St Vincent de Paul Society, Victoria: Response to the consultation paper to the Essential Services Commission, Staff paper, Victorian Default Offer for domestic and small business electricity customers.

January 2019

The St Vincent de Paul Society (Vinnies) welcomes the opportunity to respond to the Essential Services Commission (ESC) staff paper on Victorian Default Offer for domestic and small business electricity customers.

Detailed below are some thoughts on issues raised by this staff paper for consideration by the Commission.

Service quality and VDO

In setting the VDO we also believe that the ESC should seek to detail not only the terms and conditions that come with the VDO but also consider the quality of service that is expected with this price.

We are concerned that in setting the price it may encourage retailers to change the service levels / quality of service that is being offered. In regards to this the ESC should consider such items as: paper billing collection cycles, over the counter receipting of payments at various outlets, scope and type of payment methods, payment arrangements, additional information on energy use, call centre availability / hours and so on.

Solar households and the VDO

Currently the Victorian State Government has three interventions that relate specifically to solar households. These policies all interplay with the VDO creating cross subsidies and other policy challenges.

This includes the “fair solar policy” that limits the ability of retailers to exclude retail offers designed specifically for non-solar households from solar households. This we believe creates a cross subsidy from solar households to non-solar households. This occurs as offers designed for households with unique consumption profiles (i.e. non solar profiles) have a different cost structure that can be cherry picked by solar households.

Secondly, solar households receive an additional cross subsidy from non-solar households though the government policy that requires an additional 2.5 cent additional payment for exports as a reward for the special and environmental benefits of solar. Currently we estimate these costs are in the order of $10 – $20 million. Over time with the government policy of having an additional S650,000 households with solar power, these costs will be more significant. As such the VDO would need to make allowance for this.

Furthermore, our analysis though the Vinnies tariff tracker suggests that the current 2.5 cent social and environmental benefits of solar charge is more likely to be allocated to those on standing offer (as market offers are set though competitive processes). Therefore, how these costs are allocated in the broader market will directly impact on the VDO or the current market offers. The Commission will need to take into account how these costs are allocated.

Finally, solar households also receive additional protections though the minimum regulated feed- in rate. This also poses challenges. The paper suggests and this is confirmed by Frontier Economics, that in determining prudent cost of retailers that a prudent retailer would have significant financial instruments to cover their profile. As we understand it, if the ESC setting a minimum feed in rate assumes these benefits can be captured by the retailer, it may or may not align with the retailer's position, potentially making the regulated rate not the efficient price. It may even introduce additional costs.

We believe that the interplay of these three policy settings create significant subsidies from non-solar households to solar households. This trend has been identified in a number of "tariff tracker" reports undertaken by St Vincent de Paul society and Allviss consulting https://www.vinnies.org.au/icms_docs/291687_Victorian.pdf

This impact can be demonstrated through analysis of the various cost stacks detailed below.

We would like to draw particular attention to two key elements: the allocation of green schemes and in particular the estimated TOTAL retail component of the bill paid by solar households relative to those on market offers and standing offers.

Standing offers

Table 6 Deduction of bill components for standing offers, average annual bill based on offers effective as of July 2018 (4,800kWh per annum, single rate[77]

	Citipower	Powercor	Ausnet	Jemena	United
Retail bill incl. GST^	1,982	2,148	2,250	2,097	2,031
Retail bill excl. GST	1,802	1,953	2,045	1,906	1,846
Retail bill excl. GST and NUOS*	1,409	1,483	1,454	1,467	1,397
Retail bill excl. the above and whole-sale^^	903	977	948	961	891
Retail bill excl. the above and 'Green Schemes'**	813	887	858	871	801
Retail bill excl. the above and smart meter costs***	734	815	775	788	744

^ Based on the three incumbents average standing offers (July 2018)
** NUOS as of January 2018*
^^Based on $105.4/MWh
***LRET @ 0.88 c/kWh, SRES @ 0.33 c/kWh, FIT @ 0.38 c/kWh and VEET @ 0.29 c/kWh*
****Based on AER estimated AMI charges for 2018*

Market Offers

Table 7 Deduction of bill components for market offers (including pay on time discounts), average annual bill based on effective as of July 2018 (4,800kWh per annum, single rate)

	Citipower	Powercor	Ausnet	Jemena	United
Retail bill incl. GST^	1,472	1,629	1,745	1,595	1,526
Retail bill excl. GST	1,338	1,481	1,586	1,450	1,387
Retail bill excl. GST and NUOS*	946	1,012	995	1,011	938
Retail bill excl. the above and whole-sale^^	440	506	489	505	432
Retail bill excl. the above and 'Green Schemes'**	350	415	399	415	342
Retail bill excl. the above and smart meter costs***	271	343	316	332	285

