zone Powercor, found a number of offers with large headline discounts were more expensive than offers without any discount. This included a 40 per cent discount offer that was \$333 more expensive than the cheapest ‘no discount’ alternative (see Figure 2).

Figure 2 – Annual cost of offers (\$) by advertised offer discount in the Powercor distribution network (Victoria), January 2018

Figure 13.2: Annual cost of offers (\$) by advertised offer discount in the Powercor distribution network (Vic), January 2018



- Consumer research has found that information asymmetries and poor consumer engagement are in part a result of the complex nature of the product and the time required to make informed decisions.¹⁴ This in part has led to the retailer practice of relying heavily

¹⁴ Oxera, [Behavioural insights into Australian retail energy markets](#), 2016, p18

on discounts of highly priced standing offers, as they provide consumers with a sense of gain even where a product may not be an overly competitively priced offer.¹⁵

- Retailers already have to clearly present the price of their offers on their websites and other communications materials – even if these prices are not part of the headline advertising. Consumers can calculate their expected bills using this information, together with an understanding of their electricity usage. Alternatively, consumers can input information into a variety of websites, which can help identify which offer is ‘best’ for them.
- But even the simplest tariffs have two parts – a usage component and a fixed component. The scope for a consumer to calculate their likely bill for a given offer depends on both the availability of useful pricing information and the consumer’s numerical literacy.¹⁶ And websites require consumers to have a level of online literacy and access to the internet for them to be useful.
- The ACCC found that these challenges meant that the current minimum retail pricing information requirements (such as those under the National Electricity Retail Law, or NERL), are not sufficient to address the ‘discount off what?’ problem that exists for standing offers in states with de-regulated retail markets.¹⁷

Past action to address high standing offer prices and information asymmetries

- Over the past decade there has been growing concern that there have been problems with retail electricity pricing, particularly in the state of Victoria which was the first state to fully deregulate electricity prices in 2009.
 - : In 2010, St Vincent de Paul began tracking retail tariffs in Victoria which then extended to other states in the NEM. In November 2012, St Vincent de Paul produced their first national report into retail electricity prices which showed that standing offer prices increased by between 34 per cent (Queensland) and 66 per cent (Ausnet distribution zone in Victoria) from 2009 to 2012.
 - : The report found that in Victoria, increases in retailer margins (retail costs and profits) contributed to 34 per cent of the price increase over the three year period. In other jurisdictions where prices were still subject to regulation, increases in retailer margins only contributed between three per cent and seven per cent.
 - : In May 2013, the Essential Services Commission Victoria (ESCV) released a discussion paper regarding the level of retailer margins. The analysis showed that:
 - : gross retail margins on standing offers had increased from 31 per cent in 2006 to 46 per cent in 2012; and
 - : the net retail margin, or profit margin, on standing offers had increased from 15 per cent in 2006 to 27 per cent in 2012.
 - In July 2015, the Brotherhood of St Lawrence argued for an urgent review of the Victorian retail electricity market, after finding that the retail component of electricity

¹⁵ Oxera, [Behavioural insights into Australian retail energy markets](#), 2016, p28

¹⁶ Oxera, [Behavioural insights into Australian retail energy markets](#), 2016, p12

¹⁷ ACCC, [Restoring electricity affordability & Australia’s competitive advantage](#), 2018, p260.

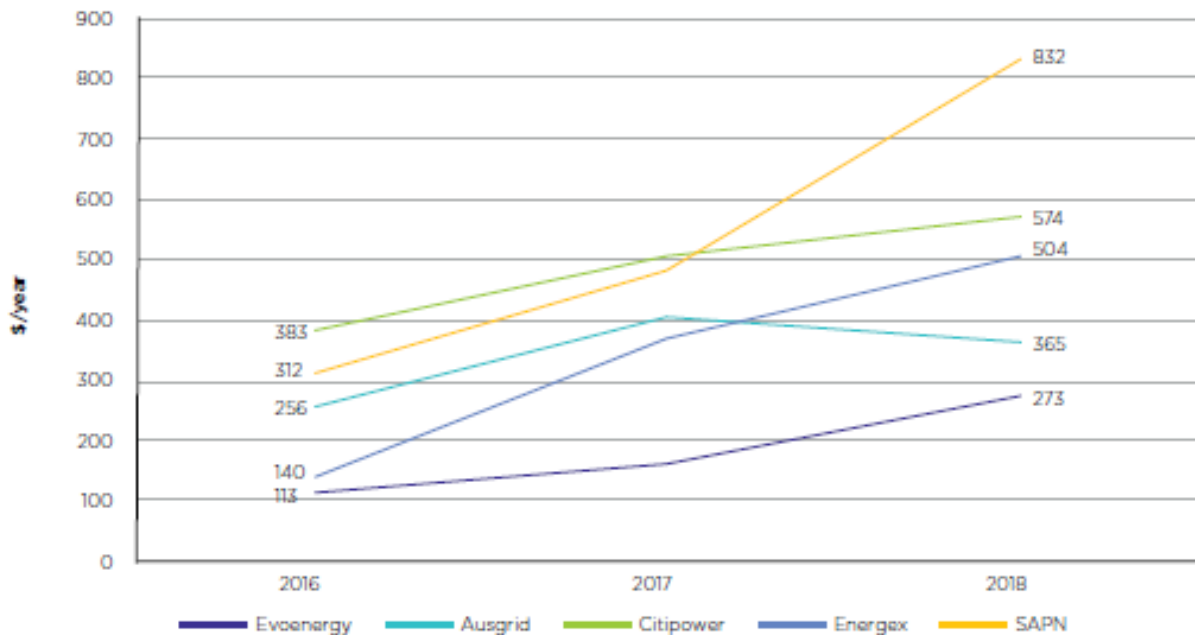
bills rose by an average of 212 per cent over the six years to 2014 from between \$86 to \$183 in 2008 to \$371 to \$471 in 2014.

- In March 2017, the Grattan Institute released a report that estimated that the retailers' profit margins in Victoria were 13 per cent, more than double the margin regulators traditionally considered fair when they had responsibility for setting prices.
- In all of these reports, increasing retail margins have been stated as a reason for the increase in retail electricity prices in Victoria, and for standing offer prices. It should be noted that each report has used modelling to estimate the level of retail margins, as none of the authors had access to retailer data to identify exactly what a retailer's costs and profits are.
- Other states in the NEM do not currently exhibit the outcome of high prices caused by high retailer margins to the same degree. But it should be noted that other states deregulated their retail markets later than Victoria did. South Australia deregulated in 2013, New South Wales in 2015 and South East Queensland in 2016.
- While there are differences between the jurisdictions' electricity markets, the outcomes experienced in Victoria may eventuate in those other states that have deregulated their markets at a later date. This appears to be borne out by the experience of New South Wales where retail profits have risen to 10 per cent following complete price deregulation.¹⁸
- Significant action has been undertaken by both Commonwealth and State Governments to address concerns around retail electricity market:
 - The development of both national and state specific comparator websites;
 - Communication campaigns including the Commonwealth Government's Powering Forward campaign; and
 - The introduction and continued development of the Retail Pricing Information Guidelines, ensuring a consistent approach to the presentation of retail electricity offers.
- But information asymmetries have continued to exist, indicating that such activities have had limited impacts on consumers and retail prices. For example, there is low awareness and usage of both the Victorian and national price comparator website.
- Retail standing offer prices have continued to rise and price dispersion – the price between the standing offer and the lowest market offer – has increased (see Figure 3).

¹⁸ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p8.

Figure 3 – Gap between the median standing offer bill and lowest price market offer bill in Canberra, Sydney, Melbourne, Brisbane, Adelaide (2016-18)

Figure 12.1: Gap between the median standing offer bill and lowest price market offer bill in Canberra, Sydney, Melbourne, Brisbane, Adelaide (2016-18)



Source: AEMC, 2018 Retail Energy Competition Review Final Report, June 2018, p. 76; AEMC, 2016 Retail Energy Competition Review Final Report, June 2016, pp. 17, 20, 23, 25.

- Action from retailers in response to the issues raised in above mentioned reports has been limited.
 - In 2013, the Energy Retailer’s Association Australia along with the Australian Council of Social Service (ACOSS) and the Australian Energy Ombudsman convened an energy affordability roundtable. The roundtable made a range of recommendations to Federal, State and Territory energy ministers to improve retail market outcomes for vulnerable consumers. However, many of the recommendations from industry were to be government rather than industry-led. For example, the need for “a coordinated government led campaign with input from industry and peak consumer groups” to “develop ways to increase low income customers’ awareness of the competitive market so that low income consumers can better understand how to access the best deal for their household.”
 - In March 2016, AGL announced it would give guaranteed discounts to all customers participating in their hardship programs, be writing to all concession card holders on standing offer tariffs offering to help them move to a better plan, and any concession card customer in Victoria on a standing offer would receive a 15 per cent discount off their usage charges.
 - In December 2018, retailers responded to the ACCC Inquiry to put in place an industry-led energy comparison rate for retail offers. A technical design paper for the comparison rate was circulated in December, but no further details of the industry led approach have been publicised.
 - In January 2019, the industry launched the Energy Charter. The Energy Charter seeks to establish a vision for the sector as well as purpose and values. Members of the

charter will submit voluntary disclosure reports against the principles in action on a voluntary basis.

