

7 December 2018

Mark Feather
General Manager, Policy and Performance
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email: DMO@aer.gov.au

Dear Mr Feather,

Re: Australian Energy Regulator (AER) Position Paper – Default Market Offer Price

Thank you for the opportunity to respond to the AER's *Position Paper – Default Market Offer Price (Position Paper)*. The Energy and Water Ombudsman of Victoria (EWOV) is mindful that the Default Market Offer (DMO) price is being developed at the same time as the Victorian government has committed to developing a Victorian Default Offer (VDO)¹, and this inevitably creates some uncertainty as to whether the DMO will apply in Victoria. EWOV provides comment on the basis that the policy intents of the DMO and VDO are reasonably similar, and the experiences of the customers we assist in Victoria are relevant and can inform both consultation processes.

The Australian Competition and Consumer Commission (ACCC) report *Restoring electricity affordability and Australia's competitive advantage (ACCC Report)* found that:

[Retail energy] incumbents have benefited from large parts of their customer bases being inactive or disengaged from the competitive market, often remaining on high-priced standing offers. Incumbents are able to make very attractive offers to retain customers, effectively through cross-subsidies paid by their inactive customer cohort. This has enabled incumbents to compete only selectively, and with a disproportionate focus on efforts to retain profitable customers rather than to win new ones.²

While EWOV is unable to identify what proportion of electricity complaints received by us relate to standing offers, we can report that in 2017-18, 11,747 customers (one in three) contacted EWOV worried about being able to pay for energy or water.

High bills overtook energy disconnection/water restriction as the number one category for complaints, in a year which saw an 8% increase in complaints overall - including an 11% increase specifically in the electricity sector. Of those electricity sector complaints, 36% related to billing (the next highest category

¹See: <https://www.premier.vic.gov.au/new-victorian-energy-default-offer/>

² ACCC, Retail Electricity Pricing Inquiry – Final Report, June 2018, p. xi

was credit, which includes disconnection complaints, at 23%). This represented a 17% increase in electricity sector high billing complaints.

The average residential arrears in the complaints we investigated in 2017/18 was \$2,698, with 473 residential customers holding arrears of over \$3,000; some as high as \$10,000. A significant number of customers presented with limited capacity to reduce their consumption or increase their capacity to pay. From our conversations with them, we often learnt that they were carrying debts across multiple utilities. In many cases, it was also evident that utility debt was part of a much more complex financial situation they were facing.

Taking these indicators together, high electricity prices are clearly causing financial distress for a growing number of Victorian consumers. Essential Services Commission (ESC) data shows that standing offers are typically the most expensive offers made by retailers (although in some cases, market offers can be more expensive if they are subject to conditional discounts which are not realised).³ EWOV is supportive of policies that aim to deliver affordable energy and reduce the occurrence of complaints. For consumers on standing offers, a reduction in standing offer prices will have a positive material impact which will mitigate financial harm and should lead to a reduction in high billing complaints.

About EWOV

The Energy and Water Ombudsman (Victoria) (EWOV) is an industry-based external dispute resolution scheme that helps Victorian energy or water customers by receiving, investigating and resolving complaints about their company. Under EWOV's Charter, we resolve complaints on a 'fair and reasonable' basis and aim to reduce the occurrence of complaints⁴. We are guided by the principles in the Commonwealth Government's Benchmarks for Industry-based Customer Dispute Resolution⁵. It is in this context that our comments are made.

We have provided a brief response to the Position Paper below, commenting only on those questions which are relevant to our customers and operations.

Question 2: For residential customers, what type of tariff structures should be subject to a DMO price? Should there be different types of tariff structures subject to a DMO price in different distribution zones? Please provide reasons for your preferred approach.

EWOV is unable to provide comprehensive data regarding the tariff structures of the customers who contact us. However, we are conscious that customers face growing complexity in the retail electricity market, and as new entrants introduce increasingly complex pricing structures (such as spot prices), this will make effective comparisons even more difficult. This creates an imperative to balance the policy aims of the DMO so that those consumers who do become overwhelmed and find themselves unable to

³ ESC, Victorian Energy Market Report 2016-17, November 2017, p 35.

⁴ See Clause 5.1 of EWOV's Charter: <https://www.ewov.com.au/files/ewov-charter.pdf>

⁵ See EWOV's website: <https://www.ewov.com.au/about/who-we-are/our-principles>

engage confidently with the market are protected from confusing or excessive pricing. If this is achieved, we are confident that we will see a decline in high billing complaints.

In their 2016-17 Victorian Energy Market Report⁶ the Essential Services Commission (ESC) reported that flat-rate tariffs were by far the most common tariff type among Victorian households, despite accounting for less than 25 per cent of all generally available offers (by contrast, flexible tariffs represented 64 per cent of offers available despite being unpopular with customers).⁷ The prevalence of customers on fixed-rate tariffs concurs with the network pricing data cited in the Position Paper, which also found that controlled-load tariffs were common.

In term of standing offers, the ESC again found that flexible tariffs were the most numerous form of offer – although the vast majority of retailers also offer flat-rate tariff standing offers (the only exceptions were Simply Energy, Momentum, Sumo Power, Diamond Energy and Pacific Hydro). Despite these exceptions, most customers on standing offers are likely to be on flat-rate tariffs.

On that basis the AER's proposal to determine DMO prices for residential customers based on flat-rate usage tariffs and controlled load tariffs appears sensible.

Question 3: For small business customers, what type of tariff structures should be subject to a DMO price? Should there be different types of tariff structures subject to a DMO price in different distribution zones? Please provide reasons for your preferred approach.

EWOV does not typically receive a high proportion of complaints from business customers, and this trend has held in recent times with business customers accounting for only 10% of cases in the 2017-18 year (3,421 cases).⁸ Of those, only 229 were high billing complaints – 190 of which were electricity cases.

