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COTA (NSW)

Council on the Ageing (NSW) Inc
Estab. 1956

User Participation Working Group
Ministerial Council on Energy
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16/4/04

Dear Hillary

Re: UPWG Discussion Paper

The Public Interest Advocacy Centre (PIAC) and the Council on the Ageing (NSW) wish to submit the attached joint response to the Working Group's Discussion Paper on *Improving User Participation in the Australian Energy Market*.

PIAC is an independent, non-profit legal centre based in Sydney. It established the Utility Consumer's Advocacy Program (UCAP) in 1998 with funding from the NSW Government. The aims of this program include the development of policy and advocacy in the interests of residential consumers, particularly low-income consumers, in the NSW energy and water industries. A community-based Reference Group supports the development of policy by UCAP.

The Council on the Ageing (NSW) is a peak non-government organisation which represents the views of seniors in NSW. COTA (NSW) is a member of the national COTA movement. The members of COTA (NSW) include individuals and their organizations. The principles which govern the work of COTA (NSW) include maximising the social and economic participation of older people and the promotion of sustainable, fair and responsible policies.

This document has been prepared jointly by myself and Ms Brenda Bailey of COTA (NSW). Please feel free to contact me should the Working Group require any further information or clarification of our views.

Yours Sincerely,



Jim Wellsmore
Senior Policy Officer
Public Interest Advocacy Centre

1. Demand Side Response

Both our organisations and the NSW community sector more broadly question whether an effective demand side response to issues of peak electricity load can be delivered by a market based mechanism. The UPWG *Discussion Paper* has focussed on the role of end-users in delivering partial solutions to demand management issues. However, a successful market-based approach requires the active participation of distributors and retailers. We believe this is unlikely in the absence of a regulatory regime which balances incentives for the businesses with obligations backed by a system of penalties.

The *Discussion Paper* argues for a relationship between the development of a demand side response and the pricing of electricity for end-users. It is important that the limitations of this approach be understood, particularly in the case of residential users of electricity. While residential consumers represent a large load in aggregate the price benefits of any demand side response behaviour will be insignificant for an individual household. For residential consumers security of supply arguably is the more important issue. Price is not an appropriate means for addressing this issue given that electricity is an essential service.

Households face non-price barriers to aggregation. For example, we are aware of the negative response from energy retailers in Victoria to the CommunityPower initiative of several local government bodies which had the effect of undermining the early viability of this aggregation scheme for low-volume consumers.

Yet, in the absence of large scale responses to load management issues residential consumers increasingly are being targetted for penalty pricing. We believe it would be more productive if efforts were made to investigate and develop schemes which recruit residential users into an aggregated demand side response. Utilities in Australia have growing experience with residential retrofitting schemesⁱ and with initiatives such as interruptible tariffs. An example of the latter is the trial of interruptible airconditioning load undertaken by Integral Energyⁱⁱ. Both approaches can deliver direct benefits to distributors and retailers without the negative impact on social equity inherent in penalty pricing.

Resort to price penalties ignores the current attitudes and behaviour of households toward management of their energy demand. Equally, it fails to consider the social costs of a behavioural response to price signals. Older people, for example, often place a high priority on paying utility bills in order to avoid recovery action by their providers and the threat of disconnection. We are aware from anecdotal evidence from NSW charitable organisations that some groups of customers will go so far as to deny themselves other essential purchases in order to avoid energy related debt. Clearly, more needs to be known about these issues before regulators and industry resort to penalty pricing. It is our understanding that these questions are the subject of a study currently being undertaken in South Australia and await keenly the results of that research.

A final issue not addressed by the *Discussion Paper* is that of the various costs and benefits of demand side responses and how these are to be allocated between distributors, retailers and end-use customers. We note that Integral Energy have commented on this concern in the report of their trial of interruptible airconditioning. A continuing lack of certainty on this question can only undermine efforts to create greater demand side responses to load management issues whether regulatory or market based.

2. Interval Meters

We note the claim of the *Discussion Paper* that there have been criticisms of the current tariff structures across the NEM as being based on accumulation metering. In general these criticisms are not made by household consumers of electricity. This is because residential electricity consumers place a high priority on having access to a simple and transparent system of supply of an essential service without the need for innovation or complex retail supply offers.