- There are serious questions as to whether the industry by themselves can deliver the reforms needed in the retail market to address the concerns raised by the ACCC.
 - Some of this activity – the industry-led comparison rate and the Charter – has occurred following the release of the ACCC Inquiry and Commonwealth Government’s acceptance of the ACCC’s recommendations regarding retail. Despite issues being raised in regards to retail markets from 2012, retailers have only substantially responded to these issues when the threat of re-regulation has materialised.
 - It is not clear that, despite the agreement to fast-track a voluntary comparison rate at the end of 2018, retailers have been able to agree to the form and function of a comparison rate in the market.
 - Energy Charter membership is voluntary and currently only includes some, not all, of the registered retailers that service small customers. Current membership is limited to include AGL, ACTEWAGL, EnergyAustralia, Powershop, Origin, and Ergon Retail. The concern is that this light touch voluntary reporting and communities of practice approach may not be able to address the issues arising from the ACCC Inquiry.
 - The impact that industry-led charters and self-regulation have on consumer outcomes are questionable. The first banking code of practice was introduced in 1993. There have been reforms of the code over time, with a new code expected to be adopted by banks in July 2019. But in the final report of the Royal Commission into Financial Services, it outlines the limitations of codes when used as self-regulation and that “there may now be some doubt about the extent to which obligations contained in industry codes can be relied on and enforced by individuals.” As a result, the Commission recommended that parts of the industry code become enforceable – that a breach of the code represented a breach in the law.
- In recent years, and outside a limited number of cases, industry led action has been precipitated from strong political pressure at state or national levels.
 - Following their own review of retail markets, the Victorian Government exerted pressure on retailers to reduce excessively price standing offering offers at the end of 2017. Retailers did not reduce their standing offers, but did provide time-limited discounts to standing offer customers. There is no guarantee that these discounts will persist into the future.
 - Following the release of the ACCC Inquiry, the Commonwealth Government exerted further pressure on retailers to reduce their standing offers from the beginning of 2019. Some smaller retailers reduced their standing offer prices, but a number of the larger retailers again provided time-limited discounts instead. In some cases, these discounts were only available to concession customers.
 - The Prime Minister met with retailers twice, on 9 August 2017 and 30 August 2017, at which retailers made a number of commitments aimed at ensuring consumers were not paying more for their power than necessary. Energy retailers committed to develop simpler bills, to support a new rule to requiring notice at the end of discount periods, and to inform customers on more expensive standing offers that alternative market offers were available.

- Arguably these bursts of public pressure rather than regulatory pressure cannot be guaranteed to have a sustained effect.
- Given that, over a ten year period, the industry has failed to address the issues raised with regards the retail market, the appropriate response from the Commonwealth Government is to directly intervene and impose regulations on the market.

PART 2. OBJECTIVE OF REFORM

There are two objectives that the reform is seeking to meet.

1. To place limits on standing offer prices to prevent retailers from taking advantage of disengaged consumers by increasing the prices of standing offers – well above the costs of supplying a customers on standard retail contracts.

The ACCC found that measures were required to reduce the incentive for retailers to inflate the standing offer prices and take advantage of disengaged consumers in the market. As outlined in Part 1, standing offer prices can differ substantially from the best priced offers available in the market, which disengaged consumers can end up paying.

That said, there are also genuine, additional costs associated with being on a standard retail contract compared to being on market contracts so it is expected that the price of a standing offer should be greater than that of market offer. However, as outlined in Part 1, some retailers have inflated their standing offer prices to the extent that the price now significantly outweighs the benefit of having the additional protections provided by the standard retail contract.¹⁹

2. To increase transparency in the retail electricity market to allow consumers to easily compare offers and remove the confusion arising from pricing practices including discounts.

Much of the current marketing of retail offers is based on the level of discount that a retailer is willing to offer in the market. But, as outlined in Part 1, these discounts are not necessarily comparable. An offer with a high discount may not be cheaper than an offer without a discount. As such, consumers may not pick the retail product that best suits their circumstance. Reform is needed to ensure that consumers have access to information that allows them to accurately pick the 'right' retail offer.

¹⁹ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p246

PART 3. POLICY OPTIONS

Option 1: Maintain the status quo

Under a 'do nothing approach', consumers currently on standing offers would be expected to continue to pay above market rates until they switched from a standing offer to a market offer. There would be nothing to prevent retailers from continuously increasing standing offer rates above the rate of inflation and well above the reasonable costs of supply in order to maximise the discount they could advertise rather than genuinely compete on price. It is not clear that retailers would do this; however, it would be consistent with recent behaviour.

Option 2: Default Market Offer (DMO)

In their Inquiry, the ACCC recommended the introduction of a DMO – a regulated price that capped standing offers in the market. Under this model, the Australian Energy Regulator (AER) would determine the maximum price of the DMO in each non-price regulated jurisdiction. The price of the DMO would be set based on “the efficient cost of operating in the region, including a reasonable margin as well as customer acquisition and retention costs.”

Retailers would be required to adjust their standing offer at or below the rate set by the AER.

The ACCC argue that a DMO would result in price reductions for customers who are on standing offers in the non-price-regulated jurisdictions. The ACCC did not envisage the DMO as being the cheapest offer in the market, but that it would prevent retailers from pricing standing offers substantially above cost in a manner that is detrimental to standing offer customers.

Currently, Victoria, New South Wales, South Australia and South East Queensland are all non-price regulated jurisdictions. Regional Queensland, the Australian Capital Territory, the Northern Territory, Western Australia and Tasmania already have regulated prices and the introduction of a DMO in these jurisdictions would replicate existing state regulations. As noted in Part 1, Victoria is moving to introduce its own DMO, in the form of the VDO, from July 2019.

A DMO could be implemented either through changes to the NERL or through Commonwealth Government regulation. In terms of Commonwealth Government regulation, the DMO and reference price could be introduced via a mandatory industry code under the *Competition and Consumer Act (2010)* or through standalone legislation.

In terms of the regulatory approach, there would be no practical difference whether the DMO and reference price were implemented through a state or Commonwealth framework. The same obligations would apply to retailers, and each option would ensure the relevant jurisdictions are subject to a regulated standing offer price cap.

Option 3: Reference price

A reference price rate would provide consumers with a clear benchmark against which to compare offers available in the market. As outlined in Part 1 of this regulatory impact statement and in the ACCC Inquiry, the level of discount provided to a consumer is not necessarily a clear indication of the price of an offer. For example, an offer without a discount may offer consumers a cheaper deal than one with a 35 per cent headline discount.

Under a reference price, retailers would be required to benchmark all offers against that reference price. Where a retailer's offer is greater than a reference price, they would be required to market that offer as being more expensive. The ACCC recommended that the

DMO is used as a point of comparison for discounts,²⁰ but the Commonwealth Government sees benefit in ensuring that retailers are obliged to use the reference price in all comparable offers including those that do not feature discounts. The benefit of including non-discounted offers in the reference price obligation is mitigating the risk of retailers changing their pricing strategies to circumvent the obligation of a reference price.

Where the offer varies from the reference rate, retailers would be required to market the offer as such.

There are two main options for how a reference price can be expressed; a 'bill amount' or a unit rate.

- A reference 'bill amount' would be expressed as the averaged dollar figure the average / medium household is expected to spend on electricity over a specific period of time (day / month / year).
- A reference 'unit rate' would be expressed as the unit price the average / medium household is expected to spend on each unit of electricity it consumes averaged over a year.

For the purposes of benchmarking, there is no practical difference in calculating a bill amount and a unit price. An independent body, such as the AER, would calculate the reference price. The main point of difference is how the price would inform decision making. Considering that electricity is an invisible good from a consumer perspective an average annual price may be more useful from the point of consumer understanding and behaviour. The presentation of the obligation as a unit price or an annual bill figure is considered further in Parts 5 and 7 (the consultation and implementation sections).

The ACCC Inquiry recommends the implementation of both the DMO and the reference bill on the basis of their differing policy objectives. The original ACCC proposal was to implement these changes under the NERL, and for Victoria to harmonise with the NERL until it applies.

Option 4: Basic Service Offer (full retail price re-regulation)

The Basic Service Offer (BSO) was proposed by the Thwaites Review. A BSO would act as a regulated price, determined by the regulator that was based on the efficient cost of running a retail business: however, neither marketing costs, known as Customer Acquisition and Retention Costs (CARC), nor headroom, would be included in the regulated price. As a result a BSO would be priced at a far lower cost than existing standing offers.

Under a BSO, retailers would be required to offer the BSO as the DMO in the market. Effectively this would act as a hard cap on electricity prices. The exclusion of CARC or headroom would mean that the cap would be set very low and retailers would have limited room to undercut the BSO and produce competitive market offers.

²⁰ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p266.

PART 4. COST BENEFIT ANALYSIS OF EACH OPTION / IMPACT ANALYSIS

Option 1: Maintain the status quo

The do nothing approach has been argued to be in the long term interest of consumers on the basis that it will drive greater competition and put downward pressure on prices as consumers move to cheaper market offers. The removal of price regulation has happened at different points in time across the NEM and in markets like Victoria and South Australia there is evidence to support that consumers have in the vast majority shifted from standing offer products to market offer services.

But this option fails to deal with the problems identified in the ACCC Inquiry. There would be no compulsion for retailers to reduce the 'loyalty tax' imposed on consumers that are on standing offers. And the current complexity in the market that prevents consumers from identifying the right retail products will persist.

