



8 January 2020

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Dear Charles,

Submission to Queensland Competition Authority Interim Consultation Paper on Regulated retail electricity prices for 2020-21

Thank you for the opportunity to make a submission to the Queensland Competition Authority (QCA) Interim Consultation Paper (ICP) on Regulated Retail Electricity Prices for 2020-21.

QCROSS' vision is for equality, opportunity and wellbeing for every person in every community in Queensland. Everyone must have access to and deserves to be able to afford the basics in life without spiralling into debt. Unfortunately, our 2019 *Living affordability in Queensland*¹ report found that many people do not have enough money to get by, especially in regional areas where the cost-of-living can be higher. People on low incomes spend a higher proportion of their income on essentials, such as housing, food, electricity, transport, phone and internet services. As the cost of essentials continue to increase, those on the lowest incomes are being left further and further behind. With these financial pressures increasing, the cost of energy remains a key issue for the communities across regional Queensland, and must be front of mind for the QCA.

As the economic regulator, the QCA must seek out prudent and efficient costs and ensure that regulated prices in regional Queensland do not result in customers paying a cent more than they should have to. There is no room for complacency when it comes to the cost of living and affordable and equitable access to essential services.

QCROSS engaged the services of David Prins at Etrog Consulting to provide advice in making this submission. This advice, which outlines our comprehensive feedback to the QCA, is attached. The key issues we would like to highlight are:

- **Ensuring prices are no higher than the Default Market Offer**
We agree with the request in the delegation, that if the application of this standing offer adjustment results in a higher bill than the equivalent Default Market Offer (DMO), it should be discounted to the level of the equivalent DMO price. We acknowledge and congratulate the commitment of the Queensland Government to seeking affordability for customers by including this direction in the Minister's delegation. Any resulting discount means reduced electricity prices for customers and that customers do not pay a cent more than they have to.
- **The importance of including options for cost reflective tariffs**
We support Tariff 11 as the proposed default tariff for new accounts. However, we believe that regional Queensland retailers should also develop options for notified cost reflective tariffs

¹ <https://www.qcross.org.au/living-affordability-queensland>

(based on the Australian Energy Regulator's approved new network tariff structures) to consumers on an opt-in basis. As tariff reform is imminent, delaying the introduction of these tariffs without substantial rationale for delay will reduce the available window of time for research trials, education programs and other learnings, particularly during a period where initial cost-reflective tariffs are expected to contain very low demand price signals. It is essential that consumers are provided a well-planned and sufficient transition-period, which includes introductory/grace periods, customer impact monitoring and forward-thinking approaches to managing the transition. Any new tariffs should be implemented with accompanying communications and education, ideally including the ability for people to compare bills on different tariff structures via the Energy Made Easy website.

- **Standing Offer Adjustment**

We do not agree with an arbitrary percentage adjustment and the QCA should not simply carry forward the value of 5 per cent for 2020-21. The QCA should undertake and publish more robust analysis of the value customers place on having standard terms and conditions. If QCA's view is that standard contracts provide additional value to customers compared to market contracts, then it is reasonable that the analysis and data used to determine the adjustment be made public and available for stakeholders to review and engage on.

- **Updating prices based on efficient Retail Costs**

2020-21 will be the fifth annual regulatory price-setting period since the last retail cost calculation was undertaken. For this reason, we especially welcome that the QCA is now considering a possible proposed approach to establish new retail cost allowances, based on more recent market data. We ask that the QCA – as a matter of urgency – carry out an up-to-date calculation of efficient retail costs, and not use an indexation based on CPI for the setting of notified prices for 2020-21. This should include further investigation of the retail margin noting the available evidence that economies of scale are in fact prevalent in the retail energy market and retail margins should be further understood.

Since the QCA last undertook detailed analysis on retail costs, the retail energy market has experienced significant change aimed at improving retail competition, reducing cross-subsidies, and driving cost-reductions for the benefit of consumers. It is important that these cost savings are assessed as we would anticipate significant downward price pressures to be found.

Recalculation of retail costs on a regular basis will ensure that only efficient costs and not costs of market inefficiencies or transitional regulatory burdens are included in retail prices. It is important that consumers do not wear the risk should it be found that poor market decisions have resulted in retailer costs increasing rather than decreasing over time. Given the motivation of much of the recent reforms are to remedy market inefficiencies and improve customer benefits and energy affordability consumers must not bear any of the cost-burden of the reforms themselves including any unreasonable transitional costs.

