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1 May 2007

NSW Electricity Regulated Retail Tariffs and Charges
Independent Pricing and Regulatory Tribunal
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Thank you for the opportunity to provide a further response to the Tribunal's consideration of regulated retail tariffs and charges for 2007-2010 and, in particular, to comment on *Draft Report and Draft Determination No 1, 2007*.

The Energy & Water Ombudsman NSW investigates and resolves complaints from customers of electricity and gas providers in NSW, and some water providers.

The *Draft Determination* outlines price rises of considerable magnitude for small retail customers for each year of the determination. The potential for these increases to impact vulnerable consumers is considerable. For this reason, EWON's response to the *Draft Determination* has focussed on the needs of this customer group in particular.

For ease of reference we have adopted the same numbering as the *Draft Report and Draft Determination No 1*.

If you would like to discuss this matter further, please contact me or Brendan French, Deputy Ombudsman, on 82185250.

Yours sincerely

A handwritten signature in blue ink that reads 'Clare Petre'.

Clare Petre
Energy & Water Ombudsman NSW



Energy & Water
Ombudsman NSW

Independent Pricing and Regulatory Tribunal

Draft Report and Draft Determination
No 1, 2007

Promoting retail competition and investment in
the NSW electricity industry - Regulated
electricity retail tariffs and charges for small
customers 2007 to 2010

Response by the

Energy & Water Ombudsman NSW

2 May 2007

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Introduction

The Energy & Water Ombudsman NSW (EWON) is pleased to respond to the *Draft Report and Draft Determination No 1, 2007*.

Established in 1998, EWON is the approved independent dispute resolution mechanism for customers of electricity and gas providers in NSW, and some water providers. Our aim is to provide fair, equitable and independent investigation and resolution of customer complaints. We work with all the key stakeholders – providers, community, government, regulators – to improve the standard of service delivery for the benefit of NSW consumers.

At several points the Tribunal's *Draft Report* identifies the different circumstances that apply in this determination than in those that preceded it. The Minister's Terms of Reference for the determination are such as to require the Tribunal to develop a pricing methodology for standard retailers – with established business infrastructure and pre-existing customers – based on the putative establishment costs of a hypothetical new mass market entrant. Unsurprisingly, this reverse extrapolation has resulted in the *Draft Determination* foreshadowing significant price increases for customers on regulated tariffs.

The Terms of Reference specifically require the Tribunal to consider 'the effect of its determination on competition in the retail electricity market'.¹ The clear inference is that for the NSW contestable electricity market to become more dynamic, new entrants need to be encouraged by means of increased 'headroom' between the regulated tariff and their own retail offerings.² While this would be a likely outcome of higher regulated tariffs, EWON suggests that this approach may take insufficient note of the increasing market activity already obvious in New South Wales (under the current Determination).³ It is also difficult to ignore that the increases foreshadowed in the *Draft Determination* as a means of attracting more customers to market contracts will be felt exclusively by those who – through circumstance or election – remain on the *regulated* tariff. By implication it will be these customers – no doubt many of whom may be defined as

¹ Independent Pricing and Regulatory Tribunal of New South Wales, *Draft Report No 1, 2007: Promoting retail competition and investment in the NSW electricity industry – Regulated electricity retail tariffs and charges for small customers 2007 to 2010*, Appendix 1, 'Terms of Reference', 93. (Hereafter: *Draft Report No 1*)

² The Terms of Reference suggest that the 'level of regulated prices for small retail customers is a crucial factor in encouraging new entry in the retail sector. If the level is set too low, it is not possible for new retailers to attract small retail customers away from the regulated price' (*Draft Report No 1*, 93).

³ It is worth noting that hundreds of thousands of New South Wales customers have switched to market contracts between the writing of the Terms of Reference and the *Draft Report and Draft Determination*. Compare, for instance, the customer numbers listed on pages 23 and 91 of the *Draft Report and Draft Determination*.

particularly vulnerable to price increases – who will be paying the cost of this increased headroom.

