



# **Submission to the Australian Energy Market Commission's Review of Retail Electricity Market Trends**

## **Efficiency of Different Electricity Jurisdictions' Residential Supply**

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## Summary

The four major states within the National Electricity Market (NEM): NSW, Queensland, South Australia and Victoria have data on the various components of electricity supply - generation, transmission, local distribution and retailing - that allows comparisons to be made of relative efficiencies in supplying households. This paper sets out the different cost components assembled by the Australian Energy Market Commission (AEMC)<sup>1</sup> with adjustments to the Victorian data to enable more accurate comparisons through the Essential Services Commission of Victoria (ESCV)<sup>2</sup>.

In general, efficiency is best ensured with competitive markets and easy entry into those markets.

Where there is a monopoly enforced by government this is a less likely outcome and even more so if the monopoly is government owned and does not therefore have shareholders who would pursue lower costs to improve their profits. This was a consideration in former Prime Minister Julia Gillard, having long been a proponent of public ownership, accepting the deficiency of NSW and Queensland state electricity monopolies compared with their privately owned counterparts. The Abbott Government has indicated it will facilitate privatisation by state governments.

Generation largely determines wholesale costs, which because of the NEM are similar for the four mainland states.

In general the data supports the case that private ownership of transmission and distribution is more efficient than public ownership in bringing about lower costs. Other data on system interruptions indicates that this is not achieved at the expense of quality and reliability.

With regard to retailing, the fully deregulated nature of the Victorian market makes it difficult to compare with other markets and there have been suggestions that there is some form of oligopoly prevailing which has entailed very high cost. Careful analysis of the data indicates the retail costs are not appreciably higher in Victoria than in other states. To the degree that they are higher this is due to additional costs imposed including as a result of the state's smart meter rollout, its highly intrusive energy Ombudsman, difficulties in disconnecting delinquent customers and a low maximum termination fee.

## Different Costs of the Electricity Supply Components

### Wholesale costs

There is some disparity between the states as a result of different costs. Although the market is interlinked there are occurrences when links are constrained and this tends to mean higher average prices in South Australia and lower in Queensland reflecting the different costs of generation. In addition, the load curve differs among the states - South Australia is the peakiest and Queensland the flattest. This contributes to differentials: the costs are greater for the peakier loads but the

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<sup>1</sup> State of the Energy Market, <http://www.aer.gov.au/sites/default/files/State%20of%20the%20energy%20market%202011%20-%20complete%20report.pdf>

<sup>2</sup> Energy Retailers Comparative Performance Report <http://www.esc.vic.gov.au/getattachment/1e7292eb-2441-4856-b423-69b42b6a8024/ddd.pdf>

flatter loads are more oriented to cheaper coal and incur higher carbon tax costs. The carbon tax raises costs by 1.30-2.00 cents per kwh in 2013/14.

The cost differences between the states as shown in Table 1 below are in accord with expectations.

**Table 1**  
**Wholesale costs**

	NSW	Qld	SA	Victoria
2010/11	7.51	5.65	9.54	7.31
2011/12	7.56	5.39	10.13	6.64
2012/13	10.71	8.42	11.9	9.71
2013/14	11.16	9.46	12.56	10.32

### Transmission and Distribution

These costs are regulated but there has been considerable criticism that in the past some costs incurred would be rolled into the regulated price irrespective of the views of the regulator.

There have been frequent accusations, including by former Prime Minister Julia Gillard, that the state owned enterprises gold-plate their systems and pad their costs. The incentive to do this for private networks is limited because the shareholders would seek dividends for themselves from the profits gained by management overstating costs. This reveals the true costs bringing the regulator to reduce allowable costs in subsequent price setting rounds. Such outcomes are also possible under government ownership, but governments have agendas other than commercial ones and shareholder departments do not have the private shareholders' vested interest in seeking savings hence they rarely match private ownership in efficiency.

Victoria's privatised system has lower network costs than the other states. Contributing to this is the state's relatively compact size. However, the much greater penetration of reticulated gas in Victoria compared with the other states would offset this to a degree because of the other states' power lines carrying a higher throughput of electricity to customers.

Ms Gillard's urging of state governments to privatise their networks so that lower costs can be brought about has been followed by the Abbott government indicating that it will provide state governments with incentives to privatise. It would seem to be incongruous for governments to require to be provided with incentives to undertake measures that improve consumer outcomes.

### Transmission

Transmission costs in Victoria have been remarkably stable at around 1.27 cents per kwh over the past four years.

In South Australia, where the transmission network has also been privatised, costs have edged up over the past four years by 40 per cent from 2.35 cents per kwh to 3.28 cents. The South Australian non-metropolitan coverage has a lower density than that of the other states with resultant increases in average costs, though this should not have brought the rather steep increase that has been experienced. Part of the state's increased costs may result from an expansion of the network to accommodate wind generation capacity, which has increased markedly in recent years. South Australia now has around half of the national wind generation capacity.

