

Understanding the impact of network tariff reform on retail offers

In June 2020, we published our final decisions on the new tariff structure statements (TSS) that apply to distributors in South Australia and Queensland. These statements determine the structure of the network tariffs that those distributors will charge retailers from 1 July 2020 to 30 June 2025, including what default and alternative network tariff options are available to retailers for different customer types. Retailers package these network tariffs with their other costs in shaping the retail offers available to end customers.

This explainer outlines how we expect network tariff reform will influence what retail tariff offerings retailers make available to residential and small business consumers going forward. It is based on the feedback we received from retailers in the lead up to making these decisions. We published a high level summary of these findings in our June 2020 decisions which we expand upon in this document.¹

This document focuses on the market offers from retailers in South Australia and southeast Queensland – SA Power Networks and Energex’s distribution zones, respectively – because for offers in those areas retail tariff structures are largely a commercial decision determined by retailers responding to market forces, customer preferences and other factors.²

We also made a TSS decision for the regional Queensland distributor (Ergon Energy). Retail tariff structures in regional Queensland are determined through regulation (by the Queensland Competition Authority) rather than through the commercial decisions of retailers. We also note the SA Government is currently consulting on reforming the retail tariff structure of the standing offer (i.e. non market offer) retailers provide in South Australia to reflect the new underlying time-of-use (“solar sponge”) network tariffs approved by the AER in SA Power Networks’ TSS.

Background

Currently residential customers in South Australia and Southeast Queensland are on a flat or block rate retail tariff. That is, they are charged a fixed daily supply charge and either a single rate is charged per kilowatt hour (kWh) of electricity consumed regardless of when usage occurs,

¹ The overviews and TSS attachments for the SA Power Networks and Energex decisions reference this engagement with retailers as an input to our final decision.

² Our retailer engagement summary relates to Southeast Queensland specifically (ie. Energex’s distribution zone). However, the retail energy market performance data in the charts relates to all of Queensland because this data is collected on a state-wide basis and is not disaggregated into distribution zones.

or consumption is charged in blocks where the rate per kWh depends on the customer's total usage, but does not depend on when usage occurs. Some customers also have controlled load arrangements (e.g. electric hot water) where specific devices are separately metered and charged a lower consumption rate for being programmed to only operate during off-peak times.

Our review of retail performance market update data shows that in Queensland 98.5 per cent of residential and small business customers are on a flat or block retail offer with no time-of-use price signals. The remaining 1.5 per cent of customers are on a time-of-use retail offer. In South Australia, 96.2 per cent of residential and small business customers are on a flat or block retail offer. The remaining 3.8 per cent of customers are on a time-of-use tariff retail offer.

As a result of our SAPN and Energex TSS decisions, the underlying network tariff structure that distributors will charge retailers for customers who have a smart meter will be changing. For all customers with a smart meter, the retailer will be charged a network tariff that has a time based price signal – to encourage greater use of the network during off-peak times and to encourage less use of the network during peak times. The retailer will be charged either a time-of-use energy network tariff or a peak demand based network tariff.

In February 2020, in the lead up to making these TSS decisions, we met with nine retailers and energy service providers representing a cross section of small, medium, large retailers and energy service providers. We asked them whether and how their retail offers might change as a result of changes in the underlying network tariff structures as proposed by the distributors in their revised TSS proposals. This document summarises what we heard. We discuss the findings in more detail below, but the key themes can be summarised as:

