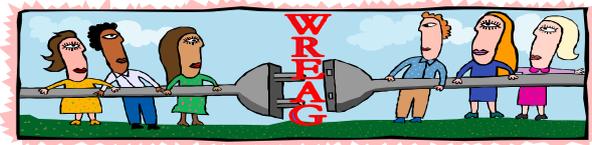


South Australian Council of Social Service Inc

and



Western Region Energy Action Group

Submission to the

**Essential Services Commission
of South Australia**

Inquiry into

**Retail Electricity Price Path
Discussion Paper**

October 2004

For further information

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Background

The South Australian Council of Social Service (SACOSS) is the peak body for the social service organisations in South Australia. Our membership of 270 includes peak bodies in the community sector and other membership organisations. Our members offer such services as counseling, family support, emergency relief, emergency accommodation, advocacy, information and referral to people in crisis, people with disabilities, migrants and refugees, youth, aged, people on low incomes and those otherwise disadvantaged.

The Western Region Energy Action Group (WREAG), a working party of the Western Region Anti-Poverty (WRAP) Forum, has been meeting since February 2002 to raise community awareness of the impacts of electricity price increases and seek safeguards for low-income households in the Western Suburbs who are hardest hit by the impacts of rising electricity tariffs. A wide range of agencies, businesses, governments and community groups actively participate in WREAG.

This submission was prepared by Mr Andrew Nance, Coordinator, SACOSS Electricity Consumers Advocates Training Project, in discussion with members of WREAG, SACOSS members and Executive Director.

Executive Summary

We welcome the opportunity to provide a submission to the Retail Electricity Price Path Inquiry. Collectively, our organisation's members are seeing, first hand, the impact energy market reform is having in the community.

We are witnessing the dramatic increase in numbers of a group of households that we will refer to in this submission as 'vulnerable'. By vulnerable, we mean vulnerable to losing access to the 'essential service' of energy (ie disconnection from electricity or gas) or vulnerable to having to forego other essentials (such as food, health care etc) as a result of allocating limited financial resources to meeting rising energy costs. Often these households will have low income but may be otherwise disadvantaged due to age, poor health, low levels of literacy and numeracy, cultural and other factors.

This submission does not therefore intend to respond to all of the issues canvassed in the Discussion Paper or even attempt to represent the interests of all residential consumers. We acknowledge that **all** consumers have an interest in ensuring that AGL are only allowed sufficient revenue as required to sustain an efficient provider of the responsibilities of the 'Declared Retailer'. We certainly trust that ESCoSA, its consultants and the input of other stakeholders will deliver against this.

However, the Discussion Paper clearly suggests that even if the overall amount of 'efficient costs' approved for AGL does not rise, or in fact reduces, the potential remains for further cost shifting amongst 'small consumers' - and that further price rises for **some** consumers are likely regardless.

Our prime concern is the extent that this could involve making the situation even worse for South Australia's most vulnerable households.

This submission challenges the assertions of many in the industry that "... competition

provides the most effective form of customer protection available ...” and goes further to challenge the perception that the SA energy market “... has reached a level of maturity where a light-handed (regulatory) approach is more appropriate ...”. This submission will show that much of the ‘competition’ seen to date and publicized as high ‘churn rates’ (particularly for those that would be categorized as ‘low-income’ or ‘vulnerable’) has been triggered only by the SA Governments \$50 ‘switching rebate’ and that a large proportion of those who took up the offer realized little or no benefits against the standing contract - some may even end up worse off.

It is not the intention of this submission to argue one way or the other about the prospect of competition benefiting all consumers on AVERAGE in the longer term. We are adamant, however, that competition in itself has and will offer nothing positive to these vulnerable households - and that the current safety net and concession regime is doing little to stem the tide of disconnections. A comprehensive review of concessions (including the Emergency Electricity Payment Scheme, EEPS), their coverage and relationship to movements in the relative costs of essential services is long overdue. SA households contribute some \$60m annually to the state’s GST revenue, it seems obvious that this is the minimum amount of re-investment in equity that should be provided.

Reflecting on the Inquiry’s terms of reference, a decision needs to be formed about whether or not the removal of cross subsidies can be ‘justified’. This submission focuses on this aspect of the Inquiry and presents a brief analysis that illustrates the pressure ‘market forces’ are expected to have on increasing the fixed supply charges applied to residential energy accounts - pressure that may increase these fixed charges by over 50% above current levels. It is our contention that, without a more detailed analysis of the potential impacts and complementary measures that would compensate for the impact on vulnerable households, further action on unwinding cross-subsidies certainly **cannot be justified**. The fervent pursuit of ‘competition’ and ‘economic efficiency’ while a growing number of households are simply ‘falling off the edges’ can not be justified at this or any other time.

