WACOSS Submission to Economic Regulation Authority Inquiry into the Efficiency of Synergy's Costs and Electricity Tariffs – Draft Report

wacoss

Western Australian Council of Social Service Inc

Ways to make a difference

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Cost reflective pricing and concessions reform

The Council is extremely concerned by the continued increase of levels of energy hardship being experienced by Western Australian households. In recent times we have seen a significant growth in the number of households experiencing utilities hardship across all relevant measures (payment extensions, payment plans, HUGS grants, disconnections[1]). Reports on increasing demand from emergency relief providers and financial counsellors also indicate that energy hardship is gradually moving up the income quintiles, with increasing numbers of working families on low to moderate incomes now also seeking assistance. With electricity prices having risen 57% since April 2009 and additional price increases in the order of 29% recommended over the next 3 years we expect electricity prices to remain of significant public concern within the foreseeable future. On this basis the Council believes that equity and efficiency are the key issues for energy pricing policy, and that concessions reform is urgently needed.

In this context the Council believes that further moves towards cost reflective pricing must be supported by targeted improvements in concessions for low income households that offset any further price shocks. Given the recent rise in energy hardship and the evidence of the increasing number of low income households struggling with cost of living issues, it seems likely that further increases in power costs are likely to result in a significant increase in the breadth and depth of financial hardship within our community.

The Council believes that the best way in which to address our combined aspirations of (1) delivering efficient and cost effective electricity supplies to retail customers within Western Australia, (2) encouraging consumers to make more effective use of energy and reduce unnecessary use, and (3) address the rising problems of energy hardship and the disproportionate impact of rising energy costs on disadvantaged households on low incomes is to guarantee that cost reflective pricing is supported by reform of concessions to ensure that they are targeted to those most in need and proportionate to their level of energy use. On this basis the Council would support a move to cost reflective pricing in the South West Interconnected System over an appropriate timeframe provided that it was supported by adequately funded and appropriately targeted concessions. In this context the measure of the adequacy of these concessions would be that they ensure disadvantaged and low income households were able to afford the rising cost of essential energy use, and that the levels of the key indicators of utilities hardship were reduced. The Council is undertaking some work on concessions reform and is happy to contribute to discussion of alternative models.

Given the sensitivities associated with energy pricing, it is important to ensure that additional and unnecessary costs are not loaded onto consumers. Keeping electricity prices artificially low by means of an across-the-board subsidy to all consumers from the public purse (via the Tariff Adjustment Payment) is a blunt measure. While it may be politically popular it is not efficient in delivering a social policy outcome nor is it cost-effective, to the extent that it subsidises the costs of those who

[1] ERA's 2010/11 Annual Performance Report – Energy Retailers. Pages 8, 14, 38, 40 and 41 has graphs and tables that illustrate the increases that have occurred since 2006-07 to 2010-11. Each hardship indictor shows an increase from 2006-07 to 2010-11 http://www.erawa.com.au/cproot_download/10259/2/20120307%20-%202010-11%20Annual%20Performance%20Report%20-%20Energy%20Retailers.pdf

can easily afford to pay for their consumption and also provides a greater level of subsidy to those who consume more irrespective of need. A more appropriate public policy measure would be to ensure that the public resources devoted to power subsidies are targeted to those in greatest need via a strengthened concessions framework.

If an appropriate concession framework is not in place then the Council believes that the glide path to cost reflective pricing should be extended beyond 2015 to 2020 to help ease the transition across for households and provide them with time to adjust to higher electricity costs. A longer time period will allow the natural progression of consumers purchasing more energy efficient appliances as needed, knowing full well that electricity price increases are going to occur. If prices were to continue on their current trajectory then households are faced with the choice of either remaining with their current (less energy efficient) appliances with the higher energy costs that are associated with these appliances until they are due to be replaced, or go out and purchase new more energy efficient appliances before needed, neither of which scenarios are optimal for Western Australian households. Clearly there is an equity issue here as lower income households have less financial capacity to be able to afford to replace inefficient appliances, and those in public and social housing or private rental have little ability to approve the efficiency of their housing.

Additional service standards

The Council is extremely concerned by reports that more consumers are accumulating debt over a number of billing cycles. It is believed that with increasing utility prices the amount of accumulative debt have grown substantially. While the Code of Conduct for the Supply of Electricity to Small Use Customers requires that Synergy provide information on "Total number of, and percentage of residential customers who have been granted additional time to pay their bill under Part 6 of the Code of Conduct" it would be of value to have more information on the amount of debt owed by residential customers. This should provide a more complete picture of the number of households facing financial hardship and the debt that is owed which can help assist in the development of new government policies and concessions.

