



**SUBMISSION TO THE INDEPENDENT COMPETITION
AND REGULATORY COMMISSION'S INQUIRY INTO
RETAIL PRICES FOR NON-CONTESTABLE ELECTRICITY
CUSTOMERS**

DECEMBER 2005

ACTCOSS COMMENT – NON-CONTESTABLE ELECTRICITY CUSTOMERS

Introduction

ACTCOSS acknowledges that Canberra has been built on the traditional lands of the Ngunnawal people. We pay our respects to their elders and recognise the displacement and disadvantage they have suffered since European settlement. ACTCOSS celebrates the Ngunnawal's living culture and valuable contribution to the ACT community.

The ACT Council of Social Service Inc. (ACTCOSS) is the peak representative body for not-for-profit community organisations, people living with disadvantage, and low-income citizens of the Territory. ACTCOSS is a member of the nationwide COSS network, made up of each of the state Councils and the national body, the Australian Council of Social Service (ACOSS).

ACTCOSS's objectives are representation of people living with disadvantage, the promotion of equitable social policy, and the development of a professional, cohesive and effective community sector.

The membership of the Council includes the majority of community based service providers in the social welfare area, a range of community associations and networks, self-help and consumer groups and interested individuals.

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Should the transitional franchise tariff continue?

When ACTCOSS became aware that the Independent Competition and Regulatory Commission had been given a reference to look at the cessation of the transitional franchise tariff (TFT) arrangements, we immediately issued a press release calling for their retention. That media release said, in part:

“FRC (Full Retail Contestability) in the ACT electricity market is still in its infancy after three years, with only one additional retailer actively enlisting customers, and then only a few households have actually changed suppliers,”....

“It is simply too soon to know whether FRC has been a successful move or otherwise.”

“It will take many years before the ACT develops a mature, competitive retail electricity market, and until that time transitional arrangements should be retained.”

“Any move to allow the transitional arrangements to lapse would remove important protections for consumers at a time of staggering price increases,”....

“As the Essential Services Consumer Council noted in its annual report for 2003-04:

“energy “supply” charges for the last 3 years have increased by a total of 20% for electricity and 25% for gas; and “consumption” charges have increased by a total of 11% for electricity and 23% for gas. During the same period, the CPI (to which many Centrelink payments are aligned) has increased by a total of only 8.4%.”¹

“On top of that, Canberra has one of the harshest climates for any large city in the country, with temperatures down to minus 8 in winter, plus 40 in summer, and one of the highest 24 hour differential temperature ranges.”

“ACTCOSS is pleased that the discussion is happening....But ACTCOSS will be advocating for the retention of the transitional arrangements...”

This remains ACTCOSS' position.

In chapter two of the Inquiry document, the ICRC outlines some of its parameters:

In considering the state of the market to determine whether it is sufficiently competitive to no longer require the existence of a regulated tariff for franchise customers, the Commission will review and seek comment on the following market characteristics:

- *the size of the market*
- *the entry of new retailers*
- *information available to customers*
- *barriers to further competition*
- *churn rates*
- *pricing*

¹ (http://www.jcs.act.gov.au/eLibrary/AnnualReports/2003_2004/JACS_vol1_2003_2004.pdf Page 220)

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- *the emergence of new tariff options*
- *safeguards.*

In addition, the Commission will seek comments on whether actual or potential competition should be the basis for any decision on whether there is a need for the continuation of a regulated franchise tariff.

ACTCOSS will address these issues specifically, starting with the size of the market and the entry of new retailers.

The Commission seeks views on how the size of the ACT market should influence considerations of the competitive state of the market and how this relates to a continuing need for a regulated tariff.

At this time, ACTCOSS is aware that the 145,000 potential retail electricity customers (users of less than 160MWh pa) make up a wide cross section of the community, from commercial operations such as food outlets, to small residential consumers. While this may seem like an attractive market, given the high average incomes and high level of uptake of technology and electrical equipment among Canberrans, only three retail businesses are actively pursuing customers – ACTEW AGL, Country Energy and Energy Australia.

Country Energy is not pursuing domestic consumers, but is focussing on businesses and Government operations. A fourth retailer, Origin Energy², has withdrawn from the market.

In total, 14 electricity retailers have taken up licences in the ACT, and it must be assumed that the remaining 10 have valid reasons for going through that process yet remaining inactive. ACTCOSS believes that the businesses who have shown no activity in the ACT may have taken a decision to become licensed in all jurisdictions as a hedge against the unknown elements of the National Electricity Market (NEM). It is also notable that there are around 20 licensees in each of the larger NEM states, so not all retailers have chosen to come to the ACT.

The Commission seeks views on how the number of licensed retailers should be taken into account when investigating the competitiveness of the market and how this relates to a continuing need for a regulated tariff.

ACTCOSS therefore believes that the size of the market and the potential number of retailers is irrelevant. The fact is that only two retailers out of 14 licensees are pursuing domestic customers in the ACT, and one of those is the former monopoly incumbent who still has 98% of the small consumer market.

ACTCOSS would therefore like to comment at this stage on the idea that potential competition could be used as a measure for a decision on the need for the regulated tariff safeguard.

The ICRC put this issue in these terms:

The Commission seeks views on whether actual or potential competition should be considered by the Commission when it is considering the ‘competitive state of the market’.

² Origin was originally a gas retailer, but held an ACT energy retailer licence and sold some air conditioning equipment, offering bundling of energy usage and appliances.

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If it is believed that actual competition should be considered, how should it be measured and is the market currently sufficiently competitive?

If it is believed that potential competition should be considered, how should it be measured and is the market currently sufficiently competitive?

ACTCOSS totally rejects any assumption that, simply because the parameters for a market exist on paper, that a market will develop. The past three years have provided ample demonstration that retailers are not interested in competing for the under 100MWh sector, despite the potential. Our comments on the other issues raised are embedded in our discussion on competition.

This brings ACTCOSS to the issue of information available to consumers.

The Commission seeks views on the amount of information available to customers and whether it is sufficient for customers to make informed decisions about the services they require and to make comparisons between the costs of alternative services offered.

ACTCOSS would argue that information must be relevant and easily understood. ACTCOSS and others have made comments in previous consultations on presentation of billing information, and ACTEW AGL has carried out some changes to content. It can only be hoped that smart metering may provide some alternate formats of information that will be relevant to consumers. For example, the cost per day as a real time figure.

The breakdown of the ACTEW AGL full cost stack³ is not clear and transparent. ACTCOSS suspects, however, that for most consumers understanding their utilities bill is not a high priority and that most see the cost of electricity as a necessity over which they have little, if any control. South Australian research⁴ has shown that some low income households actually UNDER consume electricity in their attempts to save money and may be putting their long term health in jeopardy. For low income households, control of electricity use may not be within their means because of poor housing infrastructure and condition of appliances. One-on-one programs, such as the Water and Energy Savings Trial (WEST) scheme are having some success helping low income households better understand electricity usage. Part of that scheme is providing base-level knowledge needed to understand energy terminology and consumption. ACTCOSS has similar experience with other information campaigns which have also showed that any amount of printed information and web sites must be complemented with an informed person to whom you can address your questions in person.

ACTCOSS therefore believes that there should be a community-based advocacy and information service on utilities issues that is independent of individual corporations⁵. There should also be a standard set of the type, quantity and

³ The contribution of distribution and retail standing charges, the costs of transmission (TUoS), the costs of distribution (DUoS), the retail flat load charge of energy, the allocation of peak load energy charges, the amount allowed for the retail risk premium, the amount allocated for ancillary service payments plus the retail profit margin. If prepayment meters are rolled out then the difference in revenue between the use of prepayment meters and one two or three monthly billing after consumption needs to be accounted for as well.

⁴ Western Region Energy Action Group, "Powering Poverty". July 2004.

⁵ ACTCOSS has included a recommendation for such a position, located within the community sector, as part of its submission to the 2006-07 ACT Government Budget process.

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layout of information that provides relevant and meaningful information for a wide range of consumers. Such information must also be made available in a variety of formats to cater for visual, language and other needs.

The Commission seeks views on any barriers to further competition that exist, and the extent of those barriers.

