



# Cost-reflective retail pricing: Risks and opportunities for retailers

Prepared for the AEMC Power of Choice Review – Third Stakeholder Reference Group Meeting

11 May 2012

# Overview

This presentation covers the following...

- Original thinking re metering and cost-reflective retail pricing
- Why haven't we seen a progressive shift towards time-sensitive retail tariffs?
  - Victorian ToU moratorium
  - Retail tariff regulation
  - Metering and settlements arrangements
  - Commercial and cash-flow risks
  - Network tariff bundling and metering exclusivity
  - Lack of customer understanding / customer resistance
- Implications of time-sensitive network pricing
- Treatment of vulnerable customers

Each of these is discussed in turn

# Original thinking re metering and retail pricing

Market forces were expected to encourage more cost-reflective pricing

- In opposing the ACCC's Interim Authorisation on the FRC Code changes (which imposed a sunset on Type 6 meters), Vic EPD and NSW MIG argued:
  - Profiling would facilitate straightforward price competition between retailers
  - Requiring interval meters to switch would impose barriers to switching
  - Competition would encourage retailers to offer customers with relatively flat load profiles interval meters and ToU tariffs
    - “Over time, as the costs of interval meters fall, more customers would find it worthwhile to install interval meters. This will lead to the wholesale settlement price for customers remaining on the profile becoming more cost reflective” (p.6)*
  - As the NSLP became 'peakier' – and hence more expensive – this would provide stronger incentives for some of the remaining profiled customers to install interval meters
  - ACCC relented but retained the view that peaky customers should get interval meters first, not last
- This has not occurred – why?

# Victorian ToU moratorium

## Moratorium can't explain other States

- Moratorium on distributors setting time-sensitive tariffs until 2013
  - In their 2011 cost-benefit analysis for the Victorian government, Deloitte held discussions with distributors and retailers
  - Deloitte noted a hesitation in developing time-sensitive tariffs, which they put down in part to the moratorium
  - Nevertheless assumed that distributors and retailers would offer time-sensitive tariffs on a voluntary basis from 2014
- But no restriction in NSW on time-sensitive tariffs being offered to small customers
- Ausgrid has done some work on time-sensitive pricing options as part of its Network Pricing Study (discussed below), suggesting interest but as yet little action

# Retail tariff regulation

## Is it regulation or availability of anytime tariffs?

- Problem does not seem to be the requirement for retailers to offer standard/regulated anytime tariffs (flat or inclining block)
  - Sufficient 'headroom' now available in all jurisdictions to enable second-tier retailers to undercut standard tariffs offered by first-tier retailers
- However, the availability of anytime tariffs could make it harder to encourage customers to voluntarily adopt time-sensitive tariffs
  - Retailer doesn't know in advance whether a given customer will be better off moving to an interval meter combined with time-sensitive tariff
  - Undertaking to leave the customer 'no worse off' may be risky