That being said, we do know that a considerably higher proportion of Victorian small business customers are on standing offers when compared with residential customers. The 2017 *Independent Review into the Electricity and Gas Retail Markets in Victoria (Independent Review)* found the figure was around 17 per cent⁹, and the ACCC Report also found that the proportion of small businesses on standard offers across the NEM was high. As a result, small business customers have much to gain from the abolition of standing offers and the implementation of DMO prices:

For small business customers, similar savings can be made. However, as a larger proportion of small businesses are on standing offers, the recommendation to abolish the standing offer and

⁶ Please note: The 2017-18 ESC Victorian Energy Market Report is not currently available owing to inaccuracies in data reported by AGL.

⁷ ESC, Victorian Energy Market Report 2016-17, November 2017, p 26.

⁸ EWOV, 2018 Annual Report, October 2018, p. 19.

⁹ Independent Review Panel, Independent Review into the Electricity & Gas Retail Markets in Victoria, August 2017, p. 27.

implement the lower-priced default tariff will have a proportionately greater benefit to small business customers.¹⁰

EWOV is hopeful that given the relatively high proportion of small businesses on standing offers, implementing the DMO will have a positive downward impact on business high billing complaints to our service.

Question 4: What factors should we take into account in determining DMO prices?

The AER will need to determine DMO prices which recognise the differing impact of current standing offer prices in communities across Australia. This variation occurs both within state boundaries, and between states. Within Victoria, EWOV found that the highest rates of high bill cases (per 1000 people, residential customers) came from regional Victoria – specifically Alpine Shire, Murrindindi Shire, Hepburn Shire, Northern Grampians Shire and Bass Coast Shire.¹¹

At the national level, the ACCC Report and the 2017 *Independent Review into the Electricity and Gas Retail Markets in Victoria (Independent Review)* found that Victorian electricity consumers are paying a particularly high retail component in their bills, although the ACCC Report indicated that this amount was comparatively lower than found by the Independent Review (21 per cent as opposed to approximately 30 per cent).¹²

Despite this disparity, the ACCC Report still showed that the retail component is proportionally higher in Victoria than any other jurisdiction in the NEM (New South Wales was next highest, at 18 per cent).¹³

Another major consideration is that the proportion of consumers on standing offers varies considerably across NEM jurisdictions. In Victoria, only around 6 per cent of residential customers are on standing offers, which is considerably less than the 15 per cent of residential customers in New South Wales.¹⁴ This has important implications for the potential risk of a DMO being set too low and dis-incentivising participation in the market by consumers.

Through our outreach work EWOV sees a wide range of consumers including many who cannot engage and find it difficult to navigate the market even when guided through the use of available tools such as Victorian Energy Compare (VEC). These experiences align with a body of research that shows electricity to be a notoriously low-engagement product with a 'sticky' consumer base.¹⁵

¹⁰ ACCC, Retail Electricity Pricing Inquiry – Final Report, June 2018, page xv.

¹¹ EWOV, 2018 Annual Report, October 2018, p. 28.

¹² Independent Review Panel, Independent Review into the Electricity & Gas Retail Markets in Victoria, August 2017, p. 9.

¹³ ACCC, Retail Electricity Pricing Inquiry – Final Report, June 2018, p. 8.

¹⁴ ACCC, Retail Electricity Pricing Inquiry – Final Report, June 2018, p. 15.

¹⁵ For example see: Centre for Competition Policy, University of East Anglia, *Switching Energy Suppliers: It's not all about the money*, August 2017, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3024534 and; CSIRO, *Australian consumers' likely response to cost-reflective pricing*, June 2015, available at: <https://publications.csiro.au/rpr/download?pid=csiro:EP152667&dsid=DS2>

Taking both our own outreach experiences and this research together, it is possible that there will always be a rump of consumers who remain unengaged and fall back on standing offers (or DMOs). Under this analysis, the smaller the proportion of customers currently on standing offers the less utility there is in ensuring that price-settings do not dis-incentivise those customers from participating in the market. It may be that some customers simply cannot or will not ever engage, in which case the imperative to set a DMO price that protects them from excessive cost may outweigh the imperative not to dis-incentivise competition. If so, this would have a material impact on the price points the AER may decide on when determining DMO prices. Where the point of acceptable disengagement lies (or even if there is one) is a matter entirely for the AER to decide, but it is certainly a factor worth considering.

Question 6: For residential customers, are the proposed upper and lower thresholds reasonable, given the policy intent? If a more targeted upper threshold was used, which retailers standing offers should be included? Are there any offers or categories of offers that we should not include as inputs into our proposed methodology? Should the range be the same in each distribution zone? Please provide reasons for your preferred approach.

The approach the AER has proposed is reasonable given the constraints the AER is operating under and will mitigate the unjustifiably high standing offer prices that disengaged consumers are currently paying, while at the same time not reducing those costs so much as to disincentivise future engagement.

In all cases, the over-arching policy intent of mitigating the consumer harm of excessive standing offers and identifying a fair and reasonable cost for such offers should guide the AER's decision making. As previously stated, EWOV is conscious that one out of every three contacts we received in 2017-18 was from customers concerned about their capacity to pay for their energy and water, and an overwhelming majority of those contacts relate to electricity. With that in mind EWOV recommends that the AER model prices based on both the method proposed and a more targeted upper threshold and consider both when making DMO price determinations. As the AER notes, DMO price setting will require a degree of judgement.

We trust these comments are useful. Should you like any further information or have any queries, please contact Janine Rayner, Communications and Policy Manager, on (03) 8672 4289.

Yours sincerely



Cynthia Gebert
Energy and Water Ombudsman (Victoria)