

Reforming the electricity Default Market Offer

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Overview

The electricity Default Market Offer (DMO) was introduced on 1 July 2019, after it had become clear that the competitive market was not delivering sufficient benefits to consumers. Many consumers were paying prices well above the best deals available. Others, who had not engaged with the competitive market, were on preset offers with unjustifiably high prices.

The DMO is intended to address both problems. Firstly, it sets an annual maximum amount, or safety net, that an energy retailer can charge consumers who have not engaged, or are unable to participate in the market. Secondly, it serves as a reference price by which consumers can compare competing electricity plans. The DMO's 'reasonable' cost structure includes an allowance for customer acquisitions, and, until recently, included a further allowance to encourage innovation and new competitors.

The DMO is set annually by the Australian Energy Regulator in NSW, South Australia, and south-east Queensland, and a similar mechanism, the Victorian Default Offer (VDO) is set by the Essential Services Commission in Victoria. Other states and regions, where retail competition is less established, have various forms of retail price regulation.

The DMO and VDO have been partly successful. Over the past five years, real prices have been flat in SA and Victoria and have risen by between 12 per cent and 14 per cent in NSW and Queensland. The difference is primarily due to higher wholesale prices in the northern states. More than 90 per cent of consumers in the DMO regions are now on market contracts.

On the other hand, several concerns have emerged around the cost elements of the DMO and the quality of communication between electricity retailers and their customers:

- More than 2.5 million consumers are on contracts with prices above the default offer. Consumers who do not actively maintain engagement with their retailer, through loyalty, limited understanding, or lack of interest, often find they have been transferred from a low-cost offer to the higher priced default offer when the term of the initial contract expires.
- These consumers, and even some on the default offer, could save hundreds of dollars per year by switching to a better deal.
- The safety net tariff includes costs for competitive activity from which disengaged or vulnerable consumers receive little benefit.

The DMO is now being reviewed, with a major focus on a proposal to align it with the VDO and include only costs that an efficient retailer would incur in delivering the service. This proposal should be adopted.

There remains a fundamental tension between ensuring that all consumers are provided with a largely undifferentiated essential service at a fair price, and supporting a market where competition is expected to deliver innovation, investment, and lower prices.

In the supply of many products and services, it is not the role of governments to protect consumers from their own indifference or lack of commercial self-interest. But the way in which retail competition for electricity was introduced, and the nature of the sale and purchase transaction, mean there is a social equity case for government to protect electricity consumers. Action should be taken to address the above shortfalls, even as signs of real innovation around the supply of electricity are finally beginning to emerge.

Recommendations

Maintain the concept and overall form of the Default Market Offer with the dual objectives of providing safety-net pricing for vulnerable consumers and a benchmark to enable comparisons in the competitive market.

Make two changes to the DMO to move it from setting a reasonable price towards an efficient price:

- Permanently remove the competition allowance from the DMO cost stack, with a market impact review to follow in 2027-28.
- Reduce the allowance for customer acquisition and retention, to exclude costs associated with adding value through innovation and new technologies.

Following the above, combine the DMO and Victorian Default Offer methodologies and processes under the responsibility of the Australian Energy Regulator.

The large number of consumers on contracts that are above both the DMO and the best offers in the competitive market suggests that the process of contracting and recontracting is creating unreasonable barriers beyond consumer indifference. Two actions should be taken:

- The Australian Energy Regulator (AER) should implement the proposals of the Essential Services Commission to reduce the customer loyalty penalty.
- The AER should review retailer practices associated with moving customers between market offers and the DMO, including customer communication practices.

Innovation and investment in new technologies, alongside more complex tariff structures, are likely to make comparisons steadily more complex. And, maintaining a single mechanism to meet both objectives may become harder. If this scenario emerges, consideration should be given to creating a single safety net offer, available to vulnerable consumers and possibly those who explicitly choose not to participate in the competitive market. Such an offer would exclude both the competition allowance and most, if not all, of the customer acquisition and retention costs.

1 Introduction

This submission is by Alison Reeve and Tony Wood of Grattan Institute, an independent think tank focused on Australian domestic public policy. Grattan aims to improve policy by engaging with decision makers and the broader community.

The federal Department of Climate Change, Energy, the Environment, and Water has published a Consultation Paper on potential reforms to the framework of the Default Market Offer (DMO), to ensure retail electricity customers on a standing offer pay an efficient price that compensates retailers only for the costs they incur in providing an essential service.