The submission concludes with a discussion around the question “Do vulnerable households deserve ‘special’ arrangements?” We must conclude that the answer to this is yes and, given the dire situation as it stands, we cautiously present some options around the creation of a ‘sub-market’ that encompasses the vulnerable. Such a sub-market provides the ability to deliver mechanisms that have otherwise been received with hostility by industry as being counter to the goals of unfettered competition.

For now, we must accept the Commission’s limited empowerment to deal with the issues of vulnerable households directly. However it is our strong view that, with insufficient understanding of vulnerability and the consumption patterns of households and knowing there are insufficient other mechanisms to adequately compensate for the possible effects, the Commission’s obligations to the interests of consumers as a whole would not be met if elements of the proposed price path are allowed to increase the risk of disconnection for vulnerable households.

In summary, this electricity experiment has gone far enough. Before it can be allowed to go any further, South Australians need a watchdog with teeth that is going to be a champion for the interests of our most vulnerable households.

Vulnerable to Disconnection

A recent initiative of OFGEM, the UK's Office of Gas and Energy Markets, and the UK's Energy Retail Association (ERA) has attempted to define 'vulnerable groups'. A number of submissions were received (June 2004) in response to their consultation paper and proposed definition. One of note was from the UK's National Customer Council (NCC):

The proposals should ... disallow disconnection of households at any time that contain anyone over pension age, or any adults or children who are disabled or have a long-term illness or condition, or young children aged 5 or under. This should include people with physical disabilities, and/or learning difficulties, and people with mental health problems.

At this stage, we haven't attempted to prescriptively define 'vulnerable' in a way such as this, but it may well prove to be an appropriate thing to do, as the aim of disallowing disconnection of the vulnerable is attractive. There has been a significant amount of work on this issue in the UK and US and this warrants further investigation in an Australian and South Australian context (including the probability that most indigenous households are likely to meet the criteria of 'vulnerable').

Kathryn Davidson's work at Adelaide University supports work in the UK and elsewhere that highlights the three 'pillars' of energy affordability:

1. Available Financial Resources
2. Energy prices (ie tariffs, fees and charges)
3. Levels of consumption

Clearly, since all three are a factor to varying degrees to householders, action on all three is required to enhance affordability, especially for 'vulnerable' households. Davidson's work has also highlighted the paucity of up-to-date information currently available to consumer advocates attempting to develop and monitor indicators of affordability in the market.

The absence of current, detailed information also prevents an accurate assessment of the potential equity impacts of the proposed price path. The Discussion Paper (p25) states that while concession recipients consume, on average 15% less energy than other households there are a large number (70,000) that consume more than the state average. This is of course consistent with the findings of surveys by the Carer's Association of SA (2003)¹, where carers reported consumption 14.5% higher than the state average, and The Western Region Energy Action Group's August 2004 Powering Poverty report². The Powering Poverty report highlighted that consumption for 'vulnerable' households is often driven by the poor energy performance of their dwellings and/or a myriad of health conditions that demand higher levels of consumption.

¹ available from the 'News' section of www.carers-sa.asn.au

² Western Region Energy Action Group August, 2004 'Powering Poverty - A report on the impact of the 2002-2003 electricity price rises on 12 low-income households in South Australia', available from the 'What's New' section of www.sacoss.org.au

The level of residential disconnections in an energy market is a crude but obvious indicator of how well the market deals with 'vulnerable' households. South Australia's most recent figures (2003-4 Financial Year) are due to be released by ESCoSA in November 2004 in their 5th Annual Performance Report of Regulated Energy Businesses. The 4th APR released in November 2003 reported 5450 residential electricity disconnections in the 2002-3 FY from a customer base of 631,630 for a disconnection rate of 0.86%.

To provide a comparison, information from the Essential Services Commission of Victoria for 2002-3 shows 12,147 disconnections (across the five retailers) for a disconnection rate of 0.33%³

Information from the UK for 2003-4 shows that the reported disconnection rates are at just over half historic levels at 12,774 disconnections (combined electricity AND gas) in a residential customer base of 20m gas and 26m electricity for a rate of approximately 0.06%⁴. Note that the reduction in disconnections has been as a result of a structured 'debt and disconnection' initiative of energywatch and the UK regulator Ofgem (Office of Gas and Electricity Markets) in the second half of the reporting period.