- **Retail offers can be categorised as:**
 - **Insurance style – where the retailer faces cost reflective network price signals but shields the end customer from this price volatility, for example, by offering the end customer a retail offer with a fixed daily charge and a flat kWh energy charge³**
 - **Pass through offers - where the network tariff structure is reflected in the retail tariff structure**
 - **Prices for devices – where a retailer manages an end use customer’s smart device(s) to respond to cost reflective network prices signals, while keeping simple retail structures**
- **The predominant retail structure offered by larger retailers is a flat tariff offer. This may be in the form of ‘pass through’ when the underlying network tariff is flat, but it may also be ‘insurance style’ when the underlying network tariff has a time-of-use or demand based tariff structure.**
- **Larger retailers suggested they are more likely to offer ‘insurance style’ retail products in response to new more cost reflective tariff structures.**
- **Medium sized and smaller retailers suggested they are more likely to ‘pass through’ underlying cost reflective network tariff structures in response to new more cost reflective tariff structures, particularly time-of-use network tariff structures. Passing through the network tariff is regarded as less of a business risk, particularly for smaller retailers.**
- **Most retailers considered it was too early for ‘prices for devices’ retail offers as required technology is not widespread or fully developed enough yet. However some retailers are working on developing these types of offers.**
- **Most retailers were not in favour of passing through complex tariff structures to end users, particularly tariffs with demand charges. This is because retailers found it difficult to explain demand charges to the customer which limits the customer’s ability to understand them.**
- **Most retailers considered if more complex network tariff structures are introduced such as demand charges they would offer ‘insurance style’ retail products, or ‘prices for devices’ retail products instead of ‘passing through’ the demand charge.**
- **Due to the complexity of explaining demand tariffs to customers, retailers are unlikely to opt-in customers to underlying network tariffs with demand charges.**

³ Note: A flat retail structure which reflects an underlying flat network tariff is referred to as a ‘pass through’ offer. However, a flat retail structure with an underlying cost reflective / time-of-use or demand based network tariff is referred to as an ‘insurance style’ retail offer.

AER Tariff Structure Statement Final decisions

Summary of SAPN's Tariff Structure Statement July 2020-July 2025 – Final Decision 5 June 2020

The key elements of SAPN's tariff structure statements (TSS) are:

- to charge retailers a time-of-use energy tariff as the default tariff for residential customers with smart or interval meters (Type 4 or Type 5)
- to introduce an alternative option for retailers to be charged a 'prosumer' demand tariff for residential customers with a smart meter (Type 4)
- to charge retailers a time-of-use energy tariff as the default tariff for small business customers with smart or interval meters
- to charge retailers a time-of-use tariff with maximum demand charge as the default tariff for small business customers using more than 120 kVA.

SAPN's tariff structures and customer assignment policies are summarised further in Attachment 1. For more detail our final decision for SAPN can be viewed on [our website](#).

Due to covid-19 default assignment of customers to more cost reflective tariffs will be delayed until July 2021 - for this year the residential single rate (RSR) will be open for anyone to remain/opt-in to, and the time-of-use will only be default for new connections and customer initiated changes (e.g. connecting distributed energy resources DER). The same applies for business single and two rate tariffs (BSR and B2R).

Summary of Energex's Tariff Structure Statement July 2020-July 2025 – AER Final Decision 5 June 2020

The key elements of Energex's tariff structure statements (TSS) are:

to introduces three cost reflective network tariff options for residential and small business customers:

- a transitional demand tariff as a default tariff for customers with smart meters
- an optional 'standard' demand tariff
- an optional time-of-use (TOU) energy tariff.

Energex's tariff structures and customer assignment policies are summarised in Attachment 2. For more detail our final decision for Energex can be viewed on [our website](#).

Due to covid-19 default assignment of customers to more cost reflective tariffs will be delayed until July 2021. Similar to SAPN, from 1 July 2021, new connections and customer initiated changes will be assigned by default to a cost reflective network tariff. For customers who receive a smart meter for reasons which are not customer initiated (e.g. end-of-life meter replacement), the retailer will be charged a cost reflective network tariff 12 months after the smart meter is installed to provide the retailer and customer with more information on the customer's actual load profile prior to re-assignment.

Retailers responses to tariff reform

Retail offers

- All electricity retailers interviewed consider underlying network tariff structures when designing their retail offers. The predominant style retail offer is a 'pass through', where the network tariff structure is reflected in the retail offer – this could be an underlying flat network tariff or a cost reflective network tariff. Passing through the network tariff is regarded as less of a business risk, particularly for smaller retailers.
- As most retail customers currently have an underlying flat network tariff the predominant retail offer has a flat structure.
- Larger retailers are more likely to offer 'insurance style' retail products. This is most likely because larger retailers are better able to absorb the associated risk.