The consultation must grapple with the dual objectives of the DMO – to act as a safeguard for customers unable, or unwilling, to participate in the competitive retail market, while also maintaining incentives for retailers to compete and make a profit. Addressing the inherent contradiction in this framework is a key challenge for the review.

The consultation is focused on the retail costs that are included in the DMO and whether the DMO is meeting its objectives. These costs represent only 20 per cent of the DMO, and the structure and calculation methodology of the network, wholesale, and environmental cost components is outside the scope of the consultation.

This submission addresses the scope of reforms as contained in the consultation paper, and considers the more fundamental issues of the DMO methodology.

We would welcome the opportunity to engage further with the department on any of the matters raised in this submission.

2 Background

2.1 The DMO attempts to reconcile competing objectives

The concept of a competitive retail electricity market emerged from the broader 1993 Hilmer¹ Review of Competition Policy that sought an a national overhaul of government ownership and competition to stimulate competition, including in electricity. One of the outcomes of the Hilmer Review was the creation of the National Electricity Market in 1998, connecting five regional jurisdictions: Queensland, NSW (including the ACT), Victoria, South Australia, and Tasmania.

Privatisation of previously state government-owned, integrated electricity providers was accompanied by disaggregation into competitive wholesale and retail markets, joined by monopoly transmission and distribution infrastructure. The intent was for market competition to deliver consumer benefits, and for economic regulation to control costs.

The privatisation of the retail businesses created competing businesses. South Australia and Victoria moved reasonably quickly, while NSW and Queensland have taken longer due mostly to changing political views on the merits of the privatisation model.

This model of creating a competitive market resulted in significant market concentration, particularly as consolidation occurred via acquisition. The advantage of scale meant that, in 2024, the 'cost to serve' of the largest retailers was 36 per cent lower than for smaller players. The largest, so-called Tier 1, retailers began with about 80 per cent of consumers. Despite their scale advantage, competition has steadily reduced that share to 62 per cent.

By the second decade of the NEM, it had become clear that expecting a competitive market to deliver consumer benefits in the provision of a largely undifferentiated essential service was not being realised, at least for most consumers. The ideal that competition would drive out costs and provide incentives for adding value through differentiated offerings was in question².

The result of this concern was that the Victorian government introduced the Victorian Default Offer (VDO), and the federal government introduced the Default Market Offer (DMO) to cover South Australia, NSW, and south-east Queensland.

These mechanisms apply where there is retail competition. In other regions, where competition is less developed or non-existent, prices are set by a regional regulator. The ACT has its own reference price, set annually by the Independent Competition and Regulatory Commission. That price is used to compare electricity offers for residential customers.

The DMO and VDO are implemented by government-appointed regulators, the Essential Services Commission and the Australian Energy Regulator respectively. Both offers are subject to annual review, with the outcomes being applied from 1 July. For the 2025-26 financial year, the Australian Energy Regulator increased the DMO for domestic consumers by between 3.2 per cent and 8.6 per cent (nominal). For the same period, the Essential Services Commission increased the VDO by 1 per cent.

The default offers must be made available to consumers, who can decide whether to accept that offer or to accept an alternative market

1. Hilmer (1993).

2. Wood et al (2017).

offer from one of the competing retailers. There are more than 25 competing retailers in Victoria and NSW.

The DMO sets the maximum price energy retailers can charge electricity consumers on default plans, known as standing offer contracts. These are contracts consumers find themselves on when they have not actively shopped around or switched to a new plan. About 8 per cent of consumers in the regions covered by the DMO are on standing contracts, and about 12 per cent of Victorian consumers are on the VDO.

The default offers are based on the costs incurred by efficient retailers, averaged within or across regions depending on the nature of the cost component. More than 80 per cent of these costs are common in structure to both the DMO and VDO and would be the same whether the end price was set by regulation or competition. The current consultation is on the other 20 per cent, described as retailer costs.

For the purpose of this consultation, there are four cost categories: the cost of an efficient electricity retailer in providing the core service; the cost of acquiring and retaining customers; an allowance, or headroom, for competition; and the retail margin. The first of these includes the cost of billing, call centres, debt management, etc, that are reviewed but not really contentious. The allowed retail margin is currently 6 per cent of the selling price for the DMO and 5 per cent for the VDO. Consumer groups have criticised these margins as being overly generous, but the regulators have maintained the existing figures.

The regulators defend the inclusion of the cost of acquiring and retaining customers, saying it flows directly from the requirement to maintain a competitive retail market.

