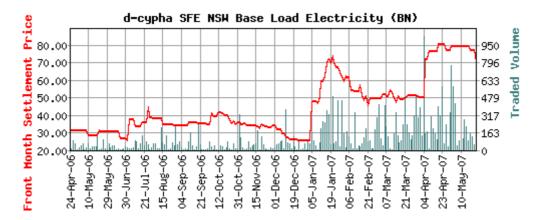


ON THE WIRE



June 2007, edition 13.

Media attention in recent months has focused on rising wholesale energy prices. On 9 May, the *Australian Financial Review* reported that Queensland electricity futures have more than doubled since January, and average prices of <u>Sydney Futures Exchange contracts</u> are as high as \$74.50/MwH (after an average of \$30-40 over the past few years). Most of these price spikes are said to be driven by the ongoing drought and consequent constraints on generation capacity. The graph below for the NSW market demonstrates the large price spikes.



Wholesale energy costs currently make up about 40% of a consumer's bill. In the context of further pushes for deregulated retail energy prices, consumers could have to deal with these price shocks. This is despite the fact that consumers are the market participants that are least able to manage this cost burden. Retailers and generators are clearly better placed to engage with this market, and can enter into hedge contracts to mitigate risk.

The price spikes also have implications for the competitive retail market, as the Australian Energy Market Commission (**AEMC**) is about to begin its review into the effectiveness of competition in the Victorian retail market (see <u>below</u>). Increased wholesale energy prices will impact new market entrants, who have not had the benefit of locking in long-term contracts when prices were lower. Such volatility essentially gives market power to the incumbents, impinging on competitive outcomes for consumers.

We welcome feedback on the information provided in *On the Wire*. Further, we encourage you to forward the newsletter throughout your networks. Production of *On the Wire* is funded by the <u>National Electricity Consumers Advocacy Panel</u>. To subscribe to *On the Wire*, please email <u>info@consumeraction.org.au</u> with "On the Wire" in the subject line. The next edition of *On the Wire* is scheduled for release in August 2007. Past and the current edition of *On the Wire* can also be found <u>here</u>.

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1. Regulatory developments

1.1 Ministerial Council on Energy

The Ministerial Council on Energy (**MCE**) met for the 13th time in Melbourne on Friday 25 May 2007. The meeting's <u>communiqué</u> discussed a number of current areas of energy market reform:

- **Drought impact on the NEM**: The MCE released a <u>report</u> by NEMMCO about the potential impact of drought on the generating capacity of both hydro and coal-fired plants, and hence the potential impact on the NEM in terms of system security and prices. The report concluded that with low rainfall and extreme events, the reserve margins will be reduced and there may be a need for additional action to maintain reliability of the system. The MCE has subsequently requested the AEMC Reliability Panel to review and advise on the effectiveness of current market arrangements in managing limitations due to input constraints.
- Further energy market reforms coming from CoAG, including:
 - Creation of a National Energy Market Operator (NEMO) to replace NEMMCO;
 - The formation of a National Transmission Planner (NTP) and development of a national framework for transmission network reliability standards;
 - o A review of all remaining derogations from the national framework; and
 - o A national review of energy Community Service Obligations with a view to developing a consistent national framework.
 - This review may be significant for consumers, and we will keep you updated in future editions of On the Wire.

 Smart meters: CoAG has previously agreed to a mandated rollout of electricity smart meters to areas where benefits outweigh costs. MCE will prepare a minimum functionality for smart meters, determined following a firststage cost-benefit analysis, for consultation by September 2007. A full-cost benefit analysis for a smart-meter rollout will be completed by the end of 2007.

There is still no sign of CoAG doing any customer trials for smart meters, as has been promised in relation to the Victorian rollout. Considering this, consumer advocates continue to doubt whether the final cost-benefit analysis will actually be rigorous or accurate.

Other items discussed in the communiqué include the <u>National Framework for Energy</u> <u>Efficiency</u> and the <u>CoAG Climate Change Agenda</u>.

