UnitingCare Australia

SUBMISSION TO SENATE SELECT COMMITTEE ON ELECTRICITY PRICES SEPTEMBER 2012

Introduction

UnitingCare Australia is pleased to have been given the opportunity to contribute to this inquiry into electricity prices. The adverse impact on low and middle income consumers of price increases for standing energy are becoming more and more apparent to our agencies, through our interactions with people who access our services.

There has been significant and positive action by government in recent times to improve the workings of the energy sector. UnitingCare would like to take this opportunity to emphasise the need to take into account the negative impact of price rises on low income consumers and the economy as a whole. Regulatory transformation, that ensures domestic consumer interests influence energy policy, regulation and pricing, is essential.

Key Concerns

1. Cost of living is the issue of most concern to Australian citizens at the moment and home energy costs – electricity and gas – are the cost of living pressure of greatest concern
2. Electricity pricing is highly regressive, with low and modest income consumers bearing a dis-proportionately high cost as a proportion of income
3. Energy Costs are considerably higher in rural and regional locations
4. Distributional impacts of energy pricing and other policy impacts must be given higher credence than averages as measures of policy impacts on consumers
5. A significant number of low and middle income households have trouble paying their energy bills on time.
6. People reliant on government allowances are most likely to experience difficulties in paying their utility bills, including energy bills.
7. Sharp increase in electricity price rises will have dramatic impact on household budgets, across all income levels
8. Sharp increase in electricity price rises will impact on health and well being of citizens as well as reduce economic opportunity
9. Low income households place the highest priority on paying energy bills on time and yet they are the most likely to be affected by price increases.

Background

The UnitingCare network is one of the largest providers of community services in Australia, providing services and supports to more than 2 million Australians each year through 1,300 sites in remote, rural and metropolitan Australia. UnitingCare employs over 35,000 staff and 24,000 volunteers. This network works directly with and supports disadvantaged and marginalised individuals and families

UnitingCare Australia works with and on behalf of the UnitingCare network to advocate for policies and programs that will improve people's quality of life. UnitingCare Australia is committed to speaking with and on behalf of those who are the most vulnerable and disadvantaged for the common good.

UnitingCare Australia believes that all people have the right to access a decent standard of living. This includes access to:

- appropriate food, clothing, housing and health care;
- meaningful work, education, rest and recreation;
- the opportunity to meaningfully express and explore spiritual needs; and
- the opportunity to participate in and contribute to communities.

UnitingCare Australia believes that belonging in community is fundamental to people's well being. UnitingCare Australia values an inclusive community that strives to remove all barriers that prevent people from belonging and participating as fully as they wish and are able.

The values that UnitingCare agencies hold as important and that play a role in informing our responses to this public policy set of questions include:

1. Commitment to the common good and indeed our belief that government policy,community programs and citizen engagement need to put a commitment to the community or the common good ahead of individual gain
2. Equity matters, the more unequal our society, the more citizens who are excluded from participating in society, the more quickly that society experiences problems.
3. Stewardship of our environment is a fundamental responsibility of societies both in the short-term and for the benefit of future generations. We strongly support the notion of the triple bottom line for government, community and business organisations whereby economic stewardship, environmental stewardship and the nurture of citizens (social stewardship) are equally valued and reported on publicly.

Summary

Over the last decade, UnitingCare agencies have become increasingly concerned about rising energy costs for their clients and their services.

Electricity is an essential service to residential consumers. Reliable access to affordable electricity underpins good health and access to the technologies that enable workforce and social participation. Ensuring reliable, affordable access to this essential service should underpin policy development.

UnitingCare Australia welcomes the opportunity to make a submission to the Senate Select Committee on Electricity Prices. We applaud this inquiry, as it indicates that the Federal parliament is concerned with increases in the cost of electricity and its impact on residential consumers, and low income households in particular.

Our submission addresses a number of the Committee's terms of reference.