Retailers' responses to cost reflective network tariff structures

- Retailers prefer cost reflective network tariffs with time-of-use price signals to those with a demand charge⁴.
- Retailers find demand charges difficult to explain to residential customers and have found residential customers cannot easily measure their demand and respond to these charges.
- Retailers consider customers more readily understand time-of-use tariff structures with peak and off-peak charges, and are better able to respond to and manage bill impacts on time-of-use tariffs by shifting consumption from peak times.
- Seasonality within a time-of-use tariff was considered difficult for customers to understand. It was noted that the seasons are not consistent across all networks and suggested retailers consider that ideally this would be rationalised. One retailer commented that they recently removed seasonality in retail offers for new customers, but are now re-instating it because they wore too much risk when seasonality was not reflected in retail offers.
- Most retailers considered demand charges for residential customers premature and it was suggested that it may be more appropriate to wait a year or so, when there are more devices in the market and the market is more mature, to introduce demand charges.
- Many retailers commented that if demand charges are introduced they would be unlikely to opt a customer on to it and some smaller retailers indicated they would avoid taking on a new residential customer with an underlying network tariff with a demand charge.
- Larger retailers felt more comfortable taking on new customers with demand tariffs, but in this case they were unlikely to 'pass through' the underlying network tariff structure and were more likely to offer an insurance style product to reduce complexity for the end-use customer.
- Some retailers indicated that for those customers with underlying demand based network tariffs they would ideally control a certain percentage of devices in the customer's home, for example batteries, so people can avoid a high demand charge.

⁴ A demand charge is when a charge is applied to customers based upon the highest amount of power drawn during any (typically 30-minute) interval during the billing period.

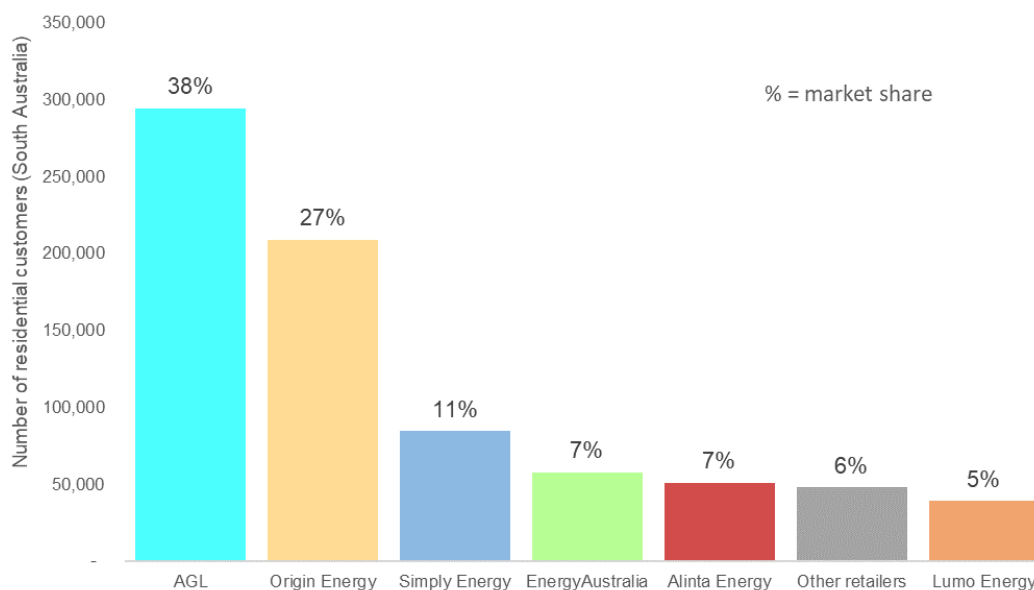
- Retailers considered a rationalisation of network tariffs is something they would like to see. It was noted that some distributors, particularly in Victoria and NSW, have many network tariffs. This increases costs for retailers to replicate every tariff structure over the last 10 years because there could still be customers on the earlier tariffs. Retailers also noted the significant cost in updating IT, billing systems and education of staff when new tariffs are introduced.
- Most retailers indicated they are unlikely to actively reach out to customers about other opt-in network tariffs which might be more suitable. Retailers did not see a benefit in moving customers when most customers are on a flat rate, noting it is too onerous to communicate with the customer.
- Unless the customer requests a change the retailer was unlikely to re-assign a customer. Retailers prefer to see a customer's load profile over time (3 to 12 months) before making a tariff re-assignment. Smaller more innovative retailers were the exception and commented that they actively try to pick the tariff that works best for the individual customer.

