Etrog Consulting

REPORT

Prepared for:

Queensland Council of Social Service (QCOSS)

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Regulated Retail Electricity Prices 2019-20: Draft Determination

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1. INTRODUCTION

This report has been prepared by Etrog Consulting Pty Ltd for Queensland Council of Social Service (QCOSS). It comments on the Draft Determination on regulated retail electricity prices to apply in Queensland from 1 July 2019 to 30 June 2020 which was published by the Queensland Competition Authority (the QCA) on 28 February 2019, inviting submissions from interested parties.

At the same time, the QCA also released a report written by ACIL Allen on estimated wholesale energy costs for use by the QCA in setting regulated electricity retail prices for 2019-20, with supporting data from ACIL Allen, four customer factsheets, and a stakeholder notice.

Since publication of the Draft Determination and associated documentation, the QCA has also held community workshops in Ayr, Bundaberg, Cairns, Charleville, Mackay, Townsville and Brisbane.[1]

The QCA has requested that submissions to the Draft Determination should be received by 12 April 2019. This report has been developed in consultation with QCOSS with the understanding that QCOSS is intending to submit this report to the QCA as its response to the Draft Determination.

1.1. Delegation from the Minister

As stated in Chapter 1 of its Draft Determination, the QCA has received a delegation from the Minister for Natural Resources, Mines and Energy (the Minister) to determine regulated retail electricity prices (notified prices). The delegation specifies that the notified prices will apply to standard contract customers for customer retail services in Queensland, other than those in the Energex distribution area, for the tariff year 1 July 2019 to 30 June 2020. A copy of the delegation, dated 17 December 2018, is provided in Appendix A of the Draft Determination, along with the Minister's covering letter.

1.2. The review process to date

On 20 December 2018, the QCA released an Interim Consultation Paper advising interested parties of the commencement of the review. The QCA received 13 submissions in response,[2] which included a response from QCOSS.

The remainder of this report comments further on various matters in the QCA's Draft Determination. It builds on the QCOSS submission to the December 2018 Interim Consultation Paper, as well as previous years' submissions from QCOSS to the QCA.

1 The QCA's Draft Determination and the ACIL Allen paper and other materials including the workshop presentation have been published on the QCA's website at http://www.qca.org.au/Electricity/Regional-consumers/Reg-Electricity-Prices/In-Progress/2019-20-Regulated-electricity-prices-for-regional.

2 Twelve of these submissions have been published; one was deemed confidential and has not been published.

2. PRICING FRAMEWORK FOR RESIDENTIAL AND SMALL BUSINESS CUSTOMERS

As set out in Chapter 2 of the Draft Determination, QCA's draft decision is to base notified prices for small customers in regional Queensland on the expected costs of supply in south east Queensland, plus a standing offer adjustment.

This is consistent with the wording in the Delegation, which states that "QCA must consider the Government's Uniform Tariff Policy, which provides that, wherever possible, customers of the same class should pay no more for their electricity, regardless of their geographic location."

On that basis, we agree that the QCA is correct to base notified prices for small customers in regional Queensland on the expected costs of supply in south east Queensland, and this decision should be carried forward to the QCA's final decision.

The QCA also considered and rejected two further approaches:

- Base the notified prices for small customers on the lowest costs of supply in regional Queensland (that is, the costs in Ergon Distribution's east pricing zone, transmission region one); or
- Set the notified prices in each of the pricing regions in Ergon Distribution's distribution area at cost-reflective levels.

We concur with the draft decision of the QCA that these approaches would be inconsistent with the Queensland Government's definition of the Uniform Tariff Policy (UTP) for 2019-20. We agree that the QCA's draft decision to continue basing notified prices for residential and small business customers on the costs of supply in south east Queensland is appropriate, because it is consistent with the Queensland Government's UTP, and it avoids the potentially large price increases associated with the other approaches.