# Metering and settlements arrangements

## Risk of customer reversion may deter installation of interval meters

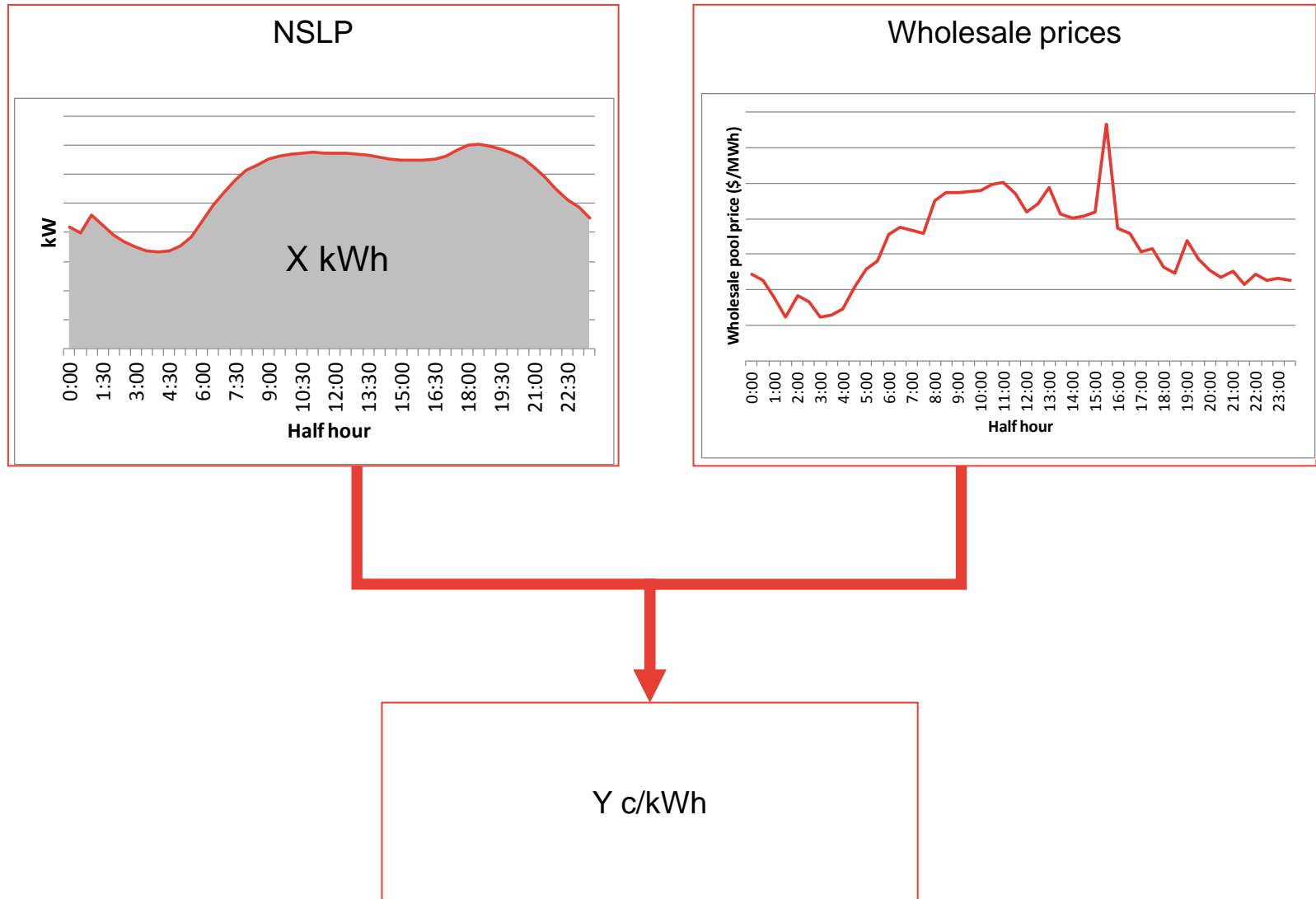
- Issue is whether retailers continue to be settled on a customer's actual consumption after that customer has reverted to an anytime tariff
- If this could occur:
  - Retailers would face the risk of the cost to serve differential between the customer's actual load profile and the NSLP
  - This would tend to deter retailers offering interval meters combined with time-sensitive tariffs

# Commercial cash-flow risks

Interval metering and time-sensitive tariffs seem to assist risk management

- Retailers face two key wholesale price risks in serving small customers on NSLP:
  - Profile is peakier than anticipated – hence more expensive
  - Wholesale prices are higher than anticipated – hence more expensive
- Serving same customers on time-sensitive tariffs based on interval data can address the first issue, and could address the second depending on tariffs

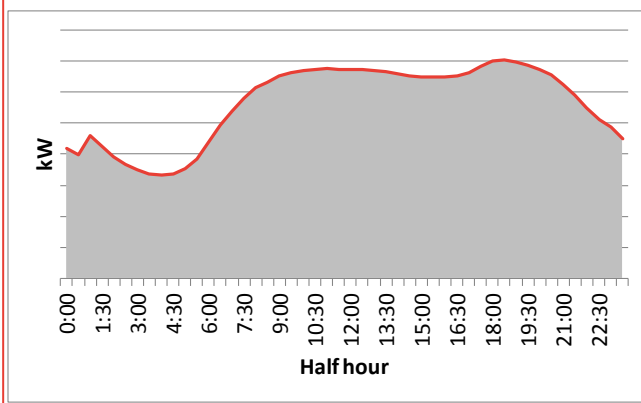
# Commercial and cash-flow risks: Flat tariff derivation