Snapshot of South Australia and Queensland retail markets

South Australia

In South Australia there are 27 retailers supplying electricity to customers. The retailers with the biggest market share of customers in South Australia are AGL, Origin Energy and Simply Energy.

Figure 1: Market share of residential customers - South Australia



Source: AER analysis of Retail Market Performance Update data – Schedule 2 Q1 2019-20 <https://www.aer.gov.au/retail-markets/performance-reporting/retail-energy-market-performance-update-for-quarter-1-2019-20>

In South Australia, 92 per cent of residential customers are on a market offer. Market offer contracts are competitive retail electricity prices offered by retailers to end-use customers. Customers with market offer contracts are those who have actively engaged in the energy retail market to seek a better retail offer.

Standing offer contracts apply to those customers who have not actively engaged in the electricity retail market.⁵

Figure 2: Residential customers on market offers – South Australia



Source: AER analysis of Retail Market Performance Update data – Schedule 2 Q1 2019-20 <https://www.aer.gov.au/retail-markets/performance-reporting/retail-energy-market-performance-update-for-quarter-1-2019-20>

⁵ The Default Market Offer (DMO) is a compulsory price cap for some electricity customers which came into effect under new energy regulations that apply from 1 July 2019. The AER is also responsible for setting a default market offer.

A DMO price is a compulsory price cap that an electricity retailer can charge a residential or small business customer on a standing offer contract. The purpose of the DMO is to act as a fall-back for those who are not engaged in the market, and should not be a low-priced alternative to a market offer. It was intended to reduce unjustifiably high standing offer prices, while allowing retailers to recover their costs in servicing customers, and providing customers and retailers with incentives to participate in the market.

All retailers must apply DMO prices in network distribution areas where there is no other retail price regulation. This applies in South East Queensland (Energex), New South Wales (Endeavour, Essential Energy and Ausgrid) and South Australia (SAPN).

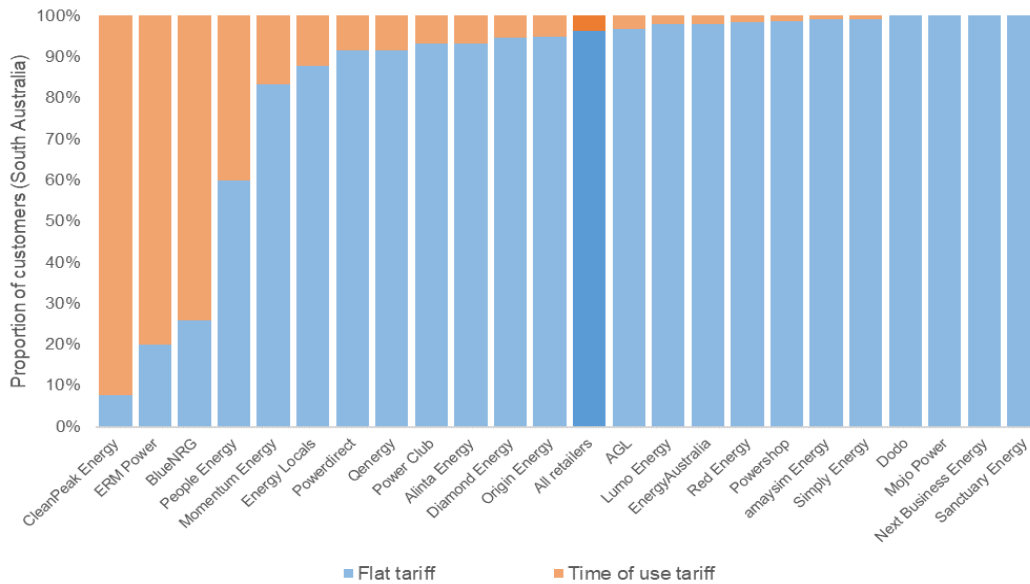
Figure 3: SME customers on market offers – South Australia



Source: AER analysis of Retail Market Performance Update data – Schedule 2 Q1 2019-20 <https://www.aer.gov.au/retail-markets/performance-reporting/retail-energy-market-performance-update-for-quarter-1-2019-20>.

