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Review of Regulated Retail Electricity Prices  
Independent Pricing and Regulatory Tribunal  
PO Box Q290  
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6 February 2007

Dear IPART Secretariat

**Review of Regulated Retail Tariffs  
Response to Frontier Economics Report**

The Public Interest Advocacy Centre (**PIAC**) is an independent, non-profit law and policy organisation that identifies public interest issues and works co-operatively with other organisations to advocate for individuals and groups affected.

PIAC is seeking to ensure that the interests of the standard retailers are balanced against the interests of customers in Independent Pricing and Regulatory Tribunal's review of regulated retail tariffs. This can be achieved through delivering fair prices for good services from the regulated industry participants in combination with strong and effective consideration for the most vulnerable energy consumers.

The consultancy work produced by Frontier Economics has provided valuable insights into the types and quantum of costs that may be passed through to customers during the 2007-2010 price determination. PIAC is confident that the costs modelled for the Long Run Marginal Costs of energy are in line with industry experience and the expectations of customers. We also endorse the estimate for Retail Operation Cost (**ROC**) of \$60-80 per customer. The ROC estimates provided by Frontier Economics is in line with customers experiences in the New South Wales market place and reflects customers ongoing expectations for a reasonable service from a mass-market supplier of retail electricity services.

However, the work produced by Frontier Economics has also confirmed that the Tribunal still will have discretion to determine the extent of costs passed through to consumers in line with the Terms of Reference. More specifically, we perceive that discretion remains to be applied in determining the allowable energy purchase costs, customer acquisition costs and retail margin.



PIAC understands that a major consideration for the Tribunal in determining the level of allowable costs in each of these categories will be giving encouragement to competition in retail electricity supply.

### **Market Failure for classes of customers**

We take this opportunity to point out that it is not the case that every electricity customer in NSW has had the option to enter into a market contract for their electricity supply, nor will they have the opportunity in the future. In the first instance, electricity customers supplied by exempt suppliers cannot negotiate a retail supply contract. This includes an estimated 40,000 residents of residential parks and villages across NSW. The price paid by tenants of residential parks is directly benchmarked to the regulated tariff in accordance with the *Residential Parks Regulation 2006*.

**Prescribed code with respect to electricity: *Customer Service Standards for the Supply of Electricity to Permanent Residents of Residential Parks***

#### **3.1.1 Maximum charge per kWh**

The charge for electricity consumption, expressed as a price per kilowatt hour (kWh), can be no more than the standard or default regulated retail tariff (Even if the park owner has elected to be supplied under an alternative tariff offered by the retailer, such as a 'green energy' tariff, this alternative tariff cannot be passed on to residents) that would have been charged by the local standard retail supplier under a standard form contract for the same level of consumption.

#### **3.1.2 Maximum Service Availability Charge (SAC)**

The service availability charge (SAC) is a component of the regulated retail tariff determined by the Independent Pricing and Regulatory Tribunal (IPART) for each standard retail supplier in New South Wales.

Secondly, we note that since 2002 electricity retailers have been able to cherry-pick customers to whom they offer a supply contract. Customers with low consumption, lacking energy-intensive goods (such as swimming pools and air-conditioners) or with a poor credit history experience limited access to the retail market. Research commissioned by IPART at the last retail price determination confirmed that lower income and lower consumption households were less likely to be offered a market contract.<sup>1</sup> However, PIAC is aware through complaints data from the Energy and Water Ombudsman that more vulnerable sectors of the community have been recently exposed to the market, albeit not always with suitable outcomes.

Customers including tenants, low consumption households, pensioners and other low-income households have unique needs within the market place. For example tenants may be well aware of the capacity to switch but they may be restricted to products with costly exit fees. Similarly households with a poor credit rating may be limited in the product offerings that they are able to access. Research from the United Kingdom suggests a large number of low-income

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<sup>1</sup> Price Waterhouse Coopers, *Report to the Independent Pricing and Regulatory Tribunal, Information on Negotiated Contracts offered to Small Electricity & Gas Customers in NSW, May 2004*

households end up with contracts for pre-payment meters carrying significantly higher energy costs.<sup>2</sup>

In the years since full retail contestability was introduced to New South Wales PIAC has observed the uneven development of the contestable energy retail market, which sees some consumers benefiting financially from competitive offers while other remain locked out of the market due to geographic, tenancy, consumption or credit profiles.