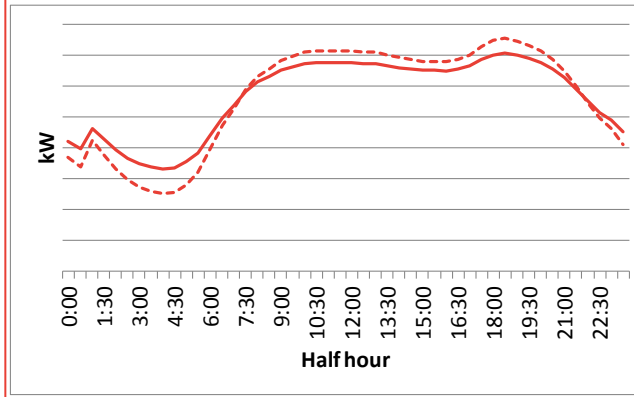


# Commercial and cash-flow risks: NSLP and flat tariff

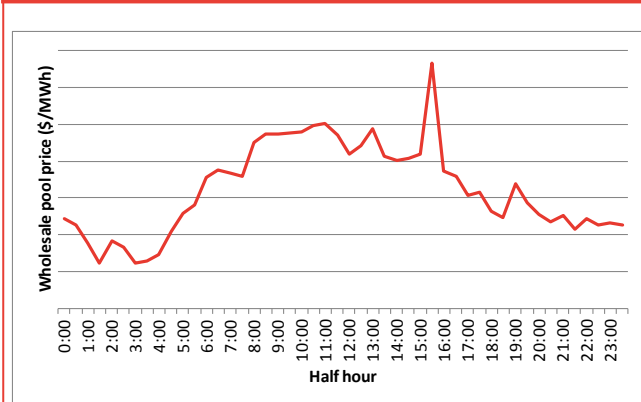
## Profile risk



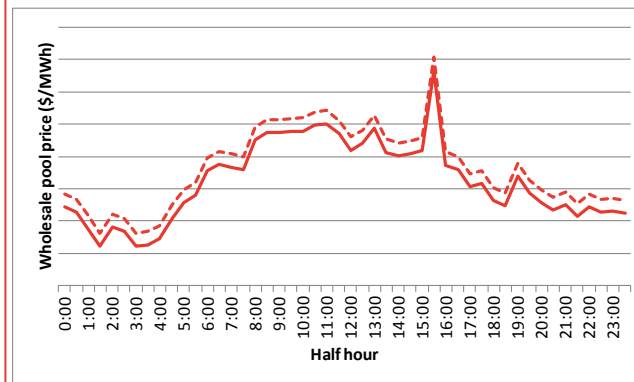
Peakier profile  $\Rightarrow$  more costly to serve than Y c/kWh