The Draft Report notes that the Terms of Reference ‘do not direct the Tribunal to have regard to the impact of its determination on customers’.⁴ Nevertheless, as we noted in our submission to the earlier Issues Paper, they nowhere preclude this.⁵ The NSW retail energy market appears to be operating effectively, with considerable marketing activity occurring. It is also our observation that customers from all sectors of the community appear to be availing themselves of market contracts. The churn rate in NSW may not yet have matched that of other states (eg South Australia) or overseas markets (eg the United Kingdom or the Republic of Ireland) but this is not necessarily a negative situation if NSW has managed to avoid the dramatic price shocks that occurred or are occurring in these jurisdictions. Such price impacts are felt most keenly by the vulnerable sectors of the community and, in EWON’s view, these are the customers who should be protected from the worst effects of such increases wherever possible. To this end, EWON would recommend to the Tribunal members that while the terms of reference for this review do not explicitly require them to have regard to the impact of their determination on customers or to take account of customers’ ability ‘to adjust to new prices’ as previous reviews have done, such considerations are nevertheless inherent and implied in the task.⁶ Further, it is clear that there is a significant likelihood of other as yet unknown costs – certain network initiatives, carbon costs, etc – being passed through to customers during the term of the 2007 – 2010 determination. These costs, on the back of a rise in the regulated tariff of the order outlined in the Draft Determination (and allied with significant rises in the costs of other essential commodities), may well create significant ‘utility stress’ for a segment of NSW customers barely coping with the current prices.

⁴ *Draft Report No 1, 2.*

⁵ The (then) Minister for Energy, the Hon Joseph Tripodi, noted this in his response to questions from *The Financial Review*: ‘The government expects the independent tribunal to address both social concerns and investment requirements and deliver a fair and responsible price determination’ (Annabel Hepworth and Steven Scott, ‘Households at risk from rising NSW power prices’ in *The Financial Review*, 12 October 2006, 6).

⁶ See Energy & Water Ombudsman, *Response to Review of Regulated Retail Tariffs and Charges for Electricity 2007-2010: Issues Paper (July 2006)*, 8.

3 Policy Context for the Review

The Tribunal's review of prices for 2007 to 2010 occurs at a time of considerable change for the energy industry and its customers. Many of these changes are known (national regulation, advanced metering, retail contestability) but many remain obscure or unknown. The latter include the impacts at the customer level of demand management programs, renewable energy initiatives, renewed vertical integration (at least at retailer/generator level), and energy price volatility. In discussing the price and other impacts of a number of these variables, the *Draft Report* notes that in 'making its determination, the Tribunal has considered ... current and proposed customer assistance measures'.⁷ EWON recommends that further consideration, at a whole-of-government level, should be given to ensuring that the customer assistance measures that currently exist are equal to the task required of them in the context of significant price rises.

Retail price regulation

The *Draft Report* references the Council of Australian Governments' expressed desire to phase out energy retail price regulation where effective competition can be demonstrated. To this end, the *Draft Determination* is presented as 'a transitional measure'. Nevertheless, EWON considers that it is important that the 2007-2010 determination does not assume or pre-empt the removal of retail price regulation entirely, particularly as some State jurisdictions have indicated reluctance to eliminate price regulation.

Time of use meters

The Tribunal indicates that the draft determination will assist retailers to develop appropriate tariffs in the context of the rollout of advanced meters. While this may well be the case, EWON notes that the likelihood is that time-of-day pricing has the potential to lead to higher costs for certain groups of customer. For instance, EnergyAustralia's analysis of the cost savings/impacts for customers resulting from its time of use metering and pricing indicates that the higher the consumption the greater the relative price advantage and that some customer groups (notably those who consume less than approximately 7 MWh per annum) may experience notable increases in bills.⁸ It is clear that there are demonstrable advantages for many consumers in being able to migrate their consumption across time bands and thus, potentially, reduce their bills. Nevertheless, it appears to be the case that the bulk of customers who face a price disadvantage because of the introduction of time of use metering/ pricing are at the lower end of the consumption spectrum. Such customers may have less discretion to move their

⁷ *Draft Report No 1*, 17.

⁸ See, for instance, Chris Amos (Manager - Network Pricing, EnergyAustralia), 'TOU Impact on Domestic Customers' in *FY07 Network Price Changes and Medium Term Strategy*, Network Information Forum May 2006, 17.

consumption across time bands, and they are already paying more for the electricity they consume under the *current* pricing determination, particularly in peak periods. If such small-use customers – often single person households on low, fixed incomes – will *also* experience the significant price rises foreshadowed by the *Draft Determination*, many will feel the price shock acutely.

