

# Electricity Price Path Review

Much of the following comments are provided at a macro level and are not as well organised as we would like, due largely to the range of issues we are currently dealing with. This paper is not organised to the same structure of the ESCOSA discussion paper, the next version of this will be better organised around these themes. However, the macro issues considered below are relevant to the inquiry and recommendations are identified throughout the text.

## Background

The National Electricity Market (N.E.M.) was established as the market mechanism for distribution of electricity. We believe that very little consideration was given to the impacts of application of market mechanisms for low income and vulnerable households, consequently this Price Path review needs to deal with emerging hardship issues.

## **What has Happened since Application of Competition Policy?**

In analysing trends in domestic utilities prices in South Australia from July 2000 July 2004, consulting firm Deloitte Touche Tohmatsu report the following:

*“the fixed Supply access charge for domestic light and Power has increased by 32.4% since July 2000, the largest increase was in July 2003 (25.4%)*

*And off-peak controlled low Supply access charge has increased by 93.1% over the five-year period with a significant increase occurring in July 2003 (144.4%). The Supply charge then decreased the following year by 23.1%*

*A number of miscellaneous charges have also increased since July 2000:*

- the standard application fee has increased by 37.5%*
- the connection fee for new customer connections was free until 2002 the fee was reintroduced in July 2003 and increased by 7.2% in July 2004*
- the after hours connection fee has increased 348.1% in the five-year period*
- a special meter reading charge has increased by 40.4%*
- the combined disconnection and reconnection fee (business hours) associated with non-payment has increased by 38.7%*
- delayed payment fee has increased 139.8% in the five-year period*
- the increase in the meter testing for single phase and double phase increased by 89.6% and 47.9% respectively.”*

Another significant change has been the reduction in average real prices for business, while prices for residential customers have increased. This is a significant development and is one of the planned outcomes from the application of competition policy to the energy market. ESCoSA has effectively documented this result in past reports.

## Impact of High Prices for Lower Income Households:

Recent research commissioned by ESCoSA and undertaken by Professor Richardson and Peter Travers from National Institute of Labour Studies shows that 58.7% of the bottom half of South Australian's income distribution households are spending 4% or more of their disposable income on power. About 4.7% of all SA households spend 9% or more of their disposable income on energy, this includes the poorest households in this State, the rate in South Australia is higher than that for the rest of Australia.

Five per cent of the lowest quintile of households report being unable to heat their home due to financial stress, this is double the rate for the rest of Australia and is taken from the General Social survey 2002.

This analysis is based on the ABS household expenditure survey completed in 1998-9, and while this is the most recent data set, the figures predate the significant increases in domestic electricity charges over the last couple of years.

A couple of attempts have been made during 2004 to assess the impacts of rising electricity prices on low income households:

- Powering Poverty, by Western Region Energy Action Group
- Survey of Financial counselling clients by David Horton, for UnitingCare Wesley (not yet published)

Powering Poverty is a study based on a 12 in-depth interviews with low income households that was conducted during late 2003. Key findings included:

- on average, participants increased their expenditure on electricity from 2000 to 2003 five \$312 60. In this. Electricity costs increased by an average of 43.16%
- average household expenditure for the participants was 6% of total household income, but this. Significantly
- all participants reported that they could not afford to heat or call their home to a comfortable level
- 5 of the 12 participants reported that they went without meals due to shortage of money.

David Horton<sup>1</sup> and Financial Counsellors from UnitingCare Wesley Adelaide surveyed 30 financial counselling clients during July / August 2004, Key findings included:

- 83% reported that high electricity prices are having an adverse impact on their finances
- 77% of those surveyed had electricity bills that are considered to be low, that is less than \$350 a quarter

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<sup>1</sup> David Horton is a Social policy student from Flinders University who's placement was based at UC Wesley Adelaide and site supervised by Mark Henley, Manager of Advocacy and Communications.

- in response to the question “what of the following items have you reduce spending on due to electricity Price increases?” - responses included:

Food	50%
Clothing	87%
Holidays	83%
Movies	80%
Sport and culture	80%
Telephone	53%

These recent surveys reinforce observations from welfare and community service organisations that rising energy costs in particular and rising utility charges in general are having a significant impact on low income and vulnerable households. Uniting Key Wesley believes that before further moves are made to change energy markets, there needs to be much better understanding of the impacts of the significant recent changes that have been made to the structure of energy markets. For example policymakers and the broader community need a much better understanding of fuel driven to poverty.