Queensland's government owned transmission business has seen costs increase 29 per cent in the past four years from an average of 1.82 cents to 2.34 cents. Over that same period, NSW transmission costs have increased from 1.76 cents to 2.35 cents per kwh an increase of 34 per cent.

Transmission costs are shown in Table 2 below.

**Table 2**  
**Transmission costs (c/kwh)**

	NSW	Qld	SA	Victoria
2010/11	1.76	1.82	2.35	1.27
2011/12	2.08	1.97	2.87	1.12
2012/13	2.21	2.19	3.08	1.24
2013/14	2.35	2.34	3.28	1.27

### *Distribution*

As with transmission, there is a marked difference between Victoria and the other states with Victorian costs only half of those in NSW and not much more than that compared with Queensland and South Australia. Like Victoria, South Australia's network is privately owned.

Differences in load profile, population density and network planning criteria mean that comparisons are less than straightforward. South Australia's peaky demand increases average costs when they are expressed in terms of cents per kwh. South Australia also has a more dispersed population linked to the distribution network than other states (and estimates 70 per cent of asset costs supply only 30 per cent of the population). Nonetheless, it has seen its average costs grow 40 per cent 2010/11 to 2013/14, rather more than other states and twice that of Victoria. Some of the more recent cost increases may reflect cyclical investment patterns.

Though geographic differences are doubtless present, the data offers a clear indication of savings available in states other than Victoria. Table 3 identifies the different costs

**Table 3**  
**Distribution costs (c/kwh)**

	NSW	Qld	SA	Victoria
2010/11	10.75	9.53	8.32	5.82
2011/12	12.84	10.56	10.74	6.19
2012/13	14.34	11.97	10.72	6.53
2013/14	14.19	12.99	11.78	6.96

### *Retail Margins*

One of the more vexed issues in electricity supply is the cost of the retail function. In all states other than Victoria, retail prices are fixed, though they have recently been freed up in South Australia and, possibly will be liberalised with reservations in Queensland. In the three regulated states, retail margins have fluctuated between 2.5 and 3.6 cents per kwh over the past four years.

Prices in Victoria have been more difficult to estimate. The AEMC, while noting that the deregulated nature of retail pricing in Victoria make it difficult to estimate comparable retail margins, published a highly qualified estimate based on standing tariff offers. These estimates place the retail margin in

Victoria at over twice that in the other states. This assumed that all customers were on a standing tariff, whereas over 80 per cent have shifted away from their host retailer and many who have remained will have benefited from an offer.

Data collected by the Victorian Essential Services Commission (ESC) allows a better informed analysis. ESC estimates that the average tariff paid is discounted, once incentives for prompt payment, by about 14 per cent. Excluding those incentives the discount is only 3 per cent.

The assessment of the retail margins estimated for the ESC is based on work commissioned from the consultancy firm SKM. This has been criticised by Deloitte in a consultancy commissioned by the Energy Retailers Association of Australia (ERAA). The Deloitte report pointed out that the data on retailer margins could be inaccurate due to its improperly factoring:

- Prompt payment discounts of between 5% and 15%
- First month free energy
- First six months or year discounted energy
- \$25, \$75, \$100, \$150, \$175 or \$250 credit on accounts or bill rebates
- Magazine subscriptions
- Airline and credit card loyalty program points
- Discounted other products, such as supermarkets, restaurants, hotels
- Monthly cash prize draws
- Tariff freeze promises
- Gift cards.

The costs in the four states are shown in Table 4, with the retail costs adjusted on the bases of a 3 and 14 per cent discount from the standing offer price.

**Table 4**  
**Retail costs (c/kwh)**

	NSW	Qld	SA	Victoria (3%)	Victoria (14%)
2010/11	2.47	2.98	3.02		
2011/12	2.68	3.15	2.96		
2012/13	2.93	3.46	3.06		
2013/14	3.02	3.61	3.15	7.32	3.99

Victorian retail margins are relatively high on all estimates, though with the 14 per cent discount the margin is more comparable with that in the other states, where the price controls may mean margins are suppressed with deleterious consequences for the longer term. The ESC considers the appropriate measure is the average 3 per cent discount which would infer that retailers in other states offer similar levels of discount to those prevailing in Victoria. The ESC takes this view because both the standard and market tariffs in Victoria are deregulated so like-for-like comparisons can be made.

Retailers contest this and argue that a 14 per cent discount understates the weighted average of offers accepted and so understates the actual average discount.

