

5 December 2022

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Dear Mr Fox,

RE: Consultation on AER Issues Paper: Default Market Offer Prices 2023-24

The South Australian Council of Social Service (SACOSS) is the peak body for non-government health and community services in South Australia with a mission to advocate for the interests of people on low incomes or experiencing disadvantaged across the state. We thank the Australian Energy Regulator (the AER) for the opportunity to comment on its *Default Market Offer Prices 2023-24 Issues Paper*, dated November 2022 (the Issues Paper).

Following on from the AER's holistic review of its approach to setting the Default Market Offer for 2022-23, the Issues Paper is seeking feedback on a defined set of issues for the 2023-24 Default Market Offer (DMO 5), including:¹

- *wholesale methodology*
- *how best to extend DMO price protections to all customers in embedded networks in DMO regions*
- *whether the DMO allowance 'glidepath' remains appropriate in the context of high prices*

SACOSS will provide specific feedback in relation to the questions posed within the Issues Paper, but we also make some broader observations on the policy objectives and frameworks underpinning the DMO and the Victorian Default Offer (VDO), as well as the current energy affordability crisis in South Australia, as these matters were raised by participants in the AER's Public Forum on 24 November 2022.

In summary, SACOSS' submission is calling for the AER to:

- take into consideration issues of fairness and efficiency when performing its function under the DMO Regulations, especially given current market conditions
- ensure the current energy affordability crisis in South Australia forms a 'relevant consideration' in its determination of DMO 5

¹ Australian Energy Regulator, [Default Market Offer Prices 2023-24 Issues Paper](#), 3 November 2022, p. 2

- allocate greater weight to the DMO objective of ‘providing protection to consumers’ when establishing DMO 5
- conduct a ‘vulnerability impact assessment’ of the DMO 5 decision, ensuring the AER ‘give regard to the impact on, or creation of, experiences of vulnerability from regulatory decision making’, in accordance with Action 12 of the *Towards Energy Equity – a Strategy for an inclusive Energy Market*
- obtain the best data it can in order to see what retailers are actually paying for electricity, including through having greater visibility of confidential contract information from market participants in South Australia, as well as options and risk management strategies to add into the book build process
- adopt a longer book build period of historical projections to bring down costs and provide greater stability for South Australian energy consumers
- ensure all retail costs are justified and efficient
- review the retail allowance glide path, with a retail allowance (if included) based on the marginal costs of the retailer and not on the price stack as a whole
- extend DMO pricing protections to embedded network customers, ensuring the design and application of the DMO does not result in those customers being charged twice for network costs
- consider the most recent performance data around usage profiles of the average customer in South Australia, when compared to a South Australian hardship customer, and
- consider the particular circumstances of smart meter standing offer Time of Use consumers in South Australia.

DMO and VDO Policy Objectives and Frameworks

The Default Market Offer

The Issues Paper outlines the purpose of the DMO, as established by the Australian Competition and Consumer Commission (ACCC), is to operate as ‘a fall-back for those who are not engaged in the market and should not be a low-priced alternative to a market offer.’² The stated policy objectives for the DMO are that it should:³

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

These policy objectives are drawn from ACCC publications, and are not explicitly stated as objectives within the legislative framework established for determining DMO prices under

² ACCC, AER Default Market Offer, Submissions to the Draft Determination, 20 March 2019, pp.1-2

³ Australian Energy Regulator, [Default Market Offer Prices 2023-24 Issues Paper](#), 3 November 2022, p. 4

the *Competition and Consumer (Industry Code- Electricity Retail) Regulations 2019* (the Regulations).⁴

The Regulations give the AER statutory responsibility for determining ‘a *reasonable per-customer annual price for supplying electricity*’ in a certain region to small customers.⁵ When setting the DMO, the Regulations require the AER to have regard to certain matters, including (SACOSS’ emphasis):⁶

- the prices electricity retailers charge for supplying electricity in the region to that type of small customer
- the principle that an electricity retailer should be able to make a reasonable profit in relation to supplying electricity in the region
- the following costs:
 - the wholesale cost of electricity in the region
 - the cost of distributing and transmitting electricity in the region
 - the cost of complying with the laws of the Commonwealth and the relevant State or Territory in relation to supplying electricity in the region
 - if relevant to the region—the cost of acquiring and retaining small customers
 - the cost of serving small customers
- **any other matter the AER considers relevant**