ACTCOSS offers little comment on the barriers to further competition, except to say that at the present time none of the “potential” consumer benefits of competition, such as retailer choice, lower prices and better products, have been produced, nor are they promised in the near future. ACTCOSS reiterates its position that electricity is an essential service which has been provided on a universal basis because of the public health and safety benefits of a uniform, high quality electricity system. Its provision should not be open to full competition without safety net provisions, as there are consumers who could not participate in ‘the market’ because of their income or other forms of market disadvantage.

The ICRC also specifically asked for discussion of churn and contract offers in these terms:

The Commission seeks views on how customer churn can be interpreted when examining the competitive state of the market and how this relates to a continuing need for a regulated tariff.

The Commission seeks views on whether there are unique: (i) cost factors; (ii) regulatory requirements; (iii) market characteristics; (iv) historical factors; or (v) other factors in the ACT that explain the extent of customer churn in the ACT relative to churn rates in other jurisdictions (see Section 2.3 of this paper).

and also:

The Commission seeks comments on whether the emergence of tariff offerings are an indication of a competitive market and how this relates to a continuing need for a regulated tariff.

The Commission seeks comments on new products and offerings that it has not yet identified.

ACTCOSS sees this point as being a corollary of the discussion of FRC:

The Commission seeks views on the ACT’s experience of FRC compared with that of other jurisdictions, and on how it relates to this inquiry.

From a consumer’s point of view, ACTCOSS does not believe that lack of information can be blamed for the low churn rate in the ACT. The ICRC in its annual report has shown that in the ACT, around 2% of ‘small’ consumers (using less than 160 MWh) have changed electricity providers since the introduction of Full Retail Contestability (FRC) in 2003. In New South Wales, this “churn” is closer to 15% after three years. ACTCOSS does not believe that lack of information can be blamed for the low churn rate in the ACT.

ACTCOSS has given some consideration to the fact that 11% of residential customers have taken up contestable contracts with ACTEW AGL, presumably because of the offers of attractive “bundling” of services (gas, electricity, Transact television and telephone and broadband Internet connection). These

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customers are not counted in the figures for churn, but have left the safety net arrangements.

ACTCOSS does not see these consumers in the same light as those who leave one retailer for another, as bundling in the ACT context has meant consolidating existing arrangements under a new contract with a discount. The fact that only 11% of consumers took up this option probably shows the extent of consumer apathy.

In terms of ACTCOSS' understanding of consumer behaviour, the low churn rate seems logical in that consumers are not being offered new products, as was the case with the boom in the communications technology market. ACTCOSS believes the 13% who have moved to market contracts were mostly the "early adopters" who had enough services to bundle, combined with a few consumers who felt they could benefit from the Energy Australia 8% discount offer. But for most people, electricity still comes out of their power sockets at 240V and 10-15 amps, so there is little reason to change.

From a retailer's point of view, the low level of churn is indicative of two issues:

- The various regulatory requirements in licences, rules, codes, metrology procedures may be impeding retail licence holders from undertaking expensive IT builds that will provide them with seamless business operations in the ACT; and
- Insufficient headroom to provide an attractive profitable environment to encourage retail competition.

ACTCOSS is strongly opposed to the headroom approach to encouraging retail competition as it is simply a way of mining the pockets of low income and disadvantaged consumers.

ACTCOSS would like to here voice its concern over other tariff 'offerings' interstate, which include links to credit card payment options, complete with loyalty points. There are also invitations to apply for credit cards that participate in these payment schemes online from the utilities sites. We are concerned that such offerings are a way for utilities retailers to avoid bad debtors, as under the terms of the direct debit contracts consumers would be in debt to credit providers, not utilities retailers. This could lead to more severe problems as people at risk of fuel poverty may be prevented from addressing these issues through such bodies as the Essential Services Consumer Council (ESCC). ACTCOSS believes that this is an unacceptable risk.

Interstate churn has accounted for much higher percentages than in the ACT, but still does not exemplify perfect competition where the retailers are price takers. Market power has not shifted significantly from the retailer to the consumer, which means consumers still have too little influence to allow the safeguards to be removed.

This relates directly to the ICRC's discussion points below:

The Commission seeks views on whether the current state of the market in the ACT is sufficient to guard against price rises that are not cost-based, should the TFT be removed.

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The Commission seeks views on the likely impact on prices if the TFT were removed.
The Commission seeks views on the possible implications of inaccurately setting the TFT.
The Commission seeks information on the retail prices charged by ActewAGL in other jurisdictions and how these compare to those offered in the ACT.

The Commission seeks views on the role the TFT may play in protecting the interests consumers and how the interests of consumers may be affected by the removal of a regulated tariff.

ACTCOSS' understanding of NEM cost issues includes the fact that peak load generating capacity is still a major concern and that all NEM transmission distribution companies have asked for price increases from their regulators over the past three years. (The regulated price increase applications may not have been granted by the relevant regulators.) It seems, therefore, that any speculation about prices falling in the short to medium term if regulated pricing is abandoned are illusory. ACTCOSS is not in a position to make judgements about the validity of electricity industry business cases. But in the distribution sector, regulators in 2004-05 found that the costs being asked for in distribution pricing had been overstated and they reduced the prices in that sector, passing on some (small) relief for consumers.

The utilities industries are now in a period where they are trying to raise their profile and maximise returns to shareholders, so ACTCOSS has no confidence that price falls would result from the withdrawal of the TFT. We also rely on the reported behaviour of some retailers, where small discounts are offered in exchange for three year contracts that may produce above-cost increases over the life of the contract, allowing the retailer to recoup any reduction in revenue from offering up-front discounts to contract customers.

ACTCOSS believes that access to essential services should be universal. At present bonds for utilities connections can be several hundreds of dollars, while standing charges are now higher than ever, making it impossible for most households to decrease the cost of their power use by energy saving measures. As was the case in our submission on water pricing, ACTCOSS sees a fairer regime in having very low standing charges, coupled with inclining block tariffs. The blocks for the tariffs can be set to allow a low cost for a subsistence level of consumption for lighting, some heating and basic hot water, with other tiers set at suitable intervals to ensure that the largest consumers in the network also subsidise augmentation for peak load, etc. Such pricing regimes need to be then complemented by robust rebates, concessions and Community Service Obligations (CSOs) to protect people who are vulnerable because of health or other forms of disadvantage that make their usage higher than normal.

ACTCOSS sees regulated pricing as an important safeguard in the transition period, which is showing no signs of moving out of transition. As outlined previously, ACTCOSS does not believe that a market has developed in the ACT and that it will take several more years to determine whether FRC has been successful in Canberra.

In the interim, the Transitional Franchise Tariff is part of a suite of protections that must be available for vulnerable consumers.

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There is also a need to ensure that product diversification does not include a downgrading of service, or enforced low-cost options that further exacerbate hardship. The ICRC has asked:

The Commission seeks views on whether the existence of a regulated tariff has any impact on the competitiveness of the market and the ability of retailers to introduce alternative products and services.

ACTCOSS was alarmed when it first attended a small consumer advocacy meeting in Melbourne in 2004 to hear discussion of how the distribution and generation arms of the NEM were discussing differentiation of product. There was concern at the lack of generation capacity to cover peak loads, and some of the demand management solutions being offered included tariffs and plans that provided for “brown outs” and times off the grid for residential consumers.

Any new tariff options should ensure that inequalities are not exacerbated and that the quality of the standard product and service support is not diminished. The existence of Time of Use (TOU) tariffs in small jurisdictions, such as Tasmania, show there is little barrier to their introduction. TOU meters primarily protect retailers revenue flows. Retailers using TOU meters get prepaid for the supply of energy while the remaining monthly, two monthly or three monthly accounts are paid post-use. While it is accepted that many businesses and industries may be able to manage their peak operating loads to coincide with lower TOU tariffs, many cannot. Similarly, residential consumers are also bound by external drivers for their time of use of electricity. ACTCOSS is very concerned that products offering a lower level of provision are potentially available with new metering technology. Should they be offered in the residential market, this would unfairly impact on low income households. Any new tariff options should ensure that inequalities are not exacerbated and that the quality of the standard product and service support is not diminished.

ACTCOSS notes that differentiated products are actually available in other jurisdictions. However, ACTCOSS has made the point in submissions and discussions on metering that any such tariffs must be voluntary, consumers need to have clear and relevant information that addresses their circumstances, and still be able to access hardship alleviation processes, such as those offered by the ESCC.

