ESSENTIAL SERVICES CONSUMER COUNCIL

(established under Part 11 of the *Utilities Act 2000*)

Response to Draft Decision – Report No 6 of 2007

Retail Prices for Non-Contestable Electricity Customers

SUMMARY OF RECOMMENDATIONS

The Attorney-General has asked the Independent Competition and Regulatory Commission (the Commission) to prepare a price direction for the supply of electricity franchise customers in the ACT for the period from 1 July 2007 to 30 June 2008.

In its Draft Decision, the Commission has proposed a 14.25% price increase from 1 July 2007 with provision for a mid-year price reset if any pass-through events occur, including an increase or reduction in wholesale market conditions.

In its Draft Decision, the Commission has made no substantive reference to its obligation under s 20(2)(g) of the ICRC Act to have regard to "the social impacts of the decision". In s 4.1 of the Draft Decision, the Commission simply restates its previous position that a competitive retail market is the best guarantee of consumer interests and then suggests that "appropriate funding of support programs by the government" is required to address the impact of price increases on vulnerable customers.

The Essential Services Consumer Council (the Council) considers that the proposed 14.25% price rise in electricity, in conjunction with other significant cost increases such as private rents, petrol and water, will have a devastating effect on the ability of low income families and individuals in the ACT to maintain even their current, very basic, quality of life. The Council considers that all efforts must be made both to defer and to reduce the cost of franchise electricity from 1 July 2007 because of the immense financial stress that low income households in the ACT are under.

The Council notes that the Commission has taken a "building blocks" approach to the price rise because of the short time frame available to it, and the lack of current electricity franchise cost data from ActewAGL. The Council also recognises that certain price increases must, of necessity, be passed through to franchise customers; a prime example of this being the pass through of the new network tax into network costs.

Bearing these considerations in mind, the Council recommends that the Price Direction of the Commission be amended in the following ways:

1. The Direction should set prices in two steps, the first for 1 July – 31 December 2007 and the second for 1 January – 30 June 2008.

2. The Commission should not allow any amount for "Customer acquisition costs" (currently $1.54/MWh + CPI).

3. The Commission should keep the "Retail margin" at 3% of sales, EBITDA rather than increasing it to 4% (a savings of $1.34/MWh +CPI).

By implementing these three recommendations, the Council estimates that the price rise affecting Winter 2007 could be reduced to about 9%, with a further 5% increase (based on 1 July 2007 prices) from 1 January 2008. More detailed information is included the "Reasons for the Council's Recommendations" following, and in Attachment A – "Comparison of the Composition of the TFT Price".

REASONS FOR THE COUNCIL'S RECOMMENDATIONS

1. Two Step Price Increase

The Council accepts that a substantial price increase for franchise electricity customers in the ACT is inevitable because of cost pressures including:

- pass through of the new ACT network tax;
- significant increases in the cost of wholesale electricity, primarily linked to the current drought.

However, the Council believes that some elements of these price increases can be deferred as some cost increases will take time to flow through to ActewAGL's cost base. If weather conditions improve substantially, wholesale market prices may come back to historical levels, making some of the proposed 14.25% price increase unnecessary, and giving ActewAGL a windfall gain during the first six months of 2007-08.

Deferral of some part of the price increases until 1 January 2008 would also have substantial benefits for consumers this Winter (July – September 2007). It would also give time for consumers to adjust to increased prices and for the ACT Government to implement targeted energy cost relief measures for low income consumers.

The two step approach also provides a check point whereby the Commission will be able to confirm its cost data assumptions before the second price increase is implemented.

In the lead up to the Commission's 2006 Decision on retail prices for franchise electricity customers (see Report 2 of 2006, February 2006), ActewAGL foreshadowed a CPI-based approach to franchise electricity pricing, with any additional pass-throughs to be subject to ICRC scrutiny. The Council considers it probable that this approach was underpinned by ActewAGL's hedging arrangements which have, in previous years, delivered good electricity price outcomes for the Territory.

The Council notes the Commission's assumptions about ActewAGL's hedging arrangements (see Table 3.1) which suggest that ActewAGL is fully hedged against the recent wholesale price rises between now and 31 December 2007 and is 80% hedged out to 30 June 2008. This suggests that financial state of ActewAGL will be reasonably protected in the regulated market in 2007-08 if the Council's approach were to be adopted.