Consumer groups tend to oppose the inclusion of both headroom and the cost of acquiring and retaining customers, arguing that these costs have no direct benefit to consumers. For the cost of acquiring

and retaining customers, this would be true if there is no benefit in competition. If that were considered to be true then maybe the simplest outcome would be to just regulate retail prices. Electricity retailers, and governments mostly, have argued that competition can bring greater innovation, service, and investment, and lower costs for the same service.

2.1.1 The cost of acquiring and retaining customers is caught in the tension

The Australian Energy Regulator includes the cost of acquiring and retaining customers in the DMO as an element of providing a service in a competitive market, including gaining and retaining customers on standing offers.

The pricing order for the VDO requires consideration of efficient costs. It does not allow for the VDO to include a competition allowance. The Essential Services Commission interpreted a modest cost for acquiring and retaining customers, by setting its benchmark based on the inflated average NEM-wide acquisition costs from 2013-14. The benchmark for 2025-26 is \$46.57, excluding GST. This is about 27 per cent below the weighted average costs for Victorian retailers and 26 per cent below the national average as reported by the ACCC. No other rationale has been provided for choosing or defining this metric as 'modest'.

2.1.2 The competition allowance is of greater concern

The concept of a competition allowance to allow 'headroom' for competitive activity has been controversial since the DMO was initiated. Allowing retailers to charge a higher price so that the price could be competed down seems a strange idea.

The Australian Energy Regulator excluded the competition allowance from both the 2024-25 and 2025-26 DMOs on the grounds of cost-of-living pressure. The regulator proposed that the exclusion

should apply when the quarterly CPI is above the Reserve Bank's target range of 2-to-3 per cent on a material and sustained basis. The regulator maintained the exclusion in the determination announced on 26 May 2025, despite underlying inflation being 2.8 per cent in April and 2.4 per cent in May. Governments were looking to the regulator to be sensitive to cost-of-living pressures in its determination. But there is only a weak case for using the cost of living as a trigger for inclusion or exclusion of a competition allowance in the default offers. Other government measures such as bill relief would be more appropriate ways to address cost-of-living pressures.

The VDO does not include a competition allowance. There is little evidence that its absence has adversely affected competition in Victoria. Nor has it done so in the DMO regions since being excluded by the regulator for 2024-25. Between Victoria and the DMO regions, there are similar numbers of competing retailers and roughly similar savings gaps between the market and default offers. The difference in the proportion of consumers on the default offers (8 per cent in DMO regions and 12 per cent in Victoria) may suggest the opposite, and it would be prudent to monitor any adverse impacts following the exclusion of the competition allowance.

2.2 Retailers impose a penalty on loyal customers

There have been well-documented complaints from consumers who find themselves on high market offers, presumably when their initial offer expires and they have taken no action to seek an ongoing lower priced offer. Such customers may be described as lazy or loyal, but it is a challenging proposal to consider as fair when the retailer is perfectly happy to provide a lower cost offer.

The ACCC has reported there are about 2.6 million customers with prices at or above the default offers who 'may benefit from engaging

in the market'. Presumably this cohort did engage at some point, but subsequently lost interest or understanding.

As offers become more complex, comparison becomes harder, and this is the challenge for the innovators.

But, for less complex services, the comparator websites give pretty clear estimates of the total annual bill. And messages like this seem reasonably clear:

'Based on your past usage, our XXX plan may cost you up to \$YYY (incl GST) less per year than your current plan. To switch to this plan, head to our website. You can compare plans from other retailers on the ZZZ comparator website at compare.energy.vic.gov.au.'

Yet this communication seems to be very often ignored or unnoticed when the customer pays routinely by direct debit.

2.3 Is the Default Market Offer broken and can it be fixed?

Price controls are an inherent consequence of monopoly businesses and are applied to the electricity transmission and distribution businesses, whether privately or government owned. Competition and consumer regulation is applied to protect consumers and participants from unfair outcomes. The case for price controls such as the DMO and VDO is to make an essential service more affordable and accessible to all consumers, particularly those in vulnerable social or economic circumstances, by setting some form of price limits.

The potential adverse outcome of price controls is that they can discourage new entrants, innovation, and investment.

3 Proposed reforms

The Consultation Paper says customers on standing offers have not engaged, or cannot engage, in the competitive process of seeking the cheapest offer in the electricity market. This is wrong on two counts. First there are customers who have, at some point, moved to a market offer and then reverted to a standing offer either through their choice or the action of the retailer. Second, customers may engage in the competitive process and accept a better offer (for them) that may not be the cheapest.