In order to support the Committee's emphasis on understanding the issues and supporting low-income households, we have also included a summary of research undertaken for UnitingCare Australia that found:

- Lower income households place a higher priority on paying their energy bills on time, than higher income households
- If energy prices continue to increase at the current rate,
    - about a half of low and middle income households expect to cut back on buying fresh food, paying other bills or
    - about 35% of these households would cut down on undertaking study or further training, and,
    - about a third of all households expect to cut back on going to the doctor and purchasing medications

UnitingCare would like to emphasise:

- the adverse impact of the current rapid upward price trajectory on low income consumers, and increasingly also on middle income consumers;
- the need to formally and actively take consumer considerations into account;
- non- competition in retail markets for electricity contributes to price rises (as displayed in Victoria);
- that the performance of the government-owned network service providers under price/revenue cap regulation has been very problematic, and this regulatory design needs to be re-evaluated as it appears to be contributing to price increases;
- that genuine empowerment which ensures consumers are decision-makers in regulatory processes, is needed. Empowering consumers is an important part of an enduring solution. This means ensuring that consumers can effectively participate in wholesale electricity markets. Effective involvement of consumers in the regulation of networks can also promote better understanding that more accurately reflects the views of the parties and allows more creative solutions than regulatory commissions are capable of delivering.

UnitingCare would also like to present a model for working with low-income households to enable them to reduce power consumption and expenditure on energy.

The story below illustrates the issues faced by residential consumers:

> *Mike is nearing retirement age and works part-time as an after hours caretaker. Both Mike and his wife are proud of the fact that they have paid off their own home, have modest savings for retirement and have done everything they can to keep the energy and water efficient. "I spent a small fortune on energy efficient light globes when they first became available", says Mike, "and they have no doubt reduced our energy use a little bit, but the bills keep going up."*
>
> *These days, Mike and his wife dread the arrival of their utility bills, both because the bills are more expensive each time no matter how little energy they use, and also because the stress of not being able to pay, on time, is uncomfortable for them.*
>
> *"For the first time in our lives, we had to ask for extensions to pay our electricity bills last year, and now we are having to use some of our limited savings to be able to pay our bills, and this is after we have done everything we can, to be energy efficient" says Mike, in frustration.*
>
> *Their most recent gas bill was a modest $80.00, but what frustrates them is that nearly $60 of that was for the supply charge, which Mike does not regarded as fair or reasonable – "we must have bought half the network over the past 40 years" suggests Mike. The most recent electricity bill, after a mild summer in Adelaide, was $397.00, nearly double what it was three years ago, and with lower use.*
>
> *"We are really worried that we just won't be able to afford to pay an energy and water bills once we retire - already we are having to use our savings just keep our heads above water" says Mike.*

The impact of price rises on low and middle income Australians

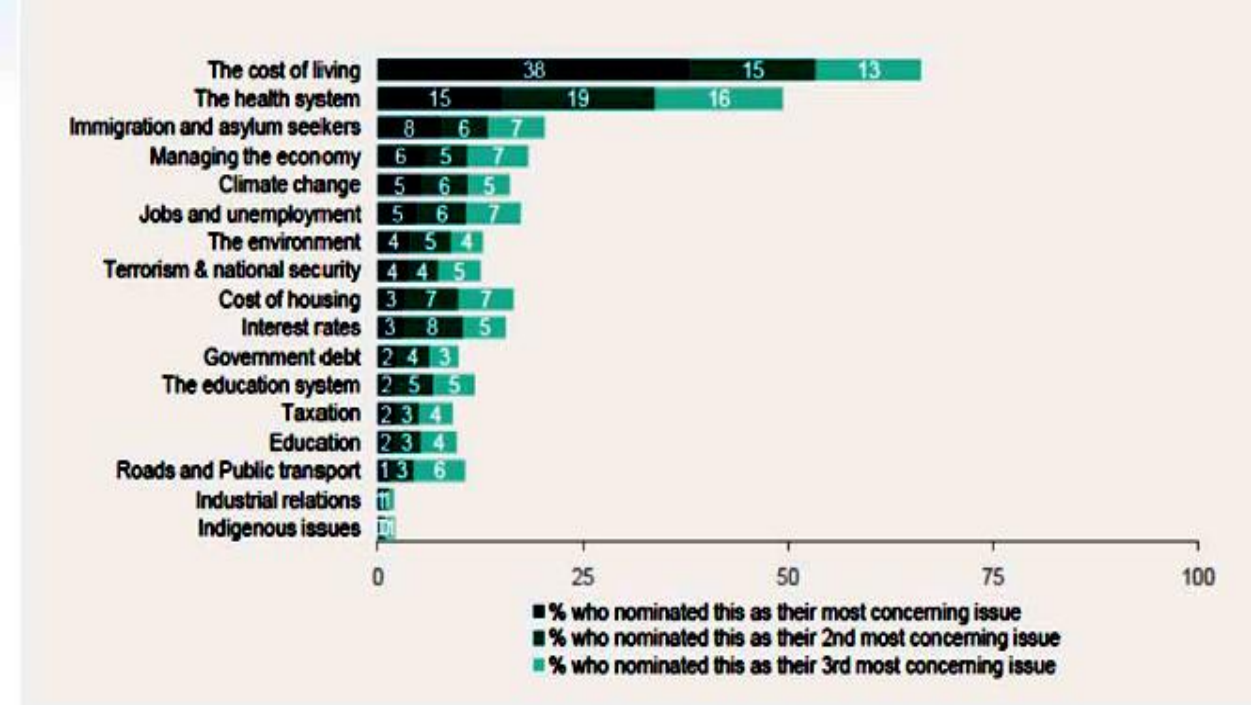
The establishment of this Select Committee implies an acknowledgement that the rate at which electricity prices have been rising is of concern to the Federal parliament. UnitingCare Australia emphasises the impact of rising electricity prices on low income households, and the need for special consideration of the impact on low-income houses