It should also be noted that the 2002-3 SA figure was low by historical comparison. This has been explained by ESCoSA:

The number of disconnections recorded by AGL SA in 2002/03 made pursuant to Clause 9 of the Electricity Retail Code declined significantly from 2001/02, totalling about 5,450.

AGL SA has advised that the number of disconnections is lower since no disconnections were effected for a period from September 2002 to December 2002 due to billing system refinements.⁵

It should also be noted that the 2002-3 FY contained only the first six-months of Full Retail Contestability (FRC) and hence the January 1st, 2003 average price rise of nearly 25% only impacted on a short, latter part of the reporting period (and only one full billing cycle for most customers). Levels prior to FRC (but still while AGL was the monopoly retailer) were in the order of 7,000 disconnections per annum.

So, even with a hiatus in effecting disconnections and prior to the full impact of the FRC prices rises of 25%, disconnection rates in SA in 2002-3 were:

- 2 and a half times those in Victoria
- nearly 15 times those now achieved in the UK

How will the 2003-4 figures, the first full year under the higher tariffs, compare? Anecdotal evidence suggests we can expect significantly higher figures for what is shaping up to be a damning indicator of the market's performance.

³ ESCV, Energy Retail Businesses Comparative Performance Report 2002-3, December 2003 from www.esc.vic.gov.au

⁴ energywatch UK, Annual Report April 2003 - March 2004 from www.energywatch.co.uk

⁵ ESCOSA, 4th Annual Performance Report- Performance of Regulated Electricity Businesses in SA 2002-3, November 2003 from www.escosa.sa.gov.au

Who's problem is it anyway?

In its September 2004 'Monitoring the Development of Energy Retail Competition in SA Statistical Report', ESCoSA has stated (p37):

*"One measure of the outcome of reform is the extent to which benefits are shared amongst affected parties. The Commission's primary objective is the protection of the long term interests of South Australian Consumers with respect to price, quality and reliability of essential services (refer section 6 of the Essential Services Commission Act 2002). The Commission considers it important to monitor the extent to which financially disadvantaged consumers are fairing. **Ultimately, it is a matter for the Government and parties other than the Commission to determine how any inequalities that might emerge should be addressed.**"*

ESCoSA also notes that the UK regulator Ofgem has stated that it "... places particular weight on ensuring that vulnerable customers are benefiting from supply competition" ("Domestic Gas and Electricity Supply Competition - Recent Developments, Ofgem, 2003 (June), p(i), in line with statutory duties conferred on Ofgem.)

The last sentence of the ESCoSA quote above strikes at what may well be the heart of the issue; It is not so much an issue of stakeholders acknowledging that 'vulnerable consumers' exist and need protection, but an issue of who should take the lead in doing so.

The supply industry appears to have a similar view as ESCoSA. In their submission to the earlier Issues Paper of this Inquiry, the Energy Retailers Association of Australia (ERAA) has stated (p2):

*"It is our view that the long-term interests of SA consumers with respect to the price, quality, and reliability of electricity supply can be best served by allowing competitive markets to work. We believe that the focus of the inquiry should be on increasing competition in the energy market to deliver benefits that are sustainable in the longterm. Where there is a **conflict between the objectives of economic efficiency and social equity**, it is important that these are identified and addressed in an efficient and transparent manner to avoid distorting the operation of the competitive market."*

then further on page 4:

The ERAA recognises that governments may wish to pursue social equity and/or affordability issues. To the extent that governments identify these issues, they should be addressed not through price controls which inhibit competition, but through direct and transparent government payments.

... The ERAA would promote that regulated tariffs should transition to cost-reflective levels quickly and then, ultimately be removed. Governments may continue to monitor retail prices and take action under competition law, if required.

This is consistent with AGL's Standing Contract Price Proposal 2005-8 (August 2004). AGL state (p31):

"Should the Commission or the government see a need to subsidise a certain class of customers these should be through transparent arrangements (eg concessions) that do not distort the operation of a competitive market."

While this might sound reasonable if we were discussing a simple 'market good', it ignores the 'essential service' nature of electricity, its many attributes that don't accord with simple market theory and seems to suggest that the energy businesses have no social responsibilities of their own.