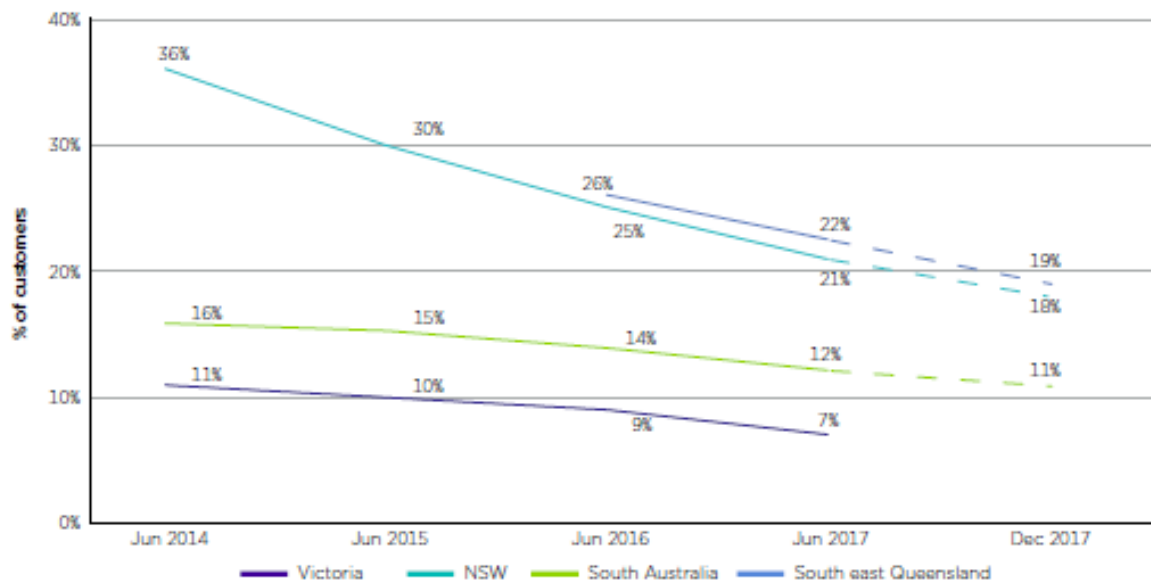
As a result, under a status quo approach standing offer prices will continue to be above the reasonable cost of providing standard retail costs, resulting in a financial transfer from consumers to retailers. And information asymmetries between retailers and consumers will remain resulting in consumers choosing retail products that do not meet their requirements.

The number of residential standing offer customers has reduced over time as a result of consumers becoming active in the market (see Figure 4). In Victoria, where they first fully deregulated prices in 2009, the proportion of customers on standing offers has fallen to just under six per cent.²¹ Standing offers in other deregulated jurisdictions have also been falling over time.

²¹ Essential Services Commission, [Victorian Energy Market Update January to March 2018](#), 2018

Figure 4 – Residential customers on standing offers in non-price regulated jurisdictions, 2014-17

Figure 12.4: Residential customers on standing offers in non-price regulated jurisdictions, 2014-17



Source: ACCC analysis based on AER data; ESC Victoria data.

Note: The dotted lines indicates a six-month gap between figures (rather than 12 months). Figures for Victoria for December 2017 are not included as the ESC Victoria only reports annually. Figures for south east Queensland prior to June 2016 are not included as reporting to the AER for Queensland only commenced in the 2015-16 financial year.

An argument can be made that, given the reduction in standing offer customers over time, this cohort of customers will disappear and no longer be impacted by high standing offer prices. But such an approach is likely to take a number of years to occur. As noted below, it is also likely that there will always be a small group of consumers that require access to standing offers, as market offers are out of reach for them due financial or other reasons.

The above chart shows that in New South Wales and South East Queensland the proportion of standing offer customers is reducing rapidly from a high base. But in Victoria and South Australia, the rate of reduction from a lower base is a little over one percentage point per year. And while the proportion of customers on a standing offer is small, the actual number of standing offer customers in Victoria – approximately 150,000 – is not insignificant.

As such, it is unlikely that the number of standing offer customers will reduce to zero. As the proportion approaches zero, it is likely that the customers remaining on standing offers will be those that are unwilling or unable to engage with the market.

Additionally, there will always be new standing offer customers, such as customers who fail to accept an offer with a retailer when they move into a new property or those that who have failed to renegotiate after their existing deal ends. There are also those customers who, for a variety of reasons including poor credit rating, cannot access alternative offers in the market. In short, there will always be some customers who will be paying standing offer prices.

Option 2: Default Market Offer (DMO)

The DMO was identified by the ACCC as the appropriate means of addressing the problem of excessively priced standing offers in the market. The ACCC highlights two reasons for a DMO to be introduced.

1. It will act as a cap for the price of DMO to limit the 'loyalty tax' that is levied on disengaged consumers; and
2. It will be used to calculate the reference bill amount which all discounts must be taken from.

The standing offer is generally the highest priced offer in the market.²² Standing offer contracts are regulated and contain additional customer protections that mean that they should be higher priced than market offers available. But the rate of price dispersion between the standing offer and market offers is high and has been growing over time. The ACCC noted this difference exceeds the costs of providing the additional protections,²³ and could be equated to a 'loyalty tax'.²⁴

Putting a cap on standing offer prices will protect these standing offer customers from retailers inflating their standing offers to take advantage of consumers who are not engaged. Consistent with the ACCC's intention of providing standing offer customers with a 'safety net', the intention is that the DMO price would not be the lowest price, or close to the lowest price in the market, and should be set above the price for competitive market offers to avoid incentivising consumer disengagement.

An argument can be made that capping retail prices crowds out competition particularly of smaller or less efficient / higher cost market participants.²⁵ These potential market impacts should be taken into account, but balanced against the costs consumers are paying to support competition.

The approach to setting the DMO can have a broader impact on how revenue is streamed across customer groups, retail pricing design, and CARC strategies for retailers, such as how they market and advertise their electricity offers. The DMO is designed to provide a safety net for those consumers on the highest price offers in the market. The DMO is not designed to replace competition entirely in placing downward pressure on prices in the market, but is designed to address the disproportionate profitability of standing offer customers to those other offers in the market.

To mitigate the risk of a poorly targeted price, the approach to determining the DMO is to apply both a consistent approach and criteria across applicable regions, but allow the AER to have regard to differences between regions in terms of both competition and the costs of operating in each region.

The DMO will also serve as a reasonable and universal point of comparison from which consumer can determine whether a deal is fair or not, as retailers quite often use their standing offer rate as a point of comparison with their comparable market offers.

The Australian Energy Market Commission (AEMC) noted the potential for a DMO to result in low-priced market offers within the market to increase, to the point they converge with standing offer rates in some regions.²⁶ They noted that if that were the outcome, then while standing offer customers would benefit, customers on market offers would lose out. However, the AEMC's analysis is based on the premise that retailers will seek to recover (some) of their lost

²² ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p241

²³ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p242

²⁴ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p241

²⁵ AEMC, [Customer and competition impacts of a default offer](#), 2018, pvii

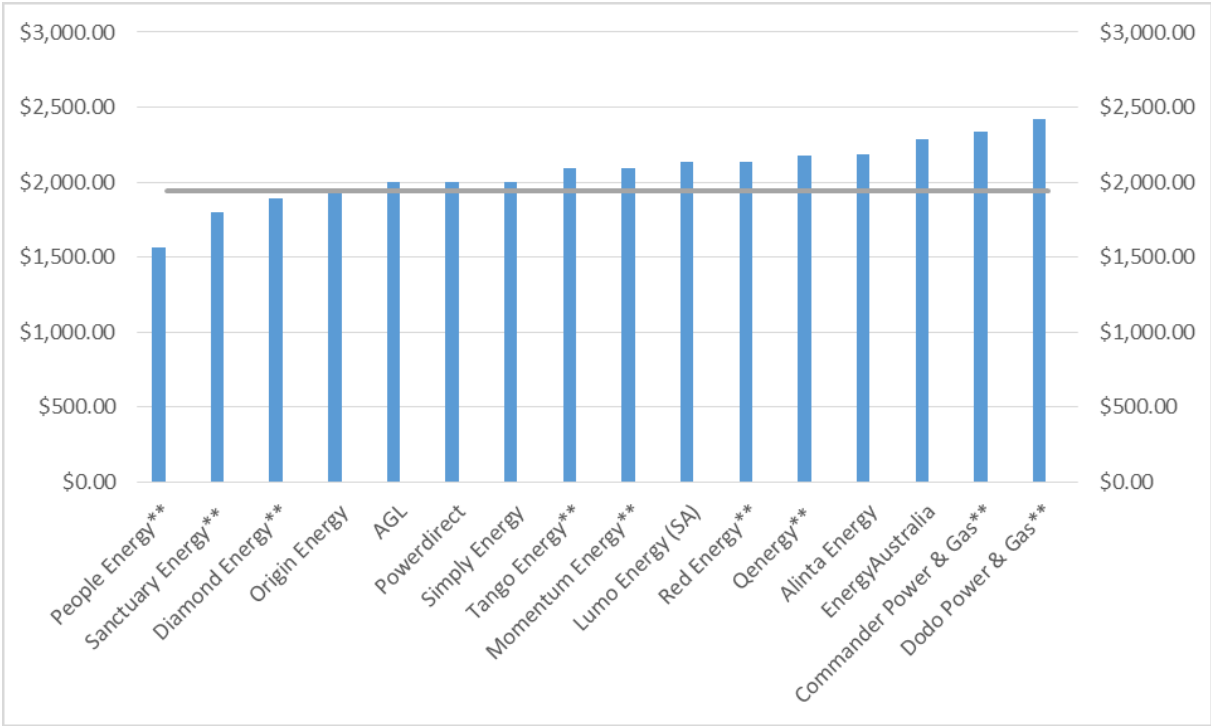
²⁶ AEMC, [Customer and competition impacts of a default offer](#), 2018, pv

revenue from the imposition of a DMO by increasing revenue from the competitive segment of the market. Clearly, in a market where retailers are subject to some level of competition, this is not realistic. The AEMC also cited the example of the United Kingdom (UK), where the price of market offers increased following the decision to re-regulate prices.²⁷ But in the UK, the majority of customers are on the UK’s equivalent of a standing offer (57 per cent)²⁸ compared to only 14 per cent in the jurisdictions that would be affected by the introduction of a DMO.