As we move into a period of major transition to a future electricity grid we encourage QCA to consider how it's role must shift to optimally support an effective transition. Under the Paris Climate Agreement alone, Australia has committed to achieving net zero emissions as a nation by 2050 and the energy sector is to play a major role in achieving to this. With the arrival of the AEMO's Integrated System Plan we appear to be moving towards a planned multi-decadal transition which will require perspectives and decisions to be made now to meet this transition. QCOSS believes, if done right, decarbonisation and the transition to a decentralised two-way energy network with the customer at the centre presents enormous opportunities for improving equity, reducing vulnerabilities, increasing energy affordability and increasing resiliency to climate risks.

We would be pleased to discuss our submission with you. Should you have any questions, please contact Luke Reade on 3004 6910 or luker@qcross.org.au.

Yours sincerely

A handwritten signature in dark ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

Mark Henley
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REPORT

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Regulated Retail Electricity Prices 2020-21: Interim Consultation Paper

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The information in this report is of a general nature. It is not intended to be relied upon for the making of specific financial decisions.

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The views expressed in this document do not necessarily reflect the views of Energy Consumers Australia.

8 January 2020

TABLE OF CONTENTS

1. INTRODUCTION.....	1
2. OVERARCHING FRAMEWORK	3
2.1. THE UNIFORM TARIFF POLICY (UTP)	3
2.1.1. Cost considerations.....	3
2.1.2. Tariff structure considerations	3
2.2. THE N+R METHODOLOGY	5
2.3. NOMINATING DEFAULT TARIFFS	6
3. NETWORK COSTS.....	7
3.1. NETWORK COSTS AS TREATED IN THE MINISTER’S DELEGATION.....	7
3.2. THE QCA’S INITIAL CONSIDERATION OF NETWORK COSTS FOR 2020-21	7
3.3. OUR VIEWS ON HOW NETWORK COSTS SHOULD BE TREATED IN SETTING NOTIFIED PRICES FOR 2020-21	7
4. ENERGY COSTS.....	9
5. RETAIL COSTS	10
6. STANDING OFFER ADJUSTMENT – RESIDENTIAL AND SMALL BUSINESS CUSTOMERS	12
6.1. THE QCA’S INITIAL CONSIDERATION OF STANDING OFFER ADJUSTMENT FOR 2020-21	12
6.2. OUR OVERALL VIEW ON A STANDING OFFER ADJUSTMENT FOR 2020-21	12
6.3. FURTHER CONSIDERATION OF WHAT SHOULD BE THE LEVEL OF STANDING OFFER ADJUSTMENT FOR 2020-21	13
6.3.1. Our previous views provided on the QCA’s draft determination for 2019-20.....	13
6.3.2. QCA’s response in its final determination for 2019-20	14
6.4. FURTHER INPUT FOLLOWING THE QCA’S CONSULTATION ON THE DRAFT DETERMINATION FOR 2019-20	14
6.5. CONCLUSION	15
APPENDIX A : RETAIL COSTS – OUR SUBMISSION TO THE QCA’S DRAFT DETERMINATION OF NOTIFIED PRICES FOR 2019-20.....	16
APPENDIX B : STANDING OFFER ADJUSTMENT – OUR SUBMISSION TO THE QCA’S DRAFT DETERMINATION OF NOTIFIED PRICES FOR 2019-20	18

8 January 2020

1. INTRODUCTION

This report has been prepared by Etrog Consulting Pty Ltd for Queensland Council of Social Service (QCOSS). It comments on the Interim Consultation Paper on regulated retail electricity prices to apply in Queensland from 1 July 2020 to 30 June 2021 which was published by the Queensland Competition Authority (the QCA) on 11 December 2019, inviting submissions from interested parties.¹

The QCA has requested that submissions to the Interim Consultation Paper should be received by 13 January 2020. 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 Interim Consultation Paper. This report comments on various matters in the QCA's Interim Consultation Paper. It builds on previous years' submissions from QCOSS to the QCA.

QCOSS is the state-wide peak body in Queensland representing the interests of individuals experiencing or at risk of experiencing poverty and disadvantage, and organisations working in the social and community service sector. QCOSS therefore focuses on the interests of residential customers, and examines the impacts of regulatory processes and decisions on those experiencing or at risk of experiencing poverty and disadvantage in particular.

On the same basis, this report only considers the regulated retail electricity prices to apply to residential customers. It does not consider business customers or other customer classes.

Delegation from the Minister

As stated in Chapter 1 of its Interim Consultation Paper, the QCA has received a delegation and terms of reference from the Minister for Natural Resources, Mines and Energy (the Minister) to set regulated retail electricity prices (notified prices) to apply in regional Queensland in 2020-21. A copy of the delegation, dated 10 December 2019, is provided in Appendix A of the Interim Consultation Paper, along with the Minister's covering letter.