ACTCOSS has also expressed its opposition in other forums to the idea that customer service standards may be used as a way to provide differentiated tariffs. All consumers deserve to have a product that is reliable, and service standards that do not produce hardship. Again, this is in recognition of electricity as an essential service.

Tariffs must be kept differentiated from other services that may be bundled into a utility service contract. In the recent demonstration of prepayment meters for the Essential Services Consumer Council, it was noted that additional charges could be loaded onto the meters to cover such things as appliance purchases. In ACTCOSS view, such bundling of costs is inappropriate and does not allow people to understand their debt levels. We do not exclude combined billing of purchases and utility costs, but there needs to be a separate accounting for the

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components so that the consumer is provided with the cost of the appliance and the level of debt against that item, and the cost of the utility, including break downs of TOU tariffs, standing charges and any other charges that may apply. Such accounts must also be sent at regular intervals to ensure that the consumer is aware of the progress of their account. Therefore ACTCOSS recommends that pooling of appliance debt and energy costs should be prohibited in any new technology adopted in the ACT.

To address the issue of ACTEW AGL's interstate tariffs, ACTCOSS was unable to find any easily available information as the relevant links from the company's web site don't work.

The Commission seeks views on the role agencies such as the ESCC, Care Financial the Consumer Law Centre and the ACT Council of Social Services play in providing assistance to disadvantaged consumers and how this role may be affected by the removal of the TFT. Specifically:

- How are the needs of electricity customers experiencing difficulty with bills addressed?
- How are the needs of gas customers experiencing difficulty with bills addressed?
- How are such needs of customers of alternative retailers addressed?

ACTCOSS has discussed safeguards in terms of tariffs throughout this submission. Our major concern at this time is that the Essential Services Consumer Council and the ACT's financial counsellors be consulted and listened to in terms of their knowledge of vulnerable consumers.

In ACTCOSS' view there will always be a need for a basic, low cost safety net scheme. Such a scheme must be available universally, as gatekeeping on a means-tested scheme quickly makes it high cost. At the present time, the more you have the more you save in terms of the consumer's ability to bundle services. However, many low income households are not in a position to take advantage of these offers, with no internet connection, no computer, no mobile phones (sometimes no fixed line either) and no gas heating or hot water. They are also often on the highest cost tariffs, as no one has made them an offer of a lower rate. A number of low income households are also high energy users – not because they waste energy, but because their housing is energy inefficient and has electric heating. A safeguard tariff must take into account the needs of such households⁶.

This is doubly important when it is remembered that the ACT has the best ombudsman scheme across the NEM (the ESCC) and significant increases in the level of churn will leave the first tier retailer with the less profitable customers. This in turn will add to ACTEW AGL applying for price increases due to the high costs of servicing consumers who are not seen as profitable by the second tier retailers.

ACTCOSS also sees a need for a commitment to other safeguards, such as the ESCC. Consumers need to access independent, accessible, user-friendly services that meet their needs when they are in crisis. The ESCC is unique in Australia in

⁶ There is a NEM wide problem associated with the tariff and charge setting is the almost complete lack of customer income, energy consumption, quality of housing stock and appliance information. This point was previously made in ACTCOSS comments on role of standing charges.

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terms of its legislative base, being a one-stop-shop for complaints and hardship cases, its ability to meet people in informal surroundings that put consumers at ease, its practical approach to problem solving, and its insistence on reporting on issues that affect consumers in a meaningful way, such as its recent gender analysis of its clients and the former reporting of rises in the costs of electricity and gas under FRC. The ICRC is asked to ensure that any proposed changes do not adversely impact on the ability of the ESCC to assist vulnerable consumers to manage their energy costs, or to perform its functions in an open, transparent way that informs policy making.

There is, therefore, a need for a commitment to other safeguards, such as the ESCC, improved consumer codes and robust concessions programs. Consumers need to access independent, accessible, user-friendly services that meet their needs when they are in crisis. The ESCC is unique in Australia in terms of its legislative base, being a one-stop-shop for complaints and hardship cases, its ability to meet people in informal surroundings that put consumers at ease, its practical approach to problem solving, and its insistence on reporting on issues that affect consumers in a meaningful way, such as its recent gender analysis of its clients and the former reporting of rises in the costs of electricity and gas under FRC. The ICRC is asked to ensure that any proposed changes do not adversely impact on the ability of the ESCC to assist vulnerable consumers to manage their energy costs.

Equally important in the ACT is the WEST scheme, which provides assistance and advice on retrofitting energy inefficient housing stock that is causing hardship for occupants. As mentioned earlier, this type of scheme that provides independent advice and assistance with practical measures can have a profound impact on households. ACTCOSS believes such schemes, and the Government's energy audits, are necessary to provide information to consumers in a way that they understand and can act upon.

Calculation of a further transitional franchise tariff

Have conditions in the market changed sufficiently in the past three years to warrant a change from the approach the Commission adopted in 2003?

ACTCOSS believes that there has been significant change since the last regulatory decision on electricity pricing – but this has not happened in the 'market'. The main change has been the engagement of the ICRC with consumer advocacy groups and its willingness to seek relevant information on consumer issues that cover what is being called, in this review, 'non-contestable electricity customers'.

ACTCOSS has also seen an increase in the attention paid to consumer issues across the NEM, although we would add that most attempts to raise the profile of small consumers have been unsuccessful. ACTCOSS would therefore ask that any change in methodology in determining the TFT keep in perspective the impact of pricing decisions on the lowest income households, and that consideration of their need for affordable electricity be included in those

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deliberations. ACTCOSS would also like to see some compensation provided to small users for the cost increases that have come about in the past three years (see ACTCOSS' earlier extract from its press release on the TFT).

The Commission seeks views on whether a cost build-up approach to regulation, such as a tariff determined by the Commission, is appropriate for the regulation of retail tariffs in the ACT.

Given the list of costs in Section 3.1, the Commission seeks comment on the following:

- Are these costs still sufficiently comprehensive, or should other costs also be considered?
- What costs identified above are not relevant to TFT customers? Why?
- How should the Commission approach the cost allocation problem?

ACTCOSS believes that the comments it made in 2004 on distribution pricing are still relevant and attaches a copy of that submission to this paper. We understand that there may have been some unintended cost incursions under the NEM rules, including which utility bears the costs of churn, and settlement of accounts within the NEM, but these are not costs that should be passed through to consumers. ACTCOSS leaves any further discussion of these items to the regulatory economists.

ACTCOSS, does, however, reiterate its earlier comments about the form of any tariffs, preferring a formula of low fixed charges and an inclining block tariff that reflects the cost of excess consumption. This needs to be backed with a robust concessions, rebates and Community Services Orders regime that provides relief for households experiencing fuel poverty.

ACTCOSS knows that the transitional arrangements do not simply apply for hardship reasons. We therefore see reform of the way tariffs are structured as providing other long term benefits. This could include achieving environmental goals by sending better price signals to mid-range to high energy use consumers who do not monitor their electricity consumption. The base line, cheap allowance of electricity would provide households with enough electricity to meet health and safety needs, and use over and above that amount could then be truly discretionary. Of course, this must be supplemented with concessions, rebates and CSOs for households with high heating/cooling needs, such as larger low-income families and those with family members who suffer chronic ill health.

ACTCOSS notes that a recent Australian Centre for Regulatory Economics (ACORE) Working Paper has found regulatory decision making across Australia to be fairly consistent.⁷ In ACTCOSS' view, this seems logical and provides an opportunity for the ACT to make some ground-breaking comments on fuel poverty as it considers the TFT, given that all jurisdictions seem to take interest in each others deliberations.

The Commission seeks views on the appropriateness of benchmarking and monitoring approaches to the regulation of retail tariffs in the ACT.

⁷ The Australian National University Working Papers In Regulatory Economics "Price Regulation in Australia: How consistent has it been?", Robert Breunig, Scott Stacey, Jeremy Hornby and Flavio M. Menezes . Viewed at: <http://www.acore.org.au/research/Paper%2005-1%20Price%20Regulation%20in%20Australia.pdf> revenue

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The Commission seeks views on the most appropriate benchmarking or monitoring approach to apply to the regulation of retail tariffs in the ACT.