^ Based on the three incumbents average standing offers (July 2018)
** NUOS as of January 2018*
^^Based on $105.4/MWh
***LRET @ 0.88 c/kWh, SRES @ 0.33 c/kWh, FIT @ 0.38 c/kWh and VEET @ 0.29 c/kWh*
****Based on AER estimated AMI charges for 2018*

Solar offers

Table 8 Deduction of bill components for solar market offers (including pay on time discounts), average annual bill based on offers effective as of July 2018 (4,800kWh per annum, single rate), Metropolitan households with 3kW system installed

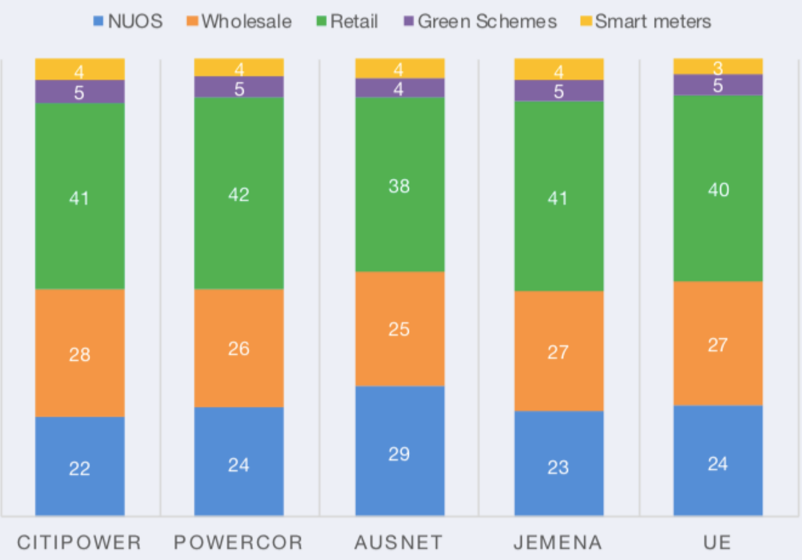
	Citipower	Powercor	Ausnet	Jemena	United
Retail bill incl. GST^	663	766	814	712	668
Retail bill excl. GST	603	696	740	647	607
Retail bill excl. GST and NUOS*	366	402	403	408	373
Retail bill excl. the above and whole-sale^^	116	152	153	158	123
Retail bill excl. the above and 'Green Schemes'**	72	107	109	114	78
Retail bill excl. the above and smart meter costs***	-7	35	26	31	21

^ Based on the three incumbents average standing offers (July 2018)
** NUOS as of January 2018*
^^Based on $105.4/MWh
***LRET @ 0.88 c/kWh, SRES @ 0.33 c/kWh, FIT @ 0.38 c/kWh and VEET @ 0.29 c/kWh*
****Based on AER estimated AMI charges for 2018*

Based on the calculations above, below are detailed the estimated bill cost within the various household.

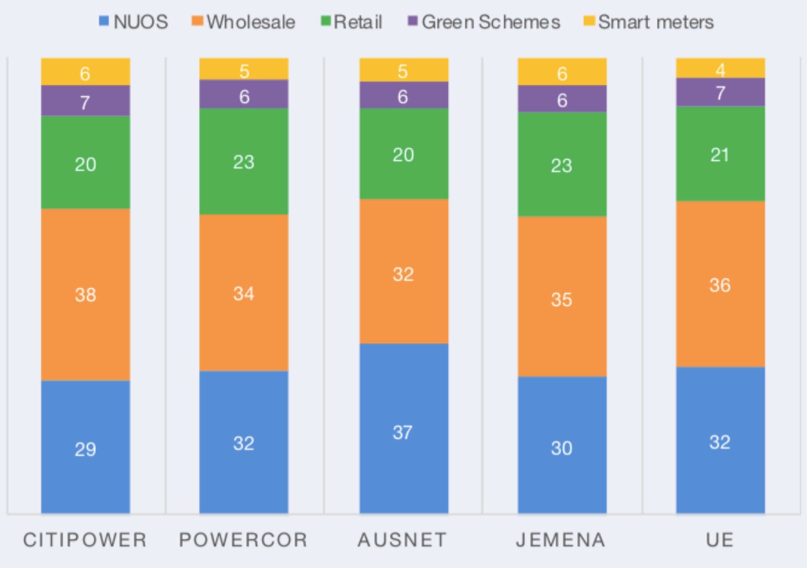
Standing offer

Chart 28 Bill-stack (%) for standing offers, average annual bill based on offers effective as of July 2018 (4,800kWh per annum, single rate)