As noted in the Minister's cover letter, the delegation and terms of reference for 2020-21 are generally consistent with the approaches in the Minister's delegation and terms of reference for 2019-20. However, there are some important additional considerations. Many of these are associated with managing potential adverse impacts on retail customers of the anticipated changes to network tariffs, including continued advancement of network tariff reform by Queensland's electricity distributors and the Australian Energy Regulator (AER) as well as the commencement of the new 2020-25 distribution regulatory control period.

¹ The QCA's Interim Consultation Paper has been published on the QCA website at <https://www.qca.org.au/project/customers/electricity-prices/regulated-electricity-prices-for-regional-qld-2020-21>

8 January 2020

In particular, of relevance to residential customers, the Minister set out:

- In general, network tariff reform should not create perceptions of differential treatment among a class of retail customers based on their geographical location or the type of meter they have. It is important for regional customers to continue to access price structures that are similar to those accessed by the majority of similar South East Queensland customers, unless they specifically choose an alternate tariff.
- The Minister is seeking to ensure that all current standard retail tariffs (standard tariffs) are retained in their current form, and where practicable, customers are provided new and additional choice of retail tariffs resulting from the national network tariff reform agenda.
- 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. In addition, the Minister considers that 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 a similar magnitude in notified prices for 2020-21 while ensuring that notified prices do not exceed the equivalent South East Queensland DMO where set.
- In setting prices for 2020-21, the Minister encourages the QCA to consult closely with retailers operating in regional Queensland, in particular regarding the continuation of existing standard tariffs. These consultations will also be key in the establishment of any new standard tariffs reflecting new network tariffs approved by the AER for the 2020-25 period.
- The government has refined the definition of the UTP to clarify that it applies to the structure of retail tariffs, as well as the price level. This ensures customers are not treated differently because of where they live in Queensland.
- Customers often do not nominate a tariff when they seek to establish an electricity account. To expedite account establishment in the interest of customers, Ergon retail generally assigns Tariff 11 for residential and Tariff 20 for small business customers as default tariffs when this occurs, reflecting current underlying network tariff assignment. However, it is likely that default network tariff assignment practices will change from 1 July 2020. Further clarification is provided to assist the QCA in its application of the UTP and maintain existing retail tariff assignment practices to avoid potential risks of adverse and unintended outcomes for customers in the first year of new network tariffs. The QCA should consider nominating Tariff 11 to be a default residential tariff and Tariff 20 a default small business tariff, to apply when a customer does not nominate a tariff when they seek to establish an electricity account. This default designation should not limit customers from selecting alternative tariffs they are eligible for if they choose to do so.

This report takes into account these new points as well as issues that QCROSS has raised previously with the QCA.

8 January 2020

2. OVERARCHING FRAMEWORK

2.1. THE UNIFORM TARIFF POLICY (UTP)

The Minister's Delegation requires that the QCA should consider the Government's UTP, which provides that **wherever possible, customers of the same class should pay no more for their electricity, and should pay for their electricity via similar price structures, regardless of their geographic location.**

The QCA's Consultation Question 1, in section 2.2 of its Interim Consultation Paper, invites stakeholders to comment on the considerations affecting how the QCA has regard to the UTP when setting notified prices for 2020-21, in light of the network tariff reforms underway.

This report section considers the cost and tariff considerations separately.

2.1.1. Cost considerations

QCOSS and Etrog Consulting have consistently supported the QCA's decisions to base notified prices for small customers in regional Queensland on the expected costs of supply in South East Queensland.

In the past, the QCA has considered and rejected other 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.

These approaches would be inconsistent with the Queensland Government's definition of the Uniform Tariff Policy (UTP) for 2020-21.

The QCA should continue to base notified prices for small customers in regional Queensland on the expected costs of supply in South East Queensland, in its draft and final decisions for 2020-21.

A decision to continue basing notified prices for small 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 other approaches that have been proposed and rejected in the past.

2.1.2. Tariff structure considerations

The delegation directs the QCA to consider:

- Maintaining existing retail tariffs and structures; and
- Options for introducing new retail tariffs (based on the AER's approved new network tariff structures); and
- Options for potentially aligning the existing retail tariffs with new network tariffs (based on the AER's approved new network tariffs with similar structures).

8 January 2020

Maintaining existing retail tariffs and structures

The existing retail tariffs and structures are known and published, having been gazetted for 2019-20. They can easily be retained, even when the structure of new more complex tariffs is not yet certain.

Customers who do not have metering that supports more complex tariff structures will necessarily continue to be served through flat retail tariffs (and, where applicable, load control tariffs), even after more complex network (and retail) tariffs are introduced in Queensland.