Yet as a market for an essential service, residential consumers are ultimately not able to absent themselves from the retail supply of electricity. For customers who are unable to participate in the competitive retail market, retail price caps play an important role in ensuring access to competitively priced electricity.

### **Search costs and switching behaviour**

The Terms of Reference (**ToR**) require specific consideration of the Government's stated objective of reducing the reliance on the regulated tariff. We make the initial observation that it remains the individual customer's choice as to whether or not they elect to enter the competitive market. Those who choose to remain on a standard regulated tariff should not incur a penalty for exercising their consumer sovereignty. As stated in the ToR reference, the overwhelming majority of NSW customers have exercised their choice not to enter the competitive market.

PIAC also makes the observation that the experience of customers internationally suggests that it is not purely the level of the regulated retail tariff that drives customer behaviour in a market for essential energy services. Transaction and search costs have a considerable impact on customer churn and switching behaviour. Allowing headroom pricing to be built into regulated retail prices does not reduce search and transaction costs.

A recent review into early termination fees (**ETFs**) carried out by the Essential Services Commission of Victoria highlighted the difficulties faced by customers in the marketplace and the complex benefits and challenges posed by energy supply contracts.<sup>3</sup> The determination resulted in the more stringent regulation of ETFs capped at \$25. In NSW customers routinely see termination fees at five times that level. Policy initiatives such as these are more likely to induce customers to enter into the competitive market.

### **Customer Acquisition Costs and Retail Margin**

PIAC is confident that the Australian Energy Market Commission's review of the effectiveness of competition, due to be undertaken during the 2007-2010 determination period, will identify the classes of customers systematically subject to market failure. In the absence of that formal review process (and in the absence of any new or alternative government initiatives) the

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<sup>2</sup> Beth Keehn (ed) *Life Lines: Affordable Utilities*, Published by the National Consumer Council, September 2004  
<sup>3</sup> Essential Services Commission of Victoria, Final Decision: Early Termination Fees, December 2006

regulated retail price cap is the only policy mechanism in place to address the systemic market failures of retail electricity supply.

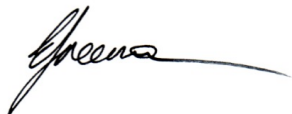
On both economic efficiency and equity grounds PIACs reject the notion that prices should be inflated to encourage retail price competition. If the regulated retail tariff is set at an efficient level, then retailers can compete on efficiencies and services. Higher regulated tariffs will result in non-switching customers cross-subsidising switching customers.

In accordance with the Government's commitment to retain regulated retail tariffs, PIAC makes the following comments:

- The proposed retail operating costs for mass-market new entrants of \$60-\$80 per customer cover acquisition activities including call centre costs, customer information costs, corporate overheads costs, regulatory compliance costs, marketing costs, billing costs, corporate overheads costs and costs of bad debt. Any additional allowance for acquisition activities represents inefficient headroom above the regulated retail tariff.
- The Ministerial Council on Energy has observed that that an effectively competitive energy market will not necessarily reflect a perfectly competitive market.<sup>4</sup> As outlined above, there are observable market failures in the NSW market for electricity supply. In the absence of a purely competitive market, a retail margin above the efficient level will produce a profit gain for standard and new entrant retailers. It will see non-switching customers subsidising inefficient profits for standard retailers. We therefore encourage the Tribunal to adopt a conservative retail margin at the bottom end of proposed range.

Thank you for your consideration of these issues as part of the Tribunal's review of regulated retail electricity prices. PIAC looks forward to providing further input into the determination process.

Yours sincerely



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<sup>4</sup> Ministerial Council on Energy Standing Committee of Officials *Phase Out of Retail Price Regulation for Electricity and Natural Gas - Draft Effective Competition Criteria, Consultation Paper*, July 2006, p3