



Brotherhood
of St Laurence

Working for an Australia free of poverty

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Essential Services Commission
Level 37, 2 Lonsdale Street
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Submission regarding Victorian Default Offer staff working paper

The Brotherhood of St Laurence welcomes this opportunity to comment on the Victorian Default Offer (VDO) staff working paper issued by the Essential Services Commission (ESC).

This submission outlines the Brotherhood's views on the VDO, and its appendix contains modelling of a regulated price, extracted from a forthcoming ACOSS–BSL report.¹ Our submission does not address some of the technical questions in the working paper, which require specialised expertise. It does raise some implementation issues not contemplated in the staff paper, and we urge the ESC and Victorian Government to consult more broadly with community groups on such issues.

The Brotherhood strongly supports the introduction of the Victorian Default Offer.

The VDO should help all consumers by offering a guaranteed fair price for electricity and gas. The effectiveness of the VDO will depend on its price (it needs to be a low-cost offer) and how people access it (it needs to be a default, easily accessible offer).

Many low-income and vulnerable Victorians suffer because they pay too much for energy

Many Victorians pay too much for the energy they need to live, particularly those who can least afford it. We know that certain groups pay more than the general population on average, and this is a critical issue for their wellbeing.² These include low-income households, those who are culturally and linguistically diverse, rental households and sole parents. These groups are paying a higher price for energy even though there are cheaper offers available in the market, and even when the amount of consumption is controlled for. This suggests that the problem lies in the retail energy market.

¹ ACOSS & BSL 2019 (forthcoming).

² Colmar Brunton for ACCC 2018; Azpitarte & Sullivan 2017 (unpublished); ACOSS & BSL 2018.

Higher energy prices also lead to other forms of harm for consumers, particularly those who are low-income or vulnerable. It is well known that many people face difficulties paying their energy bills and there are high rates of disconnection. At the same time, too many people go without essentials or ration their energy use to the detriment of their health, and they will be best served by guaranteed lower prices, not nebulous promises of future innovation delivered by greater competition.

The VDO should offer a guaranteed fair price.

The VDO will only serve its purpose if it is a low-cost offer that all consumers can afford. This would be in line with the terms of reference, which require the offer to be ‘reasonably priced’.³ Customers who default to, or choose, the VDO should be confident that they are paying a price close to the best in the market, and the Brotherhood considers that the VDO price should be set at a level where a significant proportion of customers would benefit from switching to it. BSL and ACOSS worked with an industry consultant, who modelled an efficient regulated price and found that 60% of Victorian consumers would benefit from switching to it.⁴

In general, we support the Commission’s proposed cost-based approach to setting the VDO price. In Victoria, consumers pay an average unit rate of 30.3 c/kWh, on which the retail margin is 11%.⁵ We support the Commission’s proposal to use the existing work of other regulators, who have typically considered retail margins of 5–6% to be fair.⁶

In relation to setting the VDO’s customer acquisition and retention costs (CARC), we suggest that current Victorian costs are excessive. Retailers spend more on CARC in Victoria than in any other Australian jurisdiction⁷, yet it delivers no meaningful value to customers. We recommend that CARC is set as low as practicable.

Recommendations:

- The VDO should be determined using a cost-based approach.
- The VDO retail margin should be set as low as practicable (possibly around 5–6%).
- CARC should be set at zero or as low as practicable.

The VDO should be a true default for those who are inactive in the market.

As of 2017, 8% of Victorian non-solar customers were on standing offers⁸; and these households will automatically be moved to the VDO when it is implemented. This is a welcome development for these customers, who typically pay very high rates.

³ Victorian Government 2018, p.1.

⁴ ACOSS & BSL 2019 (forthcoming).

⁵ ACCC 2018, p.8.

⁶ Wood & Blowers 2017, p. 17.

⁷ ACCC 2018, p.230.

⁸ ACCC 2018, p.245.