In addition, higher prices in Victoria stem from higher costs due to regulatory matters. There are several such factors, including:

- The requirement introduced by former Minister Candy Broad that no retailer may charge late fees on small Victorian customers. This “consumer protection” provision backfires on genuine consumer interests by bringing additional costs which are passed on bringing a standard tariff higher than in other states which do not have such conditions; its effect is amplified by very onerous conditions attached to retailers seeking to disconnect delinquent customers
- The smart meter rollout. Although this is separately costed to consumers, not all these stipulated costs might be incorporated in the charge and retailers incur additional costs that they need to recoup. In this respect, one such cost would be additional meter readings - according to ESAA, “Retailers had to manage moving from four meter data readings per year to 17,520”.
- Costs associated with defraying the expenses due to the operations of the Energy and Water Ombudsman in Victoria who has been particularly aggressive in pursuing complaints; the Ombudsman’s staffing has grown from zero in 1996 to 120. Costs from this staffing, associated penalties on retailers for deemed infractions, and each business’s expenses in interfacing with the Ombudsman would eventually be passed onto consumers. The Ombudsman’s costs are charged to retailers and apply as soon as a complaint is received; there is no charge to customers, even those conducting vexatious complaints.
- The relatively low maximum early contract termination fee in Australia (\$20) compared with one proposed by IPART for NSW at \$130 in the first year and \$45 after that. IPART estimate customer acquisition costs to average \$150<sup>3</sup>.

On top of these factors, the customers on standard tariffs in Victoria are likely to be high risk. In Victoria only around 20 per cent of customers have not taken advantage of market offers (IPART estimates that 40 per cent of NSW customers remain on the standard tariff). A large proportion of Victoria’s residual 20 per cent would be people not willing to take advantage of early payment terms which is often associated with bad credit risk. Late payment itself is estimated by IPART to increase average customer costs by \$10.90<sup>4</sup>.

It is also possible that the other states’ regulated prices are set too low and are unprofitable, even though the regulators, especially IPART in NSW, have striven to provide “headroom” that will encourage greater competition and a milestone to eventual deregulation.

It is not plausible that the higher Victorian margins are due to “oligopoly” or other forms of market failure. For a start the three majors are fiercely competitive. There are also some 30 other competitors of varying sizes (the three largest, Lumo, Essential and Red) are together comparable in size to the majors. And there are no barriers to entry. If there are spare dollars available it is difficult to see these not being eroded by competition, although recent actions by the ACCC in inhibiting door-knocking reduces competitive pressures.

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[http://www.ipart.nsw.gov.au/Home/Industries/Electricity/Reviews/Retail\\_Pricing/Review\\_of\\_requirements\\_for\\_early\\_termination\\_charges/21\\_Oct\\_2013\\_-\\_Media\\_Release/Media\\_Release\\_-\\_Draft\\_Report\\_on\\_early\\_termination\\_fees\\_for\\_electricity\\_contracts\\_for\\_small\\_customers\\_-\\_October\\_2013](http://www.ipart.nsw.gov.au/Home/Industries/Electricity/Reviews/Retail_Pricing/Review_of_requirements_for_early_termination_charges/21_Oct_2013_-_Media_Release/Media_Release_-_Draft_Report_on_early_termination_fees_for_electricity_contracts_for_small_customers_-_October_2013)

<sup>4</sup> IPART Review of Regulated Retail Prices for Electricity, June 2013, p.100

### Other costs

Victoria has pioneered a mandatory roll-out of “smart” meters which has generated costs that are considerable enough (around 10 per cent in the current year) to discourage other states from following suit. In the current year the meter rollout adds 2.77 cents to the average bill in Victoria (plus the additional costs indirectly imposed on the retailers which are recouped in retail charges).

Other charges have been increase with the growing importance of the Commonwealth's RET scheme and been reduced by the phasing out of separate state schemes. Table 5 illustrates these other costs

**Table 5**  
**Other costs**  
**(c/kwh)**

	NSW	Qld	SA	Victoria
2010/11	0.25	0.7	0.76	0.58
2011/12	1.08	0.97	1.91	1.04
2012/13	1.34	0.93	1.9	0.91
2013/14	1.42	0.79	1.79	0.77

### Concluding Comments

Private businesses in general will perform more efficiently than those owned by governments as a result of the constant focus of shareholders and their representatives in meeting consumer needs at least cost. This is borne out in the case of electricity supply assets where private ownership is delivering superior outcomes to public ownership. That outcome provides clear policy pointers for governments regarding the remaining state-owned generation assets and the transmission and distribution networks in New South Wales and Queensland (as well as those of Tasmania and Western Australia).

It goes without saying that payment and on-time payment for electricity supply is not optional. Governments need to recognise that market interventions that attempt to rebalance supplier-consumer relations in favour of the latter will generate costs that will be passed onto consumers. Inhibiting retailers from discontinuing supply to delinquent customers may mean a short term impact on suppliers' profits but in the medium term costs are passed onto other customers. Similar well-intentioned measures through an industry-specific ombudsman and price controls will also bring costs that must be recovered in higher prices.

Finally, the AEMC has published valuable work pointing to how electricity supply can be made more efficient. Unfortunately, some of this work has depicted incorrect impressions of retail supply margins. Although heavily qualified in footnotes, AEMC publications of raw retail data indicates unduly high retail margins in Victoria, where competition is subject to the least regulation. This information is used by those who oppose private ownership and to avoid incorrect conclusions being drawn its future representation should be handled more carefully.