2. Customer Acquisition and Retention Costs

The Council notes that the Commission is recommending a higher amount for retail operating costs ($94.91 per customer) than the amount set by IPART in NSW ($75 per customer). The Commission then proposes a further cost allowance for "customer acquisition and retention" ($15.09 per customer), arising from costs associated with the negotiated market such as marketing and churning.

The Council does not accept that it is appropriate to load this market-based price element onto franchise customers.

3. Retail Margin

The Commission proposes a retail margin ("profit margin") of 4%, up from 3% in previous years. The justification for this increase, given in section 3.2.9 of the Report, is not convincing, particularly as the whole thrust of the Report, and the construction of the final price, is based on protection of ActewAGL's financial viability as default supplier and avoidance of the "California" problem.

The Council suggests that the low risk environment offered by the TFT justifies a lower retail margin than industry standards in the competitive market.

SOCIAL IMPACTS

The Council is most concerned that the proposed large price increases for electricity and for water will prove to be the "last straw" for many of its low-income clients who are struggling each fortnight to meet instalment amounts directed by the Council as a condition for maintenance of supply of utilities.

This client group has already been significantly impacted by increases in rental costs, particularly in the private rental market, as well as the increasing cost of the basket of basic commodities which low-income families consume.

The Council has grave reservations about the possibility of it having to enforce an average increase of $10 - $15 in fortnightly electricity payments on customers who currently struggle to commit an amount of this size to debt repayment, after payment for current energy consumption. In fact, many clients of the Council currently struggle to cover even current consumption costs. The Council anticipates that utility debt will rise sharply in the coming months as a result of the proposed increases.

The Council is not currently in a position to forecast accurately the social impacts of this and other price rises on its client group and on its own operations. However, its initial appreciation is that the electricity price rise will have a devastating effect. The Council anticipates that there will be a further increase in the number of new clients seeking hardship assistance and in the number of clients who are unable to meet reasonable consumption costs (let alone repay arrears). This is likely to result in significantly increased costs in running the Council processes and to justify a significantly increased level of debt discharge by the Council under s 208 of the *Utilities Act 2001*.

These social impacts will necessitate a strong response from the ACT Government through the energy concession and other safety net mechanisms.

The Council will consider this issue, in depth and as a matter of urgency, over the coming months, with a view to preparing a detailed Advice to the Government on social impacts and necessary remedial actions for low-income electricity consumers.

Peter Sutherland
Chairperson

1 June 2007

ATTACHMENT A

COMPARISON OF THE COMPOSITION OF TFT RETAIL PRICE

	ESCC 2007	**ESCC 2008**	**ICRC 2007-08** Table 3.7	**Actual 2006-07**
Energy purchase costs per customer ($/MWh)				
Electricity purchase cost ($/MWh)	53.00	63.00	58.04	51.58
Energy contracting cost ($/MWh)	0.70	0.70	0.70	0.72
Green costs ($/MWh)	2.83	2.83	2.83	2.30
NEM fees ($/MWh)	0.71	0.71	0.71	0.69
Energy losses	4.97%	4.97%	4.97%	5.06%
Total energy purchase cost ($/MWh)	**60.08**	**70.58**	**65.38**	**58.04**
Retail operating costs ($/MWh)	9.70	9.70	9.70	9.33
Customer acquisition costs ($/MWh)	0	0	1.54	0
Total retail costs ($/MWh)	**9.70**	**9.70**	**11.24**	**9.33**
Network costs ($/MWh)	**57.19**	**57.19**	**57.19**	**50.51**
Total retail costs ($/MWh)	**126.97**	**137.47**	**133.81**	**117.88**
Retail margin (% of sales, EBITDA)	3%	3%	4%	3%
Total retail price ($/MWh)	**130.78**	**141.60**	**139.16**	**121.42**
Assumed CPI change 2006-07 to 2007-08	3.40%	3.40%	3.40%	
X factor	approx 6%	approx 5% (on 1 Jul 07)	10.85%	