The Minister's cover letter states: "It is important regional customers continue to access price structures that are similar to those accessed by the majority of similar South East Queensland customers, unless they specifically choose an alternate tariff."

Though half-hourly metering is being rolled out, it will be a while (certainly after 2020-21, and likely after 2025) before a majority of residential South East Queensland customers have access to more complex tariffs.² Allowing regional customers to access flat retail tariffs in 2020-21 will meet the Minister's requirement that "regional customers continue to access price structures that are similar to those accessed by the majority of similar South East Queensland customers".

All existing retail tariffs and structures for residential customers should be maintained in notified prices for 2020-21. These include the existing flat retail tariff 11, and load control retail tariffs 31 and 33.

The Minister also specified that "network tariff reform should not create perceptions of differential treatment amongst a class of retail customers based on their geographical location or the type of meter they have".

On that basis:

Having a more complex meter that can support complex tariffs should not preclude regional customers from accessing flat retail tariffs (and, where applicable load control retail tariffs), in 2020-21.

Options for introducing new retail tariffs and potentially aligning the existing retail tariffs with new network tariffs

The Minister seeks that "where practicable, customers are provided new and additional choice of retail tariffs resulting from the national network tariff reform agenda".

² Figure A.11 in the AER's on page 18-70 of Attachment 18 – Tariff structure statement | Draft decision – Energex 2020-25 shows smart meter penetration below 10% in both Energex and Ergon Energy areas in 2018, expected to rise steadily to remain below 50% in both network areas in 2025.

8 January 2020

The QCA states in its Interim Consultation Paper that in view of the complex and rapidly evolving nature of the network tariff structures being proposed for 2020-25 in Queensland, it is unlikely there will be much certainty on the network tariff structures and pricing prior to the AER's final decision which is due in April 2020.

The QCA further asserts that it is not currently able to provide an indication to stakeholders on new retail tariffs that might be based on new network tariff structures, or on the potential to align existing retail tariffs with new network tariffs with similar structures. The QCA intends to update stakeholders on this as part of its draft determination, noting that stakeholders will have an opportunity to provide further comments as part of this review.

We support the concept that options for introducing new retail tariffs based on the AER's approved new network tariff structures be considered and made available to customers.

Before new retail tariffs are introduced, customer impact assessment and forward-thinking approaches to managing the transition for customers to new tariffs is essential.

Any such new retail tariffs should then be implemented with accompanying communications and education, alongside a well-planned and sufficient transition period which includes introductory / grace periods.

The QCA should take on a longer-term monitoring role of the implementation of new retail tariffs, and the resulting customer impacts and customer benefits, alongside the QCA's existing monitoring of the operation of the retail electricity market in Queensland.

2.2. THE N+R METHODOLOGY

As in previous years, the Minister's Delegation requires the QCA to consider using the Network and Retail (N+R) cost build-up methodology when setting notified prices.

Additionally this year, the Delegation adds: "In the event of significant uncertainty of both the prices and price structures of network tariffs to apply during the tariff year, and the QCA determines that there is insufficient time for the determination of the N component ..., use of a price indexation methodology to determine the N component for all existing Standard tariffs as set out in Part 2 of the current Tariff Schedule".

The QCA's Consultation Question 2, in section 2.3 of its Interim Consultation Paper, invites stakeholders to comment on the approaches to applying the N+R methodology for this price determination, in light of the network tariff reforms underway.

The QCA discusses the N and R components further in later sections of its Interim Consultation Paper. We correspondingly discuss these issues in later sections of this report.

8 January 2020

2.3. NOMINATING DEFAULT TARIFFS

The Minister's delegation requires the QCA to consider the 'nomination of a primary tariff for each class of small customer to apply to a customer's electricity account in the event the customer does not nominate a primary tariff when opening an electricity account'.

Additionally, the Minister's cover letter said that the QCA should consider 'nominating Tariff 11 to be a default residential tariff ..., to apply when a customer does not nominate a tariff when they seek to establish an electricity account'. Further, that 'this default designation should not limit customers from selecting alternative tariffs they are eligible for if they choose to do so'.

The QCA's Consultation Question 3, in section 2.4.1 of its Interim Consultation Paper, invites stakeholders to comment on the new matter of introducing primary default tariffs that would apply if a customer does not nominate a primary tariff when setting up an electricity account.

Tariff 11 is the existing flat-rate retail tariff currently accessed by small regional residential customers. A flat rate tariff is the only tariff that can be applied irrespective of what type of meter the customer has, and therefore it is the only default tariff structure that ensures that customers on default tariffs are not treated differently based on the type of meter they have. A flat rate tariff structure also meets the requirement that customers continue to access price structures that are similar to those accessed by the majority of similar South East Queensland customers (i.e. flat rate tariffs), unless they specifically choose an alternate tariff, which by definition is something that a customer on a default tariff has not done.