However, many other people—particularly those on market offers with expired discounts—also pay excessive prices and would benefit from being moved to the VDO. Many of these customers have not engaged with the energy market for years, and the VDO is intended to ‘safeguard consumers unable or unwilling to engage in the retail electricity market’.⁹ However, as we understand it, people who are not on standing offers will have to engage with the market in order to access the VDO. We recommend that, instead, customers on existing offers with expired discounts are moved to the VDO if it lowers their bills.

Recommendation:

- The VDO should be the default for people who are currently on standing offers and people who are inactive in the market (if the VDO lowers their bills).

A default offer should also apply to gas.

As planned, the VDO will only apply to electricity, yet the retail gas market suffers many of the same problems. In addition, all Victorian gas retailers but one also sell electricity¹⁰, so if margins in their electricity businesses are reduced, they may increase gas prices to compensate. Accordingly, we recommend that a default offer also be mandated for gas.

Recommendation:

- The VDO should be mandated for retail gas offers (as well as electricity).

For further information on this submission, please contact Damian Sullivan (e: dsullivan@bsl.org.au m: 0405 141 735) or David Bryant (e: dbryant@bsl.org.au ph: 03 9483 2470).

Yours sincerely,

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⁹ Victorian Government 2018, p.1.

¹⁰ Tas Gas sell gas in 10 regional Victorian towns but do not sell electricity. See <<https://compare.energy.vic.gov.au/retailers>>.

References

Australian Council of Social Service (ACOSS) & Brotherhood of St Laurence (BSL) 2018, *Energy stressed in Australia*, ACOSS, Strawberry Hills, NSW.

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Azpitarte, F & Sullivan, D 2017, *Who pays higher prices for energy? Analysis of Victorian household unit prices* (unpublished), Brotherhood of St Laurence, Fitzroy, Vic.

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Appendix

This appendix presents modelling of a regulated retail price (including CARC) and a basic service offer (excluding CARC). It is extracted with slight modifications from a forthcoming report to be jointly published by ACOSS and the BSL.¹²

Scenario methodology

To understand the impact that a regulated retail price could have on improving the affordability of energy bills for low-income households, ACOSS and BSL worked with an industry expert to develop a retail tariff model to estimate:

- a Regulated Retail Price (RRP) that represents an efficient and fair price of providing a retail service, which includes costs of supplying electricity, a fair retail margin and provision for customer retention and acquisition; and
- a Basic Service Offer (BSO) more in line with the recommendations of the Thwaites Review, which proposes an efficient and fair price of providing a retail service, which includes costs of supplying electricity and a fair retail margin, but excludes customer retention and acquisition costs.

Retail tariff model assumptions

The retail tariff model calculates the generally accepted cost components that retailers face for 2018/19 in the following way:

- Wholesale energy costs are calculated by applying the premium of wholesale energy costs over wholesale spot prices 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 with the Large-scale Renewable Energy Target (LRET) and Small-scale Renewable Energy Scheme (SRES) are based on retailers' percentage obligations for 2018/19 and observed prices for Large-scale Generation Certificates (LGCs) and Small-scale Technology Certificates (STCs).
- Network tariffs are based on published network use of system (NUOS) tariffs for each distribution area in the NEM.
- Network losses are based on published loss factors.
- Market fees, ancillary services costs and costs of complying with any relevant jurisdictional schemes are based on the AEMC's most recent price trends reports.
- Retail operating costs, customer acquisition costs and the retail margin are based on recent regulatory allowances.

¹² ACOSS & BSL 2019.

- The allowance for retail operating costs is \$128/customer/year. This allowance for retail operating costs is from Independent Pricing and Regulatory Tribunal (IPART's) 2013 review of regulated retail prices for 2013 to 2016, adjusting for inflation to 2018/19.
- The allowance for customer acquisition costs is \$51/customer/annum, which reflects the recovery of acquisition costs over a number of years for which customers are assumed to remain with a retailer. This allowance for customer acquisition costs is the bottom-up estimates from IPART's 2013 review of regulated retail prices for 2013 to 2016, adjusting for inflation to 2018/19.
- The allowance for the retail margin is 5.7%. 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 ACCC¹³).