QCA considers the "standing offer adjustment" in more detail in Chapter 6 of its Draft Determination. We consider that issue in more detail in section 6 of this report.

3. NETWORK COSTS

The QCA's current determination is for notified prices, which are retail prices charged to end-use customers. Separately, the AER determines the underlying network charges that are applicable.

On that basis, we concur with the various draft decisions of the QCA in Chapter 3 of the Draft Determination, regarding which AER-approved network cost levels and tariff structures the QCA should apply in the QCA's determination of notified (retail) prices for residential and small business customers. Specifically, we concur with the QCA's draft decisions:

- To use Energex network service costs as a basis for setting the network cost component of retail tariffs;
- To use Energex network tariff structures for non-time-of-use retail tariffs; and
- To use Ergon Distribution network tariff structures for time-of-use and demand retail tariffs.

We concur on the same basis that these draft decisions of the QCA align with the government's UTP.

We also concur that the network cost components for the QCA's Final Determination of notified prices for 2019-20 should be based on the network pricing submitted to the AER, on the basis that it would be expected that those would be the final network tariffs approved by the AER for 2019-20.[3]

In its submission to the Interim Consultation Paper, QCOSS raised concerns regarding other new tariff structures being implemented by Ergon Energy. We note that the QCA has supported concerns raised by QCOSS, and states for example: "The QCA considered the concerns raised by QCOSS and accepts the tariff structure involves additional complexity. In addition, the QCA accepts this complexity may make it difficult for customers who consider going onto tariff 15 to accurately calculate the impact on their annual electricity costs."[4]

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3 We make this comment as a matter of fact, without any statement of approval or otherwise for the network tariff prices or structures that are approved by the AER. We also note that the network prices in question are the prices being set by the AER for the final year of the current (2015-2020) regulatory period.

4 Tariff 15 is a seasonal daily usage tariff, developed for potential use in the current (2015-20) regulatory period under trial conditions and is not available on request. For more information on tariff 15, see https://www.ergon.com.au/retail/residential/tariffs-and-prices/seasonal-daily-use-tariff.

It is important that concerns raised by QCOSS and other stakeholders in regard to network tariffs for the Energex and Ergon Energy network areas are addressed, to ensure that appropriate tariffs are put in place in future. The design of network tariffs for Queensland is ongoing, and is taking place outside the framework for setting of notified prices, which are retail prices for electricity based on actual published network prices and structures. We encourage Energy Queensland and the AER to continue to pursue meaningful consultation with all stakeholders, and particularly consumer stakeholders.[5]

The setting of notified prices for regional Queensland next year (2020-21) will coincide with the start of the next regulatory period, where network prices and structures will be set based on the Queensland Tariff Structure Statements for 2020-2025, on which consultation is currently taking place. We encourage the Queensland Government to consult with consumer and community stakeholders in the development of the pricing delegation to the QCA for 2020-21 notified prices. This consultation should include consideration of possible direction on what network tariffs to apply, as well as the associated assignment policy.

5 See for example Energy Queensland's consultation on network prices for the next regulatory period (2020-25) at https://www.talkingenergy.com.au/future-network-tariffs and the AER's consultation including tariff structure statements at https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ergon-energy-determination-2020-25/proposal

4. ENERGY COSTS

As in previous years, we support the QCA's estimation of energy costs for 2019-20 being based on the application of the same methodology that was used in previous years.

5. RETAIL COSTS

Indexing of retail costs from year to year

In the 2016-17 price determination process, the QCA conducted a comprehensive review of the retail cost components of retail tariffs. As part of that review, the QCA engaged ACIL Allen to provide advice on efficient retail costs. ACIL Allen used a combination of bottom-up and benchmarking methods to estimate efficient retail costs for residential and small business customers, informed by analysis of publicly available data, observed market offers, and detailed confidential information provided by retailers.