The default retail tariff for residential customers should be a flat-rate tariff, of the same form as the current Tariff 11.

8 January 2020

3. NETWORK COSTS

3.1. NETWORK COSTS AS TREATED IN THE MINISTER'S DELEGATION

As mentioned in section 2.2 above, the Minister's Delegation requires the QCA to consider using the Network and Retail (N+R) cost build-up methodology when setting notified prices, as in previous years.

Additionally this year, the Delegation adds: "In the event of significant uncertainty of both the prices and price structures of network tariffs to apply during the tariff year, and the QCA determines that there is insufficient time for the determination of the N component ..., use of a price indexation methodology to determine the N component for all existing Standard tariffs as set out in Part 2 of the current Tariff Schedule".

3.2. THE QCA'S INITIAL CONSIDERATION OF NETWORK COSTS FOR 2020-21

The standard N+R cost build-up approach involves passing through the N component. This approach results in retail tariff structures that reflect the underlying network tariff structures approved by the AER.

Alternatively, an X-factor approach could be adopted, where each individual network charge component is adjusted by an X-factor, using the 2019-20 approach as a starting point.

The QCA states that the usual approach "could not provide the same level of certainty to stakeholders on notified prices that may apply, or indicate how much consultation time would be available in light of the timing of network tariff reforms". There is an implication that the flexible approach could provide that the X-factor approach could provide more certainty, and the AER is quoted as proposing to use this approach in its Default Market Offer (DMO) determinations for default retail tariffs for 2020-21.

The QCA's Consultation Question 5, in section 3.1 of its Interim Consultation Paper, invites stakeholder comments on these matters, particularly on any appropriate network price indexation methodologies that the QCA should consider applying, if it becomes necessary.

3.3. OUR VIEWS ON HOW NETWORK COSTS SHOULD BE TREATED IN SETTING NOTIFIED PRICES FOR 2020-21

It seems to us that in regard to tariffs whose structures are known, including existing flat rate and load control tariffs, the two methods being considered by the QCA are actually identical. If the factors that the AER uses to adjust 2019-20 network tariff components to determine 2020-21 network tariffs are known, then applying those factors to 2019-20 network tariffs will give the same result as using actual 2020-21 network tariffs. The 2020-21 network tariffs should be known in time for the QCA's final determination of notified prices for 2020-21 is known.

However, when the QCA's draft determination is made, the final 2020-21 network prices may not yet be known, and it would be reasonable for the QCA to use *estimates* of X-factors in its draft determination as "placeholders" until the actual network tariffs for 2021 are known, and inserted in the final determination.

8 January 2020

The QCA's final determination should determine the N component based on actual network tariffs for 2020-21.

The QCA's draft determination may use X-factor adjustments of 2019-20 tariffs, based on the best available estimates, noting that these estimates are placeholders, pending publication of actual tariffs for 2020-21.

The issue that in a five-year reset there is additional uncertainty at this time of the year regarding the network tariffs for the forthcoming regulatory period is not new. For example, in its draft determination of notified prices for 2015-16, and the start of the current five-year regulatory period 2015-20, the QCA used as a placeholder in its draft determination the network tariffs and charges proposed by the distributors to recover their proposed revenue in our draft determination. The QCA noted at the time: "Using network charges based on the distributors' proposed revenue, rather than approved revenue, means there is a higher risk of material changes between the draft and final determinations compared to previous years."

There are extra issues with introducing new retail tariffs based on the new network tariffs (yet to be approved by the AER), which were discussed in section 2.1.2 above, where we noted that the QCA intends to update stakeholders on this as part of its draft determination, noting that stakeholders will have an opportunity to provide further comments as part of this review.

8 January 2020

4. ENERGY COSTS

The QCA's Consultation Question 6, in section 3.2.1 of its Interim Consultation Paper, asks whether stakeholders consider any changes should be made to the QCA's approach for estimating energy costs, or particular categories of energy costs.

As in previous years, we support the QCA's estimation of energy costs for 2020-21 being based on the application of the same methodology that was used in previous years.

5. RETAIL COSTS

The retail cost allowance includes costs associated with a retailer providing customer retail services to its customers (called retail operating costs) and the return to investors for exposure to systematic risks associated with providing these services (the retail margin).

The QCA's Interim Consultation Paper notes that in previous price determinations, the QCA has set the allowance for retail costs in total using an established benchmark (set as part of the 2016-17 price determination process), adjusted for inflation.