The 2004 report from the Australian Senate Community Affairs References Committee Inquiry into Poverty and Financial Hardship (Senate Poverty Inquiry) made the following observation (Ch9, p191):

"Evidence indicated the importance of ensuring access for low income households to essential utilities such as electricity, gas, water and telephone services. These services provide the basic means by which any household is able to function in a modern society."

Despite this, we have an energy market that treats the energy that provides this 'basic means' and the energy that powers the airconditioner of a CBD office block as the one, tradeable commodity. Not surprisingly, equitable outcomes are proving difficult.

The Poverty Inquiry also made the following recommendation (Recommendation 33)

"That public and private utilities have in place hardship provisions that provide for the reduction or waiver of debt to ensure that customers genuinely unable to pay for the provision of utilities retain access to these essential services."

One of the many difficulties experienced by the Community Sector in advocating better outcomes for households has been the fragmentation of actual and perceived responsibilities: Consumers blame the retailers, current and previous state governments, the media points the finger at government and the regulator, government blames the 'greedy retailers' and the retailers and regulators say that 'social equity' is a task for government.

Clearly, this is a broad social problem and the blame game is entirely unproductive. A collaborative response is the only one that is likely to be effective - between retailers, regulators, government, social service organisations and consumers. SACoSS and WREAG invite commitment from all stakeholders to work towards a collaborative response.

In order to further explore the basis for the industry claims around the primacy of competition in the provision of electricity to households, it is appropriate to explore just how 'competitive' this market is, and is ever likely to become.

Competition and the Standing Contract

In its submission to the earlier Issues Paper of this Inquiry, the Energy Retailers Association of Australia (ERAA) has stated (p1):

*"The decision of governments in the mid 1990s to introduce competition reforms into retail energy markets was based on, in our view, the correct presumption that **competition provides the most effective form of customer protection available**. This presumption is consistent with economic theory and a wealth of experience of the success of competitive markets in effectively and efficiently delivering most of **the goods and services customers want**."*

and then page 8:

"... the ERAA believes that competition in SA has reached a level of maturity where a light-handed approach is more appropriate for the minimum 3-year price path."

These statements warrant some critique.

The comment that "... competition provides the most effective form of customer protection available ..." based on a wealth of experience in markets for goods and services customers "want" is classic rhetoric of free-market advocates. However, it fails to acknowledge that when it comes to protecting consumers, this is not a market for 'wants' but a market for 'needs'. Whilst much of the energy consumed in South Australia is discretionary, and hence may be a resource appropriately allocated by market mechanisms, energy is an essential service for households. As such, all households are entitled to affordable access to sufficient energy to sustain a decent standard of living. This includes meeting the energy demands of the health needs of the household.

The second statement by the ERAA that competition in SA has reached a point where regulatory oversight should retract warrants an exploration of the published information in this regard. The latest 'data' is provided in ESCoSA's September 2004 Statistical Report (Monitoring the Development of Retail Competition in SA):

"As at the end of June 2004, there had been around 134,000 small customer completed transfers, representing around 18% of the small customer base of 740,000" (p8)

Relatively high 'churn' rates by comparison to other NEM jurisdictions and overseas markets but there's a catch:

"It is understood that a significant factor in the marked increase in transfers to market contracts that occurred towards the end of the period under review, was due to customers taking advantage of the SA Government's \$50 Electricity Transfer Rebate (ETR) offer, which ended on 13 August 2004. Accordingly, it is expected that the number of customer transfers to electricity market contracts will also be high in the 3rd Quarter of 2004, with monthly transfer rates expected to drop in the 4th Quarter 2004" (p9)

So, not exactly 'market forces' at work. From the Minister for Energy (Media Release 'Electricity Rebate Helps Concession Card Holders' August 6th, 2004):

"The State Government's Electricity Transfer Rebate is expected to have been taken up by more than 70,000 customers when the offer ends next Friday (August the 13th, 2004). Over 41 000 applications have already been processed.

Minister for Energy Patrick Conlon said the \$50 rebate has been very successful in encouraging competition in the South Australian electricity market because it has given pensioners and concession card holders an incentive to look for the best deal."

"I'd encourage as many eligible people as possible to transfer to a new electricity provider as soon as possible so they qualify for the rebate before the offer ends next Friday," the Minister said.