Furthermore it would be of great use if there were statistics published on the reasons why households are having trouble paying their bills and the demographics of those affected households. Knowing why households have been granted additional time to pay their bill, have been disconnected, have been granted a hardship utility grant or are utilising instalment plans will be of great benefit for designing and evaluating an evidence-based concession framework. Gathering this data should be of relativity low cost to Synergy, as Synergy should already be acquiring this data as part of their obligation to assess financial hardship under the Code[2]. Knowing the reasons why clients are experiencing financial hardship can help to produce a well-designed and better targeted

[2] Within the Code of Conduct For The Supply of Electricity to Small Use Customers "financial hardship" means a state of more than immediate financial disadvantage which results in a residential customer being unable to pay an outstanding amount as required by a retailer without affecting the ability to meet the basic living needs of the residential customer or a dependant of the residential customer. Basic living needs" includes— (a) rent or mortgage; (b) other utilities (e.g., gas, phone and water); (c) food and groceries; (d) transport (including petrol and car expenses); (e) childcare and school fees; (f) clothing; and (g) medical and dental expenses.

concession framework. Better targeted concessions that are proportionate to the level of hardship and need should reduce the costs incurred by Synergy by reducing the number of consumer defaults. Given the significant level of resources that are consumed in managing defaults and outstanding debts (which last financial year stood at over $80 million[3]) it is hoped that concessions reform together with a stronger focus on efficiency programs for low income households would offset the cost of additional reporting and result in a more efficient retailing operation. Given the potential benefits of this approach the Council would like the collection and dissemination of more detailed affordability and access information mandated as a Service Standard indicator. This information could further inform the learnings from the tariff and concession framework review to provide the basis for a more effective approach to State government concessions and hardship policy.

Within the Code of Conduct for the Supply of Electricity to Small Use Customers there is a requirement that customers receive a bill within 90 days of the last bill. The Council notes that Synergy has had some issues with the issuing of bills in recent years and has not always fulfilled this requirement. The provision of accurate and timely billing information has a significant impact on the ability of low income households to manage their finances and avoid energy hardship. While this important service standard is already in place, there is currently no obligation to report publicly of the number of customers who are affected. The Council would like to see this statistic included in Synergy's annual performance reports.

The need for a formalised and transparent tariff costing process

The Council notes that the terms of reference require the Authority to develop a methodology to regularly determine the efficient cost-reflective level for each tariff. We believe that it is important that a formalised and transparent tariff costing procedure is developed and declared, and that there is a clear and appropriate timeline set out for the regular periodic review of tariffs. We note that this issue was addressed at some length in the ESAA submission[4] which stated:

> "…(D)espite recognition of the importance of transitioning electricity tariffs to cost-reflective levels, Western Australia is the only state (excluding the Northern Territory) yet to establish and implement an independent price setting methodology for deriving cost-reflective retail tariffs. Instead, prices are determined largely on an ad hoc basis from year to year, giving the regulated retail sector no real certainty beyond a 12 month horizon."

The Council believes that greater certainty and transparency in these matters will benefit both electricity retailers and consumers in Western Australia. In order for consumers to make informed decisions about household finances they need to be aware of any changes to their upcoming costs. Hence, having a more formalised and transparent tariff costing procedure with prices determined

[3] Synergy's Financial Statements for the year ended 30 June 2011 Page 17 shows that debt past due 30 days now stands at $40.3 million or $82 million for all debt past due. www.synergy.net.au/docs/Synergy_Financial_Statement_10-11.pdf

[4] Energy Supply Association of Australia submission to the ERA's Inquiry into the Efficiency of Synergy's Costs and Electricity Tariffs Issues Paper, 13th September 2011, page 2. http://www.erawa.com.au/cproot/9920/2/20111003%20Public%20Submission%20-%20Issues%20Paper%20-%20Energy%20Supply%20Association%20of%20Australia.pdf

out to, say, 5 years may enable consumers to plan ahead of time for any changes to the prices of electricity and make informed decisions about the relative value of investing in more efficient appliances, home insulation and other efficiency measures. Instituting a longer timeframe would also provide more certainly for the retailer around the future prices of electricity compared to the current ad-hoc means by which electricity prices are determined.