This year, the QCA is considering whether to:

- Establish new retail cost allowances, based on more recent market data; or
- Maintain its approach and apply the established benchmark, adjusted for inflation.

The QCA states that it is open to stakeholder submissions on which approach is more appropriate at this time.

The QCA's Consultation Question 7, in section 3.2.2 of its Interim Consultation Paper, seeks stakeholder comments on approaches to setting the retail cost allowance.

Our starting point for addressing this question is QCOSS' previous submissions to the QCA. An extract on this matter from our report to QCOSS on the QCA's draft determination of notified prices for 2019-20 is included for ease of reference as Appendix A to this report.

We concluded "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."

In its final determination for 2019-20, the QCA stated that effectively it was too late after publication of the draft decision to implement a change of methodology for 2019-20, while accepting that "there may be merit in revisiting the retail cost benchmarks in the near future":

The QCA considers there may be merit in revisiting retail cost benchmarks in the near future. However, for the 2019-20 pricing process, we considered the policy uncertainty to be too great to produce reliable retail cost estimates. In addition, in order to provide natural justice for stakeholders, a change of methodology for 2019-20 of that magnitude would require further consultation, which would not be possible under the tight timelines for this pricing determination.

We welcome that the QCA is considering a possible proposed approach to establish new retail cost allowances, based on more recent market data. It is four years since the retail cost allowances were last calculated, and much has changed in that time. It is good regulatory practice to recalculate the retail cost allowances from time to time.

Recalculation of retail costs would provide a fairer and more equitable outcome if that calculation were undertaken afresh. We see no basis for continuing to index retail costs by inflation without further analysis.

8 January 2020

The recalculation should take into account expected efficiencies that all businesses should be achieving, including more use of online channels to service customers. More and more customers are opting for e-billing, direct debit and accessing information from retailers' websites or via online chat, automated customer service and sales technologies, including 'chat bots'.

The QCA's Final Determination on Regulated Retail Electricity Prices for 2016-17, May 2016 p. 30 stated:

ACIL's analysis does not suggest any clear relationship between the overall level of retail costs and retailer characteristics, particularly in terms of scale. In fact, some of the smaller retailers appear to have lower costs than some larger incumbents.

The issue of economies of scale needs to be revisited, given that the ACCC's Retail Electricity Pricing Inquiry 20 June 2018 explicitly identifies that large retailers enjoy significant advantages of scale.

The appropriate retail margin may also now be lower due to reductions in interest rates and costs of capital in recent years.

We note the QCA's comment in the final determination for 2019-20 regarding "tight timeframes". It is important that work on establishing new retail cost allowances is started as a matter of urgency, before the QCA again runs out of time, and again uses "tight timeframes" as a reason not to undertake new analysis.

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 2020-21, and for each future year that a similar Delegation is provided to the QCA for setting notified prices. The recalculation should take into account expected efficiencies that all businesses should be achieving, including more use of online channels to service customers, and increasing use by customers of more efficient electronic payment methods, as well as economies of scale, and an appropriate retail margin.

8 January 2020

6. STANDING OFFER ADJUSTMENT – RESIDENTIAL AND SMALL BUSINESS CUSTOMERS

6.1. THE QCA'S INITIAL CONSIDERATION OF STANDING OFFER ADJUSTMENT FOR 2020-21

The QCA's Interim Consultation Paper notes that as in previous years it is the Government's view that a standing offer adjustment should be included in notified prices for residential and small business customers to reflect "the more favourable terms and conditions in standard contracts".

Also new for this year, when considering the magnitude, the delegation states:

.... should the application of this value result in a bill that exceeds the equivalent Default Market Offer as set by the Australian Energy Regulator for southeast Queensland, that value should be discounted so that the resulting bill does not exceed the equivalent Default Market Offer.

The QCA sets out that given the timing of its review, and the timing of the AER's DMO process, the QCA is considering having regard to its previous approach of including a standing offer adjustment and setting the level of this adjustment at five per cent, subject to further information being available on the DMO for South East Queensland to assess whether the value should be reduced.

The QCA's Consultation Question 8, in section 3.3.1 of its Interim Consultation Paper, invites stakeholder submissions on the standing offer adjustment, including on the appropriateness of the QCA's proposed approach and alternatives stakeholders suggest.

6.2. OUR OVERALL VIEW ON A STANDING OFFER ADJUSTMENT FOR 2020-21

The Delegation states that the Government's Uniform Tariff Policy (UTP) "provides that, wherever possible, customers of the same class should pay no more for their electricity, and should pay for their electricity via similar price structures, regardless of their geographic location."