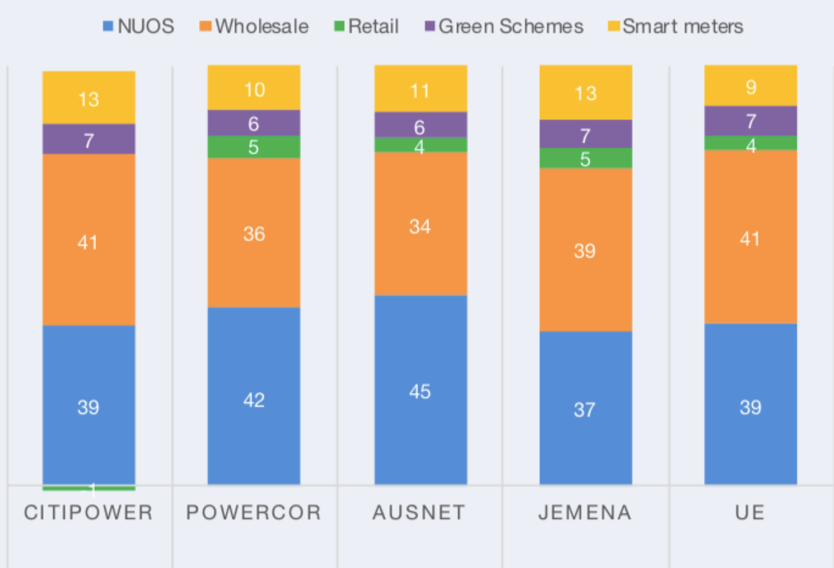
Market offer

Chart 29 Bill-stack (%) for market offers, average annual bill based on offers (inclusive of pay on time discounts) effective as of July 2018 (4,800kWh per annum, single rate)



Solar offers

Chart 30 Bill-stack (%) for solar market offers (including pay on time discounts), average annual bill based on offers effective as of July 2018 (4,800kWh per annum, single rate), Metropolitan households with 3kW system installed



As is evident, there is a large variation in cost stacks and in particular allocation of retail component of the bill.

In addition to the solar issue outlined above, we would highlight that interventions that focus on replacing the standing offer price, may also have an impact on market offers and/or solar offers. In summary, it may create more overall total losers than winners.

As such we believe the ESC in setting the VDO, must undertake some analysis to ensure that those on market offers are not worse off relative to their current position. We are less concerned about solar households as we believe and have stated above, they already receive a subsidy from non-solar households.

VMO tariff design and price setting

Firstly, we are also seeking clarity around the VMO price set by ESC. That is, is the ESC setting the rate of the various components of the tariff and the design? Or is it specifying a design and the total price, whereby the retailers cannot set the allocation between the fixed and variable charges? Or is it one where a design is specified and total cost and retailers can locate between fixed and variable?

We believe that additional risk will be borne by retailers and less efficient outcomes will be achieved for consumers (ie higher prices) where the ESC sets the tariff design and the price of each component of the tariff.

This is a significant issue as not allowing retailers to have some autonomy in allocation of costs to fixed and variable components of the tariff, will result in inefficiency in pricing wholesale and network and other charges such as green schemes – ultimately increasing costs.

Secondly, it will result in less choice VDO products for various consumer profiles, such as low consumption medium consumption and high consumption for example.

For example if the ESC were to set a price and design that was applicable to all retailers such as it will favour a particular consumption profile in the case below 10 Kwh Per day

However, if ESC gives retailers some latitude in price setting, it would also allow for potential for other profiles to be catered for such as low consumption households (See Retailer A example and higher consumption households see Retailer B example.) This is particularly important as overall it provides greater benefit to all consumers who seek to choose a VMO.

	ESC set price 10 kWh	Retailer A	Retailer B
Fixed daily	100c	50c	120c
Variable	10c	15c	8c
	Price paid per day		
Consumption level 1kWh	$1.10	$0.65	$1.28
Consumption level 10 kWh	$2.00	$2.00	$2.00
Consumption level 20 kWh	$3.00	$3.50	$2.80

This is particularly important as there are at least three distinct household types with very different profiles and consumption levels, dual fuel at 4800 kWh, all electric at 7400 kWh per annum and solar households.

In addition such an approach would allow the various retailers to price their various input costs and efficiently, this would include CAPs, Swaps, Pool exposure, NUOS charges and other charges such as Capx, Opex, Repex

Consideration of this is critical as it will shape the extent and nature of how cost will be reallocated to those who are on current standing offers when the VMO is introduced and determine the extent and amount of benefit to Victorian consumer and the broader market.

Availability of the VDO to households with Time variant and other NUOS charges that are not flat

Currently as we understand it, the VMO will be a simple tariff i.e flat, and will be available to all Victorians. We seek particular clarity from the Essential Services Commission / Victorian Government regarding the relationship of this price setting and the interaction of those households on current Time variant tariff (time of use for example) of which we believe so 25% of the customer base is on.