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1.2 Retail Policy Working Group (RPWG)

The MCE communiqué also confirmed delays for the implementation of the legislative package covering retail and non-economic distribution energy regulation. The legislative package is now set to commence on 1 July 2008, rather than 1 January 2008. The additional time is to ensure stakeholder comments are fully considered in the development of the framework.

Despite complaints from some quarters about delays in implementing the national reform package and calls to move more quickly, the amount of work involved in this process has been and will continue to be substantial. Providing adequate time for consideration of proposals by, and consultation with, all stakeholders is critical to achieving good outcomes. We therefore support the MCE's decision to allow more time for implementation of the reforms.

Two further working papers have been released by the RPWG since the last edition of *On the Wire*. The papers, prepared by lawyers Allens Arthur Robertson, consider:

- Customer transfer and metering; and
- Enforcement and objectives.

The paper on enforcement and objectives was called for by consumer representatives, who see these issues as fundamental to the operation of the national framework for retail regulation. Consumer representatives are particularly concerned that the proposed objective for the new national framework is too narrowly focused on efficiency, without any concern for who benefits from the gains of efficiency. This would remove objectives that currently exist in many of the jurisdictional frameworks, which allow the regulator to consider legitimate social and environmental objectives.

Submissions to this paper include from:

- Consumer Action; and
- Total Environment Centre.

The composite paper from the RPWG covering all of the issues involved in the transfer of retail and non-economic distribution regulatory functions to the national regulators is due at soon and should be open for public consultation for 6 weeks. The MCE is

also planning a consumer forum for discussion of the composite paper. This consultation will be a chance for consumer, social and environmental advocates to comment on the positions of the RPWG. Further consultation will be conducted later in the year after draft legislation is prepared.

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1.3 Network pricing legislative package

The MCE communiqué also confirmed further delays in the finalisation of the network pricing legislative package. This package is now set to commence from 31 December 2007. The package includes:

- the new National Gas Law (NGL),
- amendments to the National Electricity Law (NEL),
- the initial National Gas Rules, and
- <u>amendments to the National Electricity Rules in relation to distribution regulation.</u>

The MCE Standing Committee of Officials (**SCO**) has also released its initial positions in relation to stakeholder responses on these packages:

- SCO response to submissions on the National Gas Law;
- SCO response to the NEL amendment package; and
- SCO response to changes to the AEMC rule-change process.

A particular issue of importance raised in the SCO response to the NGL/NEL is the information gathering powers of the AER. The SCO has proposed a significant change to the draft legislation so that the AER can issue regulatory information orders to regulated entities and other bodies who "significantly contribute to the provision of services". This hopefully overcomes problems with complex corporate structures which are seemingly designed to evade regulatory oversight. If effective, this is something consumer advocates strongly support.

The MCE has also released for consultation some additional work by NERA Economic Consulting in relation to <u>demand-side response and distributed generation</u>. This paper, together with the Draft Rule on distribution regulation (and the NSW/ACT transitional arrangements), is open for comment until 25 May 2007. With revenue of distribution businesses making up around 40% of a consumers' final bill, consumer representatives are keen to ensure that regulatory determination processes deliver monopoly distributors sufficient revenue for the efficient provision of services only, as well as ensuring that that revenue is recovered equitably across the customer base.

The following submissions were made to this consultation:

- Consumer Action, Consumer Utilities Advocacy Centre and St Vincent de Paul;
- <u>Total Environment Centre</u>, <u>Alternative Technologies Association and Ethnic Communities Council of NSW</u>; and
- Public Interest Advocacy Centre.

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1.4 Consumer advocacy arrangements in the NEM

A particular polarisation has emerged between representatives of small consumers and larger consumers (ie, business) over the consultations of the <u>draft legislation for consumer advocacy in the energy market</u>.

The draft legislation, which has been released for a second round of consultation, provides that Advocacy Panel funding should be available to all consumers, with particular regard for small to medium consumers. When the Advocacy Panel was first set up, its intention was to assist small to medium consumers. Quoting from the report that proposed the Advocacy Panel:

Small and medium end users, in particular, currently generally do not have access to sufficient human and financial resources to ensure adequate representation whatever those arrangements. They should not be left out of the decision-making process solely because of lack of resources. The diverse and diffuse nature of the customer base, however, and the individually small scale of the direct benefits to those end-use customers as a result of national market reforms means that is unrealistic to expect self-funding coalitions of small and medium end-users to emerge.