Total annual retail bills for each of the two estimates of regulated tariffs are based on reported annual average consumption for residential customers in the relevant distribution area. The estimates of annual average consumption for residential customers are sourced from the AEMC's most recent retail price trends report.

The two regulated retail tariffs are calculated as follows :

- Regulated Retail Price (RRP) – includes the generally accepted costs that retailers face in supplying electricity to small retail customers, which include wholesale electricity costs, network costs, costs of complying with green schemes and energy efficiency schemes, market fees and ancillary services, retail operating costs, customer acquisition costs and a retail margin of 5.7% of total costs.
- Basic Service Offer (BSO) – includes all of the same costs to retailers as the RRP, except that it does not include an allowance for customer acquisition costs, and the dollar amount of the retail margin reduces because the retail margin of 5.7% is not applied to an allowance for customer acquisition costs. The BSO was therefore calculated to be \$53.90 less than the RRP.

Comparing regulated retail tariffs against existing tariffs

The RRP and BSO were estimated for each of the retailers that operate in a distribution area in the NEM. The regulated retail tariff scenarios were compared with three other tariffs:

- a standing offer tariff;
- a market offer tariff that includes guaranteed discounts; and
- a market offer tariff that includes conditional discounts.

¹³ ACCC numbers of retail margins.

Information on the three tariffs for each of the key retailers in each distribution area¹⁴ was sourced from St Vincent de Paul's Tariff-Tracking project.¹⁵ The 2018 data for New South Wales was not available at time of the analysis was done and 2017 figures were used.

Total annual retail bills for these tariffs are based on the same reported annual average consumption for residential customers used to report total annual bills for the regulated tariffs. Note that this annual average consumption is different from the annual average consumption used in St Vincent de Paul's Tariff-Tracking project, but the spreadsheets released as part of the Tariff-Tracking project allow for this adjustment.

Results – Comparison of regulated retail price to current market and standing offers

Figures 1 to 5 chart the electricity retail market offers and standing offers for FY18/19 in comparison with the Regulated Retail Price and estimated BSO, for each of the NEM networks. Comparisons were only made for jurisdictions where retail competition exists in the NEM.

The two estimates of the regulated prices are lower than standard offers and, in most cases, the market offers with guaranteed discounts, but they are more in line with market offers with conditional discounts.

In Victoria, we see that the two estimates of the regulated price are often even lower than a number of market offers with conditional discounts. This is consistent with the observation that retailers have been earning higher margins in Victoria recently.

¹⁴ Note that the New South Wales 2018 tariff-tracker data was not available at the time of developing the regulated retail tariff model, and 2017 data was used.

¹⁵ https://www.vinnies.org.au/page/Our_Impact/Incomes_Support_Cost_of_Living/Energy/.

Figure 1. FY 18/19 electricity retail market offers and standing offers in comparison with an estimated regulated price and estimated basic service offer for Victoria – Citipower Network