Proposals for more widespread use of interval metering by households rely on a variety of claims and goals. One argument is for interval metering to be introduced as a demand management tool. Others, including the *Parer Report*ⁱⁱⁱ, contend that interval metering is essential in giving retailers greater scope to manage their risks in the wholesale market. One jurisdiction currently is pursuing a roll-out of interval meters in order to drive retail competition and facilitate customer churn.

The proposition that interval metering will drive greater retail competition relies on the idea that in retail markets it is the customers who make the key decisions. Interval metering is seen as a way to free-up customers to pursue price benefits. This notion clearly is misplaced in the case of retail energy markets for low-volume consumers. It is demonstrably wrong. In practice, effective choice in these markets lies with the retailers and not end-users.

For PIAC and COTA (NSW) the more important question is whether the introduction of interval meters will deliver net benefits to households. The UPWG and the SCO need to bear in mind that the NSW Government and our organisations separately have serious reservations about the methodology used by the Essential Services Commission Victoria (ESC) to calculate the costs and benefits of interval metering for small-use customers. We have noted with particular interest the findings of research commissioned by the Essential Services Commission of South Australia (ESCOSA) which cast serious doubts on the claims of strong benefits for household consumers from the introduction of interval metering^{iv}.

The *Discussion Paper* correctly makes the point that interval meters will identify consumption during periods of peak demand. However, it is not correct to draw the conclusion that these meters will target the supposed causes of peak demand such as airconditioning. Rather, interval meters will measure all peak consumption in aggregate. While airconditioning is a major contributor to peak demand during certain periods targeting this specific usage may well require additional equipment.

Accordingly, the claim that interval metering has the potential ‘with the right price incentives’ to moderate electricity demand during peak periods is questionable. Put simply, it ignores the nature of the consumption decisions made by households. It also, unfortunately in our view, relies on time-of-use (TOU) tariffs providing a price penalty with all the attendant social iniquities.

The *Discussion Paper* includes a casual reference to the claim that interval metering will lead to a reduction in the level of cross-subsidy between consumers with and without airconditioning. It is not clear to us as to why there is so much focus from policy makers and some advocates on this particular cross subsidy and not on others. Nonetheless, PIAC and COTA (NSW) draw attention to the criticisms made of the estimate of the ESC Victoria about the value of the ‘airconditioning cross-subsidy’. We also caution against the assumption that any smearing of costs is socially inequitable. The data available to us indicates that many low-income households, including those in private rental accommodation, currently have and use airconditioning^v.

Households do not all have the same capacity to respond to the price signals and penalty regime inherent in TOU pricing. In some cases this is a consequence of the 'essential service' or quality of life' characteristics of electricity supply. Indeed, given that peak prices tend to occur around periods of extreme weather we question whether it is desirable socially to be penalising energy use at these times. Other households will not respond because they have the capacity to bear the added costs. In effect, then, TOU tariffs will not have the effect of moderating consumption across residential users but instead will penalise some households which lack the capacity to alter their consumption.

The study commissioned by ESCOSA has revealed that TOU tariffs can in fact result in small-volume electricity users experiencing higher overall bills. This is not surprising given what is known about the inelasticity of household energy demand. Clearly, this finding calls into further question the simplistic assumption that metering technology can provide the many various benefits claimed by its supporters.

Currently the retail energy market is riven by a strong segmentation based on the willingness of retailers to offer competitive supply contracts to that minority of households who are the most attractive in commercial terms^{vi}. If TOU pricing is to be introduced with the same discretion for retailers to refuse to offer supply terms (and we do not doubt this will be the case) we expect the perverse outcome of an initiative supposedly based on choice delivering higher electricity prices to the very consumers who have the least power in the marketplace and, hence, the least choice.

A critical issue not addressed by the *Discussion Paper* is that of how to allocate the costs and benefits of interval meters between the various parts of the market. The gains from interval metering for distributors and retailers (as opposed to residential users) seem clear enough but there remains the question of how to determine the appropriate match of benefit with contribution to the costs of any meter roll-out.

