

Rising retail costs and their impact on energy affordability

SUMMARY

The retail electricity market is failing Victorians, according to a new report, *A critique of the Victorian retail electricity market*, commissioned by the Brotherhood of St Laurence.

Victorians pay more for electricity because the retail component of their bills is high

The report, prepared for the Brotherhood by the Carbon and Energy Markets (CME) economics consultancy, finds that the retailer component of electricity bills, has more than doubled since 2008, and is now far higher than in other states. Victorians are now paying far more for the retailer charges in their electricity bill than for the cost of generating electricity. The report estimates that these retailer charges in 2014 are on average between \$371 and \$471 per household each year. Reducing these retailer charges would reduce Victorian households' electricity bills.

Victorian retailers' high fixed charges disadvantage low income households

The report also finds that the energy retailers' fixed charges are far higher in Victoria than in other states. For an average household electricity bill in Victoria in 2014 of around \$1,400, the report finds that around 30% to 40% of the total bill is fixed charges. This is a higher proportion than elsewhere in Australia's National Electricity Market (NEM), and higher than for household electricity bills in other developed economies.

High fixed charges especially disadvantage low-income households. The high fixed charges mean that low-income households, which generally use less electricity than higher income households, pay higher average prices for their power.

High fixed charges also diminish incentives for households to be energy efficient and undermine their ability to reduce their bills by consuming less electricity or producing it themselves to meet their own requirements.

An urgent review of the Victorian retail market is needed

The Brotherhood of St Laurence calls for an urgent review of the Victorian retail electricity market and its impact on low-income households by the Victorian Government and the state's Essential Services Commission.

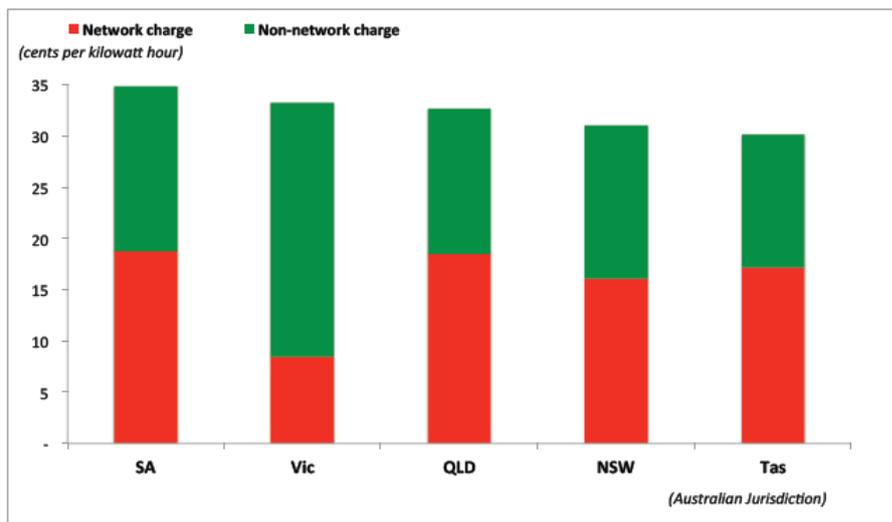
VICTORIA'S RISING ENERGY PRICES

Electricity costs have been rising across the National Electricity Market since 2007. In most Australian states rising network costs – the poles and wires – have been the primary cause of these price increases.¹

Non-network charges are the largest component of Victorian's energy bills

The Victorian case is different. Network costs are lower than in other states, and haven't risen as much². As shown in Figure 1 from *A critique of the Victorian retail electricity market*, non-network charges in Victoria, comprising the cost of generating electricity and retailer charges, are the largest component of a Victorian electricity bill.

Network and non-network charges in Victoria compared to other Australian states in the National Energy Market (NEM)