While the Council is broadly in favour of increasing the timeframe for the setting of electricity tariffs, we note that a careful balance needs to be struck between longer term certainty and the risk associated with unforseen factors that may impact on the costs associated with electricity retail. A longer timeframe potentially produces greater market risk for the retailer, to the extent that market conditions are harder to predict over a longer timeframe. This has the potential to add to the market risk premium[5] which results in a higher rate of return on Synergy's asset base (including intangible assets). A higher rate of return contributes to higher operating cost which may ultimately be passed on to consumers. Therefore to ensure that Synergy is neither advantaged nor disadvantaged by changes in market conditions and to reduce Synergy's market risk there may need to be provisions put in place to allow the retailer's costs to be reviewed within that timeframe if there are substantial changes to their cost make-up in either direction. Such a model should reduce market risk for Synergy, lowering their market risk premium and therefore the overall cost passed on to the customer. The Council does not have a position on what proportion of change in underlying costs of business might be required to trigger a tariff review.

Consideration of the Retail Margin and Cost of Acquiring and Retaining Customers

The Authority has included a Cost of Acquiring and Retaining Customers **(**CARC) in the draft report based on estimations from Eastern State utility regulators. This may not be an accurate means of arriving at a relevant or appropriate CARC for Synergy, as the Western Australian electricity market is structured in a manner that is not comparable to the National Energy Market. The National Energy Market has open competition in the retail field and therefore retailers need to market to the customer their product/service. This marketing costs incurred by retailers competing in an open market for activities such as traditional media advertising on radio or television, operating call centres, paying commissions to switching sites, employing door to door sales staff, optimisation of web searches or hosting web ads are not relevant to a monopoly retailer providing an essential service in a closed market. While Synergy may have some general customer acquisition and retaining costs, these will be significantly less than those incurred in the National Electricity Market, and hence the Council believes that the Authority should include an analysis of the costs that Synergy currently has without competition, so that Synergy's true operating costs are known. The Council notes that the Authority applies the following test as the basis to determine if existing tariffs are efficient and costs reflective: "…the test for whether existing tariffs are efficient and cost reflective is whether an efficient new retailer could come into the market and sell electricity at a lesser tariff than what the existing retailer is charging. In undertaking its analysis, the Authority has

[5] "Market Risk Premium is the average return of the market above the risk free rate. In other words, it is the premium that investors demand for investing in a market portfolio relative to the risk-free rate." *ERA Inquiry into the Efficiency of Synergy's Costs and Electricity Tariffs Draft Report* (p113)

kept this test in mind."[6] However, the inquiry's terms of reference also requires that the Authority "consider and develop findings on the efficiency of Synergy's operating and capital expenditure." This requirement can arguably only be fulfilled if the Authority analyses Synergy's current and expected operating expenditure independently of where or not a new entrant can enter the retail market. Legislative change is needed before another retailer can enter the market and it is currently illegal for another retailer to sell electricity to customers whom consume less than 50 megawatt hours of electricity annually.

Were the retail electricity market in the SWIS to be opened up to competition, the tariff structure would need at that point to take into account the cost of acquiring and retaining customers to ensure that tariffs they could charge were realistic and able to cover the costs of market entry. However, even at this point it is also arguable that Synergy would have a built-in competitive advantage to the extent that the costs of retaining customers for an existing provider would be much less than those of attracting customers for a new market entrant.

The Council is of the view that at present there is no justification in including the full estimated costs of the retail margin or CARC in the final cost reflective price until the electricity market is opened up for full retail competition. The Council is content that these costs should be investigated and included when full competition is achieved, but believes these costs should not be included in the tariffs for non-contestable costumers until then. Until the market is open and contestable adding in potential costs that are not actually borne by the retailer does little to generate energy retail prices that are reflective of the actual cost of service provision, it simply increases the cost burden imposed on consumers within a non-competitive market at a time of increasing utility hardship.