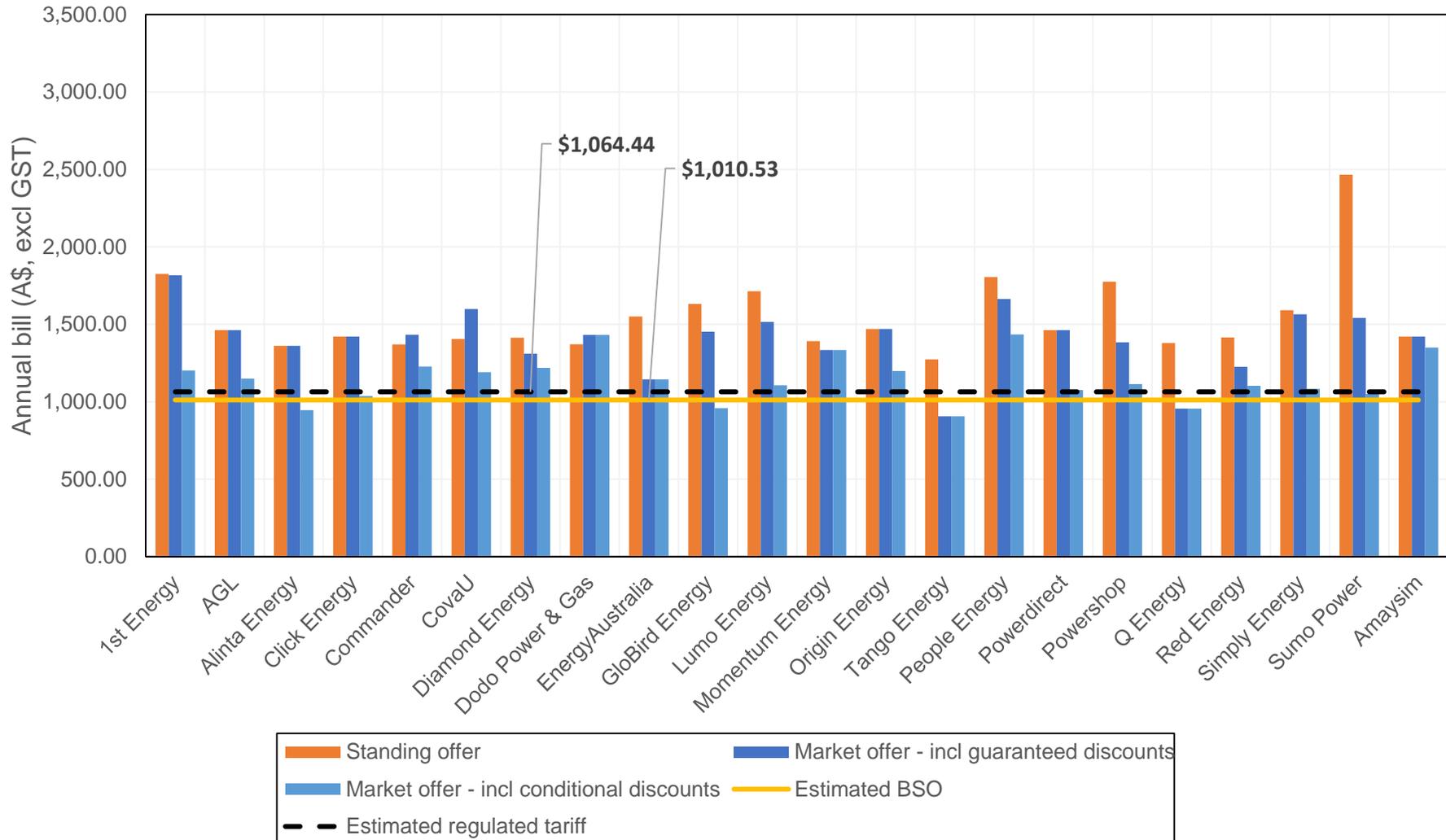


Figure 2. FY 18/19 electricity retail market offers and standing offers in comparison with an estimated regulated price and estimated basic service offer for Victoria – Jemena Network

