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Rob Heferen  
Chair  
Senior committee of officials  
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By email: [Rob.Heferen@environment.gov.au](mailto:Rob.Heferen@environment.gov.au)

  
Dear Mr Heferen

### **Recommendation to implement a default offer as a comparison rate (not a price cap) to help customers compare different market offers on a 'like for like' basis**

I write in response to your request for advice on behalf of the COAG Energy Council, on the impacts of the Australian Government's proposed default offer as specified in the request for advice on competition and the prices paid by small customers for standing and market offers. The proposed default offer would be a price cap on standing offers, set by the AER and based on the efficient costs of operating. Our advice to the COAG Energy Council focuses on New South Wales, South Australia and south east Queensland where the proposed default offer would apply.

The proposed default offer aims to:

- stop customers from paying unreasonably high standing offer prices
- help customers compare different market offers on a 'like for like' basis.

### **Declining number of customers still on standing offers**

The Commission has analysed the number and type of customers on standing offers to understand who would potentially benefit from the proposed default offer. On average, around 14 per cent of residential customers in relevant jurisdictions are currently on standing offers. This number is decreasing and our analysis suggests there are likely to be less than ten per cent of small customers on standing offers within the next two years. Also, approximately two per cent of residential customers are only on standing offers for a short period of time, generally after they have moved property or create a new connection and have not yet selected a market offer.

While the overall trend is decreasing, higher proportions of rural and small business customers remain on standing offers. Also, the percentage of hardship customers on standing offers is approximately half that of all other residential customers.

### **Impact on competition and prices**

Based on the ACCC's *Retail Electricity Pricing Inquiry*, and international experiences, the Commission has modelled the impact the proposed default offer could have on competition and prices for standing and market offer customers. We have also looked at the alternate option of a comparison rate. The key difference is that the proposed default offer is a regulated price cap, whereas a comparison rate is a single metric used to compare offers, but not a cap.

While the level of the proposed default offer has yet to be set, it can be expected to lower prices for customers on standing offers or market offers that are above a hard cap. It would also be reasonable to expect that retailers would attempt to recover lost revenue by increasing prices for their other customers, or at least in the short term, withdrawing their lower priced market offers.

Whether or not these attempts are successful for an individual retailer depends on the impacts of the default offer on competitors and the responsiveness of customers. In a workably competitive market, a retailer would be unlikely to recover the full amount however, it would be reasonable to expect that they would recover some amount from customers on market offers.

The **proposed default offer** would appear to create a number of risks, namely:

- an increase in prices for at least some customers on market offers
- an increase in standing offer prices that are currently set below the cap
- a decrease in the range of offers available in the market
- lower levels of innovation as 'discounts off the standing offer' becomes the most common offer
- higher barriers to entry for new retailers, as well as changes in consumer behaviour, resulting in decreased competition in the energy retail market and ultimately higher average prices for consumers.

A **comparison rate** is a single simple metric used to compare offers in the market on a like for like basis, such as a 'yearly bill'. It would:

- reduce customer confusion without risking price increases for customers on market offers
- remove any incentive to inflate standing offers above the comparison rate just to advertise large discounts. While retailers would be allowed to offer deals higher than the comparison rate, they would need to demonstrate the additional value customers are getting by signing up to the higher price.
- be less likely to have a negative impact on innovation and competition.

Based on the declining proportion of customers on standing offers and the risks associated with the proposed default offer, the Commission considers that caution would be needed if the default offer was to be introduced as a regulated price cap.

**Recommendation:**

In the short term, **the Commission considers a default offer should instead be developed as a comparison rate, not a cap.** Advice on the design of the comparison rate could be provided to COAG Energy Council by March 2019, leveraging off the AER's design work on the default offer already underway.

A comparison rate is likely to address the problems of unreasonably high standing offers and a lack of comparability between market offers, without the risks associated with a default offer designed as a regulated price cap. If, after 12 months, the COAG Energy Council still sees issues with standing offers, the default offer could be revisited, with the comparison rate experience providing useful evidence to inform consideration of its design.

All customers, including those who remain on standing offers, will be supported through at least 25 recent actions taken by the Commonwealth and jurisdictional governments and market bodies with the aim of improving consumer experience in the retail energy market. The ACCC has set out further recommendations, currently being considered by Ministers, to address problematic industry pricing practices.

Additional targeted support could be provided to specific sub-groups of customers (e.g. rural and small business customers) that have higher than average proportions remaining on standing offers. The Commission will provide further advice on actions to assist these customers in its 2019 retail energy competition review. This work will build on the AEMC consumer blueprint which highlighted and identified the various channels needed to effectively communicate across and within consumer segments.

I have attached the Commission's detailed advice on these matters for consideration the COAG Energy Council. The Commission will **be publishing this advice on Thursday 20 December 2018.**

Yours sincerely



John Pierce AO  
Chair

*Encl.* Customer and competition impacts of a default offer