In addition, there are issues where networks who are being reassigned to time of use NUOS to solar households. And would the VDO be available to this group.

Finally, looking ahead, we are seeking clarity around proposed network tariff reform. This includes mandated reassignment of solar households to TOU pricing and options for opt in or opt out, seasonal demand tariffs.

These issues raise whether the coverage of the VMO is available to all. The ability of time variant tariff to operate within a flat structure, how this risk will be managed, cost smearing across other customer groups, implications for network tariff reform moving forward; these are all areas requiring clarification.

VDO and impacts on Concession card holders

Currently some retailers have gazetted specific additional discounts of standing offers for particular groups notably health care cardholders and pension cardholders. This is in addition to discounts negotiated by government.

We believe that the introduction of VMO should require specific communication to this group, as their price change difference will be different to others on standing offers.

Other impacts and consideration in implementing a VDO

The current approach of the VDO forces all retailers with a licenced retailer to market to all consumers below 160MWh. This is a significant issue specifically for retailers who choose to operate in only one market, such as residential and or small and medium business. The current proposal would require these retailers to offer into both markets and as such change their business model and cost. As such we believe some consideration should be given to retailers indicating which market they wish to be active in.

The current wholesale modelling is premised on 30-minute settlement. We believe while this may be practical in the short term, as the National Energy Market moves to 5-minute settlement due to start July 2021, these changes will have a direct and not insignificant impact on retailers' wholesale positions.

We also have some concerns regarding the timing of the introduction of the VDO, in particular potential changes to the energy market as a result of a federal election and any associated policy changes that will be implemented post May. In particular, this could include the introduction of a climate policy directly impacting the energy industry. Similar interventions are also occurring at various state levels and also have the potential to impact final costs of retailing and ultimately the final price paid by consumers.

The Commission is also suggesting that the various network load shapes be used to estimate retailers wholesale position. We believe that this creates a number of challenges and inherently favours not only the incumbent retailers in the various network areas but also the larger and more diverse retailers as they have customers in all network areas. This we believe creates some challenges as the methodology indicates that they are seeking to model the position of a prudent second tier retailer.

Consideration should be given to deemed offer provisions for households that don't engage to seek a VDO for new connections. In these situations, we suggest the current Financial Responsible Party (FRP) provision apply in this situation.

Obligation to offer. As we understand it the current obligation to offer that applies to standing offers is being extended to all retailers though the VDO. We would encourage the ESC to explore the impact and ability of second and third tier retailers to manage the shift of a number of customers to their portfolio. We would suggest some thought regarding would it be desirable to have a retailer threshold point (number customers, portfolio size under management) as to where the obligations apply? This would allow for new entrants and other business models to enter the market and avoid the VDO unintentionally restricting innovation.

<u>RERT and other charges</u>

We suggest that some provision should be made that allows waiver of various unexpected fees and charges. This would include charges such as AEMO RERT fees and other unexpected costs. (RERT costs for Victorian 2017/2018 were in the order of an additional $50 million). This would apply to other fees such as FCAS etc.

Furthermore, we also believe that the ESC should allow additional provisions for "true ups" at the end of each price setting period, this would allow unexpected events in the energy market to be managed, such as early exit of generation plan and government interventions as mentioned previously.

Relationship to existing market offers and impact on market more broadly

Issues of interactions with the gas market. For example, relative position of electric retailers VS dual fuel retailers can manage risk across both whereas single fuel retailers have less flexibility here.

Introduction of VDO and other interventions could lead to more credit checking, or a situation where customers are shifting to other retailers as retailers segment the market further to avoid either perceived risks or additional cost that certain groups of households have.

The VDO and the application of additional fees and charges, both for those on the VDO but also the changes in the retailer market of fees and charges to segment and allocate costs.

Interaction if the VDO and other reform to be introduced, in particular the obligation to offer 12 month fixed contracts. We believe that is a VDO is only set by the ESC annually and this is the price market offers are to be discounted market offers in the first month of the VDO would be for a period up to 12 months however as each month goes by and the time till the next re set of the VDO is say 6 months away retailers will not be able to offer 12 month contracts as they would not know the next price to be set. This suggests that the ESC should consider setting a VDO monthly this would allow for rolling market offers all with 12 month fixed term periods.

Pauses from market and Retailer of Last Resort ROLR provisions

Consideration should be given about the interaction of the VDO and the ability of retailer to pause or withdraw from new acquisitions if the VDO is an obligation to offer to all. This occurs as all retailer will be obliged to offer a VDO at a fair price it takes away a retailer's ability to price itself out of the market, we have seen this strategy as a way retailers manage volume risk though tracking tariffs in Victoria.