Customer assistance programs

As noted above, the *Draft Report* states that in reviewing the policy context and in making its draft determination, the Tribunal has considered ‘current and proposed customer assistance measures’.⁹ EWON is pleased that these measures have been considered in the context of the price review but we have concerns regarding the degree to which they would be able to ameliorate the affects of significant price rises. To this end – and acknowledging that the Tribunal does not regulate these programs – we consider there is value in noting the following.

1. The content of retailer assistance programs

The *Draft Report* notes that retailers ‘currently have or are developing’ assistance programs that include various measures designed to provide support for customers. Included in the list of such measures are, for instance, ‘the provision of free energy audits for eligible customers’ and ‘incentive matching payments for eligible customers on instalment plans satisfying payment requirements’.¹⁰ No doubt these would be considered attributes of best-practice assistance programs but it is important to note that by no means are they common to all such programs and, in the case of NSW standard suppliers, they may not be majority practice.

2. The adequacy of the NSW pensioner energy rebate

The *Draft Report* refers to the pensioner energy rebate of \$112 currently available to eligible NSW customers. We note that to our knowledge the quantum of the rebate has not altered since the introduction of the current scheme several years ago. This is despite the movement in energy costs to pensioners, including those that have occurred as a result of the Tribunal’s previous and current determination. A simple comparison of the NSW rebate against its counterparts in other jurisdictions suggests the rebate is lower – and more restricted¹¹ – than in the majority of other States and Territories.

⁹ *Draft Report No 1*, 17.

¹⁰ *Draft Report No 1*, 17.

¹¹ With the exception of Queensland and the Northern Territory all other jurisdictions make energy concessions available to holders of a Health Care Card. This extends the eligibility of the rebate from pensioners to other vulnerable groups, eg those who are unemployed or students.

<i>State</i>	<i>Rebate</i>	<i>Value</i>	<i>Eligibility</i>
<i>NSW</i>	Energy	\$112 per year	Pensioner Concession Card, Gold Card
<i>VIC</i>	Winter (6 months)	17.5% of bill	Pensioner Concession Card, Gold Card, Health Care Card
	Off peak	13% of bill	
	Low use supply charge	Account reduced to consumption charge	
<i>ACT</i>	Summer	0.2439c per day	Pensioner Concession Card, Gold Card, Health Care Card
	Winter	0.8982c per day	
		Annual limit \$189.11	
<i>QLD</i>	Energy	\$10.84 per month (\$130.08)	Pensioner Concession Card, Gold Card,
<i>SA</i>	Energy	\$120 per year	Pensioner Concession Card, Gold Card, Health Care Card
<i>WA</i>	Supply rebate	25.57c per day (\$93.33)	Pensioner Concession Card, Gold Card, Health Care Card
	Child rebate	(1) 40.99c (\$149.61) (2) 51.74c (\$188.85) (3) 62.49c (\$228.08) (4) 73.24c (\$278.27)	
<i>TAS</i>	Electricity rebate	48.40c per day (\$176.66)	Pensioner Concession Card, Gold Card, Health Care Card
	Heating Allowance	\$56per year	
<i>NT</i>	Electricity rebate	Half quarterly bill or \$1 per day, whichever is less	Pensioner Concession Card, or NT P&CC

3. The adequacy of the NSW EAPA scheme

The *Draft Report* refers to the NSW Energy Accounts Payment Assistance Scheme under which those assessed as experiencing need can seek assistance to pay energy accounts through EAPA vouchers. As noted above in relation to pensioner rebates, we understand that the EAPA budget has remained static for several years and may not accommodate demand should prices rise significantly. It is also important to note that the current EAPA guidelines seek to limit the dollar value of vouchers given in any given year to an individual in need.

4. The rate of unrequested disconnection

The Tribunal is aware from its own reports to the Minister of the levels of disconnection in NSW for both electricity and gas. While the rate for the former decreased slightly in the last reporting period, it is nevertheless the case that the

rate of disconnection remains problematically high. While it is the case that a number of customers who would otherwise have entered the credit management / disconnection stream have been diverted to customer assistance programs, EWON remains concerned that the rate of energy disconnection remain very high and that, in the context of broad price rises, the strains on assistance programs may encourage retailers to revert to more traditional credit recovery practices.