ACTCOSS has argued that removing the regulated tariff is not appropriate, therefore we do not believe that making some form of regulatory change at this stage to benchmarking or monitoring is appropriate.

The Commission seeks views on the duration of any price direction and on appropriate trigger mechanisms.

ACTCOSS believes that the TFT must operate until there is convincing evidence of full retail competition. This would include all licensed retailers being active in the residential electricity market and being price takers.

The Commission seeks views on how the removal of a regulated tariff may affect the RoLR arrangements.

As ACTCOSS does not foresee the removal of the regulated tariff it does not see the RoLR as an issue at this time.

The Commission seeks views on whether the current obligation to supply, and protections available under the Utilities Act and Consumer Protection Code, are sufficient. The Commission seeks views from ActewAGL on whether it would continue to offer a standard customer contract if it were found that there is no need for a regulated retail tariff. The Commission seeks views on how best to ensure that the obligation to supply and the protections available under the Utilities Act and Consumer Protection Code would continue to apply to customers if it were decided to remove the regulated tariff.

ACTCOSS strongly urges the ICRC to take advice from the ESCC, the Consumer Law Centre and the Care Financial Counselling Service on the adequacy of current protections and how these could be translated to a post-regulated tariff regime. In 2004, ACTCOSS conducted consumer advocacy training as part of a program administered by the NEM Advocacy Panel. In one of those training sessions, ACTCOSS heard from the Energy Advocacy Centre in Victoria about 'red lining' and other practices aimed at excluding some consumers from access to electricity. Such practices need to be illegal.

There is also a need to increase protections to cover new and emerging technologies. ACTCOSS has recently participated in discussions on prepayment meters, and believes that, while such technologies may be sought out by some consumers, they should never be used to control consumer debt or to have people with a poor record of payment removed from the protection of consumer codes and ombudsman schemes.

ACTCOSS reiterates its position that electricity in Canberra in the 21st century is an essential service. Canberra has a good hardship provisions under the ESCC scheme, and this should remain a legislated body.

Conclusion

ACTCOSS is, as always, happy to take the opportunity to provide comment to the ICRC on issues affecting citizens of the ACT who live with poverty or other forms of disadvantage. We reiterate that we see no need for the removal of the TFT at this time, principally because there is no evidence that an electricity 'market' has developed in the ACT at this time.

Abbreviations

ACORE	Australian Centre for Regulatory Economics, ANU
ACTCOSS	ACT Council of Social Service
ACTEW AGL	ACT utilities provider (electricity and gas), formed by a merger between the former ACT Electricity and Water (ACTEW) and AGL
ACTEW	ACT water utility
CSO-	Community Service Order
CSP	Community Services Program
DUoS	Distribution Use of Systems
ESCC	Essential Services Consumer Council
FRC	Full Retail Contestability
MWh	Mega Watt Hours
NEM	National Electricity Market
TFT	Transitional Franchise Tariff
TOU	Time of Use, refers to tariffs
TUoS	Transmission Use of Systems
WEST	Water and Energy Savings Trial

CONSUMER
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A PROJECT OF CARE INC FINANCIAL COUNSELLING SERVICE

**Submission of
The Consumer Law Centre of the ACT
and
The ACT Council of Social Service**

**to the ACT Independent Competition and
Regulatory Commission Draft Decision on
Investigation into Prices for Electricity
Distribution Services in the ACT**

January 2004

ACTCOSS COMMENT – NON-CONTESTABLE ELECTRICITY CUSTOMERS - ADDENDA

Foreword

This submission has been prepared on behalf of the Consumer Law Centre of the ACT (CLC) and the ACT Council of Social Service Inc (ACTCOSS). Our organisations have an important consumer interest in the issue of electricity prices and all essential services provision, particularly to low income consumers.

The CLC was established in 2002. It is co-located with Care Inc Financial Counselling Service, the main provider of financial counselling and related services in the ACT and region since 1983. The CLC is an independent community legal centre funded by the ACT Government to provide free legal assistance and advice to vulnerable and disadvantaged consumers in a wide range of areas, including general consumer and fair trading matters as well as consumer credit, utilities and telecommunications. The CLC also plays an active role in providing consumer education, and in pursuing regulatory and market-place reforms. By advocating on behalf of and facilitating access to justice for disadvantaged consumers, the CLC aims to ensure a fair market place for all ACT consumers.

The ACT Council of Social Service Inc (ACTCOSS) is the peak representative body for not-for-profit community organisations and disadvantaged and low-income citizens of the Territory. ACTCOSS is a member of the nationwide COSS network, made up of each of the state Councils and the national body, the Australian Council of Social Service (ACOSS). ACTCOSS has the twin roles of representation and advocacy. The Council's objectives are the representation of disadvantaged people, the promotion of equitable social policy, and the development of a professional, cohesive and effective community sector. The membership of the Council includes the majority of community based service providers in the social welfare area, a range of community associations and networks, self-help and consumer groups, and interested individuals.

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CLC/ACTCOSS Submission to ACT Inquiry on Prices for Electricity Distribution Services

Introduction

The general interests of the CLC and ACTCOSS

The CLC and ACTCOSS are pleased to see that the ICRC has recommended a substantial reduction in distribution charges. Electricity and other energy charges form a large part of the household budget for people with low incomes and can place a high burden on those who are financially stressed.

Although the ACT, with high average incomes and low rates of unemployment, is generally more prosperous than other states and territories, there is still a reasonably high incidence of poverty. The ACT's poverty rate is about 8.5 percent of the population, or two thirds of the national rate; translated into individuals that means at least 25 000 people are living in poverty in the ACT.⁸

While we welcome any real price reduction in electricity, we are concerned at the narrowness of the role the Commission has adopted. The Commission has a brief to consider the equity effects of pricing, and there is nothing impeding the Commission from making observations or suggestions for changes in policy when it finds inequitable outcomes in those markets it examines. The Commission has the resources and the competence to bring equity issues more strongly to the attention of policy-makers.

In this inquiry, apart from metering, the Commission has largely confined itself to the natural monopoly aspects of electricity supply. In these natural monopoly areas price regulation can work reasonably well (though we have some technical reservations with the Commission's approach). We are not convinced, however, that the reforms in the name of national competition policy are bringing benefits to consumers, particularly those with low incomes.

Fragmentation of electricity supply into four components has brought new costs, including the transaction costs of bargaining between business entities, search costs for consumers, and the costs of regulation. The existence of offsetting benefits is hard to establish. Electricity is a fungible, standard product; indeed the notion of "choice of supplier" is a fictitious construct, for whatever supplier is chosen the same product is delivered, with no variation in quality or reliability. The cost of this fiction is that consumers have to pay for the high marketing costs borne by competing suppliers.

If there were robust price competition then the absence of product competition may not matter. But we believe it is unlikely that retail contestability can bring meaningful price competition to domestic consumers, particularly those on low incomes whose market power is weak. There are many conditions to be met for markets to operate efficiently. Few of these are present in electricity markets. Because they have limited control on consumption, people on low incomes have even less capacity than others to take advantage of competition.

⁸. DATA FROM ANN HARDING, RACHEL LLOYD, OTTO HELLWIG AND GEOFF BAILEY *BUILDING THE PROFILE* TASKGROUP PAPER #3, DECEMBER 2000, REPORT OF THE POPULATION RESEARCH PHASE OF THE ACT POVERTY PROJECT, CONDUCTED BY NATSEM, UNIVERSITY OF CANBERRA.

Structure of this submission

This submission is in three parts:

Part one is a response to the Commission's draft determination. Our main recommendation is that the full price reduction be brought in immediately, rather than being phased in over five years. We also question the Commission's estimate of a reasonable return on capital and the relevance of the CPI as an affordability indicator for those on low incomes.