The Issues Paper specifically acknowledges the AER’s primary objective in its Strategic Plan for 2020-25 is ‘to protect consumers experiencing vulnerability, while enabling consumers to participate in energy markets’. The AER is also guided by the *National Electricity Objective*⁷ (NEO), in all its functions under national energy legislation. SACOSS submits the AER is not precluded from considerations of fairness or efficiency in performing its function under the DMO Regulations, and the current energy affordability crisis should form a ‘relevant consideration’ in the AER’s determination of DMO 5. We believe the AER’s overarching goal should be to ensure DMO 5 meaningfully operates as a default protection for *all* consumers who are not engaged in the market. In order to protect consumers and to promote their interests, the DMO must be an efficient and fair price all consumers can

⁴ [Competition and Consumer \(Industry Code- Electricity Retail\) Regulations 2019](#) The overarching objective of the [Competition and Consumer Act 2010](#) is to ‘enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection’.

⁵ In accordance with the per customer amount of electricity supplied, and the timing or pattern of supply, see Regulation 16(1)(a) and 16(1)(b) of the [Competition and Consumer \(Industry Code- Electricity Retail\) Regulations 2019](#)

⁶ Regulation 16(4) of the [Competition and Consumer \(Industry Code- Electricity Retail\) Regulations 2019](#)

⁷ Section 7 of the [National Electricity \(South Australia\) Act 1996](#) : “to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- price, quality, safety and reliability and security of supply of electricity
- the reliability, safety and security of the national electricity system”

default to when no other choice is made, or can be made. This is particularly important in the context of the current energy affordability crisis and volatile market conditions.

As SACOSS has previously submitted to the AER⁸, electricity is essential to life and it is vital that all consumers, particularly people on low-incomes or experiencing disadvantage, are able to access a fair and efficient price for this essential service.

The Victorian Default Offer

The May 2019 Pricing Order⁹ issued under the *Electricity Industry Act 2000* gave the Essential Services Commission of Victoria (ESC Victoria) the role of setting prices for standing offers (the VDO). In setting the VDO, the ESC Victoria is required to:¹⁰

‘adopt an approach and methodology that best meets the objectives specified in the Essential Services Commission Act 2011 (Vic) (ESC Act) Act, the commission’s objectives under the Electricity Industry Act 2000 (Vic) and the objective of the Victorian Default Offer’.

The three objectives required to be met by ESC Vic in setting the VDO, are summarised as follows:

- to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market (VDO Objective, Clause 3 of the Pricing Order)
- to promote the long-term interests of Victorian consumers, having regard to the price, quality and reliability of essential services (ESC Act, aligns with the NEO)
- adopt an approach which promotes protections for customers, the development of full retail competition and a consistent regulatory approach between the electricity and gas industries (Electricity Industry Act).

In contrast to the VDO, the DMO Regulations do not contain any clear stated objectives for the DMO framework. The ACCC has observed the differences between the VDO and the DMO stem largely from the different policy objectives driving the reforms:¹¹

‘the stated purpose of the VDO is to provide customers with universal access to a ‘fair’ price. In comparison, the DMO is described as a ‘fall-back position’ and is intended to act as a cap for the price of default offers and to limit the ‘loyalty tax’ that is levied on disengaged customers. The key policy objective of the DMO price is to mitigate the impact of unjustifiably high prices for standing offer customers while allowing scope for continued competition in market offers’.

⁸ SACOSS, [Submission to the Australian Energy Regulator on the Default Market Offer Options Paper Methodology to be adopted for the 2022-23 Determination](#), 23 November 2022

⁹ Order in Council made under section 13 of the Electricity Industry Act 2000 and published in the Victorian Government Gazette No. S 208 on Thursday 30 May 2019

¹⁰ Essential Services Commission, [Victorian Default Offer 2022-23](#), Appendix A, p.41

¹¹ ACCC, Submission to the [Essential Services Commission Victorian Default Offer Advice](#), 4 April 2019.