Observation

EWON has supported retailer- and Government-funded assistance measures since their inception. Retailers have made demonstrable advances in this area in recent years. Nevertheless, we would advise against assuming that these measures are sufficient – or sufficiently robust – to suggest that vulnerable customers will be protected from price increases. At present there is no regulatory requirement for NSW licensed retailers to operate a customer hardship program and no benchmark against which such programs can be assessed. Further, Government-funded rebates and other assistance measures (such as EAPA) may not have the elasticity to capture all those in genuine need should regulated tariffs rise considerably.

4 Current Level of Retail Competition

The *Draft Report* and *Draft Determination* suggest that (at least the metropolitan) energy retail market is sufficiently developed to justify a considerably lighter-handed regulatory regime for 2007–2010 than exists for the current Determination. This conclusion sits somewhat uneasily with the Terms of Reference for the review itself, which require the Tribunal to encourage new entrants to the market by including costs (such as customer acquisition costs) that would accrue to a new mass market entrant *in the costs to be recovered by the existing standard suppliers*. It is arguable that by assessing the level of competition in the most populated areas of New South Wales as being sufficient to justify less regulatory oversight, the Tribunal has also highlighted the potential contradiction in the Terms of Reference themselves.

The Tribunal has looked specifically at churn rate as an indicator of the level of competition in the market.¹² While no doubt a useful and important test of market activity, it is insufficient as a sole indicator. Customer complaints to EWON, for instance, can provide further data about marketing activity (as well as marketing conduct). It is clear from the data below that there is considerable marketing occurring – much of it in non-metropolitan areas.

Complaint statistics July to December 2006

During the period 1 July to 31 December 2006, EWON finalised 4,423 complaints.

PRIMARY ISSUES PER REGION				
REGION	NO. COMPLAINTS	TOP THREE ISSUES		
Central West	128	Retail competition 50%	Billing 19%	Customer service 16%
Far West	14	Billing 52%	Credit 13%	Customer service 9%
Hunter	508	Credit 34%	Billing 24%	Retail competition 15%
Illawarra	242	Retail competition 32%	Billing 23%	Customer service 16%
Mid North Coast	163	Retail competition 56%	Customer service 15%	Billing 14%
Murray	46	Billing 26%	Retail competition 20%	Provision 16%
Murrumbidgee	54	Credit 31%	Retail competition 28%	Billing 15%
North West	40	Retail competition 49%	Billing 18%	Credit 17%
Northern	78	Retail competition 54%	Customer service 16%	Billing 9%
Richmond-Tweed	109	Retail competition 52%	Billing 19%	Customer service 13%
South Eastern	141	Retail competition 42%	Credit 21%	Billing 17%
Sydney Inner	950	Billing 36%	Retail competition 20%	Customer service 18%
Sydney Outer	1,501	Billing 28%	Retail competition 28%	Credit 16%
Sydney Surrounds	354	Credit 23%	Billing 23%	Retail competition 22%
Non NSW	95	Billing 33%	Retail competition 29%	Customer service 17%

¹² It is useful in this context to note that the *Draft Report* suggests NSW annual churn rates are not necessarily low on an international scale when compared, for instance, with the eight European Union countries with retail contestability or with New Zealand.

A further indicator of the strength of the market is the degree of product differentiation. In New South Wales it is clear that, at present at least, the ability of significant groups of customers to enter market contracts is lessened by lack of differentiation, notably in regard to term-based contracts. Many, if not most, tenants are thus excluded – or perhaps penalised through higher regulated tariffs – because they are unable to sign to three-year contracts. There are also other groups of customer – those supplied under an exempt-retailer arrangement, for instance – who are unable to enter the market but who will be significantly impacted by the methodology of the review (ie. they will pay higher tariffs designed to encourage a competitive market that they are unable to enter).¹³

The conclusion of the Tribunal is that the market is sufficiently developed in metropolitan areas so as to restrain increases in tariffs. A more stringent and comprehensive review of competition than is possible in the context of a pricing determination remains to be undertaken. Such a review in fact is foreshadowed under the COAG endorsed Australian Energy Market Commission process.