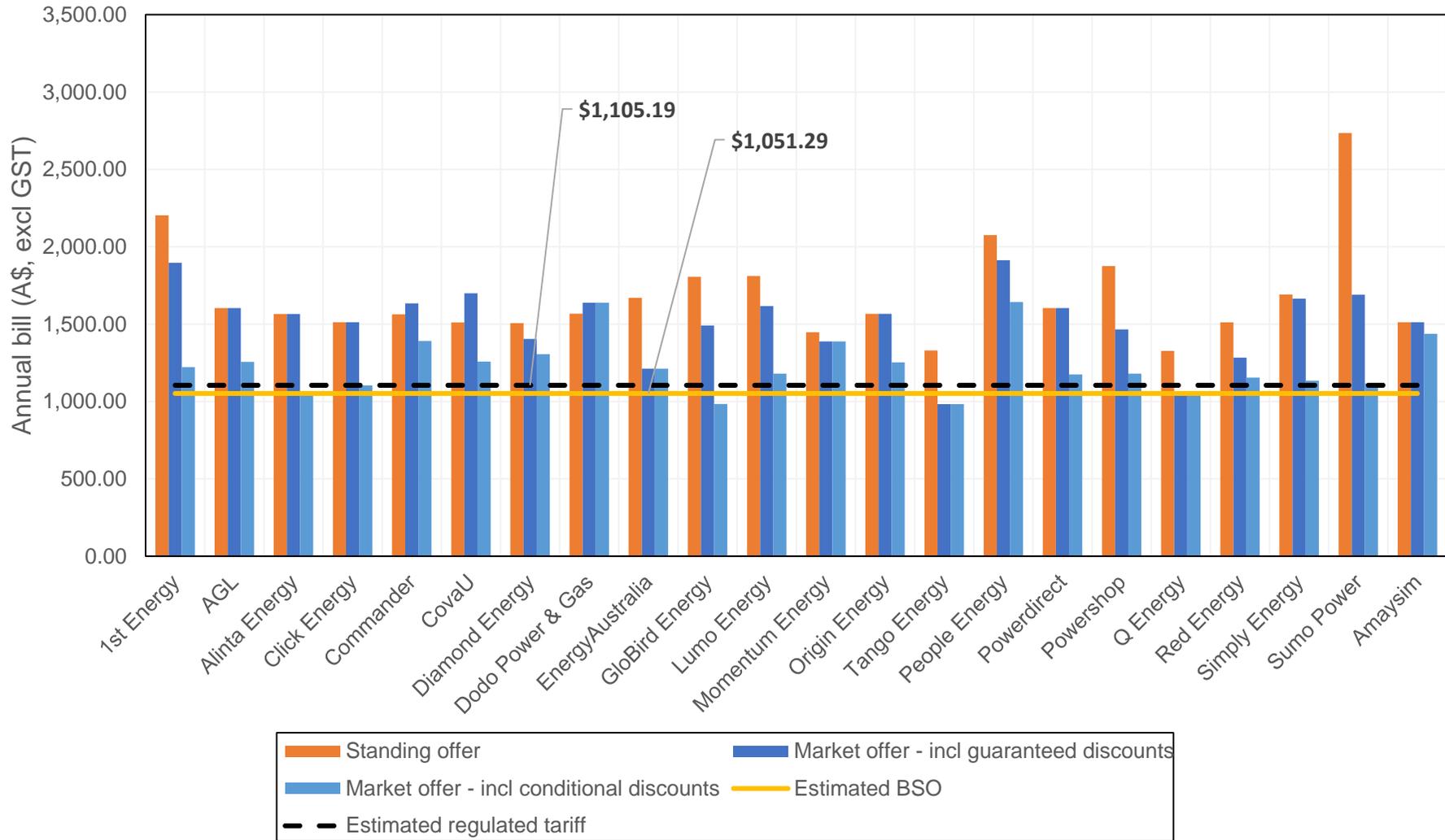


Figure 3. FY 18/19 electricity retail market offers and standing offers in comparison with an estimated regulated price and estimated basic service offer for Victoria – United Network

