



# Submission to the AER's DMO 6 Draft determination

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## **About the Public Interest Advocacy Centre**

The Public Interest Advocacy Centre (PIAC) is leading social justice law and policy centre. Established in 1982, we are an independent, non-profit organisation that works with people and communities who are marginalised and facing disadvantage.

PIAC builds a fairer, stronger society by helping to change laws, policies and practices that cause injustice and inequality. Our work combines:

- legal advice and representation, specialising in test cases and strategic casework;
- research, analysis and policy development; and
- advocacy for systems change and public interest outcomes.

## **Energy and Water Consumers' Advocacy Program**

The Energy and Water Consumers' Advocacy Program works for better regulatory and policy outcomes so people's needs are met by clean, resilient and efficient energy and water systems. We ensure consumer protections and assistance limit disadvantage, and people can make meaningful choices in effective markets without experiencing detriment if they cannot participate. PIAC receives input from a community-based reference group whose members include:

- Affiliated Residential Park Residents Association NSW;
- Anglicare;
- Combined Pensioners and Superannuants Association of NSW;
- Energy and Water Ombudsman NSW;
- Ethnic Communities Council NSW;
- Financial Counsellors Association of NSW;
- NSW Council of Social Service;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW;
- Salvation Army;
- Tenants Union NSW; and
- The Sydney Alliance.

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# 1. Introduction

The Public Interest Advocacy Centre (PIAC), Australian Council of Social Service (ACOSS) and the South Australian Council of Social Service (SACOSS) welcome the opportunity to respond to the Australian Energy Regulator's (AER) Default Market Offer 6 (DMO) draft determination. We continue to strongly support the need for effective default price protections for consumers. There are important changes in approach proposed in DMO 6 and we encourage the AER to take every further available opportunity to support energy affordability for all consumers.

The draft DMO 6 is a welcome prioritisation of energy affordability at a particularly critical time. Consumers across the NEM are experiencing an extended period of high housing and energy costs exacerbating financial hardship and consumer vulnerability<sup>1</sup>, impacting health and wellbeing<sup>2</sup> and heightening consumer dissatisfaction and distrust of the energy market.<sup>3</sup>

We understand the stated objectives of the DMO and consider the DMO 6 draft meets those objectives, while having a more material, positive impact on energy affordability for consumers. PIAC and SACOSS maintain there is no inherent tension between the three DMO objectives. We contend the AER continues to assume an unnecessarily narrow interpretation of the DMO objectives leading it to conclude tension where none need exist. In previous determinations we consider this to have resulted in poorer outcomes for consumers than was possible, and ineffective incentives for meaningful retail competition. Section 2 of this submission explores this in further detail.

PIAC, ACOSS and SACOSS strongly support the principle and approach taken to retail margin and competition allowance in draft DMO 6. Section 3 and 4 of this submission provide more detail and highlight further opportunities for the AER to consider changes to retail costs and better achieve the objectives of the DMO.

While the DMO 6 draft determination should make a welcome contribution to energy affordability, more substantive changes to the purpose and implementation of DMO are required longer term to meet the expectations and needs of consumers and the community. In this context we reiterate our long-held position on the need for substantive DMO reform beyond this process and recommend the AER support a review of the DMO be included in ongoing equity and affordability work undertake through the National Energy Transformation Partnership (NETP).

## Consultation process

PIAC, ACOSS and SACOSS note our ongoing concern with the extent to which appropriate recognition of stakeholder input is understood and framed by the AER and other market bodies. The input of stakeholders is often only recognised 'quantitatively'. That is, the position of stakeholders and the relative number of stakeholders expressing various positions is noted. For

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<sup>1</sup> Australian Energy Regulator (AER) (2023) [State of the energy market 2023](#)

<sup>2</sup> ACOSS (2023) [Energy and Cost of living snapshot](#)

<sup>3</sup> Energy and Water Ombudsman NSW (2023) [Annual Report 2022-2023](#)

example, most stakeholders think x, while only one stakeholder thought y. This suggests that the AER (and other market bodies) are primarily considering what positions are expressed and how widely they are held. At the very least it would appear that weight is given to perspectives which are more widely held. We are concerned that such an approach is not sufficiently focussed on assessing the merit of stakeholder input, or sufficiently recognising which perspectives are those of consumer stakeholders. The AER should be clearer that 'number' of stakeholders expressing a perspective is not a material consideration. Market bodies should prioritise qualitative not quantitative assessments of stakeholder perspectives.