In its submission opposing the objectives of the DMO, the ACCC considered that ‘effective competition between retailers is the best vehicle for tackling inefficiencies in the supply of electricity to drive prices down further’. The ACCC expressed concerns about the VDO having negative impacts on competition and the long-term interests of consumers, specifically by:¹²

- customers disengaging and failing to ‘shop around’ (reduced customer switching rates)
- creating a smaller pool of engaged customers, resulting in less effective retail competition and customers being worse off
- impacting non-price competition and innovation, to the long-term detriment of consumers.

Three years on, there is no evidence the policy objectives underpinning the VDO have resulted in the ACCC’s predicted negative outcomes for Victorian energy consumers. In fact, the VDO has arguably resulted in better outcomes for Victorian energy consumers than the DMO has for consumers in DMO jurisdictions. Analysis undertaken by St Vincent de Paul and Alviss Consulting as part of its Tariff Tracking project¹³ found that both market offer prices and standing offer prices had reduced in Victoria, whereas **market offers had increased in all DMO jurisdictions**. The graph below shows:¹⁴

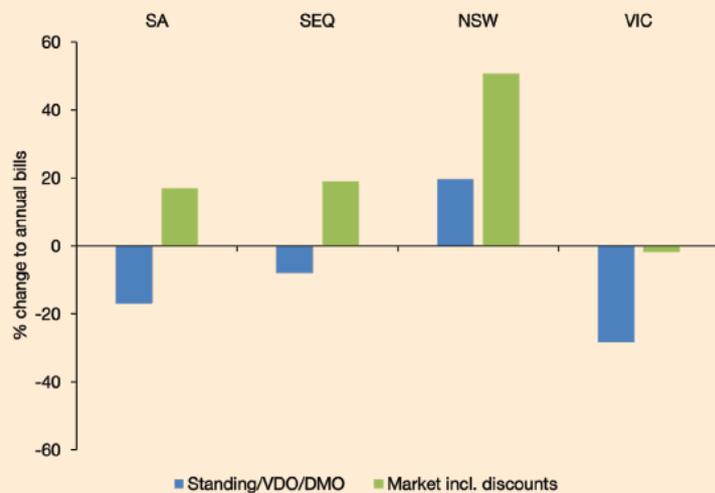
‘standing offers, on average, have decreased by 17% in South Australia, 8% in South East Queensland and 28% in Victoria after the DMO/VDO took effect in July 2019. In NSW, on the other hand, the average standing offer has increased by 20%. The average market offer bill, however, has in some cases increased significantly. In NSW, where the increase is the greatest, the average market offer bill has increased by 51% over this period. In South East Queensland the increase is 19% and in South Australia it is 17%. In Victoria, on the other hand, the average market offer bill inclusive of guaranteed and pay on time discounts has decreased by 2% (compared to 28% for standing offers).’

¹² See ACCC, Submission to the [Essential Services Commission Victorian Default Offer Advice](#), 4 April 2019, p.2

¹³ St Vincent de Paul and Alviss Consulting, [The NEM – Volatile prices, vanishing retailers and vulnerable consumers](#), October 2022