¹³ In New South Wales those supplied by a licence-exempt retailer – notably (but not exclusively) those who live in residential parks – are required to pay the retailer at the rate of the ‘maximum allowable’ regulated retail tariff for their distribution area. They are not, however, open to signing market contracts.

5 How Tariffs will be Regulated

The *Draft Determination* employs a weighted average price cap [WAPC] pricing model, thus allowing retailers to vary individual regulated tariffs without constraint within a cap weighted by customer numbers and consumption. Unlike the current Determination, the WAPC does not require regulation of individual tariffs.

While EWON acknowledges the Tribunal's data – and our own – that suggests the level of competition in the NSW market is growing at a steady pace, it could not be concluded that the market is sufficiently mature to allow for price to be controlled solely by competition. It is clearly for this reason that the NSW Government and the Tribunal sought to continue regulating pricing for 2007-2010. One of the main reasons for doing so, no doubt, is to provide added protection for those who are unable to access competitive offers. The question is whether the WAPC model is sufficient to protect the interests of this type of customer.

The Issues Paper suggested that limitations imposed at the level of customers' bills are 'relatively simple to administer'. On this basis, and given the protections that it affords to customers, it appears sensible that such limitations are maintained at least in part. If the Tribunal considers that these limitations are problematic for the purposes of achieving cost reflectivity (though it is worth noting the degree of success that has been managed in this area over recent determinations with such limitations in place), then there may well be advantage in consideration being given to 'whether different limits should be applied to different customer classes' as also suggested in the issues paper. The retailers have informed EWON that they already have systems in place to identify customers in (or potentially in) hardship – eg. those who pay/ part-pay with Energy Accounts Payment Assistance, who build-up arrears over two or more bills, who consistently pay late, who regularly request an extension of time to pay, who pay via Centrepay, or who receive a pensioner/veteran rebate. We understand that such indicators of hardship are used to determine if a customer should be offered referral to a retailer's hardship assistance program and for other purposes (eg. to determine if a late payment fee may be levied). There appears to be little reason why the same criteria could not be used to determine if a customer's account should qualify for the application of side constraints at the customer level.

In particular, EWON considers that there may be demonstrable advantage in maintaining some form of limited tariff controls for low consumption customers, either through placing side constraints on the first block of consumption or through some other mechanism. While it is clearly impossible to identify all vulnerable customers based on consumption level, it is the case that all vulnerable

customers are charged for much or even all of their usage on the first block. To maintain some level of pricing restraint at this consumption tranche would go some distance to ensuring that the most vulnerable – many of whom, in EWON’s experience, are small consumption customers – are protected from the most severe price impacts. EWON considers that this form of limited price control would have advantages for several reasons:

- Billing and other systems are already in place for controls at this level so it is unlikely that there would be new significant compliance burdens or costs. As noted above, the Issues Paper suggested that ‘limitations at the level of customers’ bills [are] relatively simple to administer’.
- Such a system would avoid the introduction of new regulated tariffs – an expressed desire of the *Draft Report* – and would not unduly impede the requirement of the Terms of Reference that tariffs reach cost reflective levels by 2010.
- If there is a concern that such a control would capture all customers, rather than those vulnerable to significant price increases, the Tribunal could require the price control be applied solely for those, for instance, who are in receipt of Government allowances/rebates. As this data is already recorded by the retailers, cross-referencing should not be onerous.
- The *Draft Determination* suggests that ‘concerns about the impact on specific customer groups could better be addressed through other, more targeted mechanisms’.¹⁴ EWON considers that this approach, while imperfect, is targeted to those most in need.
- IPART’s modelling – while indicative only – suggests that the highest percentage impact of the proposed price rises will be felt at the level of the lowest-consumption consumers.¹⁵ While it is incorrect to assume that all customers vulnerable to hardship are low consumers, it is reasonable to assume that more vulnerable customers will be represented in this category than in others.

The abolition of price constraints on individual bills has removed an important protection for vulnerable customers. If the Tribunal does not consider there is value in maintaining a limited and more targeted price constraint as outlined above, EWON recommends that the threshold price increase test which the Tribunal reserves for Country Energy be extended to the other standard suppliers.