Cost of Living Concerns

Increases in the cost of living appears to be the dominant concern of Australian citizens, followed by the health system. The following graph, Graph 1, reproduces data collected from a survey conducted for the Clean Energy Council in 2011, asking Australians "what is their issue of most concern at the moment".

Many other debates receiving considerable media coverage currently rate at very low levels of interest to citizens in comparison to cost of living concerns.

Issues of concern for Australians, 2011

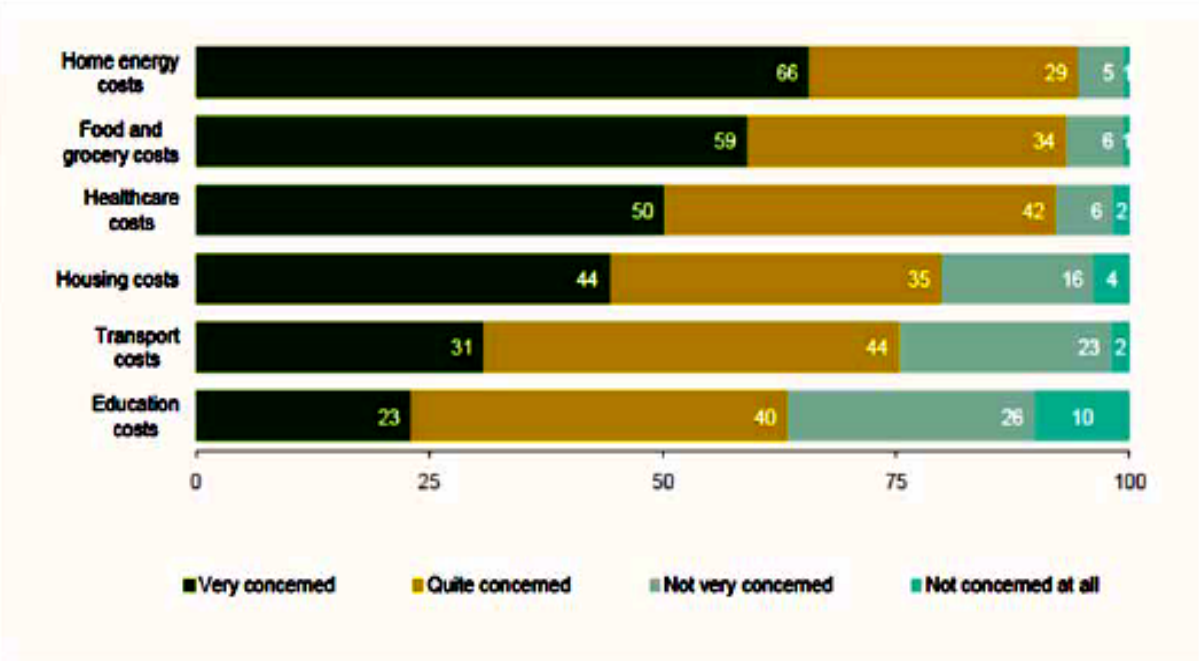


Graph 1: Source: Clean Energy Council of Australia

The data shows that 66% of respondents identified cost of living as one of their three issues of greatest concern, with 38% nominating it as their greatest concern, more than double the number of people than the second issue. The graph shows that n concern expressed about cost of living and the health system far outweighs concern about other issues.