Part two relates to the structure of electricity tariffs in the ACT. We note that ActewAGL is to submit its proposed pricing structure to the ICRC. We wish to see a pricing structure that changes the balance between fixed supply charges and use charges, with relief on supply charges for those on low incomes. The present ACT pricing structure is very favourable for high-use customers, to the detriment of low-use customers. Most high volume users are businesses, with domestic consumers generally having a lower usage. However, in the domestic user market, there is not a clear relationship between level of income and level of electricity usage - sometimes low income earners are obliged to be relatively high users because of their inability to afford more energy efficient appliances and housing. While many charges for electricity, particularly distribution and transmission, are fixed, there is no reason these have to be passed equally to every customer. Judicious price discrimination, benefiting identified lower-income consumers, or an identifiable community service obligation, can be justified on both economic and equity grounds. We see no reason why supply charges for those in greatest need should not be abolished altogether. We also believe that much more can be done in relation to domestic metering.

Part three is concerned with the broader issues of competition policy and the role of the Commission. In the case of utilities such as electricity and water, supplying essential and fungible commodities over shared networks, the case for forced competition rather than well-regulated monopoly has not been made. But we accept that for now little can be done to change the basic structures. The Commission's discretionary ability to widen its determinations and to make policy recommendations is not clear. We have drafted a set of recommendations covering policy issues, directed to the Commission or to the ACT government if the Commission's discretion is limited.

Process of development of submission

In preparing this submission, the two organisations arranged a consultation attended by consumers, consumer and community organisations (including the Conservation Council of the South East Region and Canberra) and other key stakeholders (including ActewAGL, the ICRC and the Essential Services Consumer Council (ESCC)). At that consultation held on 20 January 2004, introductory information on the operation of the National Electricity Market and National Competition Policy was provided, as well as a detailed summary of the key issues set out in the draft determination of the Independent Competition and Regulatory Commission (ICRC). Following discussion of the issues and concerns at that consultation, this submission was prepared.

1. The Commission's draft determination

Timing of price reduction

Rather than five stepped price reductions, we would prefer to see one immediate price reduction.

In terms of timing of cash flow, an immediate reduction would be less advantageous to ActewAGL than a phased reduction. To compensate ActewAGL for an immediate reduction, the average price over the period would need to be a little higher than that which is built into the present proposal.

We have calculated that in terms of present value to ActewAGL, a 14.6 percent immediate real price reduction would be equivalent to five reductions of 5.4 percent as proposed by the Commission. Over the period the average price would be less than one percent higher than it would be under the phased production. (See Appendix 1 for our calculations).

To those consumers with an opportunity cost of funds greater than ActewAGL's, this would be advantageous. It is reasonable to assume that most people on low incomes have a very high opportunity cost of funds. For a conservative estimate of this cost of funds we would suggest at least a credit card rate of 16 percent nominal, or around 12 percent real. For many people even credit card rates are unavailable – some mainstream commercial lenders charge between 24 and 33 percent for personal loans, and pay day lenders have rates above 100 percent. At these levels the distinction between nominal and real rates becomes meaningless. For those in high financial stress the very notion of an opportunity cost is somewhat bizarre; they have *no* realistic way of increasing their own liquidity.

Another reason for suggesting an immediate fall is that ongoing price reductions in one element of charges – the network charge – provides an opportunity for electricity retailers to use these price falls to mask prices in other, more lightly regulated components of retail price. A single fall now followed by real price stability makes other price movements more transparent.

Return on capital

Because electricity distribution is capital-intensive, the permitted return on capital is the most crucial variable in price determination. (This is evident from Tables ES.7 and ES.8, which contrast the cost estimates of ActewAGL and the Commission.)

The Commission has used a standard CAPM pricing formula. We appreciate that this is standard practice in industry regulation, but its relevance in utility regulation is questionable. In CAPM the β parameters are used as indicators of *risk*, but mathematically they are a measure of relative market *volatility*. For the short-term speculative investor, volatility is a reasonable indicator of risk, but for long term investors, such as the ACT Government and AGL, volatility as indicated by short-term market movements would seem to be irrelevant. Those investors are in for the long haul, and can ride out the bumps of financial fluctuations.

Similarly the method of derivation of an equity risk premium, the other significant driver of the CAPM formula, is questionable in the case of regulated industries. In fact, the process is self-referential; the examples in Table 11.2 which are used as a benchmark are mainly from markets subject to similar regulatory regimes.

The process of regulation should be to calculate a fair return on capital, having regard to risk. CAPM is one way of taking risk into account. But in industries subject to strong regulation, particularly natural monopolies, the level of financial risk is probably close to zero.

That is not to say risk is irrelevant. But it is to suggest that CAPM is not appropriate means of dealing with risk in highly-regulated industries. In electricity distribution ActewAGL does face risks – natural disasters and lower than projected market growth leaving assets stranded or under-utilized. These risks can be quantified, and added back to the corporation's operating costs. A recent exposition of this approach is in the Victorian Government's review of private-public partnerships.⁹

If the risk-free return on capital were calculated at 3.5 percent, which is a reasonable estimate of the real long-term bond rate, then that would represent an approximate halving of the Commission's estimate of 6.9 percent. That would suggest about a \$17 million lower revenue requirement in 2004-05, or a reduction of 18 percent in distribution costs.¹⁰ This is a high estimate, because the costs of statistically-calculated risks would have to be added back to the cost estimates. Given the Commission's conservative estimates of an annual growth in demand of only 1.5 percent (inferred from Table ES.2), we suggest market risk is very low.

Of course a return of 3.5 percent may be a fair estimate of the ACT Government's cost of funds, but it is unlikely to be satisfactory to the corporation's other shareholder, AGL. AGL is a profitable company, with a reasonably high opportunity cost of funds. But, as the Victorian review has stated, and as the ACTCOSS 1998 submission on ACTEW privatization¹¹ has pointed out, the case for use of public-private partnerships is not strong. Public-private partnerships may be economically justified for once-off projects, or when there are new process or product technologies to be introduced, but electricity supply is a stable industry with mature technologies.

We appreciate that this argument goes well beyond the immediate concerns of the Commission, which has tended to take the present institutional arrangements and methods of analysis as immutable, but we believe that the Commission should take a lead in questioning what have become orthodox, but excessively generous, methods of price regulation in capital-intensive industries. State and territory governments, drawing dividends from GBEs, have no incentive to raise these issues. Nor do private utility companies have any incentive. It is up to regulators to raise these concerns.

⁹. VICTORIAN GOVERNMENT *REVIEW OF PARTNERSHIPS VICTORIA PROVIDED INFRASTRUCTURE*, DRAFT REPORT, DECEMBER 2003.

¹⁰. IN TABLE ES.8 THE COMMISSION'S RETURN ON FIXED ASSETS IS CALCULATED AT \$33.4 MILLION FOR 2004-05. ASSUMING LINEARITY, WHEN MULTIPLIED BY 3.5/6.9 THE RETURN WOULD BE \$16.9 MILLION, WHICH IS 18 PERCENT OF THE CALCULATED REVENUE REQUIREMENTS OF \$92.3 MILLION.

¹¹. *ACTCOSS INTERIM POLICY ON THE PRIVATISATION OF ACTEW*, NOVEMBER 1998.

CPI – X

The method of real price reduction known as “CPI – X” is well-accepted. The “X” factor ensures that at least some of the benefits of productivity gains are returned to consumers. We do not recommend any departure from this method of presentation.

But, while the CPI is a reasonable indicator of movements in the cost of living for an average household, it is not necessarily representative of cost of living movements in poorer households. Over the last 14 years (the period of the present series of the CPI), there have been very high price rises in health care and education, and above average price rises for food. The items which have kept the CPI low include telecommunications, travel, household appliances and entertainment equipment.¹² We would reasonably expect therefore that movements in the cost of living for low income households are higher than the CPI indicates.

Evidence of stress is provided by examining long-term movements in electricity prices and household consumption. Between 1984 and 1998-99 real electricity prices as measured by adjustment to the CPI fell by 15 percent. (See Appendix 2.) But over the same period electricity and other energy costs, as a proportion of household income, rose from six percent to eight percent of household income for the poorest households, while for the most prosperous households the burden of these costs fell relative to income. See Table 1.