In submissions to the Interim Consultation Paper and Draft Determination for notified pricing in 2017-18, QCOSS accepted that the retail cost allowances used for setting notified prices for 2016-17 were an appropriate starting point for setting notified prices for 2017-18, and there was no need to redo the calculations from 2016-17 for 2017-18.

However, this was premised on the basis that the retail costs from 2016-17 should not be indexed unless there was evidence that efficient retail costs had increased with inflation. QCOSS stated that it did not believe there should be an automatic assumption that efficient costs increase year-on-year by CPI. Instead, QCOSS proposed in its submissions that efficient retail costs might suitably be indexed downwards to reflect increased efficiencies.

The QCA did not accept QCOSS' argument that costs should not be indexed upwards unless there was evidence that efficient costs had increased. Instead, the QCA chose to argue that costs should be indexed upwards each year, unless stakeholders could provide compelling evidence that efficient costs had fallen in real terms.

QCOSS provided evidence that the major retailers were becoming more efficient and as a result, efficient costs were falling.[6] QCOSS expected that this trend would continue and that efficient retail operating costs would continue to fall. QCOSS had hoped that the QCA would reflect this trend in its determination of notified prices.

However, this evidence was not accepted by the QCA. Yet, the QCA did not provide any evidence of its own that efficient costs had risen in line with inflation. The QCA concluded in its Final Determination for 2017-18:

> As the QCA has no compelling evidence that actual costs have fallen in real terms for retailers in the electricity market, for either residential or small business customers we consider reducing retail cost allowances in real terms would likely result in notified prices below levels that would be consistent with the UTP.

6 QCOSS' sources were retailers' financial reports and investor presentations. See the QCOSS submission to the QCA on the draft determination of regulated retail electricity prices 2017-18, section 5.1, 3 April 2017, available on the QCA and QCOSS websites.

In its submission to the Interim Consultation Paper for 2018-19, QCOSS noted comments from the Queensland Consumers Association that the underlying retail cost structures are changing as more and more customers are opting for e-billing, direct debit and accessing information from website or via online chat. In addition, retailers are now facilitating switching to online services. These new practices serve to lower efficient retail costs, and these savings should be reflected in the retail allowances.

In its Draft Determination for 2018-19, the QCA noted that consumer groups had not established that these efficiencies would be gained precisely in the year 2018-19 rather than in previous years.

In its Final Determination for 2018-19, the QCA continued to adopt the stand that:

> For the QCA to freeze retail cost allowances, it would need material evidence that ROC borne by retailers for residential and small business customers in south east Queensland, and large customers in regional Queensland, were likely to fall in real terms in 2018-19.

It is our view that it is not for consumer groups to provide evidence of retailers' efficient costs; that is the role of QCA as the economic regulator in its annual determinations. The only way that these efficiencies can be captured is for QCA to redo the calculation of efficient retail costs each year. It is not sufficient to rely on previous years' calculations and index them, because that will continue to fail to recognise efficiencies and will continue year after year to result in notified prices above levels that would be consistent with the UTP.

We therefore submit that up-to-date calculation of efficient retail costs based on current efficient costs, and not indexation of previous costs, must be carried out as a matter of urgency for the setting of notified prices for 2019-20, and for future years if a similar Delegation is provided to the QCA for setting notified prices.

6. STANDING OFFER ADJUSTMENT – RESIDENTIAL AND SMALL BUSINESS CUSTOMER TARIFFS

We quoted in section 2 above from the Delegation that "QCA must consider the Government's Uniform Tariff Policy, which provides that, wherever possible, customers of the same class should pay no more for their electricity, regardless of their geographic location." We also stated that we would consider the quantum of a standing offer adjustment in this section 6.

The standing offer adjustment arises from the fact that the Delegation continues:

> However, as residential and small business customers paying notified prices are on standard retail contracts, the Government is of the view that QCA must consider incorporating into notified prices, an appropriate value reflecting the more favourable terms and conditions of standard retail contracts compared to market contracts.