## **2. The role of the DMO**

### **2.1 DMO objectives**

The DMO is currently underpinned by three broadly defined objectives. PIAC, ACOSS and SACOSS consider there is significantly wider scope for interpretation of the application of these objectives than has previously been applied by the AER in DMO determinations. To date the AER has chosen to interpret each objective in a particular way and, while valid, these interpretations are not exclusive or definitive. As we have noted throughout previous processes, the AER could individually (and collectively) interpret these objectives differently and still achieve their fundamental intent. We consider the draft DMO decision a positive demonstration of the scope available to the AER, and reiterate several key areas where we consider the AER has further scope to evolve its interpretation of the DMO objectives.

The objective to reduce unjustifiably high standing offer prices and protect consumers from unreasonable prices is arguably the priority objective given it relates directly to the primary purpose of pricing regulation (to protect consumers). 'Unjustifiably high' and 'unreasonable prices' should be defined as consistently and objectively as possible, from the perspective of the consumers. Given the National Energy Objective (NEO) and its subordinate objectives define the long-term interests of consumers in terms of efficiency, the AER has a concrete and objective foundation on which to assess what is justifiable and reasonable for consumers. Namely, efficiency.

The objective to allow retailers to recover efficient costs to serve requires only that scope to recover reasonable costs to acquire and retain customers (CARC) is allowed for in the final DMO determination. It does not in any way prescribe how this should be done or require it to be allowed as an additional element on top of other elements of the objectives, such as the cost to serve and reasonable margin. Setting aside any assessment of the validity of CARC, the collective reading of the DMO objectives would indicate that any allowance for CARC should result in end costs which are efficient (that is, justifiable and reasonable for consumers).

Given CARC costs are more appropriately seen as a 'retail expenditure' (in that retailers decide when and how to incur them and do so according to their own business needs rather than those of consumers), they could (and arguably should) be allowed for as part of the overall retail margin rather than accounted for explicitly. This 'interpretation' would still meet the DMO objectives, while applying a greater structural discipline on CARC costs. This is particularly important where the DMO methodology allows for generous retail costs and a margin which is in excess of what is efficient.

The objective to maintain incentives for competition, innovation, and investment has to date been interpreted relatively narrowly by the AER, predicated on the assumptions that:

- a) competition on price (i.e. offering the same essential product at a different price) must be possible/enabled by the DMO, and
- b) scope for competition must be founded on retailers charging more than is efficient for some (if not most) consumers, to offer the *potential* scope for some consumers to get a better deal.

While we accept that others may regard these assumptions (and the interpretation of the objective adopted by the AER) as valid, they are not the only assumed bases for competition and the resulting interpretation of the DMO objective previously adopted by the AER is not definitive.

PIAC and SACOSS strongly disagree that a DMO which exceeds efficient retail cost and reasonable, benchmarked retail profit margin is required to meet the objective to allow for and incentivise meaningful competition (that is competition that actually benefits all consumers). Meaningful competition is not indicated by a larger number of retailers or retail offers, or even the 'churn' in the market. Meaningful competition is that which delivers more efficient or higher value/quality services that meet the needs of all/most consumers. It is open to the AER to interpret this objective as a direction to narrow the scope for margin in the DMO to that which is efficient and reasonably profitable, leaving retailers to compete for customers within this margin, or to innovate new business and service models and products which can demonstrate value to consumers.

Importantly, while the DMO applies directly to less than 10% of all consumers, it is the market reference for consumers determining what a 'fair' offer is. Retaining inefficient margins and cost to serve reduces any incentive for retailers to innovate as it inflates consumers' reference for what constitutes a reasonable or acceptable price and increases the likelihood all market offers will be priced unnecessarily high.

As the ACCC has documented, there is a significant proportion (if not most) of residential consumers on market offers that are equal to or above the DMO, including both customers that achieve conditional discounts and those who do not. While we consider the experience of these consumers evidence of the failure of effective default regulation, their existence demonstrates the considerable extra scope for 'beyond reasonable' retail profits and competition outside of the DMO.<sup>4</sup> We note this both in support of our recommendation for a wholesale review of the purpose and application of the DMO and as a crucial consideration in calculating the DMO and interpreting how the three objectives as the DMO can be met without requiring further inefficient allowance or margin for retailers.