Figure 4 shows the proportion of residential and small business customers on time-of-use tariffs compared to flat or block tariffs for retailers in South Australia.

Figure 4: South Australia flat rate / block tariffs are the dominant tariff structure for most retailers

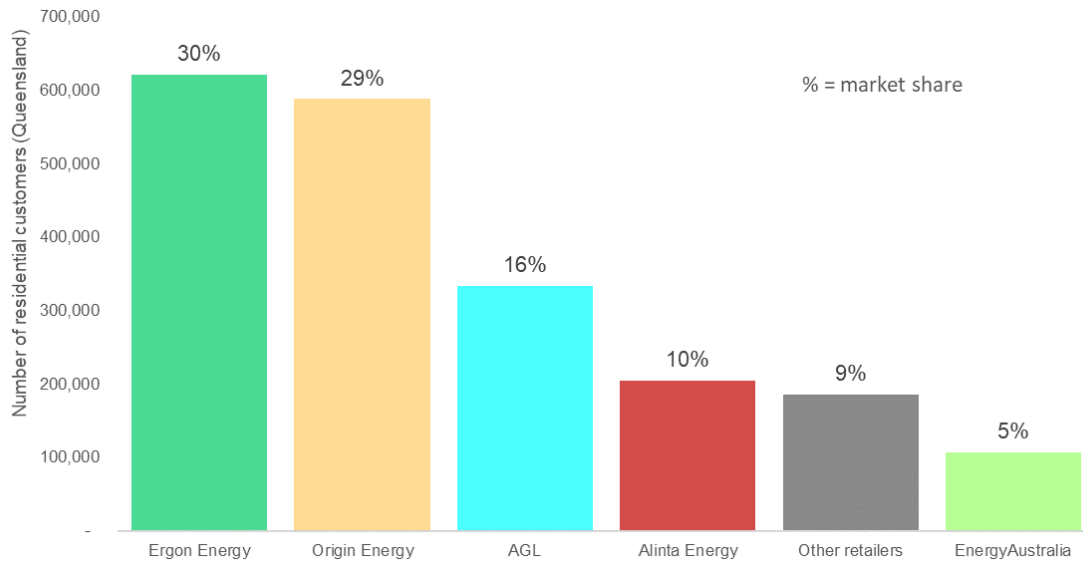


Source: AER analysis of Retail Market Performance Update data – Schedule 2 Q1 2019-20 <https://www.aer.gov.au/retail-markets/performance-reporting/retail-energy-market-performance-update-for-quarter-1-2019-20>

Queensland

In Queensland there are 30 retailers supplying electricity to customers. The retailers with the biggest market share of customers in Queensland are Ergon Energy, Origin Energy and AGL

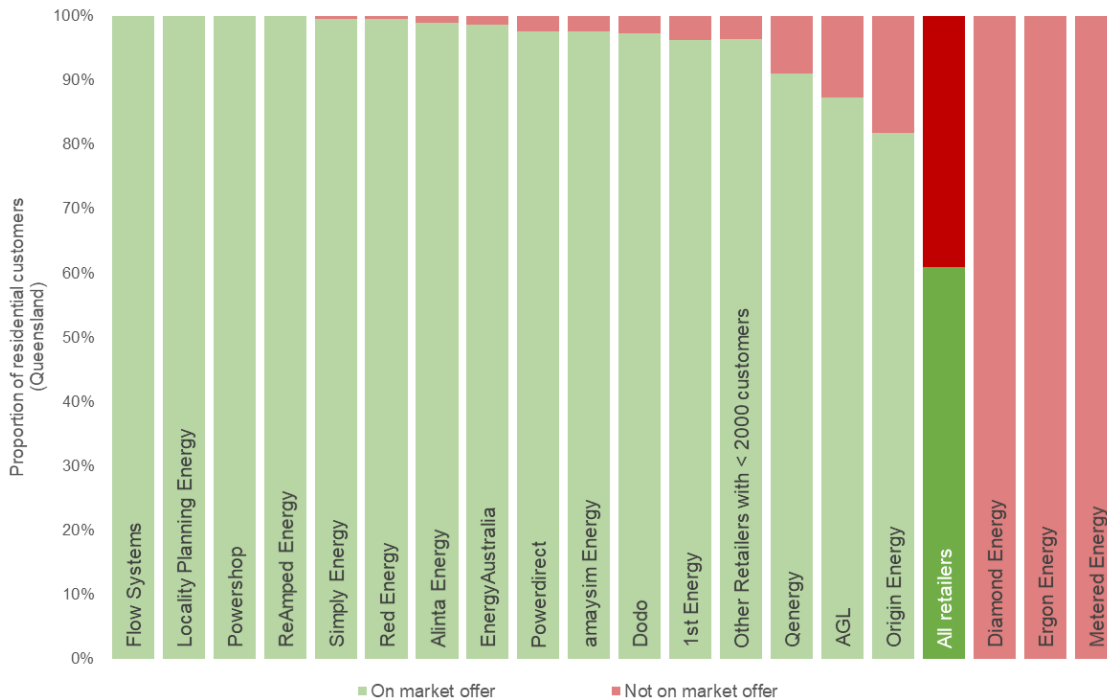
Figure 3: Market share of residential customers - Queensland