Customers in South East Queensland have access to market contract prices. Therefore, under the UTP, customers in regional Queensland should also have access to electricity at the same market contract price levels that apply in South East Queensland, otherwise customers in regional Queensland would be required to pay more for their electricity than customers in South East Queensland on market contracts, which would go against the UTP.

On that basis, the correct standing offer adjustment for the QCA to apply would be zero adjustment.

Notwithstanding, the Delegation also states that "the Government is of the view that the 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".

8 January 2020

If the QCA believes that this legally obliges the QCA to set a standing offer adjustment that is non-zero, then it should be set as stated in the Delegation only at a level that reflects the more favourable terms and conditions of standard retail contracts compared to market contracts.

The correct standing offer adjustment for the QCA to apply is a zero adjustment.

However, if the QCA believes it is legally obliged to set a non-zero standing offer adjustment in notified prices for residential and small business customers, then it should accurately reflect the value to customers (if any) of more favourable terms and conditions in standard contracts.

Whatever standing offer adjustment is used, the value of the standing offer adjustment should then be discounted so that the resulting bill does not exceed the equivalent Default Market Offer.

We do not accept that the level of the standing offer adjustment to reflect the value to customers (if any) of more favourable terms and conditions in standard contracts should be five per cent.

While it is the view of the Minister that the QCA should consider including an adjustment of similar magnitude in notified prices for 2020-21 as in previous years, it is left open for the QCA to consider and apply a different value.

6.3. FURTHER CONSIDERATION OF WHAT SHOULD BE THE LEVEL OF STANDING OFFER ADJUSTMENT FOR 2020-21

6.3.1. Our previous views provided on the QCA's draft determination for 2019-20

Our starting point for addressing what should be the level of the standing offer adjustment is QCOSS' previous submissions to the QCA. An extract on this matter from our report to QCOSS on the QCA's draft determination of notified prices for 2019-20 is included for ease of reference as Appendix B to this report.

As stated in the extract in Appendix B, we reviewed last year chapter 4 of the QCA's November 2018 retail electricity market monitoring report and was not 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 noted that some fees were mutually exclusive, and provided further analysis which concluded that we doubted that any customer would ever incur anything like this maximum set of charges.

We proposed various analytical ways in which the QCA could better estimate the added value to a customer of a standard retail contract as against a market contract.

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.

8 January 2020

We also said that it would 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.

6.3.2. QCA's response in its final determination for 2019-20

In its final determination on notified prices for 2019-20, the QCA acknowledged that "QCOSS suggested the QCA should undertake a comprehensive and representative survey and/or some statistical analysis to ensure the basis for the adjustment was robust". The QCA did not follow that suggestion, on the basis that "undertaking a quantitative assessment remains a difficult and complex task", and "assessments do not allow for the level of transparency and reconciliation of the adjustment value that stakeholders may desire".

The QCA's final determination for 2019-20 opined on the "value" customers place on having standard terms and conditions being highly subjective, while still talking up (qualitatively) what that value might be, without any basis that customers place any value on anything the QCA might conjure up as having value to those customers.

The QCA did not explain how a customer on a market contract could incur fees of \$116. Nor did it address our proposal that 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 to inform the real value to customers of terms and conditions contained in standard contracts.

Instead, without further analysis, the QCA chose to use the same adjustment as it had in previous years, namely 5%.

The QCA did however state: "While the time required to undertake such analysis precludes such work being done for this review, we consider it may be possible to refine the approach further if we are delegated the task of determining notified prices for 2020-21."

It is therefore very disappointing that the QCA's Interim Consultation Paper for 2020-21 does not take this statement further and actively consider how it might refine the approach for 2020-21.

6.4. FURTHER INPUT FOLLOWING THE QCA'S CONSULTATION ON THE DRAFT DETERMINATION FOR 2019-20

We very much doubt that customers consciously place any value on a standing offer over a market offer. Customers do not choose to pay any percentage more for a standing offer as against a market offer. There are many ways that the QCA could conclude that the value of the standing offer adjustment should be zero or close to zero, based on analytical calculations, market surveys, or a combination of both.

8 January 2020

Further, on 15 May 2019 the QCA issued a media release³ stating that it was taking enforcement action against Origin Energy. In January 2019, the QCA identified six Origin standing offers that included \$12 late payment fees. In March 2019, Origin informed the QCA that it had charged late payment fees to some of its standing offer customers between December 2011 and August 2018. The number of affected customers was greater than 450.

The breach of the pricing rules was found by analysing retailers' standing offers on the Australian Energy Regulator's electricity price comparison website, Energy Made Easy.