¹⁴ *Draft Report No 1*, 45.

¹⁵ *Draft Report No 1*, 85-6.

Given that the Draft Report suggests the ‘threshold price increase test is designed to deter a significant, unjustified increase in an individual tariff, while ensuring that increases based on underlying costs are allowed’,¹⁶ there may well be value in applying it equally across all standard suppliers.

A symmetrical pass-through mechanism

The Tribunal has suggested that in a market with sufficient competition, cost savings – expected and unexpected – would be passed through to customers. Just as NSW electricity retailers seek the Tribunal’s assurance that the materiality threshold for passing unexpected regulatory and/or taxation costs through to customers is not so high as to expose their businesses to undue risks, EWON would recommend that the threshold not be so low as to make the customer bear the larger portion of such risks.

¹⁶ *Draft Report No 1*, 42.

6 Allowance for Energy Costs

EWON understands that the ability to assess energy costs is to a significant degree predicated on the accuracy of available load data. In assessing load, it appears a primary cost factor is the 'peakiness' of a retailer's profile due to the fact that 'peaky' load is costlier (requiring more plant, etc). In this context we note that the NSW Government and retailers have invested significantly in educational and other campaigns to assist consumers, where they are able, to shift their consumption to off-peak and shoulder consumption bands. This reduces costs to customers and to providers. Consequently, we recommend that consideration be given to the likely downward effect on energy costs of such demand management initiatives over the period of the determination. If this is difficult to quantify at this point, we would recommend that some form of reopening mechanism be provided should it become clear that load forecasts were unduly high. In this context, EWON notes that in some other jurisdictions, symmetrical adjustments to energy retail prices have benefited consumers when falls in the wholesale cost of electricity were passed on via retail prices. Consumers in Ontario, Canada will experience a 3.3% decrease in their per kWh electricity costs from 1 May 2007 thanks to a symmetrical regulatory pricing decision by that province's regulator.¹⁷

¹⁷ [*OEB Announces Electricity Prices and Distribution Rates, Ontario Energy Board, 12 April 2007.*](#)

7 Allowances for Retail Costs and Retail Margin

As noted above, there is an inherent contradiction in assessing costs for current retailers based on the costs that would likely be incurred by a hypothetical new entrant. The latter is an abstract entity with (presumably) significant initial costs whereas the former are standard retailers with pre-existing customers, significant synergies between retail and distribution businesses, established hedging contracts (including the NSW Electricity Tariff Equalisation Fund scheme for much of the period of the determination) and the portfolio advantage of contracts that combine regulated and contestable load.

Some of the contradictions become clearer when individual cost and margin items are considered. For instance, based on the Terms of Reference the Tribunal has included among the retail costs a customer acquisition cost of \$200 per customer (amortised over the assumed period of retention of the customer, typically around six years for residential customers). While in an abstract and theoretical context it is impossible to imagine that the hypothetical new mass market entrant of the Terms of Reference would not incur such costs, it must be emphasised that the determination will cover regulated customers whose numbers are precisely known and who *will not need to be acquired*.

The *Draft Report* notes that the ‘need to consider hypothetical retailer costs rather than Standard Retailer costs has led to most of the differences between the assessed costs for this determination and the cost allowances in the 2004 determination’.¹⁸ Given that this is the case and that the Draft Determination makes no allowance for the lower market risks, vertical synergies, pre-existing customer base and portfolio benefits enjoyed by the standard retailers, EWON queries whether there may be value in reconsidering the \$75 per year retail operating costs allowance provided in the *Draft Determination* (noting that Frontier Economics recommended a range from \$60 - \$80).

¹⁸ *Draft Report No 1*, 76.

9 Outcomes for Customers

Over recent years pricing determinations have emphasised the axiom that those who use more should pay more. This approach has led to a regime of stepped pricing being introduced in NSW across a range of industries, including many of those regulated by IPART. When combined with time-of-day pricing, NSW consumers have learned that per-unit costs rise dramatically in two circumstances: when their usage increases significantly and when they use energy at expensive (peak/critical) times of the day or season. This rationale has underpinned the theory of price signalling, demand management initiatives, network investment strategy and the rollout of time-of-use metering.