The Minister's covering letter also states:

> I consider that standing offer prices in the SEQ market no longer provide an appropriate reference point for setting prices in regional Queensland. However, the Government holds the view that standard contracts provide additional value to customers compared to market contracts, for example, through additional protections gained in the terms and conditions of standard contracts.
>
> In order to reflect the intent of the UTP, the QCA should give consideration to including an adjustment in notified prices that appropriately reflects the additional value of the terms and conditions of standard retail contracts. I also consider the standing offer adjustment made by the QCA in previous determinations appropriately reflects this additional value and as such, the QCA should consider including an adjustment of similar magnitude in notified prices for 2019-20.

While it is the view of the Minister that the QCA should consider including an adjustment of similar magnitude in notified prices for 2019-20 as in previous years, it is left open for the QCA to consider and apply a different value.

The QCA notes in its Draft Determination that for residential customers, the highest fees contained in a retail market offer that could be incurred by a customer were around $116 and represented 9.5 per cent of a median annual bill. The QCA further noted in footnote 108:

> Fees and charges for each retailer as presented in the QCA's November 2018 retail electricity market monitoring report (chapter 4). We have calculated the sum of all fees charged under each individual retailer market offer—this represents the maximum charges a customer could incur in a given year. The fees are then used to determine the percentage the charges represent compared to a median annual customer bill.

We have reviewed chapter 4 of the QCA's November 2018 retail electricity market monitoring report and have not been able to reproduce the QCA's calculation that the highest fees contained in a retail market offer that could be incurred by a customer are around $116. We also note that:

- Some fees are mutually exclusive: a customer cannot incur a cheque dishonour payment fee and a direct debit payment fee and a credit card fee all on the one bill (and of course cannot incur both a Visa and AmEx charge at the one time).
- Presumably to attract the maximum fees a customer would need to incur all or most of a dishonour fee, a paper bill fee, an over the counter fee and a late payment fee, as well as choosing to use the most expensive credit card payment, and happen to be with a retailer who charged all those fees, and on a tariff that attracted those fees, since not all tariffs attract the fees of any given retailer.
- As noted by the QCA, it is difficult to determine what portion of the maximum fees and charges we have observed would be incurred. For example, there is no evidence on the level (or incidence) of actual charges a customer typically incurs (it is likely to be some portion of charges which would vary based on individual customer circumstances).

We doubt that any customer would ever incur anything like this maximum set of charges. The QCA says that its analysis “supports a value of 9.5 per cent or less as being appropriate to reflect the value of terms and conditions contained in standard contracts.”

We consider that the QCA should reconsider the upper bound of the value of terms and conditions contained in standard contracts based on a more realistic set of circumstances that may occur, to arrive at a more realistic upper bound. It should also be noted that this value represents the maximum theoretical charge, which might never be incurred, and might only apply to one tariff offer with one retailer.