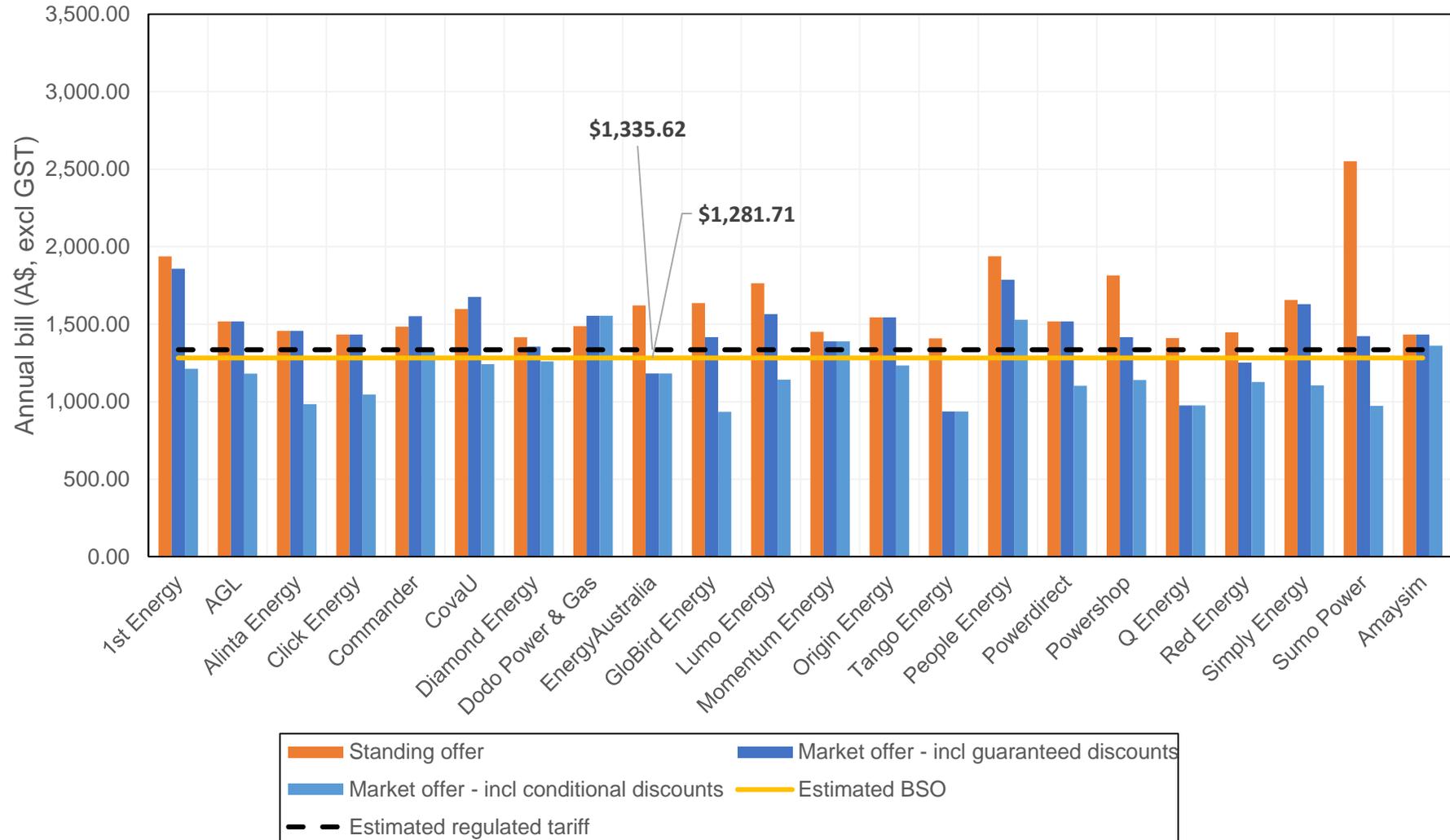


Figure 4. FY 18/19 electricity retail market offers and standing offers in comparison with an estimated regulated price and estimated basic service offer for Victoria – Powercor Network