*"The rebate is aimed at **assisting people** on fixed incomes to **minimise** their power bills by looking for the **best possible deal** and it has succeeded beyond my expectations. "*

Success however, is subjective. AGL have reported what has been anecdotally reported on numerous occasions in community consultations:

*"A significant proportion of the current market activity has resulted from the government's \$50 rebate paid to customers who hold a concession card and who move to market contracts. Effectively, **many of these customers have moved to market contracts with prices equivalent to the standing price and no termination fees. These customers could readily return to standing contract arrangements at any time**" (p28)*

So, somewhere between a third and a half of the overall 'transfers' have involved direct government intervention and many of these market offers have actually provided no other benefit at all to the consumer (it is arguable that given the variations in 'hardship' programs offered by the various retailers some will actually be worse off). Particularly in relation to vulnerable consumers (in so far as concession eligibility is an indicator of vulnerability), it is questionable just how much the market really has to offer them (the report did not detail how many concession recipients have, or would have, changed retailer without the rebate). As mentioned, success is subjective - is this the 'best possible deal', did the market provide any 'assistance' as intended by the Minister? It would appear not, and very likely not \$3.5m worth. However, it was an interesting policy experiment that highlights aspects of the market's ability to deliver on this promise of competition providing "the most effective form of customer protection available".

Recognising the artificial nature of competition to date, it is then worth reflecting on the role of the standing contract. In relation to the earlier Issues Paper para 5.5 'Fail-safe' or 'Normal' prices, Discussions with consumer representatives supported the second option:

"As the 'standard' supply arrangement: with no regard to the price having an impact on market development.

... place greater emphasis on setting a price at the "proper" or "normal" level, without any consideration of its role in encouraging the development of competition in market contract. This view would recognise that a large number of customers will always remain with the standing contract retailer, regardless of competition and the availability of market offers" (p22-23)

We must concur that a large number of customers will always remain with the standing contract and it is our expectation that the vast majority of vulnerable households will fall under this category. Supporting this has been conversations with retailers that suggest their marketing efforts are no longer focussing on price - rather on other issues such as incentives (discount vouchers etc), co-marketed offers (AFL club membership, GreenPower) and terms & conditions (fees and charges, contract length, portability etc.). Not exactly a list of 'benefits' that will enhance affordability of vulnerable households (we are unaware of anyone enjoying the 'benefits of competition' by changing retailers in pursuit of a better hardship policy or a more empathetic approach to debt).

It is not the intention of this submission to argue one way or the other about the prospect of competition benefiting all consumers on AVERAGE. However, we are adamant that competition in itself has and will offer nothing positive to these vulnerable households - and the current safety net and concession regime is doing little to stem the tide of disconnections either.

Cross Subsidies and Tariff Rebalancing

The Discussion Paper states:

*"Almost all submissions received agreed that there was a need for tariffs to become cost reflective and for the current cross-subsidies to be unwound. However, the Commission is of the view **this must be balanced against the need to protect customers from unacceptable price increases.**" (p23)*

It should be noted that 'almost all' refers to the submissions from business consumers and the electricity industry but the Commission's comments are consistent with the Inquiry's Terms of Reference:

" ... the Commission is to have regard to:

*3.4.7 Any cross-subsidies between, and within, business and residential small customer classes, and **whether these cross-subsidies are justified to prevent a disproportionate price impact on any small customer group;**"*

Further, the Discussion Paper states:

The Commission has commented (specifically in its 2002/03 Performance Report on the Electricity Industry) about the progressive removal of cross-subsidies in South Australian tariff structures since the late 1980s, and the impact this has had on residential consumers.

It stated that, in a competitive market, it is not possible to implement tariff

structures which involve deliberate cross-subsidies between consumer types (eg business and residential) or within consumer groups (eg large and small consumers). If a tariff structure is forced on a retailer which involves some consumers paying well above their true cost of supply, so that other consumers will pay less than their true cost of supply, other retailers will target the consumers with a high margin, leaving the original retailer to supply proportionately more of the consumers with a low or negative margin, without the ability to cross-subsidise. Such a situation eventually becomes untenable, unless a third party (ie government) is prepared to pay a specific subsidy to cover the low margin customers.

South Australia has, since the late 1980s, removed many cross-subsidies - such that most consumer classes are now generally paying their "true" costs of supply. South Australia has one of the most open and competitive electricity markets in Australia, but this has resulted in significant increases in price for residential and small business consumers whilst large business prices have fallen substantially as these cross-subsidies have been removed.