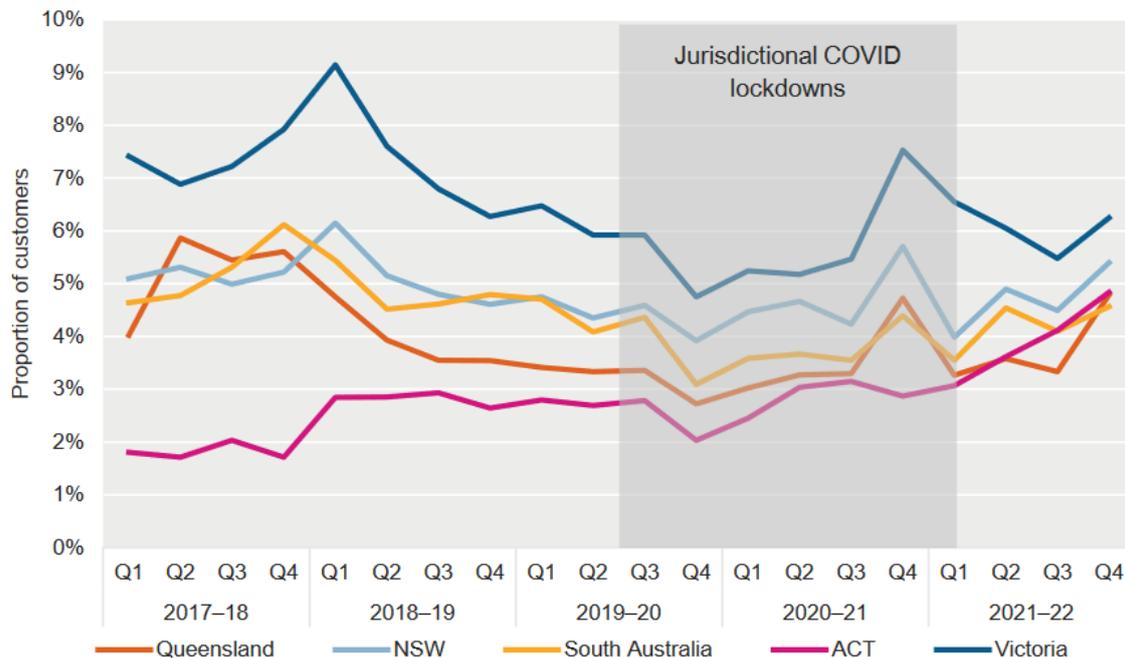
¹⁴ St Vincent de Paul and Alviss Consulting, [The NEM – Volatile prices, vanishing retailers and vulnerable consumers](#), October 2022, p.19

CHART 11 | Percentage change to average standing offer/DMO/VDO bills and market offer bills (guaranteed and conditional pay on time discounts) post July 2022 compared to bills prior to new regulation taking effect in July 2019. Bill calculations based on 6,000kWh per annum, single rate, GST incl



In addition, the ACCC’s concerns about the VDO negatively impacting switching rates to the detriment of consumers, have not eventuated. AER data shows Victoria still has the highest electricity switching rates between retailers in NEM jurisdictions:¹⁵

Figure 1.19 Electricity switching rate between retailers



Note: Data as at 30 June each year.
Source: AER.

SACOSS considers the concept of fairness is not explicitly precluded from the AER’s considerations under the Regulations in setting DMO 5, and the ACCC’s concerns around the impact of a ‘fair price’ on competition have not been borne out. The AER has scope to

¹⁵ Australian Energy Regulator, [Annual Retail Markets Report 2021-22](#), November 2022, p. 25

consider ‘any other matter it considers relevant when setting the DMO’ and SACOSS believes it should take into consideration issues of efficiency and fairness, especially given current market conditions. A fair and efficient DMO is in the long-term interests of South Australian energy consumers, particularly consumers experiencing vulnerabilities.¹⁶

Current energy affordability crisis in South Australia

South Australia is currently facing an energy affordability crisis, and the outlook for 2023-24 does not hold much promise of relief for struggling South Australian energy consumers. The AER’s *Annual Retail Markets Performance Report 2021-22*, provides a picture of the experience of South Australian energy consumers to 30 June 2022, but we know that prices have continued to rise in the last five months to December 2022.

The AER’s Report shows that, as at 30 June 2022:¹⁷

- South Australia had the highest electricity price per unit in the National Electricity Market (NEM), with wholesale costs typically higher in South Australia, and network costs above the NEM average.
- the median market offer in SA was the same as the standing offer (DMO) of around 45 cents per kWh, the highest in the Nation. In 2020-21, the median market offer in SA was around 36 cents per kWh, where the standing offer was around 42 cents per kWh.¹⁸ This represents a 25% increase in the median market offer in SA over the 12 months to 30 June 2022.
- In terms of affordability (calculated on the basis of the AER’s Pricing and Affordability methodology), SA has the second most unaffordable energy behind Tasmania, this is despite SA having amongst the lowest average household electricity usage in the Nation (4,526 kWh), compared to Tasmania, which has a much higher average annual electricity usage of 8,393 kWh.
- Electricity in SA in 2021-22 was more unaffordable than last year, with low income consumers spending 5% of their disposable income on electricity, compared to around 2% for average income consumers.
- Importantly, it is estimated that hardship households in SA use 73% more energy than the average SA households (7,830 kWh average annual hardship household usage, compared to 4,526 kWh for average households). Which means energy is more unaffordable for hardship households in SA, at **around 8% of disposable income**.¹⁹
- Energy debt levels are worsening across all indicators, clearly demonstrating an energy affordability crisis in South Australia:
 - South Australia has the largest average residential energy debt in the NEM. The average debt of residential customers in SA is now \$1,321, \$320 above the National average of \$997. This represents an increase of \$277 in the average amount of residential energy debt in SA from 2018/19 (pre-pandemic) levels.