Large-end users by comparison, by virtue of the large financial stake in the outcomes of energy market regulations and reforms, have a direct incentive to engage in advocacy and the resources to do so.

Consumer representatives have become concerned with the definition of 'small to medium consumers' in the draft legislation. Small to medium consumers are defined to be those that consume less than 4000 megawatt hours of electricity and 100 terajoules of natural gas per annum. These limits equate to annual bills of around \$350,000 for electricity and close to \$1 million for natural gas. Thus they would effectively allow large businesses prioritised access to funding by defining them as 'small to medium consumers', and appear to be the result of effective lobbying by representatives of large end-users. Submissions on the draft bill were made by:

- Consumer Action; and
- Public Interest Advocacy Centre.

Consumer representatives have argued that the most appropriate definition is 160 Mwh per annum for electricity and 10 gigajoules for natural gas (common definitions in jurisdictional regulation). These levels cover not only residential consumers, but many small to medium sized businesses.

It is worth noting that in the RPWG negotiations, there has been pressure to reduce the definition of 'small consumer' to something below these levels due to an argument that these consumption thresholds are too high and thus cover consumers who are able to protect their own interests. Considering this, even higher consumption thresholds would be entirely inappropriate in determining which consumers need to be the particular focus of advocacy funding.

In its <u>submission</u> to the draft bill, the <u>Energy Users Association of Australia</u> (**EUAA**) supports the proposed definition. The EUAA argues that because large users spend more on energy, the Panel's funding is based largely on money spent by large users, thus they should be entitled to access the funding. However, the EUAA's argument is

disingenuous – it is like saying rich people pay more taxes, so should get more in social security payments! The whole point of the Panel is to **redistribute** funds to where they are needed, in order to resource something that would not occur otherwise – representation for small to medium energy users. The EUAA also argues that funding should be limited to member-based organisations. This appears rather self-interested – EUAA is a member-based organisation and its members include Alcoa, Amcor, BHP Billiton, Bluescope Steel and Rio Tinto. Groups that represent smaller users, such as consumer groups, consumer legal services and financial counselling services, often do not have formal members, but work to represent the interests of their clients and disadvantaged consumers. Therefore, limiting funding to member based organisations would exclude the majority of small user representation, suiting big business interests.

While Consumer Action strongly disagrees with the EUAA's arguments, it has a right like any stakeholder to make them in good faith. However, we were particularly disappointed with the misleading import of this claim in the EUAA's submission:

'Enterprises with this energy usage [up to about \$350,000 per annum for electricity] cannot be classed as large end users and would not, for example, qualify for full membership of the EUAA.'

This claim clearly attempts to convey that the EUAA would not benefit from setting the definition of 'small to medium consumer' at the thresholds proposed in the draft legislation, thus its arguments are put solely on their own merits. However, in addition to "Full Members", the EUAA also has a category of "Associate Member" and, as the EUAA website confirms: 'Associate membership is open to bona fide end-users of electricity and/or gas with an annual spend of **less than \$5 million**. Associate members are entitled to **the same benefits as Full members**' (our emphasis). The proposed definition would therefore allow the EUAA to apply for funding to represent the interests of companies who fall into their associate membership category, representation that will no doubt also benefit the big business interests the EUAA represents.

Consumer advocates will continue to keep a close eye on the progress of the draft legislation.

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1.5 AEMC Update

The <u>Australian Energy Market Commission</u> (**AEMC**) has announced the sequence of its reviews of the effectiveness of competition in the gas and electricity retail markets - Victoria in 2007, South Australia in 2008, New South Wales in 2009 and the Australian Capital Territory in 2010, if required.