However, a number of cross-subsidies remain, and AGL SA has indicated a desire to remove these progressively during the price path period. (p23-24)

... if AGL wishes to take steps to reduce cross subsidies even further, the Commission does need to come to a decision about how rapidly it will allow cross subsidies to be unwound. In other words, it needs to determine the nature of the constraints it will allow on changes to individual tariffs." (p26)

The Discussion Paper does not mention any of the cross-subsidies built into the building block elements of Network Charges and Wholesale Energy Costs (WEC). As mentioned in the Discussion Paper (p9), these elements combined account for nearly 80% of the average annual household electricity bill. We do note however that these items have been discussed by the Commission in its submission to the Select Committee on the Electricity Industry in South Australia⁶. The submission states that much of the cross subsidies built into Network charges (through the use of 'postage-stamp' pricing as mandated in the Electricity Pricing Order and in the disproportionately small network supply charge compared to the actual fixed costs of providing the infrastructure) should remain on equity grounds. The discussion concluded with the statement (p23)

*"If the social consequences of removing cross-subsidies are to be managed, **Governments should provide policy direction in relation to the acceptance and extent of cross subsidies.**"*

It is difficult not to agree. However, to enable the 'retail' cross-subsidies to be put in context, and in order to fulfill item 3.4.7 of the Terms of Reference of the Inquiry, the above referenced discussion should have been included and expanded on in the Discussion paper.

A further cross subsidy that exists in the building block elements of Network Charges

⁶ ESCoSA, March 2004. Available from the March 17th 2004 entry under 'What's New' at www.escosa.sa.gov.au

and WEC occur in the recovery of the 'cost of peak demand'. The use of 'profiling' (Net System Load Profile) in the settlement of the NEM means that all small customers are assumed to contribute equally to the impact of peaks in demand on wholesale energy costs. As noted by the Electricity Supply Industry Planning Council (ESIPC) in their August 31st 2004 Information Paper (on LRMC) accompanying the Price Path Discussion Paper:

"Customer transfers to AGL's market contracts or to other retailers operating in SA are not expected to alter the underlying shape of the demand profile of standing contract customers, or the cost of supplying energy to this group of customers, because under the NEM rules all small customers are deemed to have an identical load shape." (p9)

Similarly, the cost of maintaining the Network infrastructure to agreed service standards is in large part (CapEx) determined by the cost of meeting demand that is only reached on a few days per year. As is the case with wholesale energy costs, all household consumers contribute to this cost in proportion to their annual energy consumption, regardless of their actual demand on the network at these times of peak demand (and hence impact on WEC and on Network Capital Expenditure). The actual extent of the overall cross subsidy manifested in current tariff structures between a household that places a relatively small load on the network at times of peak demand and a household that, for example, operates many kW's of air conditioner during these peak demand (and high pool price) times is not clear but is expected to be significant.

To the extent that a household's annual energy use is correlated to its peak demand (as has been anecdotally reported in household monitoring studies conducted by ETSA/AGL in the past), the use of Inclining Block Tariffs (IBT, as proposed with the concept of Socially Responsible Tariffs) for Network charges and for Wholesale Energy Costs may go some way to achieving this.

It should be noted that the current price structure used by AGL for the standing contract already contains an IBT for energy charges. The effects of this could be amplified by encouraging consideration of a similar approach to Network tariffs in the current Electricity Distribution Price Review.

In relation to 'retail' cross subsidies, the Discussion Paper reiterates ESCoSA's findings from the October 2002 Final Report of the Inquiry into Standing Contract Electricity Prices. The analysis presented (of AGL's tariffs, proposed at the time) stated that customers consuming below the annual household average of 5000kWh would provide below the 5% profit benchmark while those with greater consumption contribute more. It also indicated that customers consuming below around 2500 kWh would actually provide a negative margin (loss) for the retailer.

The prime reason why the analysis has these smallest consumers as 'loss making' relates to the way 'fixed charges' are handled in the standing contract.

Fixed Charges and Retail Cross Subsidies

To understand the role of fixed charges it must be remembered that AGL's allowed revenue for the provision of the standing contract is built up using a building block approach. The elements of the building block that contain fixed components are the

network supply charge and the allowance for Retail Operating Costs. The values assigned to each of these elements is being reviewed as part of this Inquiry, figures below reflect prices as they stand at October 2004:

AGL's standing contract currently includes a fixed supply charge of \$112.931 (30.94 cents per day, ex-GST)⁷. The current residential charges from ETSA Utilities include a fixed supply charge of \$80.541 (ex-GST)⁸. Assuming that ESCoSA have been reasonably accurate in their view that "an appropriate retail operating cost per customer of \$82 should apply for 2004"⁹, AGL must meet fixed costs (internal and external) of \$162.54. Including the 'allowed' 5% margin, this rises to \$170.67.