¹⁶ It is worth noting that both legislative frameworks reference a ‘reasonable’ price.

¹⁷ Australian Energy Regulator, [Annual Retail Markets Report 2021-22](#), November 2022, p.31-45

¹⁸ Australian Energy Regulator, [Annual retail markets report 2020-21](#), November 2021, p. 33

¹⁹ Australian Energy Regulator, [Annual Retail Markets Report 2021-22](#), November 2022, p. 129

- Average debt on entry into hardship programs in SA in 2012-22 was \$2,185 (highest after Tasmania), which is \$553 more than pre-pandemic levels of \$1,632 in 2018-19, and \$493 above the national average of \$1,692.
- Average debt of hardship customers has also increased significantly from pre-pandemic levels - in 2021-22 the average debt of a SA hardship customer was \$2,424 (highest after Tasmania), up \$561 from \$1,863 in 2018-19, and \$651 above the national average of \$1773.

Energy debt in South Australia is increasing because people can no longer afford to pay for their ongoing energy usage, and with projected increases in energy costs of around 50% over the next couple of years, governments and Market bodies must ensure their decision-making has energy affordability as a primary consideration.²⁰

In these circumstances, SACOSS is calling on the AER to allocate greater weight to the DMO objective of ‘providing protection to consumers’ when establishing the DMO for 2023-24. We consider efficiency, energy affordability and the need to protect consumers should be overriding considerations for the AER. This approach would align with the NEO and the AER’s consumer vulnerability strategy ‘*Towards Energy Equity – a Strategy for an inclusive Energy Market*’.²¹ In addition, we support the AER conducting a ‘vulnerability impact assessment’ of the DMO 5 decision, ensuring the AER ‘give regard to the impact on, or creation of, experiences of vulnerability from regulatory decision making’, in accordance with Action 12 of the Strategy.²²

Wholesale methodology

Over the last few years, spot market electricity costs in South Australia have fallen to amongst the lowest in the National Electricity Market (NEM). However, South Australian electricity consumers continue to pay the highest price per unit of electricity in the nation.

The South Australian Productivity Commission’s *Inquiry into South Australia’s Renewable Energy competitiveness* found that:²³

The illiquid and highly concentrated market for ‘on-demand’ electricity in South Australia means that it is expensive to hedge spot market prices, creating a much larger wedge between the (generally low) spot market prices and the wholesale price passed through to electricity consumers. For example, in 2020-21 demand-weighted spot prices averaged \$55.4/MWh in South Australia, 24 per cent cheaper than the average spot price in New South Wales. However, the wholesale price passed through to South Australian consumers averaged more than twice this at

²⁰ Secretary to the Treasury Speech, 8 November 2022 <https://treasury.gov.au/speech/opening-statement-economics-legislation-committee-4>

²¹ Australian Energy Regulator, [Towards Energy Equity – a strategy for an inclusive energy market](#), 20 October 2022