Financial Counsellors note that an overwhelming majority of their clients budget extremely carefully and make payment of utilities bills a top priority. The recent price rises have therefore had dramatic impact on the actual discretionary money available to households. Discretionary money refers to spending on food, clothing, health – ie basics, not luxuries.

## **RESPONSES FROM UNITING CARE WESLEY**

UnitingCare Wesley recognises that it needs to be responding to energy related stress, as part of shared government / industry / community responses

UnitingCare Wesley has responded to the financial stress for households created by increased electricity costs in four (4) areas, these being:

1. Service provision
2. Public policy advocacy with measures to reduce fuel poverty
3. Public policy aimed at lowering household energy prices
4. Other developments

### **1. Services:**

Uniting Care Wesley Services provides financial counselling which includes support for low income households struggling to meet utility bills.

Uniting Care Wesley Adelaide has recently been successful in obtaining funding to work in the southern suburbs to provide community audits and advice on sensible demand management for low income households, through the energy friends program.

### Energy Friends

A "Free Home Energy Check" is offered as a free service that can help with understanding how households use electricity and gas. Consumers are encouraged to learn ways to use less electricity and get tips on how to make their home more comfortable in summer and winter, without increasing energy bills.

A Free Home Energy Check takes about 1½ hours, and is carried out with the help of a trained Home Energy Adviser. Together, householders and Home Energy Advisers look at past energy bills, hot water system, window blinds, lights, and other appliances.

The Home Energy Adviser can also install a free energy-saving retrofit kit (AAA-rated showerhead, low-energy light globes & draft stopper).

This service is available to householders with a low income (for example, with a Health Care Card or Pension Card).

This is one of a range of demand management strategies which are intended to help reduce electricity costs by reducing the load on the system and therefore reducing the need for additional generation and transmission infrastructure, these costs are spread over all electricity bills.

## **2. Public Policy to reduce impact to disadvantaged:**

Uniting Care Wesley supports the following moves and strategies to reduce the impact of electricity prices on low income households:

- A review by the State Government of its current concessions policies. There are sound reasons to increase electricity and gas subsidies for low income households
- A clear understanding is needed as to what comprises an essential service and what legislative and regulatory arrangements need to be established in order to protect consumers and to ensure appropriate access to essential services. (A short discussion on this topic follows this story)
- An industry levy should be applied to all sectors of the electricity market that can then be applied to services that assist low income and vulnerable households. In particular this levy should be used to support financial counsellors, given that the significant amounts of their work involves utilities problems. The funds would be managed by an independent group drawing membership from energy industry stakeholders. Then the funds could also be utilised for retrofit and other energy efficient measures for vulnerable households.
- There is a clear need for community service organisations to work with energy retailers to develop and implement appropriate hardship policies. Similarly there is a clear need for a better understanding of community service obligations as applied to empty markets. For example, on equity grounds there is a strong argument for a guaranteed minimum supply of electricity for all households - maybe enough to operate a refrigerator, maintain hot water and run a couple of lights.
- One of the consequences of application of competition policy to the electricity industry has been the loss of data, particularly related to stresses for vulnerable consumers. It is imperative that ESCoSA collect

and publish data on disconnections, energy used by household type and in particular develop fuel driven poverty measures that are published annually.

Before any further moves are undertaken to establish an Australian Energy Regulator, a national fuel driven poverty research project needs to be undertaken these impacts are considered in developing in the legislative regulatory stuff. or programmatic change

### **3. Public policy strategies to reduce household energy prices:**

- Uniting Care Wesley believes that there is a sound case for State Governments regulating to cap prices if the market is unable to effectively moderate energy prices, as has been the experience in South Australia since application of competition policy to the electricity market
- There is also a strong view that it is appropriate for State Government to consider re-entering the electricity generation market. This is likely to have the effect of increasing competition amongst electricity generators, thereby reducing consumer prices.  
For example, the government could enter the generation market through the provision of renewable energy, with government partnerships aimed at increasing the percentage of South Australia's electricity coming from renewable sources, specifically wind and solar energy.
- Another very useful idea is the notion of socially responsible tariffs (SRT).

### **4. Other measures:**

Uniting Care Wesley has also been active in establishing an electricity buying group which enables a wide range of church based community services to pool their buying power nationally. AGL was the successful tenderer to supply power to the combined group of church based agencies. The challenge is now to develop a strategy to establish buying groups that would be accessible to low and modest income residential households.