The effectiveness of a DMO will be determined by the level at which it is set. Profit margins for retailers in the NEM are currently at about eight per cent, compared to the 3.5 per cent margin found in the United Kingdom²⁹; although this average hides some significant variations between states. Margins in Victoria average 11 per cent, while margins in South East Queensland are below three per cent. States with high profit margins should – in a competitive market – see any lost revenue from a reduction in standing offers be subsumed by reduced profit margins, rather than by seeing an increase in prices of other offers in the market.

In terms of the impact of the DMO on retailer revenue outcomes, the impact will vary depending on the number of customers on standing offers, where the retailer’s standing offer is set, and the use of standing offer rates as a part of the retailers’ broader pricing strategies.

Figure 5 – 2018 Standing offer Prices in the South Australian Power Network against the DMO rate



For instance, the impact of the DMO on retailers with high priced standing offers, but few or no customers on those offers should be negligible. This can be seen in Figure 5, with retailers like Alinta Energy who are reported to have less than two per cent of their customer base on standing offers in the South Australian Power Network.³⁰

²⁷ AEMC, [Customer and competition impacts of a default offer](#), 2018, p1v
²⁸ Ofgem, [Ofgem publishes supplier standard variable tariff league table](#), 2017.
²⁹ Competition and Markets Authority, [Energy market investigation: final report](#), 2016, p356.
³⁰ The graph is based on data from Australian Energy Regulator, [Annual report on compliance and performance of the retail energy market 2017-18](#), 2018 and EnergyMadeEasy prices from September

For those with a greater number of standing offer customers but rates closer to the determined DMO – predominantly the ‘big three’ retailers (AGL, Origin and EnergyAustralia) – it is possible they will see a reduction in revenue due to the DMO cap on standing offers. But the ACCC argued that retailers with these far lower costs and significantly higher margins should be able to bear the reduction in revenues resulting from a small reduction in standing offer rates. Other retailers whose standing offers are below the DMO will not be affected.

There is a possibility that some retailers’ revenue could be reduced as a result of some market offers being pegged to their current standing offer rates which, for some retailers, is priced well above the local DMO. Depending on the contract structure, it may be necessary to either adjust the market offer percentage discounts or change other parts of the pricing structure to maintain the same revenue outcomes.

This issue was raised by stakeholders through the consultation process, in particular that the introduction of the DMO would result in a reduction in competition due to less retailers.³¹ While it is true that the introduction of a DMO will impact retailers’ revenue, the risk will be mitigated, in part, by the fact that the DMO should be relatively high compared to market offers available in the market. Consistent with the ACCC recommendation.

This is borne out by comparing the outcomes from implementing a DMO to a more aggressive form of price-capping. In March 2019, the ESCV released their own draft determination for the VDO. Unlike the DMO, which is intended to limit retailers from increasing their standing offers to take advantage of disengaged customers, the VDO is based on the efficient cost to run a retail business with no allowance made for headroom.

The result is that the VDO delivers a far lower price than the DMO. The ESCV found that for households, the DMO could be around \$200 higher than the VDO.³² This difference indicates that a DMO will be priced at a level that will limit the potential for unforeseen impacts on the viability of efficient retailers, while still providing room – around \$200 in Victoria if the was DMO introduced - for price competition.

It is acknowledged that there may be some retailers whose costs are such that they cannot bear the reduction in revenues without either raising their market offers or exiting the market. But, arguably, these retailers are in such a position because they are not cost-competitive with other retailers.

There are also some retailers who have standing offers that are below the DMO. Under the policy, these retailers will not be affected can still have their standing offers set at their current level. There is no requirement they increase their standing offer prices to the same level as the DMO.

The imposition of the DMO will not, by itself, resolve the ‘discount off what?’ problem identified by the ACCC. This is because many retailers – although not all – currently provide discounts off their standing offers which vary between retailers.

The imposition of the DMO is likely to result in a convergence of standing offers available in the market, meaning that discounts are more likely to be calculated off a similar base. But

2018. The DMO is based on data from Australian Energy Regulator, [Draft Determination – Default Market Offer Prices](#), 2018

³¹ Powershop, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p2.

³² Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Draft advice, 8 March

retailers retain the discretion to set their standing offers at a rate below the DMO and discount off that rate. Moreover, some retailers, such as Momentum, currently employ a pricing strategy where they do not advertise discounts and instead offer low-priced offers in the market, which are not easily compared with 'headline discount' offers from other retailers.

As such, improved transparency for consumers cannot be assured. Further intervention is required to resolve the information asymmetries that exist when marketing is predominantly based on the level of discount retailers' offer.

Option 3: Reference price

The introduction of a reference price would give consumers greater clarity from simple advertising as to which offers are 'good' and which are 'bad'. Greater comparability of prices can be expected to drive greater retail competition and benefit consumers.

A reference price may also have the impact of imposing a 'soft cap' on the market. Although there would be nothing to stop them, retailers may be reticent in pricing offers above the reference price amount. Consumers are less likely to sign up to offers which are higher than the independently-set reference price.

If the reference price were set too low – below the reasonable cost of providing electricity – retailers can still price above the reference price. As such, the risk of an inappropriately set reference price impacting on the competitiveness of the market would be less than were a hard price cap (DMO) introduced. Were the reference price to be inadvertently set below the efficient price of electricity, retailers could still seek to recover the necessary revenues through pricing their offers above the reference price.

While a reference price will help address current information asymmetries in the retail market, it would not necessarily address high levels of price dispersion or the high price of some standing offers. Customers on standing offers are often those least engaged with the market. While simpler, more comparable pricing is likely to lead to more consumers engaging with the market, those on standing offers may not switch. Marketing may not reach standing offer customers and those same customers would remain unaware of how high their standing offers are.

The ACCC envisaged using their benchmark price – 'the reference bill' – purely to address the 'discount off what?' problem. Any retailer wishing to offer headline discounts must calculate that discount off the reference bill.

As a result, the ACCC reference bill is targeted at the problem of retailers offering large – often meaningless – discounts off inflated tariffs. But its limited scope would not allow for a comparison of all tariffs available in the market – for instance, where a retailer chooses not to advertise 'using a discount claim', they would not be required to benchmark against the reference price.

An alternative approach is to require all offers available in the market to be benchmarked against the reference price. Offers would need to be expressed in the same way as the benchmark price to allow a direct comparison and be advertised as such. For example, if a retailer's market offer was 10 per cent higher than the benchmark price it would need to be presented as such to the public.

The main risk of the reference price is noted above, and that is retailers will lose market share as consumers see that their current, deeply discounted market offers based off high standing

offer rates are, in fact higher cost than other, less discounted market offers. But this would be the result of enhanced competition to the benefit of consumers, which is the purpose of introducing a reference price.

Given the DMO is intended to act as a safety net rather than the lowest price in the market, it will remain possible to offer reasonable discounts to consumers. Alternatively, retailers could also consider innovating their existing products to provide more attractive prices or products to consumers.

Option 4: Basic Service Offer (full retail price re-regulation)

A BSO would provide standing offer customers with a lower priced electricity product than the ACCC's DMO would deliver. Standing offer customers, or those on market rates that were higher than the BSO could gain significant price relief.

The ACCC considered there were significant risks associated with introducing a BSO. First, the BSO is intended to reflect the efficient costs for a retailer, and provides no allowance for CARC or headroom. But what the efficient costs are will be an estimate based on factors which vary through time, particularly wholesale costs. As such, there is the potential for the regulator to set the BSO too low, which would hamper the ability of efficient retailers to operate in the market. While ensuring inefficient retailers can continue operating is not an objective of the reform, a mechanism that reduced the numbers of efficient retailers in the market may reduce competitive pressures and its associated benefits.

An indication of how the market may respond to the introduction of a BSO can be made through a consideration of the VDO calculation. The VDO is similar to a BSO but allows retailers to recoup reasonable retailer costs, including CARC.

But the VDO has been set at a level that, according to the ACCC, is significantly below the cost a smaller retailer – a tier 2 retailer – to compete. The ACCC calculate a smaller retailer's retail costs, inclusive of CARC, at \$233 per consumer,³³ while the ESCV have allowed recovery of only \$156 per consumer for their retailer costs.³⁴ It is difficult to see how some retailers with retailer costs of over \$200 per customer can continue to operate when they are only allowed to recover \$156 per customer.

A BSO is likely to produce an even more pronounced effect, given it would not include CARC. This means that a retailer would only get a little over \$100 per customer to cover retailer costs. The result is likely to see many small retailers leave the market.

Second, a BSO may result in the benefits from competition experienced by those who are engaged in the market disappearing. Cheap electricity offers may no longer be available and innovation would be less likely to occur.

³³ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p223 - 230

³⁴ Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Draft advice, 8 March, p.49 – 54.

PART 5. CONSULTATION

ACCC Retail Electricity Pricing Inquiry (2017)

As noted previously, the Commonwealth Government's decision to introduce the DMO and reference price is heavily informed by the ACCC Retail Electricity Pricing Inquiry. The ACCC Inquiry spanned the entire electricity supply chain and took into account the multiple issues experienced across the NEM. The ACCC Inquiry resulted in 56 recommendations to improve the consumer outcomes and market efficiency across the NEM. The ACCC's recommendations including the recommendations considered in this regulatory impact statement were based on an issues paper, preliminary report, public stakeholder forums, and 200 public submissions, as well as 48,000 retailer documents arising from 100 information gathering notices.