Noting the Commission's comments in its submission to the Select Committee mentioned earlier, it appears that the ETSA Utilities supply charge may well be significantly less than what is reasonably justifiable. Accepting its value as it stands, and also noting historic debate over the allowance for Retail Operating Costs, for the purposes of this discussion, supply charges around \$170 (ex GST) will be accepted as indicative of 'cost-reflective'.

With AGL collecting \$112.93 (ex GST) from each account, residential customers are starting from an annual deficit of just under \$60 at current tariffs. To return a positive margin (profit), AGL must recover this starting deficit from the throughput charges of the standing contract (ie. the 'cents per kWh' charges).

ETSA Utilities Network charge is set at 7.673 cents per kWh¹⁰ and AGL's allowable Wholesale Energy Cost is 6.85 cents per kWh (\$68.50 per MWh per ESCoSA Guideline 10). Combined these total 14.52 cents per kWh (all figures ex GST). AGL is therefore 'allowed' to charge an average 15.25 cents per kWh to achieve its margin of 5%.

The difference between these 'allowable' throughput charges and the actual standing contract charges (15.96 cents for the first 1200kWh pa and either 17.03 or 18.90 cents - depending on the season - for all other consumption) reflects the 'rate of recovery' of this \$60 'starting deficit'. (Note: typical household consumption of 5000kWh, spread evenly across the four quarters, is charged at an average 17.13 cents per kWh (ex GST) - over 12% above the 'allowed' average rate).

So, the potential appears to exist for the fixed supply charges to increase in the order of \$60 per annum (plus GST) to around \$170. However, since this amount would no longer be collected from the 'per unit' charges, tariffs should fall to the average of around 15.25 cents per kWh (down around 12%). Combined, these measures would ensure that all households, regardless of consumption levels would earn a 5% margin for the retailer (whether or not this is an appropriate margin is not discussed in this submission).

While it is clear that not all 'vulnerable' households consume less than average, the

⁷ As published at www.agl.com.au accessed October 6th, 2004

⁸ As published at www.etsautilities.com.au accessed October 6th, 2004 - a slightly reduced value from that published in ESCoSA Guideline 10 Schedule 2 (December 2003) of \$80.931

⁹ ESCoSA Inquiry into Electricity Standing Contract Prices Final Report and Determination (December 2003)

¹⁰ As published at www.etsautilities.com.au accessed October 6th, 2004 - a slightly reduced value from that published in ESCoSA Guideline 10 Schedule 2 (December 2003) of 7.809 c/kWh

average concession recipient consuming around 4000kWh or more per annum would actually see a small reduction in overall energy costs. However, smaller consumers would see increases of around 17% for 1500kWh and 5% for 2500kWh and clearly some, but not all, vulnerable households will find themselves significantly worse off. As mentioned earlier, the absence of current, detailed information prevents an accurate assessment of the potential equity impacts.

The discussion paper also alludes to apparent loss making in the supply of off-peak hot water. This has not been analysed as part of this submission but the same comments apply regarding the equity implications of any changes - decisions without assessing the impacts are unacceptable.

Reflecting on the Inquiry's terms of reference, a decision needs to be formed about whether or not the removal of such a cross subsidy can be 'justified'. It is our contention that, without a more detailed analysis of the potential impacts and complementary measures that would compensate for the impact on vulnerable households, it certainly cannot be justified.

Do vulnerable households deserve 'special' arrangements?

There is no doubt that retailer hardship programs have a role to play in managing affordability issues. However, payment plans, referrals to financial counselors and energy efficiency advice are of limited effect on those at the limits of their available resources and close to 'falling off the edge'. Difficulty in early identification of the genuinely vulnerable is clearly hampering progress.

The earlier discussion around the real levels of competition and the absence of any real benefit in even what competition there is for the vulnerable highlights the need to consider more than just what might work for the 'average' electric household.

Alternate approaches worthy of consideration involve attempting to quarantine the vulnerable within an arrangement that delivers initiatives not necessarily available to all consumers (standing and market contracts). This of course raises the issue of whether all 'vulnerable' households are either eligible or actually in receipt of the concession - the current concession is not necessarily an all-encompassing indicator of vulnerability. A comprehensive review of concessions (including the Emergency Electricity Payment Scheme, EEPS), their coverage and relationship to movements in the relative costs of essential services is long overdue.