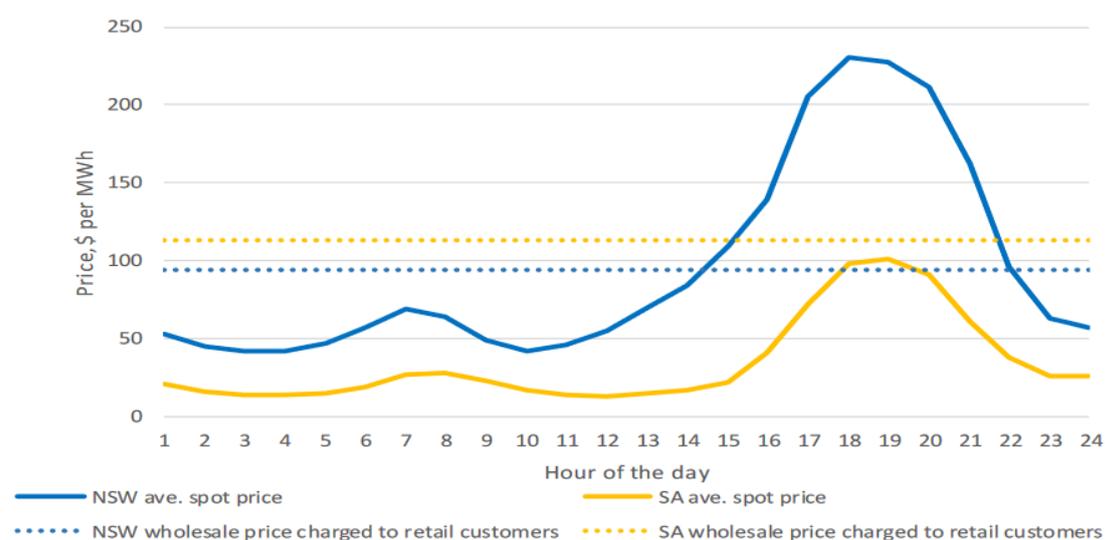
²² Australian Energy Regulator, [Towards Energy Equity – a strategy for an inclusive energy market](#), 20 October 2022, p.34

²³ South Australian Productivity Commission, [Inquiry into South Australia’s renewable energy competitiveness: Final Report](#), 10 August 2022 (published 9 November 2022), p. 7

\$113.1/MWh and was significantly higher than the wholesale price in New South Wales (\$94.1/MWh).

The difference in wholesale spot prices paid by retailers in South Australia, and the wholesale prices passed through to South Australian consumers is clearly illustrated in the graph, below:²⁴

Figure 2.4: Average spot electricity prices by hour of the day and wholesale price charged to consumer – SA and NSW (2020-21)



Source: AEMC Residential Electricity Price Trends Report (2021)

Against this background, the Issues Paper is seeking specific feedback in relation to the following questions on setting the wholesale component of DMO 5.

Do you support the inclusion of confidential contract information into the book build process? How could we make this process as robust, reliable and transparent as possible?

The liquidity issues in South Australia are not a justifiable reason to accept a higher price being paid by retailers. The AER must obtain the best data it can in order to see what retailers are actually paying.

The whole purpose of the DMO is to protect consumers from ‘unjustifiably’ high prices. It follows that retailers must justify the wholesale prices they are charging South Australian consumers, through increased visibility of wholesale market practices. We currently do not know if there is price manipulation and it is essential the Regulator is aware of how much speculation, including non-energy market participant activity, is in the market. The limited ASX data will not provide an accurate picture of retailer’s risk positions or costs in South Australia, and would therefore, in our view, mean those costs are unjustified.

Speaking broadly, SACOSS overwhelmingly supports greater transparency around the energy wholesale market practices of retailers and other participants. The current wholesale

²⁴ South Australian Productivity Commission, [Inquiry into South Australia’s renewable energy competitiveness: Final Report](#), 10 August 2022 (published 9 November 2022), p. 46

electricity trading practices of retailers and vertically integrated retailers through the use of futures and OTC trades remains completely opaque. We strongly support the AER having greater visibility of these transactions by obtaining confidential contract information from market participants in South Australia, as well as options and risk management strategies to add into the book build process. SACOSS considers all this information should be before the Regulator, and we accept commercial confidentiality issues may result in less transparency from a consumer's perspective. On balance, SACOSS considers it is more important for the Regulator to have visibility of confidential contract information in setting the DMO, than for consumers to have complete transparency of these matters.

Do you support the inclusion of additional contracting products in the modelling process, such as options?