In order to consider the regulatory impact of the DMO and the reference price the Commonwealth Government has drawn on the analysis, research and consultation processes from the ACCC Inquiry. Submissions to ACCC Inquiry's Issues Paper and Preliminary Report clearly identified the difficulty consumers experience navigating the electricity market with consumers often being required to review up to 80 offers, this includes multiple retailers from the same retailer.³⁵

In the ACCC Preliminary Report on the Retail Electricity Pricing Inquiry the ACCC consulted extensively on the problems and barriers consumers face in the electricity market and other issues between energy businesses amongst other issues.

The ACCC Inquiry asked for advice from stakeholders to test the hypothesis that retail competition is working in the interests of consumers, and that price de-regulation was resulting in savings for consumers through increased competition and efficiency. The ACCC Inquiry also tested with stakeholders as to whether current market structures were leading to inefficient costs.

Retailer submissions argued that the NEM is vigorously competitive and retail offers were strongly based on consumer preferences for discounts.³⁶ Submissions from retailers further contended that maturing competition and ongoing innovation would improve the customer experience.³⁷

A number of submissions from consumers and consumer groups made the argument for greater consumer protection, on the basis of information asymmetry and market concentration of certain retailers. For instance, the Consumer Action Law Centre argued that that "the interests of firms and consumers are not well-aligned" and called for a shift in the regulatory framework from solely addressing information asymmetry to some form of pricing protection.³⁸

Other submissions from state governments and state based regulatory authorities, like Independent Pricing and Regulatory Tribunal, also support maintaining the current regulatory

³⁵ Energy Consumers Australia, [Submission to the ACCC Inquiry Issues Paper](#), July 2017, p14

³⁶ AGL, [Submission to the ACCC Inquiry Issues Paper](#), 18 July 2017, p22

³⁷ *EnergyAustralia*, [Submission to the ACCC Inquiry Issues Paper](#), 13 July 2017, p15

³⁸ Consumer Action Law Centre, [Submission to the ACCC Inquiry Preliminary Report](#), 17 Nov 2017, p2

framework and highlighting the risks of re-regulation of retail electricity markets, particularly noting the experience in the United Kingdom.³⁹

As noted in this regulatory impact statement, the ACCC, using retailer data and documents, found there were significant issues regarding the health of retail competition, price outcomes, and claims regarding the benefits of price dispersion.

The Thwaites Review⁴⁰ also conducted in 2017 undertook a consultation processes and came to a similar conclusion that policy intervention was required to protect consumers from current pricing outcomes. Submissions to this processes were consistent with the input made to the ACCC Inquiry in terms of the range of views expressed.

Since the ACCC Inquiry there have been other consultation processes specifically on the DMO and reference price. These are:

- The AER DMO Methodology Consultation Process (December 2018),
- The Senate Economics Legislation Committee review of the *Treasury Amendment Laws Prohibiting Energy Market Misconduct (2018) Bill* (the PEMM Bill),
- The *Competition and Consumer (Industry Code—Electricity Retail) Regulations 2019* consultation.

The AER DMO Methodology Consultation Process (December 2018)

Under the policy, the AER is responsible for determining the methodology including its information requirements in setting the DMO rate in each applicable network region.

On 9 November 2018 the AER released an issues paper regarding the approach it might take to setting the DMO in each network region for each customer class. The paper highlighted the high level methodology the AER would apply including the type of information used and the general calculation approach. For the first determination the AER indicated it would do a priced based determination (top-down) rather than a cost based determination. This means the AER indicated it would look to set the DMO rate based on a calculation of the mid-point between the median standing and the median market offer rate.

The consultation paper sought feedback on thirteen specific questions regarding the proposed methodology for setting DMO rates. The areas for consultation included:

- The extent to which the DMO should take into account other information (including other determination processes in Queensland specifically around non-Energex price determinations).
- Appropriate network tariff structures (flat, flexible, controlled load and demand) that could have the DMO applied for both residential and small business customer.
- Whether the top down approach is reasonable when considering the policy intent.

³⁹ Independent Pricing and Regulatory Tribunal, [Submission to the ACCC Inquiry Issues Paper](#), 17 June 2017, p2

⁴⁰ Engage Victoria, [Independent Bipartisan Review of Electricity and Gas Retail Markets](#), accessed Mar 2019

- Other criteria and risks stakeholders thought the AER should take into account when applying a top down approach.
- The basis for usage thresholds for both residential and small business customers.
- What if any input costs the AER should have regard to.

The AER issues paper provided scope for stakeholders provided views on the DMO in terms of the original policy intent of the ACCC recommendation, as well as the design of the methodology for setting the price.

The consultation process elicited a similar range of views on the benefits and risks associated with the introduction of price caps on standing offer rates as those raised during the ACCC Inquiry. Some of which overlap with the submissions to the ACCC Inquiry process as well as the consultation process for the Code itself (as per below).

Consumer organisations representing households and particularly those representing vulnerable households were supportive of the introduction of a DMO and reference price. Broad based consumer groups like Choice expressed support for the benefits to all small consumers through both the DMO and the reference price.⁴¹

Similarly, ACOSS also supports the DMO as competitive markets are not delivering the expected consumer benefits for consumers.⁴² ACOSS does not agree with the contention that deep price dispersion is guaranteeing good outcomes, noting that even engaged consumers are not getting the lowest or best price.⁴³ This view is also supported by ACOSS's state based member organisations including Queensland Council of Social Service⁴⁴ and South Australia Council of Social Service as well as St Vincent De Paul⁴⁵. The Public Interest Advocacy Centre also noted that the design of the DMO should not necessarily result in reduced competition and innovation noting that a DMO could create incentives on retailers to innovate to the benefit of consumers.⁴⁶

Energy and Water Ombudsmen also provided advice on the impact of inflated standing offer prices on disadvantaged customers⁴⁷ and supporting the introduction of a DMO to minimise the impact on those households.⁴⁸ One of the main reasons cited by Ombudsmen was the inflated price on those households unable to access market offer contracts or those on market offers where all the benefit periods have expired.⁴⁹

Business organisations with membership more likely to be exposed to inflated standing offer rates and lower levels of retail competition, were also supportive of the introduction of the DMO as well as the reference price. The National Farmers Federation was broadly supportive

⁴¹ Choice, [Submission to the AER Position Paper: Default Market Offer Price](#), 7 Dec 2018, p2

⁴² ACOSS, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p1

⁴³ ACOSS, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p2

⁴⁴ QCOSS, [Submission to the AER Position Paper: Default Market Offer Price](#), 7 Dec 2018, p1

⁴⁵ St Vincent De Paul and SACOSS, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p1

⁴⁶ Public Interest Advocacy Centre, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p4

⁴⁷ Energy and Water Ombudsman NSW, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p1

⁴⁸ Energy and Water Ombudsman NSW, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p2

⁴⁹ Energy and Water Ombudsman NSW, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p1

of the ACCC recommendations noting the findings of the ACCC Inquiry around confusing pricing and reduced retail competition in certain regional network areas.⁵⁰

However, consumer organisations did differ on the preferred criteria for setting the DMO price, while some lean more to the BSO model others, like the South Australian Council of Social Services and St Vincent De Paul recommended a cautious approach (in line with the ACCC recommendation) that promotes ongoing retail competition be adopted.⁵¹

In contrast, some business organisations like Business SA, were concerned the introduction of a hard price cap would effectively be a return to price regulation.⁵² This view is arguably reflective of concerns about the perceived risk the introduction of a DMO may negatively affect the lowest priced rates in the market. Medium sized business often have higher rates of energy use and therefore face lower per unit costs than those experienced by small households and businesses. Concerns relate to the risk of retailers increasing those costs to offset the losses from the removal inflated standing offer rates. Business SA did however express both strong support for the reference price and limits on confusing discounting practices.⁵³

Incumbent energy retailers argued against the introduction of the DMO. The Australian Energy Council and retailers like AGL noted their concerns with the introduction of the DMO through the AER process, highlighting the potential impacts of the DMO policy on market offer prices and investor confidence. While some retailers conceded standing offer rates are inflated, they considered price setting would impact competitiveness as it would reduce price dispersion.⁵⁴

Smaller retailers also highlighted the importance of setting the DMO much closer to the median standing offer to avoid the risk of them having their margins eroded, and their capacity to innovate undermined.⁵⁵ Simply Energy, for instance, did not support the DMO as it did not believe the AER will have the information and flexibility to get the price right for the contemporary circumstances.⁵⁶ That said they did suggest ways the DMO could be designed to reduce the risk, including retailers being able to ask the AER to re-do the determination in the circumstance of extreme wholesale market events like those driven by weather.⁵⁷

The South Australian Minister for Energy also made a submission on the DMO and reference price. The Minister highlighted the South Australian Government's strong preference to improve the comparability of contracts over any hard caps on standing offer prices.⁵⁸ The South Australian Government highlighted the number of South Australian consumers on market offers and the risk that setting a hard cap on standing offers could negatively affect the attractiveness and quantum of market offers in the South Australian market.⁵⁹

⁵⁰ National Farmers Federation, [Submission to the AER Position Paper: Default Market Offer Price](#), 5 Dec 2018, p1

⁵¹ St Vincent De Paul and SACOSS, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p2

⁵² Business SA, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p1

⁵³ Business SA, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p2

⁵⁴ AGL, [Submission to the AER Position Paper: Default Market Offer Price](#), 10 Dec 2018, p2

⁵⁵ Powershop, [Submission to the AER Position Paper: Default Market Offer Price](#), 6 Dec 2018, p3

⁵⁶ Simply Energy, [Submission to the AER Position Paper: Default Market Offer Price](#), 7 Dec 2018

⁵⁷ Simply Energy, [Submission to the AER Position Paper: Default Market Offer Price](#), 7 Dec 2018, p5

⁵⁸ Minister for Energy, [Submission to the AER Position Paper: Default Market Offer Price](#), the Government of SA, 14 Dec 2018, p2

⁵⁹ Minister for Energy, [Submission to the AER Position Paper: Default Market Offer Price](#), the Government of SA, 14 Dec 2018, p2

The Senate Economics Legislation Committee review of the *Treasury Amendment Laws Prohibiting Energy Market Misconduct (2018) Bill* (the PEMM Bill)

The PEMM Bill includes amendments to support the introduction of the DMO, in to the provisions intended to address aspects on market misconduct ting legislation

The consultation process for the PEMM Bill related to the DMO in so far that Schedule 2 aimed to provide information gathering powers to the AER for the purpose of ensuring the DMO is efficiently set and reflective of retailer costs.