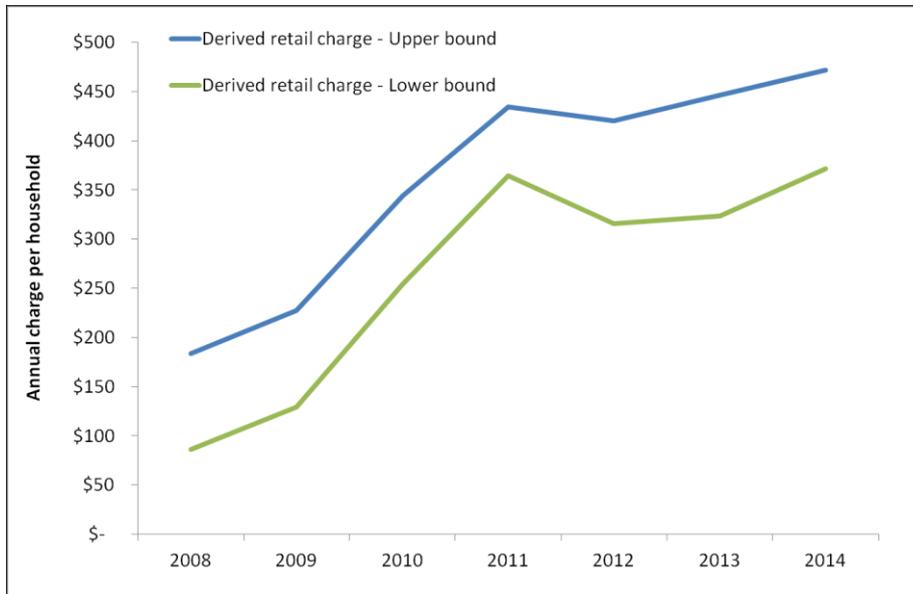
Source: CME 2015

Sharp rises in retailer charges drive up prices

CME's analysis in *A critique of the Victorian retail electricity market* breaks down the non-network charges and shows the importance of the retailer component of householders' energy bills. It is based on Australian Bureau of Statistics (ABS) data for total household electricity bills, from which network charges, environmental and metering charges and wholesale supply charges have been deducted, to estimate the amount retailers are charging for their services.

The analysis demonstrates that retailer charges rose from a range of \$86 to \$183 for the average energy bill in 2008 to a range of \$371 to \$471 in 2014.³ This represents an average increase of approximately 212% over the six years.

Average annual retail charge in Victoria over time – derived (upper and lower bounds)



Source: CME 2015

The result for consumers is that while Victorian network charges are low, relative to other states, our electricity bills have continued to increase. CME's analysis demonstrates that this is on the back of rising retailer costs.

This is a surprising result. Published reviews suggest that Victoria has a highly competitive retail energy market. In theory this should lead to lower prices for households. In practice it hasn't.

A critique of the Victorian retail electricity market reveals that the Victorian retail market is failing to deliver fully deliver on the promise of lower prices.

LOW INCOME HOUSEHOLDS AND RISING PRICES

Households on low incomes are among the hardest hit by rising energy prices

Low income households spend more of their weekly income on energy than other households, even though they tend to consume less overall. On average, households in the lowest 20% of income distribution spend close to 6% of their weekly income on energy, whereas the highest 20% spend around 1% of their income on energy. Energy price rises are much harder to accommodate in their smaller household budgets.

As electricity bills have risen so have disconnections

Victorian disconnections jumped from 6,249 in 2007-08 to 34,448 in 2013-14. The underlying rate of disconnections increased almost fivefold, from 0.29 per 100 customers in 2007-08 to 1.47 per 100 customers in 2013-14.^{4 5}

Research from the Brotherhood of St Laurence also shows that many households are unable to heat their homes⁶. Anecdotally, some Brotherhood clients have reported going without hot water for a number of years, while others have reported going to bed extremely early to avoid paying for heating in the winter.

High bills also cost the Victorian Government

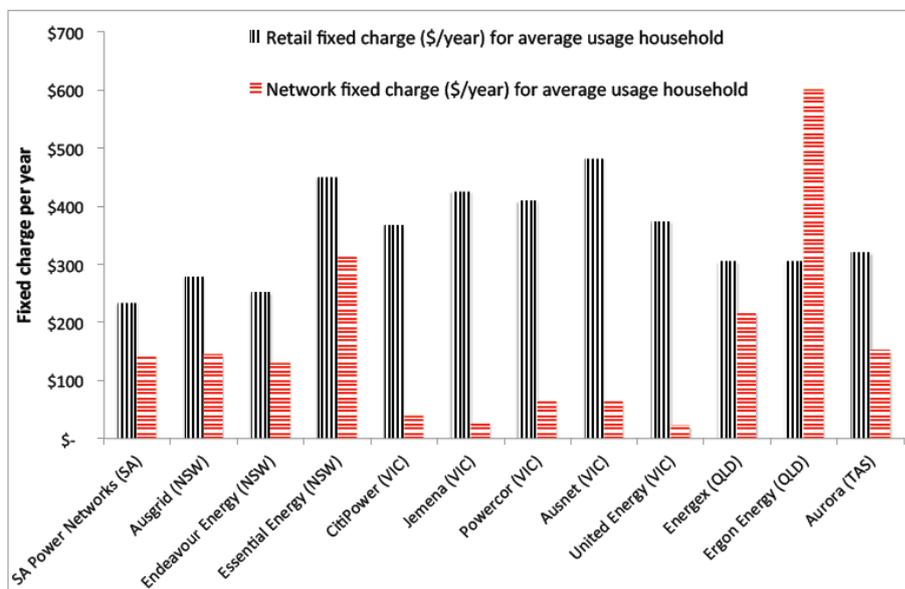
With a 17.5% energy concession offered to low-income Victorian households, excessive energy costs hit the government bottom line as well as bigger bills mean the cost of the concession rises.