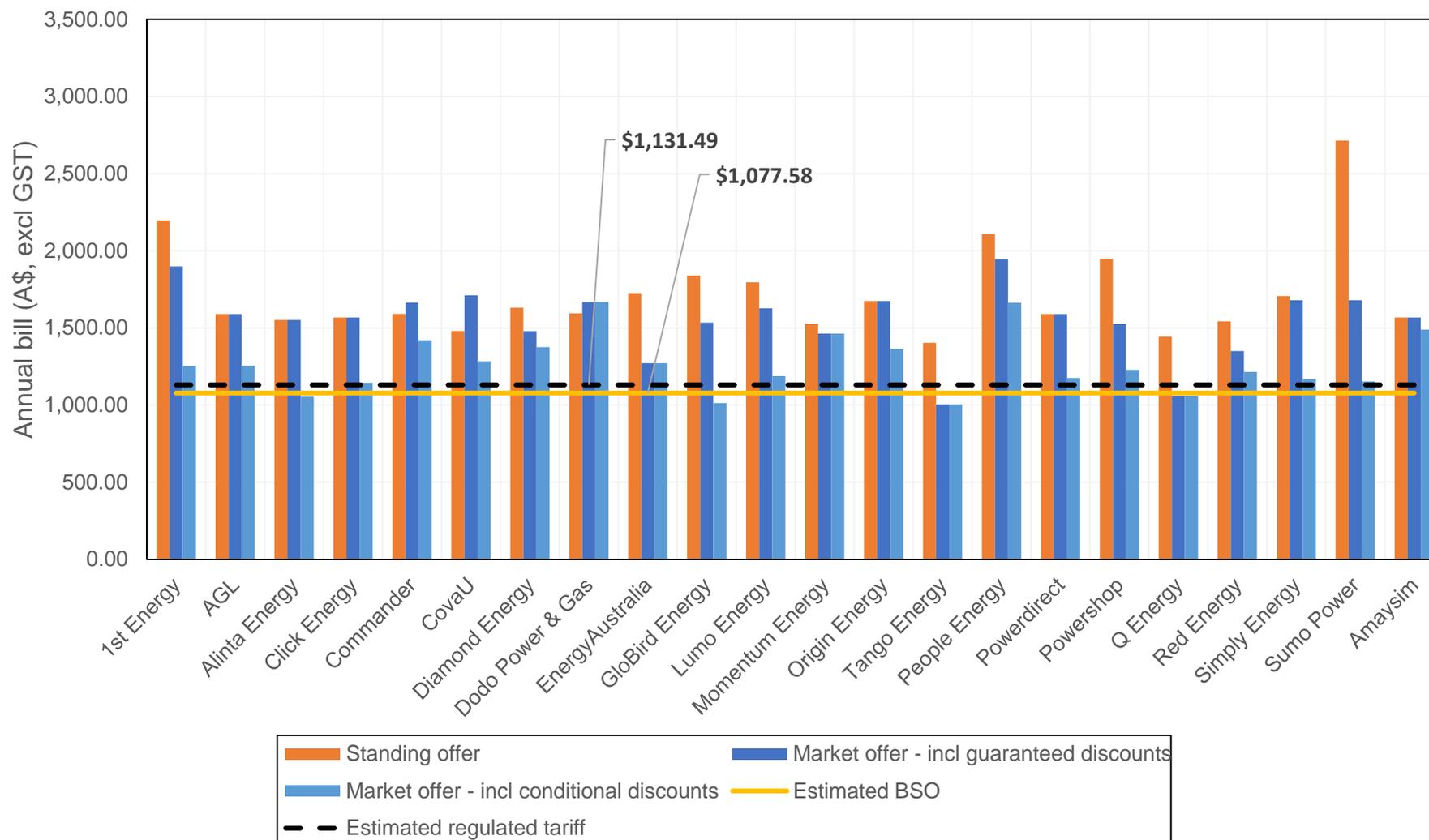


Figure 5. FY 18/19 electricity retail market offers and standing offers in comparison with an estimated regulated price and estimated basic service offer for Victoria – Ausnet Network