Implementing the DMO as an efficient and more widely applied default could arguably be more effective in incentivising retailers to innovate and provide services more efficiently for all consumers, or provide new services that offer more value to consumers. The changing energy

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<sup>4</sup> ACCC 2023, [Inquiry into the National Energy Market: December 2023 Report](#)

system provides more scope and opportunity for meaningful retail competition, given the right incentives and regulation to deliver outcomes for consumers. Retailers have increasing scope to develop genuinely innovative product offers that meet consumer needs and preferences including by:

- Re-packaging network tariffs to create useful consumer energy products e.g.time-of-use retail tariffs, solar-soakers retail tariffs, EV retail tariffs, simple and predictable flat-tariff options and demand response rebates.
- Bundling with renewable asset purchases.
- Other green energy products.

The changing landscape and growing scope to offer genuinely different products mitigates the (already unnecessary) focus on price differentiation in essential service delivery as an indicator or objective of competition. In any case it must be taken as evidence that the interpretation adopted by the AER to date need not be the only way (and certainly is not the best way from the perspective of consumers) to deliver on the objectives of the DMO.

## 2.2 DMO as a reference price

The DMO in its current iteration is a reference price, it is not a price cap (as it was referred to in the Draft). At best the DMO is a *partial* cap on standing offers, which are a diminishing percentage of the energy retail market. As we (and the ACCC) have noted, issues with the application of the DMO and the durability of consent protections mean that many (if not most) consumers are on offers in excess of the DMO, despite being registered as on a 'market offer'. In any case the distinction between a reference price and price cap is important as there is demonstrated scope for offers to be well above the DMO in the form of both new market offers and legacy offers with expired terms.<sup>5</sup>

Describing the DMO as a price cap can be seen as a justification for it being set higher than would otherwise be necessary. It has implications for how the media and consumers understand the role of the DMO which can result in unintended consequences for consumer trust in the energy market.

## 3. Retail margin and competition allowance

PIAC, ACOSS and SACOSS strongly support the AER embracing prioritisation of energy affordability in the calculation of the DMO. We support the approach to separate retail margin and competition allowance and adopt separate and transparent processes for their respective calculation. Notwithstanding our strong disagreement that additional competition allowance is necessary, it should be clear to consumers and stakeholders what premium consumers are paying to 'allow for competition' and make an assessment as to the value they derive from that cost.

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<sup>5</sup> ACCC 2023, [Inquiry into the National Energy Market: December 2023 Report](#), p.47

The draft determination for the retail margin and competition allowance for DMO 6 is a positive move towards the DMO more appropriately reflecting efficient and reasonable cost to serve and profit margins.

PIAC, ACOSS and SACOSS support the intent of the federal and NSW Energy Ministers' submissions to the DMO 6 process. We consider these letters aligned with our own position that the AER has scope to interpret the DMO objectives with a greater focus on consumer protection.

### **3.1 Retail margin**

PIAC, ACOSS and SACOSS strongly support setting the retail margin as an efficient margin. The draft determination proposes a 6% margin which is towards the higher end of ranges outlined in the analysis. While we understand the reasoning adopted by the AER, we consider this a relatively generous assumption of reasonable margin for retailers. If this is retained, it should be counted against any further retail claims for additional cost allowance elsewhere in the decision.

We disagree with the assumption that thin margin will necessarily result in retail exit, or that the exit of some (or any) retailers is inherently problematic. It is a normal nature of a healthily functioning (genuinely competitive) market for businesses to enter and exit. At this stage in the maturity of the retail market for a (relatively homogenous) essential service it is not necessary for margins to be set high enough to encourage new (inefficient) businesses and retain all the (inefficient) businesses currently operating. An indicator of efficient cost to serve and reasonable margin leaves ample scope to retain existing retailers and allow for the entry of new businesses able to meet similar levels of performance.

### **3.2 Competition allowance**

PIAC, ACOSS and SACOSS have consistently argued that retail allowance (headroom) - over and above efficient retail cost and reasonable, benchmarked retail profit margin - is not required to meet the objectives of the DMO. Competition allowance does not constitute an effective means of incentivising retail innovation or competition in the market that benefits consumers. The current energy market circumstances render the inclusion of competition allowance to be increasingly unjustifiable and unfit for the fundamental purpose of protecting consumers.

