Essential Services Commission
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Victorian Default Offer to apply from 1 January 2020: Draft Decision

The Australian Energy Council (the **'AEC'**) welcomes the opportunity to make a submission regarding the Essential Services Commission's (**'ESC'**) Issues Paper (the **'Draft Decision'**) considering the Victorian Default Offer (**'VDO'**) that is intended to be implemented on 1 January 2020.

The AEC is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

Given the position of the AEC as a representative of competitor businesses, we operate in strict compliance with the Competition and Consumer Act (the 'CCA'). The CCA prohibits the AEC discussing with members confidential information relating to costs and how they set their prices. This submission has been drafted in line with our CCA obligations, and will focus on best practice price regulation methodologies, rather than the preferred methodologies of individual members. Our members will provide more detailed views on the issues raised.

The Draft Decision in effect replicates the approach taken by the ESC in setting the 2019 VDO, despite suggestions from a number of stakeholders that the approach deviated from best practice price setting principles. This results in a Draft Decision that underestimates the environmental costs faced by prudent retailers, underestimates the wholesale electricity cost, and does not take into account the expected increases in Victorian network costs for 2020. The AEC expects these issues to be rectified in the final decision, when better data becomes available, irrespective of the impact that might have on the ESC's announcement that the 2020 price will increase by less than CPI.

The AEC is most concerned with the calculation of the wholesale electricity cost. The calculation appears to disregard genuine and plausible factors likely to impact retailers' wholesale electricity costs in 2020. At the very least, Frontier Economics has failed to publish any sensitivity analysis to the assumptions they make in determining what a prudent retailers wholesale costs would be, highlighting the concerns raised by the AEC about transparency. To that end, the AEC has engaged ACIL Allen to undertake this task. This report will be submitted to the ESC once finalised, and as such, this submission is silent on the wholesale cost calculation.

The sensitivities ACIL Allen has been asked to assess include:

- the impact of utilising historical data from 2016/17 (pre-Hazelwood closure)
- the impact of higher than average PV take-up in 2020, driven by the Victorian Government's Solar Homes program and the avoided social cost of carbon cross-subsidy included in the minimum feed-in tariff

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- the impact of including a volatility allowance, compared to utilising a particular percentile of the expected load profile
- the methodology used to scale the historical spot prices to base futures prices

Network Costs

Since the Draft Decision was published, Victorian distributors have published draft pricing proposals for 2020. These proposals, if approved, will each result in customers paying increased network costs in 2020. The AEC acknowledge that the ESC intends to update the final decision to take into account the approved network costs, however, this will mean that the ESC's prediction of a less than CPI price increase will not hold true.

Retail operating costs and CARC

The AEC considers that at a minimum, the costs of acquisition and retention must be maintained at the 2019 level, adjusted for inflation. We anticipate that other stakeholders will encourage the ESC to further decrease this allowance – we would strongly oppose such action. The CARC set by the ESC in 2019 was already vastly lower than what the ACCC identified as the actual costs incurred by retailers, and further reducing it arbitrarily would have dramatic consequences on the competitive market. Given the requirement to advise customers if the VDO would be their 'best offer', the VDO in effect acts as a market cap. Failure to adequately compensate retailers for the genuine costs of competition in a price cap can only disadvantage engaged customers. The competitive market must be allowed to operate in conjunction with the VDO. We strongly recommend the ESC undertake analysis of the cost data they have received from retailers to determine if the 2019 level needs to be increased to avoid unintended consequences.

The AEC considers that some adjustment is necessary to the retail operating cost allowance to take into account the significant regulatory interventions that have been implemented in the past 12 months. The use of a benchmark from 2013 does not reflect the heightened regulatory environment seen by retailers today. Since the implementation of the 2019 VDO, retailers are now required to publish best offer information on bills, provide customers with the clear advice entitlement, and will be faced with implementing the clear and fair contracts regulatory changes during the VDO year.

Clearly these regulatory changes will continue to increase costs on retailers and must be allowed for. Retailers are forced to implement these changes, absent any analysis of their costs or benefits. It cannot be said that these costs would not be incurred by an efficient retailer, and must be compensated in the VDO.

The AEC notes that the Draft Decision does not appear to account for inflation in the change table included on page 59. We assume these numbers will be corrected in the final decision.

Calculation of the Maximum Annual Bill

The AEC welcomes the Draft Decision to move away from the approach to cap the VDO at any consumption level. This approach clearly would have resulted in unintended consequences, and required the ESC to set a higher price overall to take into account the inability for a retailer to align the network costs they incurred with the VDO.

We note some retailers continue to prefer an approach where the ESC sets tariffs for time of use and other common non-flat tariffs. We understand the rationale behind such approach, but note the opinion of the ESC that such an approach would require a change in the Order in Council (OIC). The AEC does not consider that the drafting of the OIC should be a limitation if the ESC considers it would deliver the greatest customer outcomes, particularly given the ability for the OIC to be changed with the stroke of a pen.

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That being said, of the options initially proposed, the AEC supports the single representative consumption level approach the ESC has taken in the Draft Decision, at least for 'standard' non-flat tariffs shown in table 12. This approach aligns with the likely approach taken nationally in regulating the Default Market Offer, increasing harmonisation.

The AEC does not support the Draft Decision to require retailers to 'submit to the commission their estimation of any usage profile that is not covered in table 12, at the time of publication of their standing offers.' This approach is unnecessarily complicated, and will be difficult to comply with, for little consumer benefit. It would be preferable to limit the application of the VDO to the tariffs listed in table 12, rather than require retailers to submit derived VDO's for the few customers they will apply to. The AEC strongly considers these more complicated tariffs should be limited to market offers, where customers can be adequately informed of their implications.

The AEC understand this preferred alternative will align with the approach that the Commonwealth Government will take in expanding the application of the Default Market Offer to solar and time varying tariffs. Harmonisation on this expanded scope will mitigate additional costs being incurred by retailers. Progressing the approach taken in the Draft Decision will create operating costs for all retailers that will need to be compensated for in the Final Decision.

The AEC would welcome the opportunity to further discuss this submission, and the analysis from ACIL Allen that will be provided in the coming days, and looks forward to ongoing engagement with the ESC as it finalises the 2020 VDO.

As noted in previous submissions, failure to adequately compensate retailers for their efficient costs risks irreversibly damaging the retail market, and significantly impacting the experiences of Victorian consumers. For any questions about our submission please contact me by email at ben.barnes@energycouncil.com.au or on (03) 9205 3115.

Yours sincerely,

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