AER Posiiton Paper default Market price

ACOSS Submission to AER

11 December 2018

About ACOSS

The [Australian Council of Social Service (ACOSS)] is a national advocate for action to reduce poverty and inequality and the peak body for the community services sector in Australia. Our vision is for a fair, inclusive and sustainable Australia where all individuals and communities can participate in and benefit from social and economic life.

ACOSS welcomes the opportunity to submit to the AER s consultation on the development of a default market offer (DMO) price and a reference bill, for electricity retail services in jurisdictions where there is retail market competition (South Australia, New South Wales, South East Qld and Victoria – noting Victoria is also looking at their own process).

Introduction

Competitive retail energy markets are not currently delivering the expected benefits to customers and haven't held up the promise of lower and more efficient prices for all.

Competition was meant to drive efficiency and innovation, however the ACCC in their final report on retail electricity price reported that there has been little innovation and costs to grow and retain customers are increasing, ironically because of increased competition.[1]

The ACCC further noted that where there has been some innovation they have had limited impact on retail price offerings as most consumers appear to 'simply prefer a low price'. This is not surprising given the homogeneity of electricity and its essential nature.

Despite the essential nature of electricity there is a big price difference between standing offers[2] and market offers.

The recent annual St Vincent De Paul Tariff-Tracking report highlights that standing offers, have increased by 75% on average across the NEM since 2009.[3] The price difference can be significant between the worst standing offer and the best market offer. For example the price difference can be $2,110 - $2,675 per annum (depending on their network area).[4]

The Tariff-Tracking report also notes there is a large spread between market offers and the difference between the best and the worst offer can be more than $1,000 a year depending on the State and network area.[5]

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[1] ACCC (2018) Restoring electricity affordability and Australia's competitive advantage https://www.accc.gov.au/system/files/Retail%20Electricity%20Pricing%20Inquiry%E2%80%94Final%20Report%20June%202018_0.pdf

[2] A standard retail contract all retails are required to offer customers, that adopt model terms and conditions set out in legislation, but the final price is determined by the retailer.

[3] St Vincent de Paul Society and Alviss Consulting, The NEM – No "guarantee for consumers: Observations from the Vinnies' tariff-tracking project, October 2018, https://www.vinnies.org.au/icms_docs/298264_2018_NEM_-_No_guarantee_for_consumers.pdf

[4] Victorian Energy Prices July 2018, An update report on the Victorian Tariff-Tracking Project https://www.vinnies.org.au/icms_docs/291687_Victorian.pdf

[5] Taken from various state Tariff –Tracking Project reports in 2018. https://www.vinnies.org.au/page/Our_Impact/Incomes_Support_Cost_of_Living/Energy/

The ACCC argued:

> *"Retailers have made pricing structures confusing and have developed a practice of discounting which is opaque and not comparable across the market. Standing offers are priced excessively to facilitate this practice, leaving inactive customers paying far more than they need to for electricity. Pay on time discounts, which have emerged as a response to attempts to constrain late payment fees, are excessive and punitive for those customers who fail to pay bills on time."*

The problem now is that many customers are not getting a fair price for an essential service.

For households to get the better deals in the market, they need to regularly engage with the retail electricity or gas market to ensure they are receiving a competitively priced supply. However, even regular engagement is no guarantee you will receive the best price. The St Vinnies Tariff-Tracking Projected noted:

> *"While energy consumers are provided with tools such as Energy Made Easy to help them choose the best offer, by the time they complete the switch this may, in fact, now be a very poor offer compared to other retailers, or even compared to what the same retailer is now offering."*[6]

However, while the majority of households worry about energy, they are disengaged from the energy market and are paying more than necessary. The AEMC's 2017 Retail Energy Competition Review found around 50 per cent of all customers had not switched electricity retailer or plan in the last five years.[7] These households are likely to be paying significantly more than customers who actively pursue a better offer.