The AEMC has also finalised its <u>statement of approach</u> to undertaking the reviews. This approach includes close consultation and liaison with stakeholders, including consumers. The AEMC has stated that in order to capture the views of all interested stakeholders, it will:

 consult with jurisdictional Ombudsmen and, as noted above, government Ministers and their departments and jurisdictional regulators;

 conduct a series of briefings, interviews and/or public meetings with a range of stakeholders, including small customers and consumer, community and welfare groups. Such meetings would be held in metropolitan and regional/rural areas to enhance opportunities for small retail customers to participate;

- conduct surveys of retailers and a representative sample of retail customers, and interviews with retailers;
- undertake quantitative and qualitative research formulated and undertaken specifically for each review; and
- consider data obtained from publicly available sources, including corporate reporting information, academic literature and reports and analysis conducted by other regulatory bodies.

On finalisation of the review, the AEMC will provide the following to jurisdictions:

- an assessment of the effectiveness of competition in the electricity and gas retail markets; and
- recommendations on ways to phase out price controls if competition is found to be effective; or
- recommendations on ways to promote competition where competition is found to be less than effective.

The AEMC has recently released its <u>Issues Paper</u> for the review of the effectiveness of competition in Victorian energy markets. Comments on the Issues Paper are due by 29 June 2007. The AEMC has advised, due to tight time frames, that it will have consultation periods of 4 weeks instead of the usual 6 weeks for this review.

For more information, visit www.aemc.gov.au.

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1.6 AER update

The Australian Energy Regulator (**AER**) is currently responsible for the economic regulation of transmission networks throughout Australia. As outlined above, the AER will be responsible for the economic regulation of distribution networks from 31 December 2007. The way it regulates transmission will influence its future regulation of distribution networks.

The AER has begun its examination of the revenue of Victorian transmission businesses <u>SP-AusNet</u> and <u>VENCorp</u>. This will be the first review to be undertaken pursuant to the new Chapter 6A of the National Electricity Rules, which was reviewed by the AEMC last year. SP-AusNet owns and manages the Victorian transmission network while VENCorp, a not-for-profit statutory organisation, is responsible for directing augmentations to Victoria's transmission network. The two companies have submitted their revenue proposals to the AER and comments can be made by interested parties by 13 June 2007.

The AER has also released the following guidelines for consultation:

- Pricing methodology guidelines; and
- Process guideline for contingent project applications.

For more information, visit www.aer.gov.au.

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2. Consumer advocacy and other information

2.1 Energy debate puts heat on low income households (Gavin Dufty, St Vincent de Paul)

This article was first published in The Age newspaper on 28 March 2007.

The St Vincent de Paul Society is concerned at the suggestion of the use of a \$10 per tonne carbon levy as one of means to address the important issue of climate change. While much of the debate has focused on the impacts a levy will have on business, our concerns relate to the lack of detail regarding the strategies and programmes that will be implemented to manage the financial impacts on households. In particular those on low income or living in disadvantaged communities. This lack of detail is all the more concerning given that such a levy is estimated to raise an additional \$2 billion annually.

Governments and other proponents of such a levy must acknowledge and present strategies that propose solutions to the significant social issues that arise, including:

Firstly, such a levy will impact disproportionally on pensioner groups. This occurs as this group consumes energy at a rate below average household consumption; however conversely, as a proportion of their weekly expenditure, they expend almost double the amount compared to the average household. To be specific ABS figures show that pensioner groups expend 5.5% of weekly outgoings on utilities costs, compared with approximately 3% for couples with two children. Thus, price increases impact disproportionately upon pensioner and other low income groups, even though they consume below the average.

Secondly governments must acknowledge that that a 7% increase in electricity bills will not result in significant demand reduction. This is demonstrated by research into households demand responses to electricity price increases. This research consistently estimates that a 7% price increase will only result in a 1.5% reduction in energy consumption. This not only serves to highlight the inability of many households to reduce consumption in response to price increases, but also the bluntness of pricing as a tool to drive behaviour change.

Thirdly, such a proposal effectively negates the \$105.20 per annum that the Commonwealth Government currently provides to pensioners to meet there utility cost. Introducing a 7% energy levy not only undermines the social objectives of this allowance, it also creates inefficiencies within the welfare and tax transfer systems. Households will, in effect, be taxed and then refunded! Similar challenges exist for the Victorian government with its percentage based energy concessions, as a carbon levy not only erodes the value of state energy concessions to households; it increases the cost of the concessions to the state.