We note that apparently over a period of almost seven years not a single customer on a standing offer complained about being charged late fees. This clearly shows that none of these customers could have put any value on the fact that there were no late fees payable on a standing offer, otherwise they would have noticed that they were being charged incorrectly, and complained. It is likely that none of them was aware that there was a rule that no late fees were payable on a standing offer, let alone putting a value on that rule.

This further confirms our strong view that customers do not choose to pay any percentage more for a standing offer as against a market offer.

6.5. CONCLUSION

The QCA should not just carry forward the value of 5% for a standing offer adjustment for 2020-21.

The QCA should undertake and publish more robust analysis of the value customers place on having standard terms and conditions. This analysis should be based on the evidence provided in this report and in our previous submission on the draft determination for 2019-20. The outcomes of that analysis should form the basis of a standing offer adjustment for 2020-21.

Once the equivalent Default Market Offer as set by the Australian Energy Regulator for South East Queensland is known, the value of the standing offer adjustment should be discounted so that the resulting bill does not exceed the equivalent Default Market Offer.

The discount in the standing offer adjustment so that the resulting bill does not exceed the DMO can only be in one direction. If notified prices as calculated before consideration of the DMO exceed the DMO, then notified prices are reduced. If notified prices as calculated before consideration of the DMO are lower than the DMO, then no further change is made.

³ See <https://www.qca.org.au/project/retailers-and-distributors/enforcement-overview/enforcement>

8 January 2020

APPENDIX A: RETAIL COSTS – OUR SUBMISSION TO THE QCA’S DRAFT DETERMINATION OF NOTIFIED PRICES FOR 2019-20

For ease of reference, this Appendix contains an extract on retail costs from our report to QCOSS on the QCA’s draft determination of notified prices for 2019-20.

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.⁴ 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.

⁴ 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.

8 January 2020

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.

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.

8 January 2020

APPENDIX B: STANDING OFFER ADJUSTMENT – OUR SUBMISSION TO THE QCA’S DRAFT DETERMINATION OF NOTIFIED PRICES FOR 2019-20

For ease of reference, this Appendix contains an extract on standing offer adjustment from our report to QCOSS on the QCA’s draft determination of notified prices for 2019-20.

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 6.⁵

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.

⁵ The references here to section 2 and section 6 are to sections of our report to QCOSS on the QCA’s draft determination of notified prices for 2019-20. They are not references to sections in this report on the QCA’s Interim Consultation Paper for notified prices in 2020-21.

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.

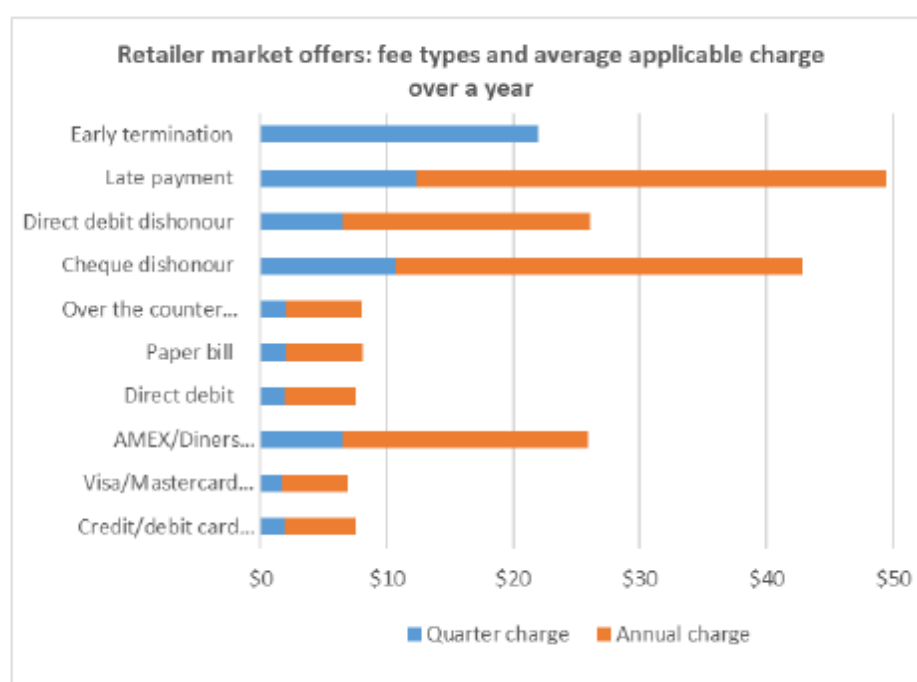
8 January 2020

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 website⁶ 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.

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.

⁶ <https://www.originenergy.com.au/for-home/electricity-and-gas/pricing/additional-charges/paper-bill-fee.html>

8 January 2020

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.