Table 1 – electricity and other energy costs as percentage of household income

	Lowest income 20%		Highest income 20%	
	1984	1998-99	1984	1998-99
Electricity	4.6	5.9	1.1	0.8
Other domestic fuel	1.6	2.2	0.4	0.3
Total	6.2	8.1	1.5	1.2

Source: Derived from ABS Household Expenditure Surveys 1984 and 1998-99

We have no reason to believe that ACT experience would be any different. While we do not have time series data for the ACT, a snapshot study of consumption patterns among low-income households has found among those households that expenditure on domestic fuel and power was similar to expenditure in low-income households throughout Australia – both in absolute dollar amounts and as a proportion of total expenditure.¹³

This growing burden of outlays for fuel and power is probably indicative of widening real income disparities over that period – disparities in both nominal incomes and in costs faced by different households.¹⁴ It carries a message to policy-makers – a fall in the CPI-adjusted

¹². SEE ABS *CONSUMER PRICE INDEX (CAT 6401.0)*, DETAILED TABLES. BECAUSE THE PRESENT BASE IN 1989-90 THE SERIES SHOWS GROSS PRICE MOVEMENTS OVER 14 YEARS.

¹³. HARDING ET AL 2000, OP. CIT.

¹⁴. IT COULD BE INDICATIVE OF GREATER FUEL USE, BUT THIS IS UNLIKELY, BECAUSE WE WOULD EXPECT SUCH AN INCREASE TO OCCUR ACROSS ALL INCOME GROUPS.

price of a commodity does not necessarily indicate relief from financial stress for all households. For those on low incomes nominal price rises lower than the community-wide CPI do not necessarily represent a real fall – if they are to benefit the nominal price rise has to be less than *their* movements in the cost of living. This is one of the reasons we seek some extra relief for those with low incomes.

2. Structure of ACT electricity tariffs

Supply charges

We note that ActewAGL is required to report to the Commission on the structure of its electricity charges, as they relate to these network costs.

We acknowledge that network costs are mainly fixed. Only in the very long run, as there is need to augment supply, could they be considered to be variable. Over the period of one year, at least, they would have to be considered fixed.

But that does not mean that such charges have to be passed on to each consumer as a fixed and equal amount. The question of how these charges are allocated should be considered an open one.

The ACT already has a very high fixed charge component, particularly for low-use consumers, as illustrated in Table 2, drawn from ESAA data for 2002-03.

Table 2 – Structure of retail tariffs

	Supply charge \$/qtr	C/kWh	Total charge \$/qtr for consumer using 1200 kWh	Fixed charge proportion
Tasmania	55	14	220	25%
ACT	34	10	148	23%
Melbourne City	38	14	203	19%
Melbourne SE suburbs	38	14	204	19%
Melbourne North suburbs	37	14	205	18%
Western Victoria	39	16	225	17%
North NSW	31	13	187	16%
Eastern Victoria	38	17	240	16%
Western Sydney/Illawarra	24	12	168	14%
Sydney-Newcastle	21	11	149	14%
Western Australia	23	14	190	12%
South Australia	25	15	206	12%
Southern NSW	0	19	226	0%
Queensland	0	18	218	0%
Far west NSW	0	18	217	0%
Central NSW	0	20	234	0%

Source: Data in first two columns derived from Pages 12 and 13 *Electricity Prices in Australia, 2002-03* ESAA 2003. Basic tariff used where choice presented.

Out of the 16 suppliers surveyed by the ESAA, only in Tasmania would a low-use consumer incur a higher fixed charge as a proportion of his or her bill. (We would expect that now that Tasmania is connected to the national grid, its electricity authority will see that its electricity has a high opportunity value, and will change its pricing structure.)

From such data it could be argued that the ACT is privileged in having low-cost electricity. But it is also apparent that the mix of charges is out of step with that applying in other markets.

We see no economic cost in introducing some price discrimination into the ACT's supply charge. Price discrimination can result in economic distortions when it changes people's consumption patterns. But in the case of electricity it is reasonable to assume that every household is connected to the grid; everyone has to pay a supply charge. Varying that supply charge between different customers is unlikely to cause any changes in consumer behaviour. In economists' terms, demand can be considered to be quite inelastic, cross-subsidies will not change resource allocation.¹⁵ Consumers with identified needs – for example concession card holders, or those in public housing, could be charged a significantly lower supply charge, with revenue neutrality being maintained by imposing a higher supply charge on other users. We suggest that for those in greatest need the supply charge should be abolished.¹⁶

Because this can be achieved without distorting real resource allocation, it would satisfy the Commission's requirement to achieve economic efficiency, revenue sufficiency and equity.

An alternative to price discrimination is to mandate a concessional supply charge as a community service obligation, which is usually funded from dividend relief or a specific budgetary allocation. In the case of ActewAGL, because the government has only 50 percent equity, a budgetary allocation would be the most appropriate. This is a matter for government policy, but there is no reason why the Commission should not canvass it.

Another possible approach is to change the mix of supply and usage charges for all users. Indeed, there is a strong economic case in terms of conservation of scarce energy resources and the external costs of carbon (and other) emissions for increasing usage charges. In the absence of a carbon or energy tax these are not reflected in energy prices; the market does not send correct price signals. ActewAGL, with its "Home saver" and "Home saver plus" plans, has a pricing structure which rewards high use and which discourages mixed sources (gas and electricity) of domestic fuel.

We would consider it to be premature, however, to raise use charges at this stage, while consumers, particularly low-income consumers, have so little control over their use of electricity. These issues we raise in Part 3 where we canvass measures to achieve a more rational domestic energy market.

¹⁵. PERHAPS, IF THE PRICE IS PUSHED TOO FAR, SOME CONSUMERS MAY DISCONNECT FROM THE GRID AND SUPPLY THEIR OWN POWER. WITHIN THIS REGULATORY PERIOD SUCH A DEVELOPMENT CAN BE CONSIDERED AS HYPOTHETICAL – OR AT MOST MARGINAL. WHILE SOME DOMESTIC CONSUMERS MAY USE SOLAR SUPPLEMENTATION, CONTINUOUS SUPPLY WOULD REQUIRE INVESTMENT IN BATTERIES OR A ROTATING GENERATOR.

¹⁶. IT COULD BE ARGUED THAT THE SUPPLY CHARGE SHOULD COVER AT LEAST THE MARGINAL COST OF AN INDIVIDUAL CONNECTION. THIS AMOUNT IS LIKELY TO BE A VERY SMALL AMOUNT.

Residential and commercial charges

One of the consequences of electricity deregulation has been a re-balancing of the prices charged to domestic and business customers. The ratio of average domestic to large business charges is shown in Table 3.

Table 3 – Ratio of domestic to large business prices (domestic as percentage of large business)

	1996-97	2002-03
NSW	115	165
Vic	155	222
Qld	118	157
SA	142	199
WA	130	150
Tas	126	177
ACT	80	132

Source: Derived from Tables A1 and A2 in *Electricity Prices in Australia, 2002-03* ESAA 2003.

We note that this ratio has risen in all states. The ACT's ratio is still much lower than it is in other places, but that can be explained, in part by the absence of large electricity-intensive process industries in the ACT.

The conventional explanation for such price dispersion is that it represents cost differences. Some large businesses, for example, receive electricity at high voltage, and use their own transformers to step down the voltage – they bear some of the distribution costs and losses. Some process industries such as aluminium can bear temporary shut down to help electricity companies manage their loads. Many businesses such as retail establishments have a steady daytime load, without calling on peak capacity – domestic consumers place high evening peak loads on electricity grids, requiring electricity authorities to maintain a large amount of capacity which is unused for most of the day.

Against these claims it is worth remembering that Australia has become more interconnected – after all that is what a national electricity market is all about. Domestic load balancing is easier and therefore less costly in a large grid with different climate and time zones. And not all industrial users are gentle on electricity grids – large motors and electric furnaces can place heavy transient loads on electrical systems. And some commercial users, such as hotels, have load patterns that are very similar to domestic patterns.

Part of the explanation for price dispersion may lie in the relative bargaining power of large businesses and domestic customers. For a start, large businesses are likely to be much better informed than domestic customers about prices and use. The transaction costs of shopping around and calculating costs, and the costs of installing smart meters, are relatively small for large businesses. They are better-informed in the market place.

Also, many large businesses, particularly those serving national or global markets, are free to move their businesses. Victoria's generous treatment of aluminium companies provides a case in point.