Fourthly, the proposal will also impact on sections of the community who are unable to meaningfully substitute electricity consumption with other energy sources such as natural gas. This limited access to alternative fuel sources will ensure that the price

increases will also impact disproportionately on many regional and rural and communities.

Finally, the proposal to increase prices, either to reduce residential demand, or as a tool to make alternatives such as nuclear power more financially attractive, when made in isolation from other community objectives, indicates a glaring absence of an overall strategic policy response to the important issue of climate change.

Pricing alone is a very blunt tool to be used to address these significant environmental, social and economic challenges. In the St Vincent de Paul Society's view, it is a simplistic one, one that does not even guarantee that the desired outcomes are achieved. What is needed is more thought on how the proposed levy will impact on various households and communities, and details of how the \$2 billion that will be raised annually will be spent. Sustainable solutions to the problem of climate change demand a response which embraces and guarantees social justice, ensuring that all Australians share equitably in responding to this challenge.

Gavin Dufty is Manager of Policy and Research, St Vincent de Paul Society Victoria. Gavin can be contacted at gavind@svdp-vic.org.au.

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2.2 More power to providers in electricity price rise (Elissa Freeman, Public Interest Advocacy Centre)

This article was first published in the Sydney Morning Herald on 18 May 2007.

When the Independent Pricing and Regulatory Tribunal endorsed a 26 per cent rise in electricity prices last month, a quick lament was that the State Government's promise of low prices had been formally dumped.

Many reasons have been given for the rise in regulated electricity prices over the next three years. Some say it is the result of climate change policies and others claim it is to ensure the lights stay on. In reality, the key driver of the forthcoming increase is the increased profitability of industry participants.

Prices are being forced up to make the energy business more attractive (perhaps to any potential buyer of NSW state-owned energy businesses) and to make it easier to lure households off the regulated tariff and onto a market contract.

At the end of the 1990s electricity users were promised lower energy bills if the power retail and generation monopolies were exposed to market forces. Yet customers now face higher power prices for the privilege of greater competition.

Full retail competition in electricity and gas was introduced in 2002, enabling households to choose their energy supplier. Importantly, the State Government retained a fully regulated tariff for households that could not secure a better deal in the market or that did not want to enter the competitive marketplace for the supply of an essential service. Since then, fewer than one in three households have elected to move off the regulated contract to have electricity and gas prices set in the competitive market.

Until now, regulation has been successful on three counts: it created effective incentives to improve productivity; it limited price increases to efficient levels; and it allowed the regulated businesses to deliver healthy dividends to the owner, the NSW Government. Everyone was winning. Except for the electricity businesses looking to enter the potentially profitable marketplace.

The tribunal's recently delivered draft determination signals a change in direction. The terms of reference issued by the Minister for Energy fail to consider the effect of the determination on consumers. Rather, the terms of reference asked the tribunal to assess costs based on a new-entrants cost profile instead of the costs incurred by the regulated entities.

The determination introduces headroom: inflated costs to stimulate competition. About half of the price increase is attributable to raising the profitability of the industry.

The tribunal justified its decision based on a flawed assumption that competition is effective. The regulator expects that any "excess" profits will be competed away. Yet there has been no analysis of the outcomes for customers who have signed contracts with new retailers, nor the effect of customer inertia and the market power of the incumbent suppliers.

The competitive market has delivered mixed outcomes elsewhere. Evidence from Britain confirms that households are not very good at making choices in a competitive energy market, often under-estimating exit fees and being hindered by high search costs. Low-income households tend to end up with the most expensive electricity rates based largely on the contracts that are marketed to them. It also suggests that the market power of the incumbent suppliers, coupled with customer inertia, leads to excess profits. Evidence from Victoria suggests rural households and tenants have not been receiving the price benefits of competition.

In NSW, the level of competitive activity has increased. But this does not mean it has all been good news for consumers - the NSW Energy and Water Ombudsman reported a 254 per cent increase in complaints relating to the marketing behaviour of energy retailers in the past year. In many cases households are being misled about the highly complex products offered by energy retailers.