The draft decision to remove competition allowance from DMO 6 is a very welcome step in recognising the unsuitability of including competition allowance in a price protection. This decision does not impede meaningful competition or the incentive to compete. Indeed, removing the additional competition allowance provides a much stronger incentive to either be more efficient to 'beat' the assumed margin, use your margin to grow the business (CARC), or develop other services which consumers value (either at the same, less or higher cost). All of these competitive options are retained (and arguably improved) under the draft determination approach.

The draft decision to set the competition allowance to \$0 will have a material impact on energy affordability for consumers, particularly those who are struggling to afford energy, housing and other essential services and items.



## **4. Retail costs**

It is not clear how retail costs for smart metering and bad and doubtful debt are calculated, and specifically how closely they reflect actual costs, as opposed to assumed, modelled or provisioned costs.

### **4.1 Bad and doubtful debt**

Bad and doubtful debt is a growing component of the DMO cost stack calculations. While there is evidence that more consumers are struggling with debt, we would like more clarity regarding the calculation of retail costs of bad and doubtful debt. Is the allowance in the DMO determination based on the actual cost of debt incurred and written off by retailers (actual) or is it based on the provisions for bad and doubtful debt made by retailers? This results in a potentially material difference in the costs retailers are assumed to face. Provision for bad and doubtful debt is, to some extent a normal risk management tool, and there are a number of factors which may lead to material differences between the provisions made by a retailer, and the actual costs they end up facing for unrecovered debt. For instance, they could receive a higher level of repayment than provided for or sell some debts for partial recovery. Where this is an increasingly material component of retail costs, greater certainty that these costs reflect what is actually being incurred, is required.

### **4.2 Smart metering costs**

PIAC, ACOSS and SACOSS reiterate our concerns regarding the lack of transparency on smart metering costs. Without access to more actual data, it is not reasonable to assume upfront cost of advanced metering is being fully incurred by all retailers for all installations to the degree it must be accounted for in the DMO calculation. The AER should provide greater clarity regarding the actual costs faced by retailers (revealed through their contracts with metering co-ordinators) including any offsets to those costs. For instance, some retailers may face limited upfront costs for meter installation (where those meters remain the physical asset of the metering coordinator), with their negotiated costs related to customer data provision and connection services.

We would also appreciate greater clarity regarding how the AER assumes these costs interplay with metering costs recovered through the network component of the cost stack.

PIAC, ACOSS and SACOSS are also concerned about the decision to include upfront fees while explicitly recognising that this will mean over-recovery of costs by some retailers. We strongly disagree with the assessment that retailers will not overcharge consumers and query the AER's justification for this claim. We request that the AER provide further reasoning and evidence in support of their assessment that the inclusion of upfront costs is in consumers' interest.

## 5. Wholesale energy costs

SACOSS has consistently highlighted the stark disparity between the low wholesale spot prices in South Australia and the high wholesale costs paid by consumers.<sup>6</sup> DMO 5 saw South Australian households experience a 68% increase in the wholesale cost component of the DMO. Whilst the Draft Determination for DMO 6 incorporates a 19% reduction in the wholesale cost component, a 50% increase from DMO 4 remains. It is clear the high penetration of rooftop solar and the operation of the wholesale market in South Australia is not benefitting all consumers through lower energy bills.

SACOSS remains concerned about the wholesale cost impacts on low-income households in South Australia resulting from increasingly peaky demand, the low-liquidity wholesale market and the opaque trading practices and risk strategies of retailers. We continue to urge the AER to be guided in all its decision-making by the considerations of efficiency underpinning the NEO, the requirement that costs are reasonable and justified under the DMO Regulations, that the practices of retailers are transparent, prudent and not overly risk-averse, and that energy consumers receive price protection (now and into the future) under the DMO.

We support the AER maintaining the current approach of using the 75th percentile estimate of modelled cost outcomes, and we welcome the AER continuing to investigate issues of low-liquidity and non-transparent trading in South Australia to ensure retailers are behaving prudently and customers are protected from unjustifiably high wholesale prices. More broadly, we repeat our call for governments and market bodies to publicly acknowledge the multiple inequitable cost impacts of the changing energy system, and to work towards identifying a long-term solution.

## 6. Environmental costs

PIAC, ACOSS and SACOSS note the AER's recognition of the issues we raised in relation to environmental costs in the DMO. While we appreciate that resolving these issues is outside the remit of the AER to address directly, the AER should leverage its significant influence by raising this issue with the NETP in ongoing work on energy affordability and equity.