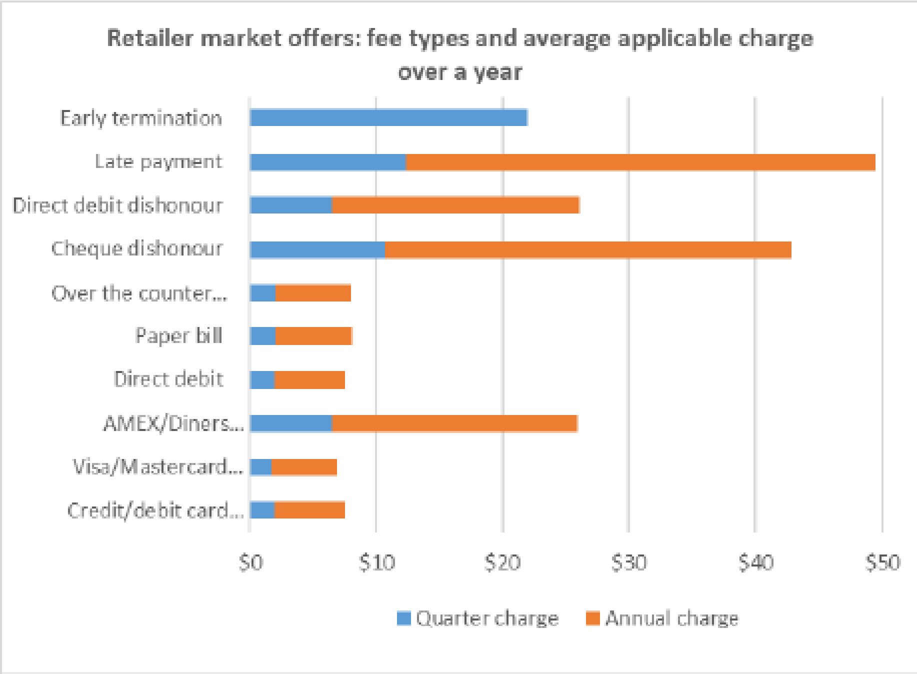
Further, some retailers carve out significant sectors of their customer base where fees and charges do not apply. For example, Origin Energy sets out on its website[7] that a $1.75 paper bill fee may apply if you get your bills by post, but the very large number of cases that are listed where the fee does not apply leaves one wondering if many (if any) customers really do face the $1.75 paper bill fee.

It would also be helpful if the QCA could document its calculations in the interests of transparency, to enable stakeholders to reproduce the calculations more easily, and make their own informed judgements on the reasonableness of the QCA’s calculations and assumptions.

7 https://www.originenergy.com.au/for-home/electricity-and-gas/pricing/additional-charges/paper-bill-fee.html

Further, the QCA shows the following figure in its Draft Determination:

Figure 15 Residential customer: summary of market offer fees and charges



While this purports to show "average" applicable charges, footnote 106 explains: "Where a retailer does not apply that particular fee type (e.g. there is a zero value for that fee type), that retailer is excluded from the sample. That is, the average dollar value calculations use only non-zero values to determine the average charge."

We believe that missing out zero values skews the average. The QCA should recalculate what an average value would be, without excluding zeros.

A 'scatter plot' with a dot for each retailer showing the average charges that might reasonably be incurred with that retailer across its tariffs, with averages including zero values, might reasonably give an indication of a value to reflect the value of terms and conditions contained in standard contracts, which we expect would be a lot lower than 5 per cent. In addition, this analysis should be proportional to the size of each retailer as this would give a more accurate representation of retailers.

In the overall averaging, more weighting should be given to the larger retailers (AGL and Origin Energy) than to the smaller retailers that may have documented more fees but have fewer customers, so overall the smaller retailers' fees are less significant.

As an alternative approach, or in addition, the QCA could survey customers on market offers and ask them what fees and charges they have actually incurred over the last year, and provide the results of that survey (without excluding zeros) to inform the real value to customers of terms and conditions contained in standard contracts. This would be a preferable solution, as it would give more accurate outcomes to meet the requirements of the Delegation.

7. DEFAULT MARKET OFFER (DMO)

We concur with the view of the QCA that it does not consider that the AER's DMO process should have implications for this price determination.

This is particularly the case since:

- The AER's determination of the DMO is in accordance with recommendation 30 from the ACCC's Retail Electricity Price Inquiry, which stated that a DMO should only be applicable in non-price regulated jurisdictions. In contrast, the QCA's task is to determine notified prices paid by customers in regional Queensland which is a price regulated jurisdiction, and therefore one in which the DMO is not relevant.
- The Delegation for 2019-20 requires notified prices to be set based on a build-up of network, energy and retail costs. In contrast, standing offer prices and DMO prices are not set on the basis of cost build-up, and may be set at levels that do not reflect underlying costs.

We agree that the QCA (and all stakeholders) should continue to monitor how this matter progresses, and may reconsider any potential implications at a later stage, if necessary.