On July 1 the new electricity prices will come into force. Alongside this will be increased marketing activity. If you thought mobile phone contracts were difficult to assess, wait until a salesperson knocks on your door to tell you how many cents per kilowatt hour at different times of the day they can offer you. You might be better convinced by the free DVD package that will be thrown into the deal.

That DVD package will be coming to you courtesy of government policy that puts profitability before efficiency and accessibility.

Elissa Freeman is Senior Policy Officer at the Public Interest Advocacy Centre. Elissa can be contacted at efreeman@piac.asn.au.

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2.3 Standards Australia releases Framework for demand response capabilities and supporting technologies for electrical products

Australian Standard 4755-2007

The Framework for demand response capabilities and supporting technologies for electrical products is one of the precursors to establishing remote demand management programs for electrical products and their consumers, aimed at reducing energy use and power consumption. These programs could see appliances such as air conditioners and swimming pool pumps controlled or switched off from an offsite location during peak demand periods or stresses on the electricity supply system.

The aim of the Framework is to set out the capabilities of electrical products and lay the foundation for similar understandings and uses of terminology between electrical suppliers, electrical product suppliers, metering and control equipment suppliers, consumers and market regulators. It does not address the technical and consumer information, health and safety issues that need to be worked through in implementing demand response programs in consumer products. Further, detailed standards will be developed for demand management capabilities and programs for specific consumer products such as air conditioners, water heaters and swimming pool pumps.

Consumers were represented in the standard development process by the Consumers Federation of Australia (**CFA**) and the Energy Users Association of Australia. The CFA representative has urged vigilance in ensuring that demand response is not seen only as a domestic consumer issue – for instance energy uses that have a low consumer impact, such as advertising and display lighting should be targeted for demand response programs. Also, health and safety implications need to be carefully considered in terms of the appliances to which programs apply. Refrigerators and freezers are currently not considered to have the thermostatic accuracy or capability for inclusion in remote demand response programs. The health needs of vulnerable consumers also need to be considered in the inclusion of heating and cooling appliances in demand management programs.

It is envisaged that demand response capability could in the future be indicated to consumers and others by reference to Australian Standard 4755 in the same way that energy efficiency information is currently given to prospective purchasers by standardized energy consumption labeling.

For more information, contact Jo Higginson, CFA Standards Project coordinator at Consumer Action on jo@consumeraction.org.au.

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2.4 Electricity matters in Queensland (Centre for Consumer and Credit Law (CCCL) and Queensland Consumers Association (QCA))

Current energy-related activity in Queensland is around pricing – but pricing issues are not just a Queensland issue. It is also a national issue with the recent Ministerial Council on Energy communiqué noting the impact of drought on the National Electricity Market and the upward pressure on spot and forward market prices. Accordingly there has been a significant spate of articles in the media including from

large end-users about whether or not government should intervene in price pass throughs.

One suggestion has been that demand management strategies should be embedded in standard retail contracts for residential users. What this early debate signifies is that price increases will continue to be a key issue in all NEM jurisdictions and that State Governments need to have adequate strategies in place to deal with price impacts.

This month the Queensland Competition Authority (**QCA**) released its Draft Decision on the Benchmark Retail Cost Index for Electricity for 2006-07 and 2007-08 which recommended a nearly 10% increase in power prices from 2006-07 to 2007-08. Like the recent decision of the regulator in NSW, this is a significant increase. It also ushers in a new way of calculating the Benchmark Retail Cost Index by relying on the Cost of Energy, Network Costs, Retail Operating Costs and Retail Margin rather than the previous reliance on the Consumer Price Index.

Of particular concern to CCCL is the inclusion of retail operating costs in the pricing decision which not only favours the incumbent retailers but imposes indirect costs on customers who are not contestable. The fast forwarding of full retail competition in Queensland for small end-users has also fast forwarded the pricing decision process with little or no time for consumer groups to respond or input into the decision. The Queensland Minister for Mines and Energy can direct the QCA to consider the social impact of pricing practices as well as give consideration to demand management and sustainability. It is time for such a directive.

For more information, contact Tenzin Bathgate at CCCL. Tenzin can be contacted at tbathgate@griffith.edu.au.

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