#### **Price Path Specific Proposals.**

##### Socially Responsible Tariff

UnitingCare Wesley is attracted to the concept of Socially Responsible Tariffs.

“In basic form, a Socially responsible Tariff, SRT, has low or no fixed charges and an ‘allowance’ of energy that reflects a quantity that can sustain a basic standard of living at an affordable rate.

The cost per unit then increases in ‘bands’ of increasing consumption. Provided a targeted concession regime exists to allow for instances of significant consumption demanded by health needs, such a tariff structure better reflects this ‘essential service’ nature of domestic energy consumption.

Such a tariff arrangement is also consistent with, what should be, the environmental objectives of energy markets: maximum energy efficiency and minimum greenhouse emissions. Households that have 'small' consumption due to economic circumstance as well as households that choose to limit consumption through active management of demand (or through operating a solar electricity system for example) are equally rewarded for the minimal 'drain' they place on the network." (Reproduced from a SACOSS discussion paper written by Andrew Nance.)

We believe that this concept can be further developed to ensure that it is well targeted to vulnerable and disadvantaged households. For example, a SRT would only be applicable to the principle place of residence, this ensures that holiday homes, for example, would not be SRT eligible.

### **Recommendation 1:**

That ESCoSA require the development and application of a Socially Responsible Tariff regime for South Australia, by 30<sup>th</sup> June 2006. We recognise that this would need to occur in association with State Government concessions.

### Vulnerable Households Levy

UnitingCare Wesley believes that all elements of the electricity industry should be contributing to a fund that supports services and assistance to low income and vulnerable households. Initially financial counselling funding would come from this fund because people having difficulty paying bills are referred to financial counsellors, but these services are already stretched in demand and considerably underfunded.

The fund could also be used to build on services like "Energy Friends" and support 'retrofit and other demand management strategies for targeted households.

There are a number of existing models for operation of such a fund, the Community Benefit Fund being an good model.<sup>2</sup>

### **Recommendation 2**

That AGL be required to contribute, with other industry members, to an industry fund supporting services for households unable to meet electricity payments.

### Fuel Driven Poverty Inquiry

There is a clear need for a much better understanding of fuel driven poverty in SA (and nationally), therefore

### **Recommendation 3**

That a review of Fuel Driven Poverty in SA be conducted in 2005, and repeated in 2007 to inform the price path review for the period beyond 2008.

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<sup>2</sup> Note that the author of this paper, has just been appointed as Chair of the Community Benefit Fund

### Transparency

UnitingCare Wesley has been very disappointed at the withholding of data by the electricity, in the name of 'commercial in confidence'. A core principle of competitive markets, and of good public policy is ready availability of information and data.

### **Recommendation 4**

AGL should be required to provide data about electricity usage in lower income households and communities as well as information about disconnection, payment difficulties etc, as required by ESCoSA, with reference to community groups and researchers.

### Fees

The escalation of ancillary fees over the last 3-4 years has been unacceptable for UnitingCare Wesley. ESCoSA must act to abolish some of these and reign in others.

### **Recommendation 5**

ESCoSA should abolish late payment fees and cap all other fees to rates of increase no more than (CPI- 1)%

### Hardship Policies

All retailers, including AGL, should be required to have 'Hardship Policies' that are negotiated with SACOSS and community service organisations, to reduce the adverse impacts of high electricity charges for vulnerable households.

### **Recommendation 6**

AGL should be required to present a socially responsible hardship policy to ESCOSA before the commencement of the price path period.

### Community Service Obligations

### **Recommendation 7**

AGL's Community Service Obligations need to be negotiated and documented prior to the commencement of the price path period.

### The Nature of Essential Services

### **Recommendation 8**

The ESCoSA Commissioners are encouraged to consider the supply of electricity to low income and vulnerable households as the provision of an essential service, where not all standard 'rules' of the market necessarily apply. (Discussion paper follows)

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## Discussion Paper:

# Characteristics of 'Economic Goods / Services' and 'Essential Services'

### Background

The Essential Services Commission of SA (ESCoSA) has been established to regulate essential services, specifically in the context of selling / leasing previously government owned (natural) monopolies to commercial operators as part of increasing the level of competition into the Australian market place. The rationale being that increased competition would result in lower prices of these essential services, for consumers.