## 7. DMO Reform

Notwithstanding our perspective that the current objectives of the DMO could be better met through further evolution of the AERs interpretation of them, a fulsome review of the DMO, its purpose, objectives and implementation should be undertaken as part of an equity and affordability workstream in the National Energy Transformation Partnership (NETP).

PIAC, ACOSS and SACOSS have consistently advocated for more effective default pricing protections. This advocacy focuses on the need for wider, more consistent application of default

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<sup>6</sup> SACOSS, [Submission to the AER on the DMO6 Issues Paper 2024-25](#), pp. 8-10

protections in conjunction with a tighter focus on efficiency. We consider this would ensure retail market incentives are better aligned with consumer expectations and preferences.

The effectiveness of the DMO as a genuine default is limited by it only applying to an increasingly obsolete category of 'standing offer' customers. A review of the DMO should consider where defaults should apply to provide more meaningful protection for all consumers in circumstances where they haven't explicitly agreed to the material terms of their energy service.

Alongside other consumer and social organizations, we have written to Energy Ministers recommending the addition of an Energy Equity, Inclusion and Affordability workstream to the National Energy Transformation Partnership. This workstream should consider whether 'active participation in the market' is an appropriate objective for the delivery of an essential service. As part of this effort, we have requested that Energy Ministers:

***Provide greater retail protection through reform of retail regulation, pricing and tariffs.*** *In 2018 the ACCC argued that the energy market and retail competition were failing consumers.<sup>7</sup> Little has changed following the report and indeed increases in energy prices have arguably seen a deterioration in outcomes for most energy consumers.*

*Regulated default offers or price caps of some form have been introduced by regulators in all jurisdictions. However, they are not all sufficient to address the issues identified by the ACCC and are not able to deliver acceptable outcomes for energy consumers. The Default Market Offer (DMO) is ineffective because it intentionally does not provide consumers with the protection of a genuinely fair default. People are burdened with unreasonable wholesale and retail costs that don't reflect an efficient cost to serve.<sup>8</sup> Many people are on contracts with expired benefits which may be higher than the 'regulated or default' standing offer, meaning people need to continuously renegotiate or switch market contracts simply to avoid paying unreasonable prices.<sup>9</sup>*

We encourage the AER to actively support the recommendation for an Equity, Inclusion and Affordability workstream, and to work with Energy Ministers to implement meaningful reform of the DMO. We note that as part of the 'Gamechanger' the AER supports the inclusion of a 'vulnerability' workstream in the partnership to further progress recommendations. The AER should support a single, broader additional workstream which encompasses the purposes of addressing vulnerability, equity, affordability and inclusion work. Our organizations encourage the AER to support our joint recommendation as a means to wholistically re-examine the DMO.

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<sup>7</sup> ACCC (2018) Restoring Electricity Affordability and Australia's Competitive Advantage, Retail Electricity Pricing Enquiry, Final Report.

<sup>8</sup> <https://piac.asn.au/wp-content/uploads/2022/11/22-30-11-Submission-to-AER-DMO-issues-paper-2023-24.pdf>

<sup>9</sup> <https://www.aer.gov.au/system/files/State%20of%20the%20energy%20market%202023%20-%20Full%20report.pdf>

A holistic review of the DMO should consider the range of issues related to consumer protection and effective operation of the retail market, including:

- The role of robust, efficient default price protection in alleviating consumer vulnerability resulting from interaction with an essential service (energy).
- The circumstances where default price protection should apply to ensure consumers are protected by a fair/efficient default in all circumstances where they have not explicitly consented to the material conditions of their retail offer.
- How consumer preferences regarding 'postage stamp pricing' (consistently revealed in distribution network consumer engagement) can be reflected in the structure of default retail pricing protections and retail regulations more broadly.
- How environmental costs can be removed from the cost stack of bills and instead recovered through government revenue and taxation to ensure vulnerable consumers are not carrying a disproportionate cost burden of transition costs.
- The role of a reformed DMO as part of the introduction of an obligation on all retailers to offer a flat-price option to all consumers.
- The role of efficient, widely applied default pricing in incentivising retailers to understand consumer preferences and create alternative products that demonstrate value to consumers and genuine choice of products.
- The role of network tariff reform and cost-reflective network tariffs in enabling opportunities for retailers to offer genuine product choice to consumers, rather than simply passing signals through to consumers.

## **8. Continued engagement**

PIAC, ACOSS and SACOSS welcome the opportunity to engage further with the AER and other stakeholders to discuss these issues in more depth.