The core thesis of the review seems to be that the competitive allowance and the current form of the cost of acquiring and retaining customers should not be incurred by customers on standing offers. The current form of the Default Market Offer accepts that the cost of acquiring and retaining customers is part of an efficient cost of providing services. The paper suggests there is a difference between a DMO that includes ‘reasonable costs’ and a VDO that incorporates only ‘efficient costs’. It could be argued that a standing offer without either represents efficient costs and may meet the safety net objective. But the same offer could hardly be used as a reference price in the competitive market.

3.1 Achieving the objectives of the Default Market Offer

The core challenge for the DMO is in trying to protect disengaged customers in a competitive retail market. This is made harder by the fact that in most cases, there is little difference in the service itself, i.e. the supply of electricity.

Over the past decade and since the introduction of the default market offers, there have been significant improvements in the availability of accessible sources of comparison information, partly through information on bills, and also via websites. Yet the core problem

remains. Many consumers are, or have become, disengaged from the competitive market and electricity remains a low-engaged commodity.

Two options should be considered.

The first would be to separate the safety net objective from the competitive benchmark objective. The result would be the same as the current DMO, but without the cost of acquiring and retaining customers or the competition allowance. The benefit of this option would be to provide the lowest cost outcome for disengaged consumers. The risk would be that such consumers might be permanently excluded from the benefits of competition and innovation.

The second option would be to introduce an ‘efficient pricing framework’ for the DMO, as described below.

There are signs that the market agencies and energy businesses are making progress on innovation and investment in electricity services that will add real and substantial value for consumers. Examples include the integration of rooftop solar and household and electric-vehicle batteries, virtual power plants that connect multiple consumers, and innovative tariff structures that enable interested consumers to be rewarded for reducing their consumption at times of major congestion. This progress has been a long time coming, and it would be a pity to abandon it now.

3.2 Efficient pricing in the Default Market Offer

The current DMO and VDO legislation has loose definitions of what constitutes a reasonable price versus an efficient price. The difference seems to be that the latter excludes a competition allowance and some proportion of customer acquisition and retention costs.

If the single DMO is to be retained, two steps should be taken. The first is to permanently exclude the competition allowance, subject to a review of the impact on competition in two-to-three years.

The second is to either remove the cost of acquiring and retaining customers, or be more explicit about what costs should be allowed to be included in the calculation. While the latter creates some complexity, it avoids the arbitrariness of the VDO approach, and it helps the DMO to better balance its dual objectives.

3.3 The form of the Default Market Offer

A DMO in the form of a model based on a nominated annual usage relatively easily understood by consumers, particularly when it can be easily applied to an individual consumer's circumstances by a retailer or online.

The increasing momentum of innovation and investment in rooftop solar, household batteries, electric vehicles, Virtual Power Plants and other more flexible offerings have much to offer, and may be better suited to some form of regulated usage tariffs. However, it would be premature to move straight to a DMO across multiple tariffs. The benefits may be outweighed by the possible complexities in how such a DMO would be structured and communicated. Further work should be done on this approach.

3.4 Addressing the customer loyalty penalty

The Essential Services Commission (ESC) has proposed two reforms to reduce the adverse impact of the customer loyalty problem. Both should be considered for the DMO.

The first reform is for an automatic best offer for customers who have having difficulty paying. Retailers would have to automatically switch customers onto their best offer, if the customer is receiving tailored

assistance, or is in arrears for at least three months and with arrears of \$1,000 or more. The ESC proposes that retailers would not need to seek explicit informed consent from the customer to switch. Customers would still be able to opt-out or request a switch back to their earlier contract. It is likely that such an arrangement, at least initially, would be applied only for consumers on flat or other simple tariffs.

A significant number of consumers are not currently on their retailer's best offer, despite the regulated provision of a best-offer message on bills. This issue is common across other low-engagement categories of services. The government needs to balance protect vulnerable consumers against rewarding indifference or laziness.

The ESC proposes that retailers should have effective processes for a customer to switch to their best offer. As a minimum, a retailer must have a switching process through its website and telephone. Retailers' websites must also have clear and simple instructions on how to switch, and must enable customers to compare their current plan to the best offer.

The Australian Energy Regulator should liaise with the ESC to monitor the impact of these proposals.

3.5 Combine the DMO and VDO under a single regulator

The circumstances that created the separate DMO and VDO have steadily been eroded. Once the changes to move the DMO towards efficient pricing have been made, cost reductions and clarity of communication would justify combining the two mechanisms under a single regulator, the AER.

The difference in the allowed margins, 6 per cent for the DMO and 5 per cent for the VDO, would need to be addressed in the first review under a single regulator.

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