The removal of the Tariff Equalisation Contribution

The Council supports the Authority's call for the Tariff Equalisation Contribution to be abolished and for the Tariff Equalisation Fund to be provided via a Community Service Obligation payment from consolidated revenue. Customers in the SWIS are currently being asked to pay an extra 7.3%[7] extra per kilowatt hour to fund the uniform tariff policy. This is placing an unnecessary burden on customers in the SWIS, and a disproportionate burden on low income households who are spending a much greater proportion of their disposable income on essential services. It also further confuses the argument about cost reflectivity by artificially inflating the cost of service provision within the SWIS. The Council remains a strong advocate for the uniform tariff policy as a means of providing equitable access to electricity as an essential service for all residential households throughout the state regardless of where they live. However, the Council believe that the funding for the uniform tariff policy should be borne fairly and equitably by all citizens of the State according to their means and ability to contribute (that is, out of consolidated revenue), rather than disproportionately by disadvantaged electricity consumers in the SWIS. Furthermore, as the subsidy currently operates, high use consumers in regional areas are receiving a higher level of public subsidy for their power usage, irrespective of their level of need or ability to contribute.

[6] *ERA Inquiry into the Efficiency of Synergy's Costs and Electricity Tariffs: Draft Report*, (p ix).
[7] ERA Inquiry into the Efficiency of Synergy's Costs and Electricity Tariffs Draft Report (pxi)

Re-amalgamation of tariffs

The Council believes that re-amalgamation of tariffs is likely to reduce the customisation of electricity tariffs for different classes of consumers and therefore should only occur if there is a demonstrated need for such an amalgamation to occur that would not be at the detriment of consumers. The Council welcomes the research and analysis of the C1 (Special Community Services) and D1 (Charitable Residential) tariffs undertaken by the Authority, and supports the recommendation that the tariff structure remains unchanged.

Pro-active concession identification and information sharing between utilities

A number of utilities in Victoria are about to trial information sharing on consumer hardship. The scheme will operate by utilities agreeing and establishing protocols to alert one another when a client is identified as experiencing hardship, so that the client only has to undertake a single financial hardship assessment. Where hardship policy provisions are consistent across different types of utilities (electricity, gas, water, phone, etc.) such an approach should reduce the administrative burden for both the utilities and the consumers by reducing duplication. Once alerted the other utilities that have a relationship with that client can implement their early intervention plans, which might entail proactively offering a payment plan or access to relevant concessions or rebates. This might then prevent the concerned client from falling into a debt spiral.

The Council feels that such a scheme could have merit in Western Australia and should be considered in due course by the Authority on economic grounds. The Council considers that such a scheme has the potential to increase Synergy's revenue stream and reduce its operating costs due to the following:

- Reduction in customer default (bad debt)
- Reduction in debt recovery fees
- Reduction in utilities physically going to a household to disconnect the electricity supply
- Customers that would have defaulted may still be connected and are therefore still providing a revenue stream for the utility
- Call centre costs are reduced as the client does not have to go through lengthy phone conversations with each utility to prove that they are in financial hardship
- Improves cash-flow issues and hence may reduce the need for utilities to purchase debt, or provide utilities with the opportunity to receive interest for their cash on hand (either way there is a cost averted or interest received)

The Council also feels that it in the best of interests of customers and Synergy alike to adopt a pro-active approach to identifying households that are eligible for some form of concession and automatically applying these concessions. This can be done at relatively low cost as Synergy already has a concession validation system in place with the Department of Human Services[8]. With

[8] "The department generally operates CCeS [Centrelink Confirmation eServices] as a free service to approved Participants. There may be initial IT costs if the Participant wishes to validate its IT system using a bulk exchange (batch process) of records sent to the department or to develop a system to system interface." Centrelink Confirmation eServices (CCeS) Policy, Department of Human Services, no date. http://www.centrelink.gov.au/internet/internet.nsf/filestores/cces_policy/$file/cces_policy.pdf

appropriate agreements and privacy provisions in place, the current system could periodically be used to check an expanded list of all customer accounts in a particular region or all new accounts established since the last assessment. Such an assessment process would also pick up customers who are continuing to receive a concession for which they are no longer eligible. The Council believes that regularly testing for concessions and applying them automatically will enhance the concession holder's ability to pay, which will reduce their financial hardship and will reduce Synergy's operating costs.

The Council believes that the pro-active identification of concessions will result in a more efficient retailing operation. With the potential for Synergy becoming more efficient the Council believes that examining this is in the scope of this inquiry and thus the Authority ought to investigate the costs and benefits of applying a pro-active approach to concession identification. If the Authority does find that there is a monetary benefit than Synergy's efficient operating should be lowered accordingly and this information be placed in the public domain.