The South Australian legislation establishing ESCoSA defined essential services as those services that would be regulated by ESCoSA. The legislation does not seek to define characteristics of an essential service. I consider that in a range of regulatory functions, ESCoSA needs an understanding of what it is that makes a service an essential service, which then leads to the question as to whether an essential service should be managed / considered / operated in different way to a standard economic good or service. In short: "is electricity different from a can of coke or a hair cut?" Does market theory need to be modified when managing the provision of an essential service?

### Core elements of an economic good or service

These are standard characteristics of any economic good or service:

- Generates utility/benefit for the consumer
- Has Price
- Has value
- Demand increases as price increases

### Other Characteristics of an economic good or service

An economic good or service is also likely to have the following characteristics:

- Homogeneity (the good or service has consistent characteristics that can be described, but there may be some variability eg an apple is a good but there are subtle variations between good, a granny smith and royal gala are different, but both are universally recognised as apples)
- Safe (within socially determined or regulated limits)
- There is accurate and accessible information about it

- Scarcity (there are tangible limits to the amount that can be produced / consumed)
- Substitutes exist

### Characteristics of a Public Good

A public good or positive externality will have these characteristics:

- Non rivalrous (does not exhibit scarcity, at least not to the same extent as an economic good exhibits scarcity)
- Non excludable (once it exists, no one can be excluded)
- Plus core characteristics: generates utility, has value
- Has price, but not necessarily determined by a market.

### Definition of a natural monopoly

A natural monopoly exists where the marginal costs of production of a good or service diminish as quantity produced increases (economies of scale). There is an understanding from economists that the efficient supply of a natural monopoly is best provided by a monopoly that is (at least) the subject of strong government regulation and monitoring.

These standard economic definitions lead back to the question of whether an essential service has some characteristics that are different from a standard economic good or service.

### Suggested Characteristics of an “Essential Service”

- Universality, all citizens need access to the good or service, at least to a pre-determined (regulated) level.
- Access to the service is generally regarded as a ‘human right’
- There is public benefit as well as private utility derived from provision / consumption of the service. (Whilst not meeting the full definition of Public Goods, there is public benefit)
- No clear substitute good or service exists
- Levels of demand vary greatly between consumers (and capacity to pay varies between consumers)
- There are elements (at least) of natural monopoly associated with provision of the service
- There are health / safety / well-being consequences of non-supply for individuals.

### Implications of Electricity being an Essential Service (in SA)

The SA government has corporatised the supply of electricity to South Australian customers, transferring supply from a vertically integrated government owned monopoly to 4 vertically disintegrated levels of supply, with competition possible within 2 of these levels, generation and retail. Transmission (high Voltage) and Distribution (low voltage) are separate (natural) monopolies.

The regulator for electricity, Essential Services Commission of SA (ESCoSA) is currently reviewing distribution (ETSA Utilities) prices and retailer standing contract process (AGL). In so doing, I argue that ESCoSA, and the regulated

companies, need to have regard to the differences between an 'essential service' and a standard economic good – is electricity different from Coke-a-Cola? In order consider this question the following are presented as factors that differentiate an essential service from a standard economic good / service:

- Supply guarantee: There needs to be a guarantee of a minimum level of supply to ensure that all customers have access to electricity to at least meet their most basic needs.
- Regulation and Monitoring: Government regulation and monitoring is essential, including setting some price limits and safety guarantees
- Primacy of regulation: Where regulatory outcomes are in conflict with perfect competitive market models, then it is the regulated outcomes that must endure.
- Risk not socialised: Governments / regulators must have regard for market outcomes for supplier entities, but have no responsibility to guarantee profits, or an set, predetermined profit margin.
- CSO's: Communities through governments can require suppliers to meet certain Community Service Obligation (CSO) goals, recognising the capacity of businesses to utilise market mechanisms to meets CSO goals or targets.
- Regulators need to require information to be provided from the market, and be readily available to the public to ensure transparency to enable informed consumer choice.

### **Current Essential (Guaranteed Supply) Services**

Currently there are at least two services that are recognised by regulation or legislation as 'essential', by virtue of there being guaranteed minimum supply:

Telephone: Any telephone is required to be able to be used to telephone an emergency service (000, police etc) and to be able to receive calls.

Water: A minimum level of supply is supplied to each household for a base charge, additional use beyond the base allocation is charged at a commercially determined cost per kilolitre.

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