Source: AER analysis of Retail Market Performance Update data – Schedule 2 Q1 2019-20 <https://www.aer.gov.au/retail-markets/performance-reporting/retail-energy-market-performance-update-for-quarter-1-2019-20>

In Queensland 61 per cent of residential customers are on a market offer.

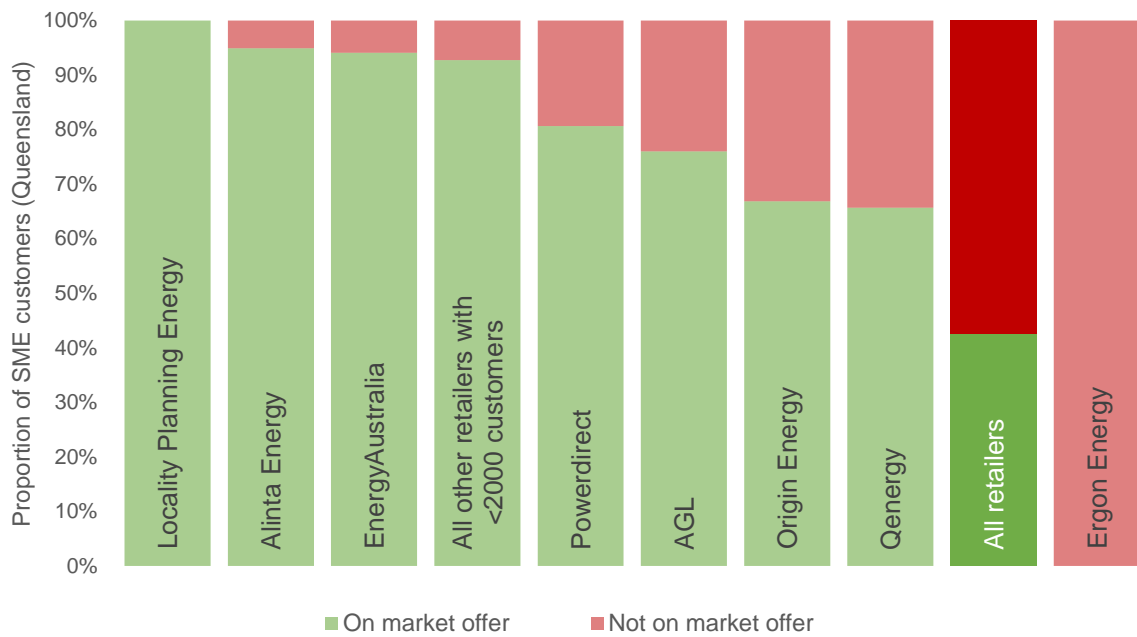
Figure 5: Residential customers on market offers – Queensland



Source: AER analysis of Retail Market Performance Update data – Schedule 2 Q1 2019-20 <https://www.aer.gov.au/retail-markets/performance-reporting/retail-energy-market-performance-update-for-quarter-1-2019-20>