It is essential the AER access all the information it possibly can in order to set the wholesale component of the DMO in South Australia, including contract terms and conditions, as well as the internal hedging products of vertically integrated retailers, and information on other risk management practices including options products. Visibility of the forward contract market will provide a better picture of what retailers are actually paying over a longer period. SACOSS strongly supports this approach, even if this means the additional information is only accessible to the AER, and there is less transparency at a consumer level. The benefits to consumers should be seen in a better reflection of a justifiable wholesale component in the DMO.

Do you support the current book build process used in the wholesale methodology component?

SACOSS understands the current book build period occurs over a 2 to 3 year period. Given recent market volatility and abnormally high prices, we are urging the AER to consider adopting a much longer period of historical projections to bring down costs and provide greater stability for South Australian energy consumers.

SACOSS strongly opposes submissions from some stakeholders suggesting the book build process should weight contract trades and prices closer to the relevant DMO period. This would result in an abnormally high DMO reflecting the recent unprecedented fluctuations in the energy market.

Retail costs and allowances

SACOSS remains concerned about the opacity of retail costs and wholesale costs within the price stack. In the current market, we urge the AER to ensure all retail costs are justified and efficient.

We strongly support the AER reviewing the 'retail allowance' part of the cost stack. Given burgeoning electricity prices and the disproportionate impact on consumers experiencing vulnerability or disadvantage, SACOSS strongly opposes retailers in South Australia being allocated a retail allowance glidepath of 8% of the final DMO 5 price. As noted in the Issues Paper 'this means that increases in input costs such as wholesale costs and network costs result in a larger retail allowance in absolute terms' placing an even greater price burden on consumers.

SACOSS considers a retail allowance (if included) should be based on the marginal costs of the retailer and not on the price stack as a whole. In terms of this proving to be a disincentive to switching, the evidence outlined earlier in this submission clearly shows a lower, more efficient VDO did not result in consumers disengaging from the market as was predicted by the ACCC, we therefore do not consider this a valid reason to include retail allowances as a percentage of the final DMO.

Embedded Networks

SACOSS strongly supports DMO pricing protections being extended to embedded network customers, as is the case in Victoria.

As outlined in the Issues Paper, the design and application of the DMO for embedded network customers should ensure those customers are not charged twice for network costs.

Annual usage

In setting the per customer amount of electricity supplied, and the timing or pattern of supply for DMO 5, SACOSS submits the AER should consider the most recent performance data around usage profiles of the average customer in South Australia, when compared to a South Australian hardship customer. The Report shows that hardship households in SA use 73% more energy than the average SA households (7,830 kWh average annual hardship household usage, compared to 4,526 kWh for average households). Which means energy is more unaffordable for hardship households in SA, at around 8% of disposable income.

Whilst we accept hardship customers may be less able to reduce their usage due to inadequate housing, inability to access solar or efficient appliances, we also consider the low average usage levels in South Australia may be as a result of the high penetration of rooftop solar in this state, and might not be reflective of the usage levels of consumers who may be less engaged, unable to afford solar, and on a standing offer.

We also remain concerned about smart meter customers on standing offers in South Australia being automatically shifted to a ToU retail tariff²⁵ with no ability to opt out, or change usage patterns, and we repeat our submission made in our previous submission to the AER on DMO 4 regarding Time of Use tariffs in South Australia.²⁶

The energy affordability context in South Australia, summarised earlier in this submission, highlights the importance of setting a fair and efficient DMO, not just for standing offer customers, but for *all* customers where the DMO is used as a reference price. We are urging the AER to go back to first principles and acknowledge energy as an essential service, with DMO 5 reflecting the fundamental right of all customers to be able to access energy on fair and just terms.

²⁵ The percentage of customers in SA on a time of use or flexible retail tariff, with an underlying distributor based time of use or flexible network tariff, has increased from 15.8% 12 months ago, to 68% in Q4 2021-22, See [AER Retail Performance Data Q4 2021-22](#)

²⁶ SACOSS, [Submission to the Australian Energy Regulator on the Default Market Offer Options Paper Methodology to be adopted for the 2022-23 Determination](#), 23 November 2022, pp. 3-8

If you have any questions in relation to this submission, please contact Georgina Morris at georgina@sacoss.org.au or 8305 4214.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'R Toohar', is positioned above the typed name.

Dr Rebecca Toohar
Director of Policy and Advocacy
South Australian Council of Social Service