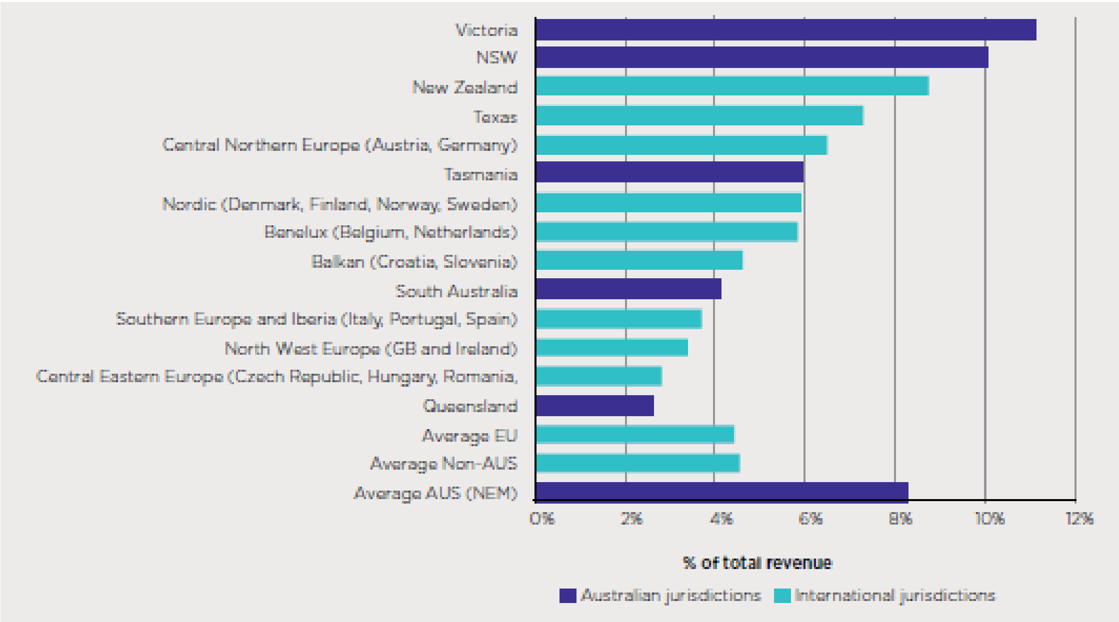
While there may be evidence that some low-income households actively engage in the energy market to try to find the best deals, there is also a significant proportion of low-income households who do not access the same low cost offers, and are being further penalised as a result of their vulnerability, whether it be through lack of access to the internet, language and literacy skills, time, trust, and understanding of the complicated practices of electricity retailers. Retailers are profiting from disengaged households.

Further, the ACCC found that Australian electricity prices, gross margins and net margins are among the highest in the world, and that retail margins vary significantly by state. The highest retail margins in the NEM were in Victoria (above 11%), which is considered to be the most mature of the competitive markets and margins in Victoria have been increasing over recent years. NSW also had relatively high retail margins (around 10%), while South Australia and Queensland have the lowest margins (see figure 1). It's clear some jurisdictions customers are not receiving efficient pricing.

[6] https://www.vinnies.org.au/icms_docs/298264_2018_NEM_-_No_guarantee_for_consumers.pdf

[7] AEMC (2017) Retail Energy Competition Review https://www.aemc.gov.au/sites/default/files/content/006ad951-7c42-4058-9724-51fe114cabb6/2017-AEMC-Retail-Energy-Competition-Review-FINAL.pdf

Figure 1. Gross retail margins, 2016-2017, c/kWh, Australian States and overseas



Based on the evidence, it is ACOSS view that competitive retail electricity markets have not and will not meet the "essential service" needs of those people on low incomes or experiencing disadvantage who struggle to engage in an opaque confusing energy market.

Competition has driven up costs across the board, market offers remain confusing, some people are benefitting at the expense of others, and innovation is minimal. Given electricity is an essential service where people cannot simply opt out, ACOSS supports the development of a regulated retail price or default offer to provide a **fair and efficient** price for electricity, that people can opt into and default to, and a reference bill to assist customers compare market offers.

Establishing a DMO

As noted in the AER consolation paper, the AER has been tasked to implement ACCCs recommendation to set a default offer price to replace the current high inflated standing offer and a reference bill for households and small and medium business.

The ACCC recommended the default offer would include a reasonable retail margin, the costs of additional customer protections (paper bills and bill smoothing) and include customer acquisition and retention costs (CARC).

ACOSS believes customer protections, offering paper bills and bill smoothing, should be considered standard and not an additional cost.

ACOSS believes that given electricity, like water, is a homogenous essential service where customers cannot opt out, the DMO should reflect a fair and efficient price to deliver electricity. It should therefore:

- be closer to if not equivalent in price to market offers (noting there can be a large range between the best and worst market offers so there is room for competition)

- with fair retail margins (noting in some regions retail margins are excessive) and
- some costs of CARC (noting CARC costs have increased because of increased competition).

Some ACOSS members, such as QCOSS and CALC have argued CARC should not be included as there is no need to actively recruit and retain customer to the DMO. ACOSS has some sympathy for this argument if the DMO acts as a safety net rather than our preferred fair and efficient price.

ACOSS supports the DMO applying to flat-rate and controlled-load tariffs.

While we note there are some recommendations to restrict pay on time discounts (which essentially act as an excessively high late payment fee), which could eliminate some of the 'best offers' in the market, ACOSS believes retailers can still compete on both price and service provision, by providing a range of innovative offerings including:

- Tariff reform – such as time of use, demand tariffs, solar energy tariffs
- Smart home energy management including peer to peer trading
- Values – like community or not for profit retailers

Ultimately, for a homogenous essential service, the goal should be to offer a fair and equitable price, not to increase competition for competitions sake.