In this context it is interesting to note that IPART's modelling suggests that for each of the standard suppliers, and for each year of the determination, the percentage increase to a bill *reduces* the more that a customer uses. For instance, the modelling suggests that a residential customer of one standard supplier who uses less than 3MWh per year could anticipate pre-GST increases of 10.3%, 8.7% and 8.6% for the three years of the determination whereas a business customer who uses 60MWh per year could anticipate pre-GST rises of 8.9%, 7.3% and 7.1% for the same years. While we understand the theoretical bases for the inversion of the prevailing paradigm ('use more, pay more'), it may well be confusing or even frustrating for customers who feel that their successful individual energy reduction initiatives should be rewarded with lesser increases, rather than greater.

10 Non Tariff Charges

Security deposits

EWON welcomes the Tribunal's decision that Centrepay should be specified as an instalment plan for the purpose of applying the exemption on security deposits.

The *Draft Determination* notes that security deposits will 'remain at the levels specified in the 2004 Determination'.¹⁹ While this is welcome, it is important to observe (as does the *Draft Report*) that security deposits are implicitly indexed as they are arrived at by a multiple of an average account – thus if tariffs rise, it is likely that security deposits will rise by an equivalent amount.

As we have noted elsewhere, customers often equate a security deposit (or surety bond) with a traditional refundable advance in which, for instance, the advance is returned once an equivalent amount has been paid for goods or services (eg. a \$100 advance is returned once a customer has paid \$100 towards an account). In this context it is interesting to observe the disproportion that applies in relation to security deposits for electricity accounts. A standard security deposit of 1.5 times the average quarterly electricity account (or 4.5 months of usage) will be retained by the retailer for an absolute minimum of twelve months and, potentially, for very much longer as it need not be returned until such time as there have been four *consecutive* on-time payments. Thus if an account is paid one day late, the security deposit may be retained for a minimum of another twelve months. As EWON noted in our earlier submission, if the underlying intention of the requirement for a security deposit is to protect retailers from bill default then an occasional reminder notice could hardly be considered an indicator of intention to default.

If the Tribunal retains its view that the deposit may be reserved by retailers for a period equivalent to four quarterly bills, then EWON would recommend that consideration be given to refunding the security deposit following four on-time payments, rather than four *consecutive* on-time payments. If this is logistically difficult for retailers, then we recommend that consideration be given to reducing the number of consecutive quarters of on-time payment – perhaps to two. In this context it is also important to note that security deposits do not attract interest so any delay in returning the deposit has a disproportionate affect on customers. Given this, and that retailers have a variety of debt recovery mechanisms available to them to recover arrears, it is hard to conclude other than that the security deposit may be being used to encourage customers to pay via preferred channels (eg. direct debit) and to penalise late payment (when another penalty – the late payment fee – already exists for this purpose).

¹⁹ *Draft Report No 1*, 87.

The current determination places the onus on the *customer* to demonstrate a satisfactory credit history. EWON recommends that the Tribunal may wish to consider the value of the Victorian approach which requires the *retailer* to establish that the customer demonstrates an ‘unsatisfactory credit rating’ (in the context of guidelines established by the Essential Services Commission).

Late payment fee

The *Draft Determination* has allowed for a 40% rise in the late payment fee – from \$5 to \$7. EWON is very concerned that rather than encourage on-time payment by those who can afford to do so, it may rather have the unintended outcome of raising energy costs for those who struggle to pay their bills and who often – or always – require extensions or instalment plans. Under the *Draft Determination*, it is not at all impossible that such customers may pay \$30.80 in GST-inclusive late fees for electricity in a single year.