High fixed charges are particularly problematic for people on low incomes

The report highlights that Victorians pay a higher fixed charge as part of their energy bills than people in other states (with the exception of the NSW Essential Energy network). Significantly, in Victoria, the retailer fixed charge is also much higher than the network fixed charge.

High retailer fixed charges mean that the average price per kilowatt hour of energy paid by low consumption (typically low income) households in Victoria is far higher than the average paid by higher consumption (typically higher income) households.⁷

Network and retail fixed charges (\$/year) for electricity supply to households in the National Electricity Market in the year to 31 December 2014 - by distribution area



Source: CME 2015

FURTHER REFORMS NEEDED TO ADDRESS RETAILER COSTS

The Victorian Government continues to take valuable steps to help consumers reduce energy costs. Examples include its *My Power Planner* online tool (<https://mpp.switchon.vic.gov.au/>), which provides accessible independent advice on the best energy market contract. We also welcome the Victorian Government's newly introduced reforms, which will mean energy retailers will no longer be able to charge customers exit fees if the retailer changes the price customers pay for energy during the period of a fixed term energy contract.

A critique of the Victorian retail electricity market, however, shows that the retail market is failing Victorian consumers and further action by the Victorian Government is needed.

RECOMMENDATIONS

Based on this report and the Brotherhood of St Laurence's concerns for low-income and vulnerable households **we recommend for an urgent review of the Victorian retail electricity market and its impact on low-income households by the Victorian Government and the state's Essential Services Commission.** The review should include:

Operation of the retail market

- Undertake further strategic analysis and quantitative work to understand retailer margins and return on investment and cost structures
- Investigate options for improving the operation of the retail market to benefit consumers
- Establish a process to ensure greater transparency of retail costs

Fixed retail charges

- Investigate the impact of high fixed charges on low income and vulnerable households
- Investigate the impact of high fixed charges on households' ability to reduce their bills through energy efficiency or producing electricity themselves
- Identify options to address high fixed retail charges including the costs and benefits of regulating fixed retail charges

Vulnerable consumers

- Undertake research to identify the impact of the competitive retail energy market on vulnerable consumers
- Identify options that enable all low-income and vulnerable consumers to benefit from better deals in the retail energy market, for example through collective energy-market switching programs
- Investigate of the role of "best in class" basic tariffs for vulnerable customers.

What you can do about your energy bill?

While we see a need for the Victorian government to investigate the retail energy market, Victorian consumers wanting a better energy deal can and should take action today.

Here are three easy steps you can take:

1. **Find a better energy market contract on My Power Planner** – the Victorian Government’s independent price comparison site <https://mpp.switchon.vic.gov.au/> or
2. **Call your existing energy retailer and ask for a cheaper deal** – or if you are wanting to change retailer contact another retailer
3. **Look at ways to lower your energy use** – but make sure you stay warm in winter and cool in summer

If you are having trouble paying your bill, or know someone who is, in the first instance you should **contact your energy retailer** and explain your situation and ask for assistance. If you aren’t able to get appropriate assistance contact the Energy and Water Ombudsman on 1800 500 509 (Freecall).

¹ Australian Energy Regulator (AER) 2012, State of the Energy Market 2012 <http://www.aer.gov.au/sites/default/files/State%20of%20the%20Energy%20market%202012%20-%20Complete%20report%20%28A4%29.pdf> p.4

² EY 2014, Electricity network services Long-term trends in prices and costs https://www.nsw.gov.au/sites/default/files/miscellaneous/electricity_network_services.pdf p.9

³ This is an increase of between 331% and 157%.

⁴ In 2013/14 the ESC reports the underlying rate is actually higher than 1.47 and is 1.87 per 100 customers. Essential Services Commission 2014, Energy Retailers Comparative Performance Report – Customer Service, 2013-14, December 2014 <http://www.esc.vic.gov.au/getattachment/0fdace1d-e672-46bc-8b9b-b432340b2d34/Energy-retailers-comparative-performance-report-Cu.pdf> p.26

⁵ Essential Services Commission 2012, Energy retailers comparative performance report— customer service 2011-12, December <http://www.esc.vic.gov.au/getattachment/edd78ebc-e203-4bea-86aa-8c8de7afade7/Energy-retailers-comparative-performance-report-Cu.pdf> p.24

⁶ Azpitarte, F, Johnson, V & Sullivan, D (forthcoming), *Fuel poverty, household income and energy spending: an empirical analysis for Australia using HILDA data*, Brotherhood of St Laurence, Fitzroy, Vic

⁷ This occurs because a higher proportion of the total energy bill is made up of the retail fixed charge in households with lower energy consumption.