ACOSS believes a regulated retail price should be developed in the following way:

- It should be a fair price that reflects the efficient costs of providing energy as an essential service.
- The fair price should be determined using a bottom up approach to identify what a fair and efficient price is in each network.
- The regulated fair price should also serve as a reference price for bill comparison.
- The regulated fair price should be opt in.

Setting the default market offer price

The AER proposes in the first year to use a "top down" approach to determine the DMO in each network region. It proposes to use public available data of market and standing offers from the energy made easy comparator website, to determine the median price of these offers and then estimate an 'efficient' price somewhere between the market and standing offers.

The AER states that it proposes to use top down approach in the first instance because:

- The AER has limited time and access to detailed cost information. Arguing they do not currently have information gathering powers for our role in determining DMO prices and limited time to seek this advice voluntarily from retailers; and
- That because the AER is determining DMO prices in distribution zones where there is competition and where a majority of customers are on market offers. The AER argues they can therefore observe competitive market offers, which will reflect market participants' own expectations about the efficient costs of providing retail services in particular distribution zones.

ACOSS fundamentally disagrees with the last point, and notes that because energy is an essential service and people cannot opt out, people are forced to take what is on offer, which may or may not be efficient. The fact that retailers in Victoria have retail margins significantly higher than some other states and are amongst the highest in the world demonstrates the offers are not efficient.

The AER suggests it will consider using a more "bottom up" approach in subsequent years, as other jurisdictions do, when there is more lead time.

ACOSS is concerned the top down method as proposed, will not determine an efficient and fair price in all jurisdictions, for the following reason:

- Utilising the mediums in each network does not address the high retail margins the ACCC identified in some network areas including in Victoria (over 11%) and News South Wales (around 10%), which are amongst the highest in the world. So households in Victoria and New South Wales will still be paying relatively higher prices than necessary.
- Across the board, there is not too much difference between market offers with conditions and standing offers, but there is a bigger difference between standing offers and unconditional market offers. As noted above regulated retail price should be closer to market offers.

ACOSS believes an actually cost based, "bottom-up" approach would provide a more true reflection of fair and efficiency price.

Given the AER has been given a short time frame to provide a default market offer price implementation by July 2019, ACOSS recommends the AER supplements its top-down approach with a desktop estimation of a fair regulated retail price. For example the AER can consider the following methodology:

- Wholesale energy costs – this can be calculated by applying the premium of wholesale energy costs over wholesale spot prices that was observed in the AEMC's most recent price trends reports to a forecast of wholesale spot prices for 2018/19 that is based on ASXEnergy swap prices for 2018/19.
- Costs of complying the Large-scale Renewable Energy Target (LRET) and Small-scale Renewable Energy Scheme (SRES) – which can be based on retailer's percentage obligations for 2018/19 and observed prices for Large-scale Generation Certificates (LGCs) and Small-scale Technology Certificates (STCs).
- Network tariffs – which can be based on published network use of system (NUOS) tariffs for each distribution area in the NEM.
- Network losses - based on published loss factors.
- Market fees, ancillary services costs and costs of complying with any relevant jurisdictional schemes - based on the AEMC's most recent prices trends reports.
- Retail operating costs, customer acquisition costs and the retail margin can be based on recent regulatory allowances.
  - The allowance for retail operating costs – based on retail operating costs from IPART's 2013 review of regulated retail prices for 2013 to 2016, or ACIL Allen's analysis for the Queensland Competition Authority for 2015/6, or similar work, adjusting for inflation to 2018/19.
  - An allowance for customer acquisition costs – based on a bottom-up estimates from IPART's 2013 review of regulated retail prices for 2013 to 2016, adjusting for inflation to 2018/19. If the DMO is developed more like a safety net, that people default to, then CARC should not be included.
  - The allowance for the retail margin: This retail margin is from IPART's 2013 review of regulated retail prices for 2013 to 2016; it reflects a regulated allowance rather than an estimate of the retail margin that retailers are actually earning (as reported by the ACCC[8]).

In subsequent years the AER should utilise a cost based bottom up approach.

[8] ACCC numbers of retail margins

ACOSS supports suggestions by other consumer advocates to review the impact of the DMO and ensure there are no unintended consequences. But as noted above, for a homogenous essential service, the goal should be to offer fair and efficient price, not to increase competition for competitions sake.

Determination should be annual to take into account changes in costs of delivering.

ACOSS supports using the average consumption per customer in each distribution zone provided that solar households are excluded from the calculations.

Specifying the DMO

It would be good to express the DMO and reference bill in both dollar terms for bill and as a c/kWh.

Expressing the DMO as a quarterly or annual bill (based on an average consumption) will enable people to compare between offers more easily in a format they are familiar with. Retailers operating in the same jurisdiction should use the same consumption level and time period assumptions when providing DMO/reference price comparison, so that consumers can compare apples with apples.

Expressing the DMO also in c/kwh, allows consumers to better estimate what their total bill might be at different times of the year (depending on their climate zone) and their typical consumption level.

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