Introduction of alternative tariff structures

The Council notes that the terms of reference for the current inquiry into the efficiency of Synergy's costs and electricity tariffs does not include consideration of alternative tariff structures, such as time of use tariffs, inclining block tariffs or other rebate structures for non-peak power usage. The Council is also aware of the recent Tariff and Concession Framework Review undertaken by the Office of Energy and awaits publication of the outcomes of that review by the Minister. While the impacts of peak load on the provision of electricity relate more to the costs of electricity production and distribution, the manner in which the opportunity cost of the relative 'peakiness' of power usage are reflected in electricity prices is likely to impact on electricity tariffs in the future. The ability of consumers to shift their electricity use in response to price signals is likely to have some impact on the predictability of the revenue stream, which may need to be modelled in the future.

If the public were to change their usage patterns accordingly there is potential for reductions in distribution and transmission network infrastructure costs, along with cheaper generation costs. An example of the costs of peak demand is illustrated within Western Power's Submission to the Strategic Energy Initiative's Issues Paper with stated that "During the whole of 2009, the top 15% of demand (loads between 3,230 MW and 3,800 MW) occurred less than 1% of the time (a total of less than 3 days). In other words the system operated at 85% of its capacity or below for more than 362 days of the year."[9] Reducing this peak demand will lower the capacity that the network needs to be built too, which has the potential to save billions of dollars in investment.[10] Furthermore lowering peak electricity usage can considerably lower generation costs. This is because as demand on the network increases there is a need for more generation. As the cheapest form of generation is utilised first any additional generation becomes more expensive per a unit of electricity generated as generation facilities that have a higher operating cost per megawatt hour come online. Hence as households simultaneously increase their usage causing a peak in electricity demand they are accumulatively causing the need for more expensive generation to occur. As residential electricity

[9] Western Power's Submission to the Strategic Energy Initiative's Issues Paper 2010, www.westernpower.com.au/documents/sustainability/StrategicEnergyInitiativeOfficeEnergy.pdf
[10] Ibid

consumers pay a levelised cost for their electricity, households that use less electricity during peak periods or use electricity at non-peak times are effectively cross-subsidising users that consume large amounts of electricity during the peak times.

The Council notes that there are potential costs and benefits to different approaches to reducing the cost and use of energy, and that the ability of different types of disadvantaged households to shift their energy usage patterns can vary dramatically. Households with children may have less capacity to shift their load to non-peak times, as a significant amount of their energy use occurs outside of school and work hours and around meal times. Should any such reform proceed, the Council is of the view that strong consideration is given to low income households and in particular households with dependent children in any consideration of alternative tariff structures and concessions. The Council would like to see mechanisms put in place (such as opt in and opt out provisions, or an approach based on incentives rather than penalties) to ensure low income households, especially those with dependent children are not worse off under any changes to their tariff arrangements.
The Council recommends that the Authority note the issue of alternative tariff structures as a potential consideration for the next inquiry into the efficiency of Synergy's costs and electricity tariffs and in its other policy work.

Recommendations:

1. Concessions reform is needed to support the move to cost-reflective pricing. Concessions need to be targeted and increased to reflect levels of need.
2. In the absence of significant concessions reform, the glide path to cost reflective pricing should be extended beyond 2015 to 2020 to reduce price shocks and increasing financial hardship.
3. Reporting on the amount of debt held by households should be included as an additional service standard.
4. Reporting on the reasons why households are having trouble paying their bills and their demographics should be included as an additional service standard.
5. Reporting on the number of occurrences when a household does not receive a bill within 90 days of the last bill in their annual performance report should be required, as mandated under the Code of Conduct for the Supply of Electricity to Small Use Customers.
6. A more formalised and transparent tariff costing process should be established that provides customers and retailers with certainly around electricity price increases out to 5 years, with provisions for a review of tariffs in the event of significant costs changes.
7. That the CARC is revised down to reflect Synergy's true efficient operating costs, given that in the absence of competition they do not need to incur costs to attract or retain customers.
8. That the Tariff Equalisation Contribution be abolished and that funding for the Tariff Equalisation Fund be provided via a Community Service Obligation payment from consolidated revenue.
9. That the current tariffs remain in place.

10. That the Authority conducts an analysis of the benefits and potential savings from a pro-active approach to concession identification.

11. That the Authority conducts an analysis of the benefits and potential rising from information sharing between the utilities that reduces duplication of financial hardship assessments.

12. That the scope of inquiry is expanded for the next review to include alternative tariff structures which improve the efficiency of the network while not adversely impacting on low income households.

Please note that no part of this submission is confidential and the Council is happy for the Authority to publish it on its website.