EWON considers that the following factors are critical to any examination of late payment fees

1. *Before levying a late payment fee retailers must have in place back-end systems to ensure that the exemptions currently in place (and any further exemptions arising from this review) are accommodated.* EWON notes that one major NSW retailer’s website indicates that late fees are not imposed on those receiving a pensioner rebate yet our experience of customer complaints suggests otherwise. EWON not uncommonly receives contact from customers who have been charged a late payment fee even though they are exempt under the terms of the current determination (eg they have paid with Energy Accounts Payment Assistance vouchers). In our experience customers are unaware that they should not be charged a late payment fee in such circumstances. EWON would recommend that the Tribunal only allows for late payment fees to be levied when IPART is satisfied that exempt customers will not – and cannot – be charged. This is an observation we have made in previous pricing reviews:

EWON is concerned that although retailers have policies to ensure that miscellaneous fees are only levied in accordance with the rules, their actual billing systems may not be able to follow the rules in practice. For example, the rules state that late payment fees must be waived where payment or part payment is made using EAPA. However, we understand that while most retailers' billing systems automatically generate late payment fees and reminder notices, these systems do not automatically remove the fees when a subsequent payment is made with EAPA. The Tribunal may wish to review this issue

further when considering the rules and requirements for retail charges.²⁰

2. *The amount charged must be a demonstrable, compensable expense not otherwise accounted in retail operating costs.* The annual revenue from late payment fees amounts to millions of dollars a year for EnergyAustralia and Integral Energy. (We understand that Country Energy does not levy this fee.) For all other retailer costs, the Tribunal requires data to demonstrate costs to be recovered via the determination. We would anticipate the same would apply with regard to late payment fees, particularly as many such costs would already have been accounted for in the Tribunal's estimation of retail operating costs.²¹
3. *There should be compelling evidence that late fees actually encourage on-time payment.* It is quite possible that many people who do not pay on time may well not be compelled to pay on time even by a higher fee and will continue to pay at their own convenience. There may be value in considering, rather, incentives that may be offered to customers to pay on time, rather than to penalise those who do not (Aurora, for instance, offers a small discount to those who elect to pay via direct debit, thus encouraging on-time payment).
4. *Those who are genuinely unable to pay on-time must be exempted from the fee.* EWON considers there is value in ensuring that exemptions are in place for all customers who receive acknowledged rebates (pensioner, life-support, etc). We also consider there is value in incorporating recipients of a Commonwealth Health Care Card into the exemption list (as applies in Tasmania, for instance) – thus including Newstart recipients, students and those in receipt of parenting payments. These are significant categories of potential disadvantage.
5. *Retailers should be required to waive the late payment fee when, in their reasonable analysis, the customer is in financial difficulty.* We feel that a customer should not be required to pay a late payment fee when, for instance, the customer regularly pays by instalment or seeks payment extension. The reality of hardship is that most customers do not wish to self-identify. The retailer is well situated to recognise the indicators of disadvantage and financial vulnerability and, in such circumstances, should not be charging the fee.

²⁰ EWON response to IPART: [Review of Gas and Electricity Regulated Retail Tariffs Issues Paper February 2004](#), 6.

²¹ *Draft Report No 1*, 89.

Dishonoured cheque fee

EWON notes that the Tribunal has recommending a legislative amendment to allow retailers to levy a fee on dishonoured direct debit payments. EWON believes that such a change should be undertaken with consideration to demonstrable retailer costs and to protecting vulnerable customers from rises in the ratio of consumption charges to fees on an average bill. This becomes increasingly critical as direct debit is clearly the preferred payment channel for retailers.

Conclusion

The Terms of Reference for the 2007-2010 pricing review are such as to require the Tribunal to assess the costs and margins of one entity on the basis of another – and entirely hypothetical – entity. This has created artificiality in the *Draft Determination* that has not existed in previous determinations.

Given the parameters for the review, the *Draft Report* and *Draft Determination* are comprehensive responses to the Terms of Reference. Nevertheless, we feel it is important to recognise that the pricing determination will not apply to hypothetical customers but to *real* electricity customers, a number of them with limited ability to take advantage of the contestable market.

When seen in nominal, GST-inclusive terms, the price increases foreshadowed by the *Draft Determination* will be likely in some circumstances to lead to increases of 30% during the period of the determination. It is probable that price rises of this order will encourage many customers on to market contracts as the regulated tariffs build up over the next three years. Equally, though, it will *increasingly* be the case that over the same period those customers who will be paying higher electricity prices will be those least able to afford to do so and least well-situated to change their circumstances. Unfortunately, there is some potential for these vulnerable customers to end up subsidising others who are better positioned to benefit from the market. This would be an unfortunate and unintended inversion of the cross subsidising that the Tribunal has sought to remove.