Clearly it would be unreasonable for end-use customers to bear any portion of the costs where the benefits were to be captured by the distribution or retail businesses. Similarly, there is the question of how to allocate costs and benefits between various groups of end-users. The ESC has proposed that interval metering be required for only some sections of the small-volume customer market. The question which follows is whether the costs of such a roll-out will be recovered only from those who are moved to TOU metering or smeared across the entire customer base.

It is pleasing that the *Discussion Paper* has made a reference (albeit only in passing) to the need for mitigation of the impact on the less wealthy of TOU tariffs and higher prices for electricity through government funded community service obligations and social programs. In those markets where private ownership has been introduced to the electricity industry the question could be asked as to why governments alone should accept this responsibility. Nonetheless, consumers cannot accept such vague offers for expanded financial assistance without governments and industry first developing the details of these programs and the indicating a commitment to fund them.

3. Retail Pricing

The UPWG makes the point in the *Discussion Paper* that the ‘MCE acknowledges the important transitional role performed by retail price regulation’. The question for PIAC and COTA (NSW) is why the creation of a fully functioning competitive retail energy market is more important to Australian governments than the certainty for consumers that they will continue to receive an affordable supply of an essential service.

It must be stressed that regulated tariffs are not a transitional arrangement for many residential consumers. Price regulation in electricity will remain an important safeguard for the well-being and standard of living of many in the community - irrespective of how well the competitive market may mature in years to come.

PIAC and COTA agree in broad terms with the principles proposed by the Working Group to be a template for price regulation in each of the jurisdictions. We understand that these principles reflect current practice of each of the economic regulators. There is a concern, however, that in raising the issue of the ‘different approaches’ employed by the respective jurisdictional regulators that the Working Group may once again be contributing to an approach which treats uniformity as ‘lowest common denominator’. Such an approach would result in a serious diminution of the protections currently provided to residential consumers in NSW.

We also wish to make the point that price regulation is only one part of a broader range of consumer protection measures which are important in ensuring that a competitive framework for the supply of household energy does not disadvantage consumers, particularly those who are vulnerable in a market setting. Other elements include such measures as marketing codes of conduct; regulated contract terms; mandated disconnection rules; and CSOs and social programs. These safeguards will only become more important if price controls are to be weakened. Both our organisations are concerned greatly that retailers in the competitive segment of the market will create pressure for a ‘lowest common denominator’ approach to these important consumer protection measures.

The *Discussion Paper* includes a reference to an ‘entrenched perception of the need for price regulation’. In our view there is less a perception than a pragmatic recognition of the continued importance for regulation to protect vulnerable consumers from price exploitation in a competitive market environment. It is not good enough for the opponents of price protection to assert that the competitive market should be the default arrangement. The UPWG, the SCO must demonstrate that there no longer is a need for price protection for vulnerable consumers.

The current very low level of churn in the Australian retail energy markets demonstrates that price regulation continues to be an appropriate mechanism to protect the interests of the vast majority of consumers. Yet, even high levels of churn can be misinterpreted in what they indicate about the state of competition. For example, the UK has achieved a higher rate of churn yet a considerable amount of customer switching between retailers (as much as one third of all transfers) are comprised of customers returning to their incumbent retailer – ie. those who have found that the market does not provide the benefits they were promised^{vii}.

The UPWG has set out the claim that a ‘regulated energy price has the potential to conflict with and impede efficient market outcomes’. Yet, the *Discussion Paper* goes on to argue that ‘if retail price regulation is to be effective in facilitating the transition to a competitive market...(it must) create sufficient incentive for new retailers to enter the market’^{viii}. This echoes the claims by some that regulated prices at their current level pose a barrier to entry to the market by second tier retailers.

This view has resulted in demands for regulated prices to be moved above 'efficient' levels by the inclusion of 'retail headroom' to facilitate entry by new competitors.

The UPWG and other advocates of a competitive retail energy market cannot have it both ways. Retail energy will continue to be a far-from-perfect market. It is only with continued effective price regulation that the majority of consumers can be confident that household energy prices do provide a close match with efficient costs.