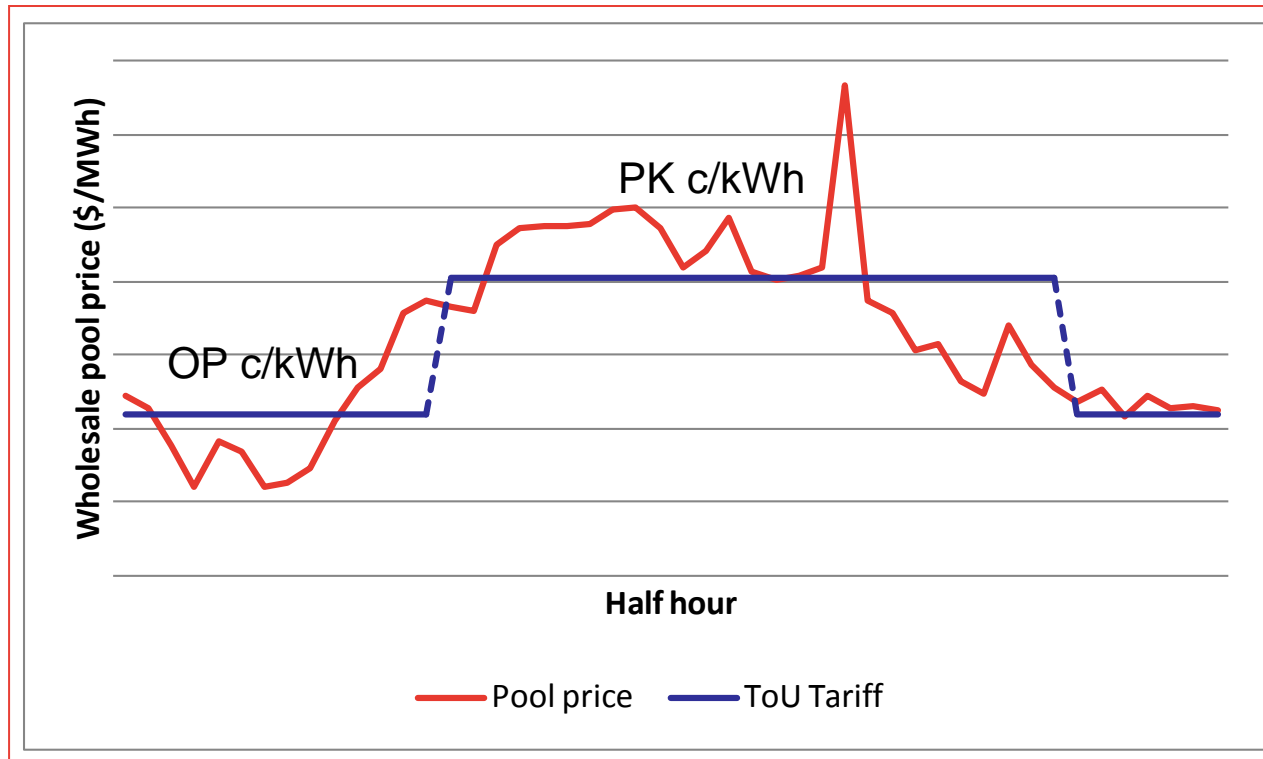
## Wholesale price risk



Higher pool prices  $\Rightarrow$  more costly to serve than Y c/kWh

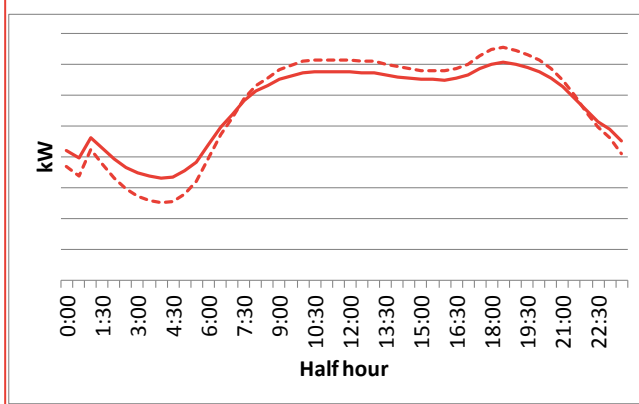


# Commercial and cash-flow risks: ToU tariff derivation



# Commercial and cash-flow risks: Interval meter and ToU tariff

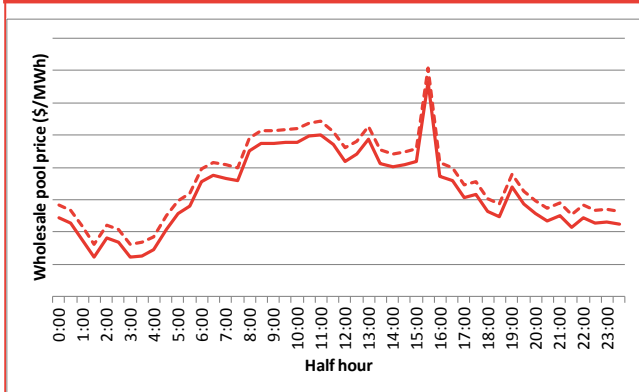
## Profile risk



Peakier profile  $\Rightarrow$  more costly to serve than Y c/kWh

- BUT interval meter means retailer can charge ToU tariffs
- ToU tariffs allows retailers to manage profile risk
  - More consumption at peak time – higher wholesale price but also higher price received (PK c/kWh)

## Wholesale price risk



Higher wholesale prices  $\Rightarrow$  more costly to serve than Y c/kWh

- Higher prices on average increases the cost to serve
- This risk cannot be managed with a static ToU tariff but maybe with CPP
- With ToU tariff, need to charge higher PK and OP tariffs to reflect increased wholesale energy cost

# Network tariff bundling and metering exclusivity

## Barriers to retailers becoming the Responsible Person

- Retailer may wish to become the RP for a customer and install a smart meter (Type 4) as part of a market contract with time-sensitive tariffs
- But retailers cannot escape meter charges by taking on the RP role:
  - Metering charges bundled with network tariffs in NSW and Qld, so customer would effectively 'pay twice' for metering services
  - Small customers can't escape AMI charges in Vic
  - Metering charges unbundled in SA but 'exit charge' payable
- Alternative is for LNSP to be RP, but some retailers seem reluctant to trust them given lack of commercial accountability/civil penalty regime

# Lack of customer understanding/ customer resistance

## The elephant in the room

- Common theme in debate is lack of customer understanding of interval metering and time-sensitive tariffs
- Lack of access to timely consumption data may lie behind this but how to provide without installing an interval meter? ('Chicken and egg problem')
- Key findings of Ausgrid Customer Research Program were:
  - Both residential and SME customers willing to move to time-sensitive tariff for 10-20% discount
  - Ability to retain control over consumption very important
- Problem for retailers is:
  - 10-20% discount off anytime market tariffs could be tricky for many/most customers
  - Hard to guarantee savings without processing a lot of information about the customer
  - Without a guarantee, customer may not wish to take on risk
- Retailers also concerned about rise in queries and complaints due to change in billing

# Implications of time-sensitive network pricing

## Retailers may take their lead from networks

- Retailer attitudes towards passing on time-sensitive network tariffs have been mixed
  - Retailers interviewed by Deloitte in 2011 mixed in attitude
  - Retailers in Ausgrid research more inclined to pass on network tariffs
- Absorbing time-sensitive network charges may be even harder if installation of interval meters means that retailers settled on half-hourly actual load
- Seems more likely that retailers would supplement time-sensitive network tariffs with energy costs to get peakier time-sensitive retail tariffs

# Treatment of vulnerable customers

## No easy fix

- Vulnerable customers likely to have quite peaky profiles – especially given strong energy conservation incentives outside of times of real need
- Migration of flat load customers off the NSLP to time-sensitive tariffs would increase the cost of anytime tariffs
- Concessional tariffs could be offered but would be at risk of abuse as discount to standard anytime tariffs widened

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