Understandably, therefore, being better-informed and having more bargaining power, large businesses exhibit more price sensitivity. Studies of price elasticity show that (in the short run at least) commercial electricity customers exhibit much higher price sensitivity than domestic customers.¹⁷ Pricing theory suggests that one charges higher prices to those customers with lower elasticity (being more captive) and lower prices to customers with higher elasticity (being more likely to shop elsewhere). We would like to see this situation changed, not by subverting basic pricing principles, but by giving consumers more power and knowledge in the marketplace.

We are not in a position to state categorically whether domestic customers are being called on to subsidize business users. Certainly the scales have been tipping in that direction. Given the large shifts that have occurred since electricity markets have been deregulated, we suggest that this should be studied in the Australian context, with specific studies in particular regions. Any national study should be funded nationally, preferably in an open forum. This would be a major undertaking – a study by the Productivity Commission in 2001 which set out to find a relationship between costs and prices in Australian and US electricity utilities found a dearth of material; many commercial pricing structures were kept secret under commercial confidentiality provisions. It may be necessary for there to be a legislative requirement for electricity utilities to reveal their pricing policies and charges to large commercial customers.

3. Competition policy and the role of the Commission

Competition policy

The CLC and ACTCOSS are not convinced about the benefits of competition policy, particularly for low income consumers. We have stated this opposition to the Commission on previous occasions, and we are taking this opportunity to re-state that case and to point to a need for the Commission to widen its role.¹⁸

Enforced competition and structural separation of electricity generators, transmitters, distributors and retailers has been costly. The fragmented businesses have had to bear high transaction and bargaining costs. Retailers are bearing costs associated with promotion and an inability to exploit economies of scale. Domestic consumers are bearing high search costs – even when they have choice, high search and switching costs may outweigh the benefits of moving on to more appropriate tariffs.

¹⁷. SEE PAGE 36 IN CHRIS SAYERS AND DIANNE SHIELDS *ELECTRICITY PRICES AND COST FACTORS* (PRODUCTIVITY COMMISSION STAFF RESEARCH PAPER AUGUST 2001), AND PAGE 3 IN *THE PRICE ELASTICITY OF DEMAND FOR ELECTRICITY IN NEM REGIONS* (NATIONAL INSTITUTE OF ECONOMICS AND INDUSTRY RESEARCH, CLIFTON HILL, 2002.)

¹⁸. ACTCOSS *SUBMISSION TO THE ICRC INQUIRY INTO FULL RETAIL CONTESTABILITY FOR ELECTRICITY IN THE ACT*, 2002.

When markets are opened to competition it is natural business behaviour for firms to target those with most to spend. When there are benefits from competition they are most likely to be enjoyed by those who are already relatively well-off, not by those with least to spend. The poor do not present attractive niche market opportunities.

Certainly there have been productivity improvements in electricity and other utilities, and some of these have been enjoyed by domestic consumers. But to suggest a causal link to deregulation runs the risk of committing a *post hoc* logical fallacy. Well-regulated and well-managed monopolies can achieve high levels of technical efficiency, and it is questionable whether governments have been sufficiently vigorous in achieving productivity gains in their government business enterprises. Governments often use privatization and formation of public-private partnerships as means of putting the hard work of productivity improvement on to other parties, with the cost of having to fund enterprises at commercial rather than governments costs of finance being passed to the community.

In most markets consumers benefit from competition in two ways – from enhanced product choice and from price competition. Electricity certainly provides no product choice, and the benefits of price competition are questionable, because of market failure.

Product choice

There is no product choice in electricity. Whoever the “supplier” is, electricity comes at the same frequency and voltage, down the same wires, with the same variations and outages. (The same holds for gas and water.)

National competition policy is obsessed with choice of supplier, but it is hard to see why consumers may prefer dealing with one supplier other than another. In some personal service markets served by small businesses consumers may form bonds with particular suppliers. But it is difficult to imagine people forming a close personal identification with ActewAGL or any other supplier. What consumers seek in most markets is choice of product, but that is not possible in natural monopolies. (And for those with low incomes what they seek above all else is affordability.)

Price competition – market failure

As an analogy to electricity retailing, we could imagine a hypothetical market for gasoline, in which the pumps at service stations provide no price information and no quantity information, and in which people receive a single bill every quarter. By any commonsense notion we would describe that as a highly imperfect market.

There are many conditions to be met for markets to bring their claimed benefits to consumers (and, after all, that is the claimed purpose of national competition policy). Among these conditions are requirements that consumers are well-informed on prices, can monitor their own consumption, and can control their own consumption.

These conditions hardly exist in electricity (and other utility) markets. Prices are posted on the Internet and are provided on bills, but few people have even the remotest notion of what a kWh of electricity is. Consumption is recorded on accumulation meters that have more in

common with Heath-Robinson's comical engineering contraptions than with current technological possibilities.

Technologically, it should be possible to provide all consumers with meters which show, on a legible screen, accumulation, price and rate of consumption of electricity. Such meters could also be linked to other utilities. Meter reading could be done electronically through telephone, broadband or even electric supply cable transmission. With simple relays routine meter readings and reconnections could be done instantly and at low cost – to the benefit of those who are mobile in their living arrangements. Central monitoring of energy use could give warning of unusual patterns of consumption (as many telecom and ISP companies do at present). And more user-friendly metering may allow more benefits for consumers and producers alike, such as lower off-peak charges for all electricity and not just electricity linked to water heating. Consumer markets could take on many of the characteristics of industrial markets.

Those who have some idea of their usage and of prices can choose a plan, but even with only one dominant supplier, choice of electricity plan is difficult. If one has kept one's bills over eight or twelve representative quarters, and has some ability to use a spreadsheet, then it is possible to search for the best plan (provided one takes care with understanding the interaction of varying seasonal usage and the break points between different plans¹⁹). With choice of suppliers, all with their own plans, which they will make sure are not directly comparable with the plans offered by other suppliers, the search costs incurred by consumers will be higher still.

And electricity is only one of two dominant energy sources. Gas is a good substitute for electricity in many applications – for example hot water when solar supply is impractical, and some heating applications. But present ActewAGL tariffs treat gas and electricity as quite separate commodities, with incentives for high use of each fuel. The consumer who judiciously chooses gas for some heating applications and electricity for most other uses does not enjoy the low prices of the all-electric consumer, or the consumer who is a high gas user. A single supply charge, covering both electricity and gas, would be a means of helping people make more rational choices of fuels.

While availability of information is a *necessary* condition for markets to function efficiently, it is by no means a *sufficient* condition. Consumers must have some control, some capacity to make choices in the light of that information. For most of those on low incomes there is very little control.

In particular, those who live in rented accommodation have little control over their energy use. In the ACT 60 percent of people in poverty live in rented accommodation, split roughly equally between private and public housing.²⁰

¹⁹. A "RATIONAL" CONSUMER WOULD PROBABLY CHANGE ACTEWAGL PLANS FROM "HOME" TO "HOME SAVER" EVERY APRIL AND BACK AGAIN EVERY OCTOBER.

²⁰. HARDING ET AL 2000, OP. CIT.

This lack of control was confirmed in the Water and Energy Savings Trial in 2003.²¹ And in our consultations relating to this inquiry we heard of absurd practices by landlords, including a claim that the ACT Housing Authority requires that their houses and apartments be let without window coverings.

In all tenancy situations, there is a principal-agent problem leading to market failure. The landlord, private or public, has little or no incentive to invest in energy-saving appliances or insulation. In private markets rental terms are negotiated before tenants can assess the energy efficiency of properties.

Even in owned premises it is not easy for people to change their energy consumption. Insulation, particularly if retro-fitted, is expensive. New appliances are expensive. The rational economic modeller can point to the benefits of investment in insulation or energy-efficient appliances, but such calculations make sense only at reasonable discount rates. People living without a buffer of cash reserves face extremely high discount rates – for them the choice to incur \$100 extra of quarterly electricity bills for perpetuity may be much more rational than outlaying \$1000 in new appliances.

But the community at large – as represented by governments or corporations – does not face extremely high discount rates. That's why some form of compulsion or public subsidy for such investments is reasonably justified.

It is to a set of public policy recommendations that we now turn.

Public policy recommendations

We do not accept the light hand of regulation associated with retail contestability. Our preference is for a well-regulated and well-managed publicly-owned natural monopoly, enjoying economies of scale, economies of backward integration (from generation to retail supply), and economies of scope (combining electricity and gas supplies).