The amendments to the *Competition and Consumer Act (2010)* set out in Schedule 2 of the Bill do the following:

- Clarify that the Code can incorporate other instruments at any time – that being annual determinations made by the AER.
- Ensure that any determinations made by the AER for the Code are non-disallowable by Parliament.
- Provide the necessary information gathering powers to the AER, bringing the AER's powers in line with comparable regulators including the ACCC.⁶⁰

This consultation process was the first opportunity for stakeholders to consider the DMO and reference price as introduced under a Commonwealth law framework and so stakeholder comments largely focussed on introducing pricing policy under Commonwealth law rather than state based legislation.

Retailers including EnergyAustralia referred to the risks highlighted in the AEMC analysis that the DMO would increase the price or reduce the range of offers in the market.⁶¹

Some state governments including the Western Australian Government and retailers like AGL raised broader energy market governance concerns around the impact of Commonwealth law intervention in retail electricity markets, citing risks to the Australian Energy Market Agreement.^{62,63}

The *Competition and Consumer (Industry Code—Electricity Retail) Regulations 2019* consultation

The implementation of a DMO and reference price will occur through a mandatory industry code (the Code) under the Commonwealth Government *Competition and Consumer Act 2010*. Consultation on the Code occurred between 23 February 2019 and 12 March 2019.

The Commonwealth Government received 16 submissions from a mix of consumer groups, retailers, consultants, peak industry bodies and state governments. The number of

⁶⁰ [Treasury Laws Amendment \(Prohibiting Energy Market Misconduct\) Bill 2018, Explanatory Memorandum](#)

⁶¹ EnergyAustralia, [Submission to the Senate Standing Committee on Economics Inquiry into the PEMM Bill](#), 25 Jan 2019, p4

⁶² WA Government, [Submission to the Senate Standing Committee on Economics Inquiry into the PEMM Bill](#), 29 Jan 2019, p4

⁶³ AGL, [Submission to the Senate Standing Committee on Economics Inquiry into the PEMM Bill](#), 25 Jan 2019

submissions was lower than expected by the Commonwealth, and could reflect a number of factors, including general support for the Code. But it may also be the result of a shortened consultation process which was criticised by retailers and retail bodies or consultation fatigue, as submissions on the Code was the fourth time stakeholders were invited to present their views on the DMO and reference price.

Stakeholders' views on the code were generally consistent with previous consultations on the DMO, with retailers and consumers groups expressing different attitudes towards the DMO and reference price. Retailers were direct in expressing their opposition, arguing that the Code would cause unintended consequences within the retail market, including increases in the price of market offers and customer confusion. Retailers also raised opposition towards the Code's proposed requirement for discounted offers to be advertised against the reference price. However this viewpoint is not surprising, as the purpose of the reference price is to correct the misleading nature of advertised discounts by providing consumers with a benchmark to compare different offers.

In direct opposition to the retailers, all four consumers groups who made submissions supported in principle the objectives of the DMO and the reference price, with the Public Interest Advocacy Centre stating that the DMO would "reshape the operation of the market to support better and more equitable outcomes for consumers in the delivery of an essential service."⁶⁴

Summary of views expressed by consumers groups

The Public Interest Advocacy Centre did, however, consider that a number of elements contained within the code would "undermine the intent of the default offer".⁶⁵ They raised concerns that the manner in which the DMO would be set would not offer consumers the protection that they needed. The DMO would be a "high cap" and allow "consumers to remain on offers which are manifestly inefficient".⁶⁶

Energy Consumers Australia explicitly supported the use of the Code. "The poor consumer outcomes and the low levels of trust and confidence in the market mean that new tools, including industry codes, should be considered. Codes are not currently part of the NEM framework and may provide a mechanism for faster and more flexible solutions".⁶⁷

Summary of views expressed by retailers and retailer groups

Several retailers, including AGL and EnergyAustralia appeared to support the introduction of a form of reference price or comparator rate in general, although they did not support its implementation through the Code.^{68,69} As stated by EnergyAustralia, in regards to South

⁶⁴ Public Interest Advocacy Centre, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p1

⁶⁵ Public Interest Advocacy Centre, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p1

⁶⁶ Public Interest Advocacy Centre, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p2

⁶⁷ Energy Consumers Association, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p3

⁶⁸ AGL, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019

⁶⁹ EnergyAustralia, Submission to the DMO Electricity Code: Public consultation paper, 13 Mar 2019

Australia, “the introduction of comparison or reference rate may be more appropriate (but not the “reference rate” as currently prescribed in the Code)”.⁷⁰

As noted a major concern raised by retailers around the introduction of the Code was the potential impact on the market, specifically its impact on competition and market offers available in the market. Meridian/Powershop argued that “the proposed implementation of re-regulation is likely to lead to reduced competition, innovation and investment in new generation”.⁷¹ They also stated the application of the code will, “eliminate almost all price based advertising which will benefit established brands and disadvantage small competitive retailers and ultimately all consumers.”⁷²

Origin stated that “poorly designed or ineffectively implemented regulation can have a significant impact on the efficiency and competitiveness of the electricity sector including the quality and availability of services.”⁷³

Respondents also raised concerns regarding the way in which offers would be advertised under a reference price, in particular that consumers would find new requirements confusing. Origin argued that referring to the DMO as a total annual price would confuse customers as the DMO is not a price but an annual benchmark cost of energy. The DMO should rather be described as a “comparison bill”.⁷⁴

Simply Energy believed that restricting conditional discounts and implementing a reference price may confuse customers.⁷⁵ EnergyAustralia stated that the Code would require retailers to increase the volume of material that it has to provide customers, creating further confusion for customers.⁷⁶

The Australian Energy Council (AEC) argued that the Code would effectively lock-in the use discounting. “Retailers which do not offer discounts often make a particular point of offering simple, low cost products as a means of differentiating their business. The Code will require them to change all their collateral and campaigns, discouraging innovation and entrenching practices the ACCC considered confusing.”⁷⁷ Another retailer, Alinta stated that “placing restrictions on the way retailers can advertise certain product attributes will ultimately impact product innovation.”⁷⁸

As stated previously, retailers and retail bodies strongly criticised the consultation process for the code. The AEC argued that the consultation process was inconsistent with the development of such a Code and that there had been no public consultations on the merit of whether such a Code was needed.⁷⁹ The AEC rejected the idea that the ACCC process should form any part of formal consultation on the implementation of a Code. One of the reasons AGL argued it could not support the proposed approach was that there was a “limited timeframe for public consultation on the on the Draft Code”.⁸⁰

⁷⁰ EnergyAustralia, Submission to the DMO Electricity Code: Public consultation paper, 13 Mar 2019, p6

⁷¹ Powershop, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p2

⁷² Powershop, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p2

⁷³ Origin, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p1

⁷⁴ Origin, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p3

⁷⁵ Simply, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p3

⁷⁶ EnergyAustralia, Submission to the DMO Electricity Code: Public consultation paper, 13 Mar 2019, p7

⁷⁷ AEC, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p5

⁷⁸ Alinta, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p10

⁷⁹ AEC, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p2-3

⁸⁰ AGL, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019

Retailers also argued that implementation of the DMO and reference price through an industry code, rather than through the NERL, was an untested method that created significant risks to the market. Origin argued that the intent of an industry code was “not to introduce price regulation but to address conduct issues prevalent in an industry” and that the National Electricity Law and the NERL already provided a clearly defined process for implementing new regulations.⁸¹ The AEC argued that “rushing to implement such an impactful economic reform on the electricity retail sector by way of an unsuitable mechanism can only result in negative outcomes and confusion for energy consumers.”⁸²

The AEC argued that the code should be reviewed regularly if introduced. “As part of this review, the AEC strongly considers that a number of key performance indicators should be developed prior to any implementation”.⁸³ These include: the average prices paid by small consumers on the DMO and market offers, the median market offer at EOFY, participation, churn and engagement rates in the market, and the spread of offers in the market.

⁸¹ Origin, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p1-2

⁸² AEC, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p2

⁸³ AEC, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p7

PART 6. RECOMMENDED OPTION

The preferred option is to introduce a DMO and reference price by a Mandatory Industry Code under the *Competition and Consumer Act (2010)*.

This option implements both the DMO and the reference price under Commonwealth Government law. The combination of both the DMO and reference price are necessary to meet both objectives of the reform; to limit retailers from raising their standing offers to take advantage of disengaged customers and to increase transparency in the market. On their own, neither option meets both of the objectives.

The DMO will place an effective price cap on electricity retailers' standing offers. Retailers will not be able to price their standing offers above the price cap and, therefore, will be unable to artificially raise standing offer prices to increase revenue from disengaged consumers. In this manner, the DMO will clearly meet the first objective of the reform.