Note: Includes only retailers with more than 2000 residential customers in Queensland

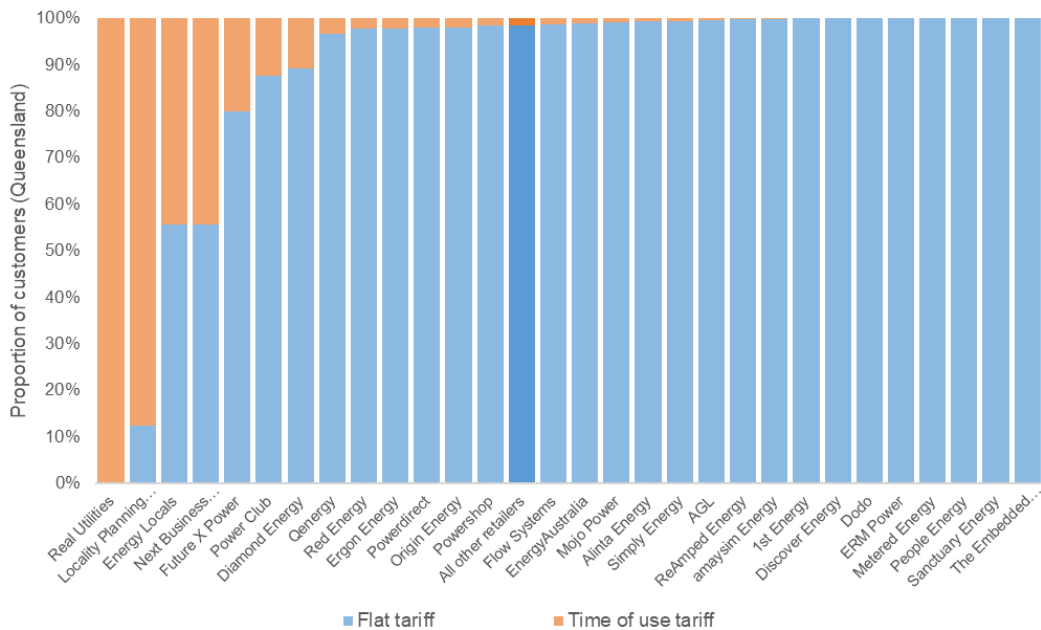
Figure 6: SME customers on market offers – Queensland



Source: AER analysis of Retail Market Performance Update data – Schedule 2 Q1 2019-20 <https://www.aer.gov.au/retail-markets/performance-reporting/retail-energy-market-performance-update-for-quarter-1-2019-20>

Figure 7 shows the proportion of residential and small business customers on time-of-use tariffs compared to flat tariffs for each retailer in Queensland.

Figure 7: Queensland flat rate / block tariffs are the dominant tariff structure for most retailers



Source: AER analysis of Retail Market Performance Update data – Schedule 2 Q1 2019-20 <https://www.aer.gov.au/retail-markets/performance-reporting/retail-energy-market-performance-update-for-quarter-1-2019-20>

Attachment 1: Summary of SAPN's final network tariffs

Customer Type	Meter	Tariff options	Tariff	Tariff description
Residential				
	Type 6	Closed	Residential single rate	Energy only
	Type 4,5	Default	Time-of-use	<p>Cost reflective This tariff has morning and evening peak times. Off-peak times are 1:00am to 6:00am, and a 'solar trough' will have a very low price between 10:00am and 3:00pm.</p> <p>Peak Pricing for the 14 hours per day not captured in the off-peak/solar sponge windows at 125% of the single rate price.</p> <p>Five-hour off-peak block every day: 1:00am to 6:00am (local time) at 50% of the single rate price.</p> <p>Five-hour off-peak block every day: 10:00am to 3:00pm (local time) at 25% of the single rate price.</p>
	Type 4	Opt-in	Prosumer	<p>Cost reflective</p> <p>Under this tariff the monthly demand is measured as the highest average demand over a four-hour period from 5:00pm to 9:00pm for November to March. The time-of-use usage rates are discounted 40 per cent in the Prosumer tariff</p>
Residential – off-peak controlled load				
	Type 5.6	Closed	Off-peak controlled load	Energy only – 50 per cent of the single rate tariff
	Type 4	Default	Off-peak controlled load – time-of-use	Cost reflective – default time-of-use
LV business <160MWh pa				