An appropriate response to the issue of fixed charges would be to index a component of a revised community service obligation / concession regime to the supply charge. The energy concession in SA is currently set at \$120 pa (increasing from \$70 at the beginning of 2004 - the first increase since 1990). The supply charge in the current standing contract prices is \$124.22 pa (incl GST). Further, with the convergence of gas and electricity into what is becoming one 'energy' market, the 'energy concession' includes gas - where the supply charge of the standing gas contract increased around 25% on July 28th, 2004 to \$137.88 (inc GST) pa and the previously provided pensioner concession was also removed from the supply charge. Exactly how many of the state's over 340,000 residential gas customers would meet the eligibility criteria for the energy concession is unknown. For those that do, the \$120 concession (or \$132 with GST) represents only half of their current combined supply charges of \$262 per annum.

It therefore appears appropriate to simply peg the concession to the supply charges (at, say 125%), as this would have the effect of lowering annual electricity costs for all concession eligible customers. The state government would then have a vested interest in monitoring movements in fixed supply charges.

Another mechanism worthy of consideration is the effective formation of a sub-market encompassing the vulnerable. Operation of this sub-market could be based on a variant of the NSW Electricity Tariff Equalisation Fund (EETF)¹¹. Such an arrangement would allow Community Service Obligations to effectively underwrite the risks of the wholesale energy market for the households in the sub-market. The success of this arrangement in suppressing retail prices in NSW is evidence of its potential. Criticism of its negative impact on competition is irrelevant if it is accepted that vast majority of the households in the market are unlikely to ever access, or derive real benefit from, market contracts.

Further, this sub-market could also include a version of the UK's Energy Efficiency Commitment (EEC) as a practical extension of the SA Government's Energy Friends 10,000 home energy audits. Resources must be made available to actually improve the energy efficiency of the dwellings rather than just making a list of what could be done. (Noting that each audit does provide two high efficiency light globes, a high efficiency AAA showerhead and a door snake and there is a link into NILS for energy efficient appliances).

*'Under the EEC for 2002 to 2005, electricity and gas suppliers are required to achieve targets for the promotion of improvements in domestic energy efficiency. The EEC will contribute to the Climate Change Programme by cutting greenhouse gas emissions. It will also help eradicate fuel poverty by focusing 50% of energy savings on lower income consumers.'*¹²

Whilst the 'obligation' rests with the energy retailers, the EEC is delivering measurable energy savings through community partnerships - a very cost effective way of accessing the community networks that are vital to implementing such a household initiative. The initiative also links to the UK's Fuel Poverty Strategy - a suite of initiatives that aim to improve the affordability of household energy and improve the energy performance of dwellings.

In terms of cost-effectiveness, reports predict energy benefits of around £7.50 to around £16.50 per year for a cost of £3.60 per customer per year!

As an initial response the predictable 'we can't afford to fund it', it is suggested that consideration be given to GST revenue. SA's approximately 650,000 residential consumers have an average electricity bill of around \$1100. So GST revenue just from household electricity bills would amount to around \$60m pa. This should represent a reasonable starting budget figure for the initiatives identified.

¹¹ The NSW Government established the Electricity Tariff Equalisation Fund (EETF) on 1 January 2001 to manage purchase cost risk for those standard retail suppliers that are required to supply electricity to small retail customers at tariffs determined by the Independent Pricing and Regulatory Tribunal (IPART). More information is available from www.treasury.nsw.gov.au

¹² from www.defra.gov.uk/environment/energy/eec/

In Closing

Disconnections are probably the most powerful indicator of the energy affordability crisis that has plagued SA since the introduction of Full Retail Contestability (FRC) for electricity in January 2003. It is also clear that the impact on vulnerable households reflects a range of issues for which a collaborative response is the only one that is likely to be effective - a collaboration between retailers, regulators, government, social service organisations and consumers.

Reflecting on the comparatively low disconnection figures from the UK mentioned earlier in this submission, the UK regulator Ofgem has collaborated with energywatch in a 'debt and disconnection initiative'. Chief Executive Allan Asher provides a brief description of energywatch¹³:

"energywatch is far more than just a helpline, a website or a complaint-handling body. We are a champion for energy consumers. We engage with consumers across England, Scotland and Wales on a daily basis and we see the devastating impact of some of the problems in the energy market today."

The clear need for such a service in the UK energy market - one that is much more mature and 'competitive' than South Australia's, suggests the need for an investigation of a similar statutory arrangement for South Australian consumers to champion this necessary collaboration and protect our most vulnerable households.

¹³ from www.energywatch.org.uk