Indeed, we are left to wonder what constitutes an 'efficient price' given the apparently overarching goal of giving artificial stimuli to market entry by competitive retailers. Or, to put this another way, why is the goal of price regulation seen to be focussed on the development of a competitive market when consumers understand price regulation as being about ensuring affordability of an essential service and preventing inappropriate market outcomes?

The behaviour of retailers to exclude the majority of households from competitive market supply contracts combined with an absence of price regulation will replicate the experience the UK market. Government figures for 2002 indicate that customers who continued to receive electricity supply from their incumbent retailer were paying as much as 23 pounds more per year than customers who had secured a competitive retail contract^{ix}.

The *Discussion Paper* offers the view that the removal of price regulation may lead to more 'innovative and transparent price structures' which would encourage small-volume customers to enter the competitive market. The paradox in this view is that removing price regulation effectively will force customers into the competitive market - whether or not they stand to benefit.

Many residential users of electricity do not want to have the experience of being forced to deal with and compare numerous complex offers and supply contracts where, for example, energy is bundled with all manner of non-price elements intended to sweeten these offers. This will be especially relevant for particular groups of consumers. A review of retail competition in the UK has shown that people over the age of 65 have a lower propensity to switch retailers than consumers of a younger age^x.

We are uncertain as to the value to consumers of the suggested web-based tool for analysing competitive supply offers. In part this is because it fails to answer the question as to why consumers should develop a higher level of sophistication in order to continue to receive an essential service. Providing information on competitive offers will be of little consequence if retailers continue to refuse to contract with particular categories of consumers. Furthermore, a survey undertaken by COTA (NSW) has revealed that while some older people have access to a computer (often as the result of a gift) many refrain from using the internet due to concerns about the cost.

Irrespective of any such web-based initiatives, the majority of individual consumers will continue to lack the skills, knowledge and time to represent their own interests in this complex market. We believe the Working Group and the SCO should give careful consideration to making provision for a more dedicated advocacy role within the national market. The Utility Consumers' Advocacy Program (UCAP) established by PIAC with funding from the NSW Government could provide a template for the creation of an advocate for the interests of low-volume (and especially low-income) consumers. This model contrasts with the current End-User Advocacy Panel and the Victorian Consumer Utilities Advocacy Centre (CUAC) in establishing a 'centre of excellence' rather than seeking to graft NEM issues onto the interests and workloads of existing community organisations.

NOTES

1 EnergyAustralia funded the 2002 REFIT pilot energy efficiency retrofit service for low-income tenants in the NSW Hunter Region

² Integral Energy (2002) *Interruptible Air Conditioning Rebate Project – Final Report*, Special Report No. S047, July 2001

³ Parer, W. (2002), *Towards a Truly National and Efficient Energy Market : Council of Australian Governments Energy Market Review Final Report*, December 2002, p.177

⁴ Energetics (2003), *Electricity Pricing Structures for Customers with Interval Meters*, Public Report for the Essential Services Commission of South Australia (ESCOSA), March 2003

⁵ The REFIT pilot in the Hunter Region revealed 19% of low-income private tenant households had an airconditioner. It should be noted that this area is based on the Central Coast of NSW. See Eardley, T. and Brown, J. (2003) *Analysis of Data from the REFIT Pilot Program*, Social Policy Research Centre UNSW, May 2003, table 4

⁶ This was commented on in ESC (2002), *Special Investigation : Review of the Effectiveness of Full Retail Competition for Electricity – Final Report*, ESC September 2002 p.46. PIAC has anecdotal evidence of this practice in the NSW retail energy market.

⁷ Office of Gas and Electricity Markets UK (2004), *Domestic Competition Market Review 2004 : A review document*, Ofgem April 2004, pp.62-63

⁸ UPWG (2004), *Improving User Participation in the Australian Energy Market : Discussion Paper*, Ministerial Council on Energy Standing Committee of Officials, March 2004 p.19

⁹ See http://www.dti.gov.uk/energy/inform/energy_prices/#section_22 See also the Ofgem review of energy competition (Ofgem [2004] opcit) which reports (on p.5) that incumbent retailers tend to charge the highest prices to the majority of customers.

¹⁰ Ofgem (2004) *ibid*, Summary