But, while the DMO will improve transparency in the market because retailers are less likely to discount off high prices in excess of the DMO, confusion for customers around the 'discount off what?' problem will remain. A reference bill will address this confusion by ensuring all offers must be compared to the same base rate, which will be set at the same price as the DMO. Customers will clearly be able to identify which are the cheaper or more expensive offers available in the market. For example, under the reference bill an offer providing a 15 per cent discount will be better than an offer providing a 10 per cent discount.

Stakeholders identified a risk that the DMO and reference price are set at levels below the efficient cost of providing electricity. This is against the intent of the policy, which is to provide a safety net for consumers, but still allow retailers to compete. Indicative comparisons between the DMO methodology and one to provide a price based on the efficient cost to run a retail business shows that there remains a reasonable gap – around \$200 were the policies to be enacted in Victoria – that would allow competition to continue to occur.⁸⁴

Implementation of both the DMO and reference price will deliver significant benefits to consumers. On the DMO, the AERs draft determination of the default offer showed that a residential customer on the median standing offer would save between \$115 and \$228 a year if they moved onto the DMO price, depending on which distribution network they were in.⁸⁵ For a small business it showed savings of between \$453 and \$937 per year. It is estimated that 725,000 residential customers are on standing offers in the affected jurisdictions,⁸⁶ and a third of small businesses in New South Wales and Queensland⁸⁷.

The ACCC estimated that the impact of a DMO would result in \$112 million worth of savings to affected customers in New South Wales, South Australia and South East Queensland.⁸⁸ This figure was determined by using estimated savings per standing offer customer of between \$105 and \$140 per annum in the affected jurisdictions.

⁸⁴ Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Draft advice, 8 March

⁸⁵ AER, Draft determination Default Market Offer price, February 2019.

⁸⁶ Departmental analysis based on AER, [Annual Report on Compliance and Performance of the Retail Energy Market 2017-18](#), 2018.

⁸⁷ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p94.

⁸⁸ ACCC, [Restoring electricity affordability & Australia's competitive advantage](#), 2018, p368.

The reference price will improve transparency in the market and allow consumers to clearly identify which offers in the market represent the best deal for them. While it is difficult to quantify this impact, the ACCC estimated that the imposition of a reference bill in New South Wales would result in a transfer of \$47 million from retailers to consumers. This estimate was based on 20 per cent of customers shifting from their existing market offer to better offers available in the market.

In terms of the other options considered in this report, the BSO is likely to deliver greater savings to customers currently on standing offers. In Victoria, the ESCV estimate that the savings for the VDO – a similar mechanism to the BSO - would be around \$200 per customer, although this figure will not necessarily be applicable to other jurisdictions.

But a BSO risks significantly impacting on competition and innovation in the market. As the ESCV analysis shows, setting costs at a level that would enable efficient retailers to continue to operate in the market will be difficult, given the variability in input costs that retailers face.⁸⁹ The result is likely to be a reduction in the number of retailers operating in the market, reducing the availability of low-priced offers and stymieing innovation.

The status quo is likely to see the size of the problem regarding the price of standing offers reduce over time as more customers move onto market offers. However, the problem is unlikely to disappear entirely with those customers remaining on standing offers continuing to pay more for their electricity than they need to. A status quo approach will not improve transparency in the retail electricity market which is key to enhancing competition and delivering improved consumer outcomes.

Undertaking the DMO or the reference price on their own would only partially address the problems identified by the ACCC. While a DMO will prevent retailers from charging standing offer customers unjustifiably high rates, it will not improve transparency and comparability for all offers available in the market. And while a reference price on its own will enhance transparency and competition, there will be nothing to inhibit retailers from inflating prices for disengaged customers on standing offers.

The main barrier to implementation of Options 2 and 3 together is securing the unanimous agreement of state and territory governments to make the changes under the NERL. On 23 October 2018 the Commonwealth Government wrote to the AER to commence work on the DMO and a reference bill. While the stated preference of the Commonwealth Government was to introduce the DMO through the COAG process, this option is not available as this agreement has not been forthcoming.

Where designed properly there should be little to no material difference in regulatory impact for energy businesses between introduction under the NERL or under a mandatory industry code under the *Competition and Consumer Act (2010)*.

Under either the NERL or the Code option energy retailers will need to ensure they meet the requirements around the setting of standing offer rates and use of the reference price in all advertising. Operational differences around the Code and the NERL options are covered in Parts 4 and 7 and include the use of subordinate instruments, the role of the regulator and penalties.

⁸⁹ See Part 4

Regulatory burden of the preferred option

As the introduction of both the DMO and reference price are interlinked, the regulatory burden for these options have been considered together. They will both commence at the same time and there are likely to be significant duplication of costs should the two options be considered separately.

Costs have been calculated for 30 retailers across the affected NEM jurisdictions, based on currently available data from the AER.⁹⁰ Retailers have been split between nine large and 21 medium-sized retailers for costing purposes.

Start-up costs

The majority of compliance costs will be imposed at the start of the regulations. Retailers will be required to undertake a range of tasks to ensure that their systems can cope changes in pricing and advertising and that customers are informed of those changes.

The estimated costs that a business will incur at the start of the regulations include:

- \$2.75 million for updating retailer pricing and contract information for customers
- \$1.73 million to notify customers of changes to their existing offers, including IT costs;
- \$2.90 million in call centre costs for fielding customer inquiries; and
- \$2.07 million in professional advice on complying with the regulations initially.

Averaged out over a ten-year period, these start-up costs equate to \$968,000 per year across the industry.

Ongoing costs

After the start-up period, ongoing compliance with the DMO and reference bill should revert to business as usual. While retailers will be required to set and advertise their market offers according to the rules set out in the code, it is not clear that this will alter retailers' costs from their current levels. Retailers already have to undertake processes to set and market their offers and, once the initial change in systems and processes occur, these costs should not change demonstrably.

However, it is prudent to allow retailers some ongoing costs with making sure they comply with the new regulations over the lifetime of those regulations. Ongoing compliance costs are estimated to be \$881,000 per year across the industry. For a large business this would involve employing three members of staff for one week to ensure compliance. For a medium sized business this reduces to one member of staff.

Regulatory burden estimate

It is envisaged that the introduction of the DMO and reference price will only impact on business and will not impose a regulatory burden on community organisations or individuals.

⁹⁰ The AER identified 35 retailers with generally available offers available across NEM jurisdictions as of August 2018. The analysis above excludes the retailers Ergon, Aurora, Tas Gas Retail, Globird and Online Power and gas, who only operate in jurisdictions that are not covered by the DMO. AER, State of the Energy Market 2018.

The estimated average annual regulatory costs are \$1,849,000 (see Table 1).

Table 1 – Regulatory burden estimate (RBE) table

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in costs
Total, by sector	\$1,849,000	\$ -	\$ -	\$1,849,000

The regulatory burden for the other two options in this regulatory impact statement are:

Option 1: Maintain the status quo – there will be no additional regulatory burden associated with implementing this option as there is no change from the business as usual.

Option 4: Basic Service Offer – the regulatory burden of the BSO will be the same as implementing the DMO and reference price. The main difference between the BSO and the DMO is the rate at which the BSO is set, rather than increasing / decreasing the burden of complying with that rate.

PART 7. IMPLEMENTATION AND EVALUATION

On 20 August 2018 the Commonwealth Government announced that it would implement the DMO as recommended by the ACCC. The Commonwealth Government stated that:

“A default offer will protect consumers from being exploited, while still allowing for the benefits of retail competition. This measure will prevent retailers from exploiting consumers and small business with inflated standing offers.”⁹¹

The Commonwealth Government also announced that it would adopt the ACCC recommendation 32:

“...requiring retailers to use the new default rate as a reference point for all advertised discounts. This will give customers more clarity when they compare retailers and offers and help ensure they get the best deal.”⁹²

Since then the Commonwealth Government has asked the AER to commence work on the implementation on developing the process for setting a DMO price by 1 July 2019.

In the interim the Commonwealth Government has been working with state and territory governments to bring effect to the DMO. The Commonwealth Government committed to introducing the DMO following on from the ACCC Inquiry, but state and territory governments have not been forthcoming in their agreement to introduce the DMO. As changes to the NERL to introduce the DMO require full agreement of all participating states and territory governments, and this agreement has to date not been forthcoming, the Commonwealth Government has decided to introduce the DMO by Commonwealth law.

Considering the reference bill recommendation is inextricably linked to the DMO, as the mechanism for setting the DMO price and the reference bill rate is the same, the Commonwealth Government has decided to also introduce the reference bill policy under Commonwealth law to reduce the risk of market confusion.

Phase two – Remake regulations in 2019 for 2020 determination

The Commonwealth Government has decided to implement these policies from 1 July 2020 in price-deregulated regions (South Australia, New South Wales and South East Queensland) through a mandatory industry code (the Code) under the Commonwealth Government *Competition and Consumer Act 2010*.

The Code will initially cap prices for standing offers which are based on flat rate’ or ‘controlled load’ tariff structures. These tariffs are the most common types of standing offer tariffs in the market, meaning the vast majority of customers on standing offers in these price deregulated regions will receive the benefits of the DMO.

The Code will also introduce reference price requirements, which will apply to flat rate, controlled load and flexible tariff offers. As for the DMO, this scope ensures that the transparency provided by the reference price will apply to the most common types of offers in the market.

⁹¹ Commonwealth Government, [Driving power prices down](#), media release, 20 August 2018

⁹² Commonwealth Government, [Driving power prices down](#), media release, 20 August 2018

However, the Commonwealth Government is keen to ensure that the maximum number of customers in price-deregulated regions are able to benefit from the introduction of the DMO and reference price. For this reason, the Commonwealth Government intends to review and remake the Code, effective from 1 July 2020 to:

- extend the DMO requirements to customers with installed solar photovoltaic units and to 'flexible' (time of use) tariff structures; and
- extend the reference price to solar customers.