Type 6	Closed	Business two rate tariff	Energy only
Type 6	Closed	Business single rate tariff	Energy only
Type 4,5	Default (<120kVA)	Time-of-use tariff	Cost reflective <ul style="list-style-type: none"> Peak is defined as 5:00pm to 9:00pm on workdays and non-workdays from November to March. Shoulder price periods are also used to reflect typical business hours i.e. 7:00am to 9:00pm workdays (7:00am to 5:00pm November to March) at a higher price, with a low off-peak price at other times
Type 4, 5	Opt-in (<120kVA)	Time-of-use + maximum demand tariff	Cost reflective – maximum demand based on highest half hour in last 12 months
Type 4,5	Default (>120kVA)	Time-of-use + maximum demand tariff	Cost reflective
Business – off-peak controlled load			
Type 6	Closed	Off-peak controlled load tariff	Energy only

Note: due to covid-19 default assignment of customers to more cost reflective tariffs will be delayed until July 2021 - for this year the residential single rate (RSR) will be open for anyone to remain/opt-in to and the time-of-use will only be default for new connections and customer initiated changes (e.g. connecting distributed energy resources DER). The same applies for business single and two rate tariffs (BSR and B2R).

Attachment 2: Summary of Energex's final network tariffs

Customer Type	Tariff	Charging time frames Weekdays	Charging time frames Weekends	2020-25 status	Availability
Residential	NEW for Energex Residential transitional demand*	Evening peak 4pm-9pm Day off-peak 9pm to 4pm	Evening peak 4pm-9pm Day off-peak 9pm to 4pm	Default from 1 July 2020	New and existing customers with smart meters. Existing customers may remain on their legacy tariff until 30 June 2021
	NEW for Energex Residential demand*	Evening peak 4pm-9pm Day off-peak 9pm to 4pm	Evening peak 4pm-9pm Day off-peak 9pm to 4pm	Opt-in	New and existing customers with digital metering
	NEW for Energex Residential time-of-use energy**	Evening peak 4pm-9pm Night shoulder 9pm-9am Day off-peak 9am-4pm	Evening peak 4pm-9pm Night shoulder 9pm-9am Day off-peak 9am-4pm	Opt-in	Existing and new customers with digital metering
	Energex flat tariff for customers <20MWh/p.a			Default	Existing customers with basic metering
	Energex time-of-use (legacy)			Retired/legacy tariff	Customers re-assigned to either the default IBT or default transitional demand tariff depending on the customers metering
Small business	NEW for Energex Small business transitional demand*	Evening peak 4pm-9pm Off-peak 9pm-4pm	No peak	Default from 1 July 2020	New and existing customers with smart meters. Existing customers may remain on their legacy tariff until 30 June 2021

	NEW for Energex Small business demand*	Evening peak 4pm-9pm Off-peak 9pm-4pm	Anytime	Opt-in	New and existing customers with digital metering
	Energex Small business Inclining block tariff			Default	Existing customers with basic metering
	NEW Energex Small business time-of-use**	Evening peak 4pm-9pm Night shoulder 9pm-9am Day off-peak 9am-4pm	Evening No peak Night shoulder 4pm-9am Day off-peak 9am-4pm	Opt-in	New and existing customers with digital metering
	Energex time-of-use (legacy)			Retired	Customers re-assigned to small business transitional demand or Inclining block tariff
	Small business primary load control			Opt-in	New and existing customers

Notes: *The two demand tariffs have the same structure with a non-seasonal peak window between 4pm and 9pm to apply every day for residential customers, and only on week days for small business customers. The tariffs differ in terms of rates, with the transitional demand tariff having a lower demand charge. This is intended to limit the network cost impact on customers re-assigned to cost reflective tariffs. Weekdays include government gazetted full day public and bank holidays.

** The time-of use tariff will be offered on an opt-in basis to reflect stakeholder concerns that some residential customers may have difficulty understanding demand tariffs in contrast to a TOU energy tariffs.