It will be some time, however, before we see a passing of the fads of privatization, forced contestability, and structural separation. Our recommendations therefore are based on the assumption that the basic structures we now have will not change, and that in the next few years we will see more companies competing for retail electricity supply.

Our specific recommendations relating to this draft report are in Parts 1 and 2. Our broader policy recommendations, mainly directed to the ACT Government, are:

Scope of Commission's inquiries – that the Commission take the broadest possible scope in its determinations, prescribing not only the quantum but also the structure of utility pricing. The Commission should make recommendations on price discrimination and community service obligations, particularly (but not solely) where such arrangements would not conflict with principles of economic efficiency.

²¹. THE WATER AND ENERGY SAVINGS TRIAL (WEST) – A JOINT PROJECT OF THE CONSUMER LAW CENTRE, THE ESSENTIAL SERVICES CONSUMER COUNCIL, ENVIRONMENT ACT AND ACTEWAGL, 2003.

Metering – that ActewAGL be required to install in all residential premises technologically advanced electricity meters, covering all three basic utilities, remotely readable, providing accumulation and instantaneous readings of price and consumption. This will place revenue requirements on ActewAGL, which could be collected as a special and identified levy on electricity accounts. Until fitting of such meters is a routine operation, metering should remain a natural monopoly, to allow for the development of standards and education of consumers, and to allow ActewAGL the purchasing power to buy and install such meters at a reasonable price.

Pricing – all utility companies should be required to offer clear and transparent pricing options, including prices for standardized consumption patterns (e.g. 1200 and 2400 kWh per quarter). They should be required to advise consumers when they could enjoy an advantage by moving to an alternative plan offered by their firm. Bundling of electricity supply with other goods and services, other than gas, should be prohibited.

Housing – the ACT Government already has requirements for disclosure of energy ratings on sale or lease of houses, but, in the case of leases, these are not always enforced. The Government should publicize and enforce these requirements. In addition, the Government should develop and enforce standards for insulation, floor and wall coverings, and appliance efficiency for all rented properties, public and private. Major investments such as insulation should be required at the time of refits. In properties which are still awaiting such improvements it should be incumbent on the landlord to disclose to tenants any shortcomings and their likely consequences for fuel use before leases are signed.

Energy integration – ActewAGL and all other retail suppliers should offer at least one package which makes it economical for consumers to choose an appropriate mixture of gas and electricity. Tariffs which reward excess consumption of either electricity or gas, with low marginal cost, should be disallowed. A requirement to offer both utilities may restrict the number of entrants into the market, but it should be remembered that even under national competition policy contestability is a means to an end, not an end in itself.

General principles of utility supply – the ACT Government should develop policies relating to utility supply, recognizing that utilities embody many elements of essential market failure. Their high fixed costs and low short run variable costs make for pricing structures which, in an unregulated market, make for inequities and waste of scarce resources. There are no practical alternatives for utility connection, and for water and sewerage utilities in particular, many of the benefits of connection accrue to society as a whole, not just to the individuals concerned.

Appendix 1 – calculation of price reduction equivalence

This calculates the present value to ActewAGL of the alternative, immediate, path to price reduction. Base price and revenue indexes of 100 have been used, and an iterative process has been employed to find the price reduction (14.6 percent) which is neutral in terms of the NPV to ActewAGL.

Annual real price reduction proposed by Commission	5.40%
Annual real revenue growth	1.50%
Commission's real opportunity cost of capital	6.90%
Equivalent single price reduction	14.6%

Year	ActewAGL discount factor	Sliding reduction			Equivalent single reduction		
		Price	Revenue	PV	Price	Revenue	PV
Base 0	1.0000	100.0	100.0	100.0	100.0	100.0	100.0
04-05 1	0.9355	94.6	96.0	89.8	85.4	86.7	81.1
05-06 2	0.8751	89.5	92.2	80.7	85.4	88.0	77.0
06-07 3	0.8186	84.7	88.5	72.5	85.4	89.3	73.1
07-08 4	0.7658	80.1	85.0	65.1	85.4	90.6	69.4
08-09 5	0.7163	75.8	81.6	58.5	85.4	92.0	65.9
		Average	NPV	466.5	Average	NPV	466.5
		84.9			85.4		

Ratio of average prices

1.01

Appendix 2 – CPI series and electricity prices

The indicator dates – 1984 and 1998-99 have been chosen to correspond with the first and latest ABS Household Expenditure surveys.

	<i>Electricity</i>	<i>All groups</i>	<i>Electricity deflated</i>
Sep-80	43.4	47.8	100
Dec-80	43.7	48.8	99
Mar-81	47.6	50.0	105
Jun-81	48.0	51.1	103
Sep-81	50.0	52.1	106
Dec-81	51.1	54.3	104
Mar-82	55.7	55.3	111
Jun-82	58.4	56.6	114
Sep-82	64.1	58.6	120
Dec-82	68.6	60.3	125
Mar-83	69.0	61.6	123
Jun-83	68.9	62.9	121
Sep-83	71.0	64.0	122
Dec-83	74.2	65.5	125
Mar-84	73.3	65.2	124
Jun-84	71.9	65.4	121
Sep-84	74.3	66.2	124
Dec-84	76.3	67.2	125
Mar-85	78.7	68.1	127
Jun-85	79.0	69.7	125
Sep-85	80.4	71.3	124
Dec-85	81.1	72.7	123
Mar-86	83.0	74.4	123
Jun-86	83.5	75.6	122
Sep-86	84.9	77.6	120
Dec-86	86.1	79.8	119
Mar-87	86.6	81.4	117
Jun-87	86.8	82.6	116
Sep-87	90.9	84.0	119
Dec-87	91.6	85.5	118
Mar-88	91.9	87.0	116
Jun-88	92.0	88.5	114
Sep-88	96.1	90.2	117
Dec-88	96.4	92.0	115
Mar-89	96.6	92.9	115
Jun-89	96.6	95.2	112
Sep-89	99.5	97.4	113
Dec-89	100.1	99.2	111
Mar-90	100.2	100.9	109
Jun-90	100.2	102.5	108
Sep-90	96.6	103.3	103
Dec-90	105.0	106.0	109
Mar-91	105.3	105.8	110
Jun-91	105.4	106.0	110
Sep-91	109.6	106.6	113
Dec-91	110.1	107.6	113
Mar-92	110.2	107.6	113
Jun-92	110.3	107.3	113
Sep-92	112.6	107.4	115
Dec-92	114.7	107.9	117

Mar-93	115.7	108.9	117
Jun-93	115.8	109.3	117
Sep-93	117.1	109.8	117
Dec-93	117.2	110.0	117
Mar-94	117.3	110.4	117
Jun-94	117.4	111.2	116
Sep-94	117.3	111.9	115
Dec-94	117.3	112.8	115
Mar-95	117.3	114.7	113
Jun-95	117.3	116.2	111
Sep-95	117.6	117.6	110
Dec-95	117.6	118.5	109
Mar-96	117.6	119.0	109
Jun-96	117.6	119.8	108
Sep-96	119.1	120.1	109
Dec-96	119.1	120.3	109
Mar-97	119.3	120.5	109
Jun-97	119.3	120.2	109
Sep-97	120.1	119.7	111
Dec-97	120.1	120.0	110
Mar-98	120.1	120.3	110
Jun-98	120.1	121.0	109
Sep-98	115.4	121.3	105
Dec-98	116.0	121.9	105
Mar-99	117.3	121.8	106
Jun-99	116.2	122.3	105
Sep-99	115.9	123.4	103
Dec-99	117.3	124.1	104
Mar-00	118.2	125.2	104
Jun-00	116.9	126.2	102
Sep-00	129.7	130.9	109
Dec-00	130.3	131.3	109
Mar-01	131.0	132.7	109
Jun-01	129.9	133.8	107
Sep-01	133.8	134.2	110
Dec-01	134.9	135.4	110
Mar-02	136.9	136.6	110
Jun-02	135.7	137.6	109
Sep-02	137.3	138.5	109
Dec-02	138.5	139.5	109
Mar-03	145.7	141.3	114
Jun-03	143.5	141.3	112
Sep-03	145.5	142.1	113
Average 1998			123.4
Average 1998-99			105.1
Percentage change			-15