The Commonwealth Government intends to adopt a staged approach to extend the scope of the Code to solar and flexible tariff customers.

- The first version of the Code, effective from 1 July 2019, will include transitional provisions enabling the Minister to apply the price cap to solar customers on standing offers for the electricity they purchase from a retailer at some future stage.
- From August / September 2019 the Commonwealth Government intends to ask the AER to commence consultation on the methodology for determining a solar-specific reference price and a flexible tariff DMO. Based on this consultation, it is proposed to remake the Code accordingly to give effect to a flexible tariff price determination and the development of a meaningful reference price for solar and solar feed-in-tariffs.
 - The Government intends these amendments to be drafted in time for a 1 July 2020 commencement.
 - A flexible tariff pricing determination is likely to require the AER be empowered to gather data from retailers. Therefore, this element may be contingent on the passage of the proposed amendments to the *Competition and Consumer Act (2010)* to provide the AER with information gathering powers, as outlined in Part 5.

Review and evaluation

The Commonwealth Government released the draft Code for two weeks public consultation on 23 February 2019. There were 16 submissions; the majority were from retailers and only four submissions were from consumer groups. As noted in Part 5, issues raised through this process were generally consistent with previous consultation on the DMO.

A number of definitional and interpretation issues raised by stakeholders to clarify and tighten the Code will be addressed in the final Code. This includes introducing a definition of 'price' to make it clear it does not capture one-off charges not related to the supply of electricity such as credit card, disconnection / reconnection and direct debit dishonour fees. The concept of what constitutes a 'conditional discount' will also be clarified to ensure it only captures those discounts that are reliant on the customers meeting payment terms and not things like sign up bonuses.

The draft reference pricing provisions will also be amended to provide that, in circumstances where a retailer provides a quoted bill for a customer based on that customer's usage over a preceding period in that distribution region, the retailer does not also have to provide the default bill amount (which is based on a representative customer). This will limit the potential for customer confusion created by two varying bill amounts, while still ensuring that the customer is provided with core information, including the comparative value of that electricity offer to the reference bill, expressed as a percent.

A number of discrete issues where the Code can be amended to reflect issues identified by retailers have also been identified and described below.

Requiring the AER to have regard to stakeholder consultation

Several retailers raised concerns that the Code did not set out a mandated consultation process for the AER in making determinations. Origin proposed that the code define a period available to comment on the draft report, to require that “the AER must provide stakeholders with at least 20 days to lodge a submission in response to a draft determination”⁹³. AGL also considered that the AER, in making its determination, should be required to “provide stakeholders with stakeholders with adequate notice as to what [additional factors they are considering in making their determination]...and consult on them”⁹⁴.

The draft code provided a minimum six week period between release of its draft determination and final determination which already enables the AER a mandated time period in which it could conduct consultation.

But to explicitly address retailer concerns, the final Code will require the AER to have regard to stakeholder views and consultation as one of the factors in making a price determination. This embeds consultation into the decision-making process, while providing the AER with flexibility around their specific consultation processes. This step should also go some way to ameliorating retailer concerns around how the AER will determine the DMO by more firmly be embedded in the decision making process.

Establishing a review date for the Code

Retailers including Origin and Alinta, and the AEC expressed concern that the Code did not include an in-built review mechanism, with the AEC writing “the lack of any review mechanism is particularly unsatisfactory given the circumstances surrounding the development of the Electricity Code. ...We would therefore like to see a public outline of the review process as soon as possible to give all affected stakeholders greater clarity”⁹⁵.

The Explanatory Memorandum accompanying the final code will commit to a post-implementation review in two years. Funding has already been sought and obtained through the Mid-Year Economic and Fiscal Outlook for such a review.

The terms of reference for such a review are yet to be determined, but the review will consider the extent to which the DMO and reference price meet the objectives of the reform: to limit the price of standing offers and improve transparency in the market around the advertisement of offers. As such, the review will need to consider the extent to which consumers are becoming more engaged in the market as a result of the reforms.

In addition, the staged approach to expanding the Code to include solar customers and a DMO cap for flexible tariff customers (outlined above) will provide further opportunities for retailers to raise any issues that they consider should be addressed following the Code’s first year of operation.

⁹³ Origin, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p6

⁹⁴ AGL, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p17

⁹⁵ AEC, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p4

Increasing the time window between a final determination and commencement

Several retailers raised concerns that the six week time window between release of the AER's final determination (by 15 May each year) and its commencement (1 July each year) was insufficient to adjust their offers. AGL considered 10 weeks would provide sufficient time for compliance⁹⁶. EnergyAustralia and Alinta proposed an eight week period, with Alinta noting "the level of complexity will increase as AER-determined pricing for flexible tariffs and solar are introduced"⁹⁷ and EnergyAustralia considering any less time will require a rushed response, and any more time will ensure the "actual cost data is less representative of that point in time"⁹⁸.

In response to these submissions, it is proposed the AER must release its final determination by 1 May each year, which provides retailers with the eight weeks recommended. This is also in accordance with the AER's determination process for this year, which should see a final determination delivered on 30 April 2019 as requested by you and the Treasurer.

Other issues raised by submissions not adopted in the Code

In addition to the issues covered above, retailers also raised other changes they wanted final Code to incorporate. However, the Government has not adopted these proposals on the basis that they are not required or would be at odds with the policy intent. Below is a short response each of them.

Defining advertising and limiting applicable advertising modes that are required to apply the reference price

A number of retailers including AGL⁹⁹ asked for a definition of advertising that would have to comply with the Code.

The *Competition and Consumer Act (2010)* does not define advertising for the purpose of the Australian Consumer Law, noting it is a known term that changes over time. Advertising in retail energy services can appear in both expected channels but noting that retailers can use other channels like customer bills and dynamic online platforms we would be reluctant to provide a limiting definition.

Retailers will still have flexibility in advertising approaches and can also seek to attract consumers with non-price related marketing to which are not regulated by the Code – for instance "see AGL for great low rates". Such claims (while not regulated by the Code) would still be subject to the Australian Consumer Law under the *Competition and Consumer Act (2010)*.

Setting the criteria for the price determinations to reflect all retailer costs including profits

One retailer suggested the Code use the cost of an average market offer in each regulated distribution area as its baseline for determining the DMO, to which the AER would allow a margin in setting the final DMO price. It considered that this would address its concerns that the requirement for the AER to have regard to the principle that retailers should be able to

⁹⁶ AGL, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p18

⁹⁷ Alinta, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p12

⁹⁸ EnergyAustralia, Submission to the DMO Electricity Code: Public consultation paper, 13 Mar 2019, p13

⁹⁹ AGL, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p10

make a 'reasonable profit' in setting the DMO, is "too nebulous". The approach proposed is somewhat comparable to that currently adopted by the Queensland Competition Authority.

Ultimately the specific methodology for setting the DMO is at the discretion of the AER. The Code has been deliberately crafted to not mandate a strict methodology for the AER's price determination process.

Rather it takes more principle-based approach which provides the AER with the flexibility to change its processes over time to accommodate new and emerging factors in the electricity market and possibly expanded information-gathering powers. As such, the Code already enables the AER to take this approach, provided it has regard to the required factors such as cost components, stakeholder consultation and prices in the market.

Other retailers raised concerns regarding future AER determinations given the criteria they needed to take into account in determining the DMO were not weighted and it was not clear what regard AER has for different retailer margins and costs to maintain a healthy market.^{100,101}

AGL also suggested the DMO should be based on costs of a 'benchmark retailer'¹⁰² noting the different costs are incurred by different retailers. In setting a benchmark rate at a level closer to the median cost of retailers and not the retail cost of the most efficient retailers (the 'big three') it would likely result in the DMO being set higher than if it was set at the most efficient level.

As noted, the final Code will require the AER to have regard to the outcomes of stakeholder consultations in setting the annual DMO price. This will ensure retailers have the opportunity for input regarding future DMO determinations.

Banning conditional discounts all together or tightly defining how the conditional discounts are represented in the Code

Some retailers raised concerns around the design of the conditional discounts provisions associated with advertising. Alinta¹⁰³ wanted it to be clear in advertising whether a discount is conditional or not, and Origin stated that consumers value different products and conditional discounts reflect can reflect 'low cost products'¹⁰⁴. The AEC also argued the proposed requirement for the unconditional discount being the prominent discount in advertisements would effectively ban conditional discounts.¹⁰⁵

Conversely AGL suggested banning conditions rather than creating requirements for retailers to comply with when advertising conditional discounts in order to avoid the added complexity.¹⁰⁶

On balance, the current provision best meets the ACCC recommendation around appropriate advertising. The drafting of the requirements regarding advertising conditional discounting is constrained by the nature of the legislative instrument in that it cannot provide for guidelines or

¹⁰⁰ Momentum, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p3

¹⁰¹ Alinta, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p11

¹⁰² AGL, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p17

¹⁰³ Alinta, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p10

¹⁰⁴ Origin, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p5

¹⁰⁵ AEC, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p10

¹⁰⁶ AGL, Submission to the DMO Electricity Code: Public consultation paper, 12 Mar 2019, p14

options for representation, but rather only requirements. The draft provision is intended to avoid the risk of over-regulating the arrangements.

Allowing the AEMC to review the Code

The ability of the AEMC to undertake a review of the code would be hampered by the fact that it does not have the information-gathering powers necessary for effective scrutiny of retailer costs and behaviour. In addition, the AEMC, as an authority created under state law, does not have standing to review the Code.