Central to cost of living concerns are deep concerns about high energy costs, with two thirds of Australians being 'very concerned' about high energy costs, followed by food and grocery costs and health care costs. See Graph 2 below.

Cost of Living Concerns 2011



Graph 2; Source: Clean Energy Council of Australia

KEY CONCERNS

1. **Cost of living is the issue of most concern to Australian citizens at the moment and home energy costs – electricity and gas – are the cost of living pressure of greatest concern**

Impacts of price increases on low and middle income households

Zahra is a proud African woman with five daughters, the two eldest being at university, she is very proud of her girls and the opportunities they have in Australia. Her husband was killed in her homeland, a reason for coming to Australia as a refugee.

"We all share a small house , we all work hard and we get by, but with only my income, it's the electricity bills that I dread the most," she says.

Distribution of impacts: household income level

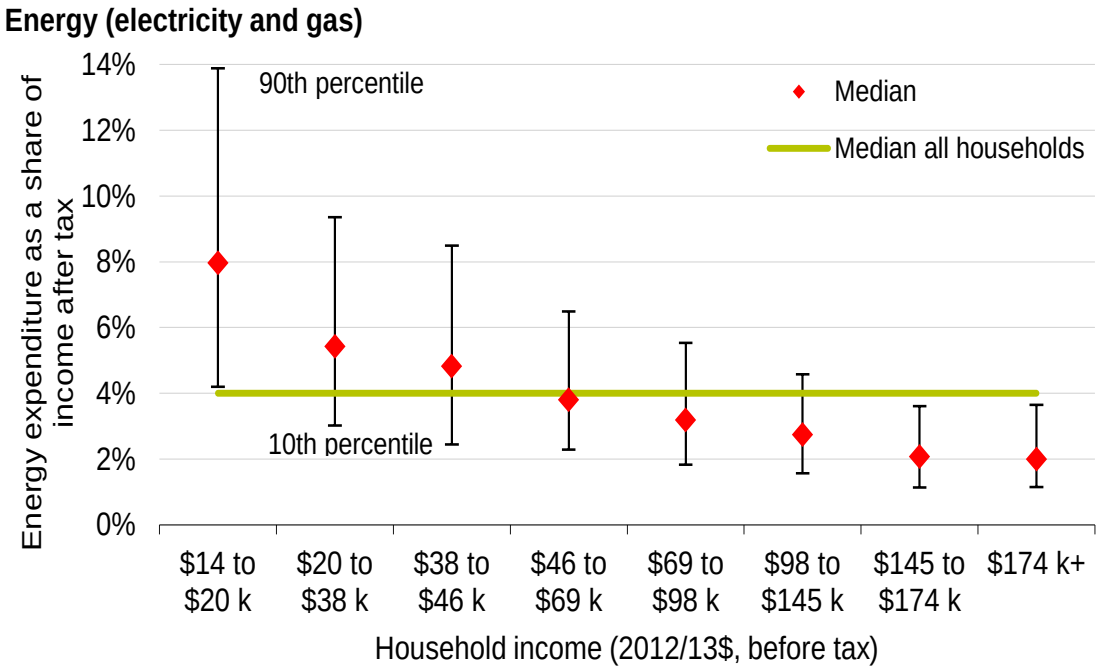
The most recent ABS Household Expenditure1 Survey (HES) reports that average household expenditure on 'domestic fuel and power' has remained unchanged from 2003-4 to 2009-10, at 2.6% of household expenditure. Unfortunately this has prompted some to observe that even with the rise in the price of energy, it is a minor part of household expenditure and consequently affordable for all.

[1] ABS; Cat no 6530.0 - Household Expenditure Survey, Australia: Summary of Results, 2009-10

This average figure masks the impact of price rises on low and middle income households, who now spend an increasingly high proportion of their income on domestic power.

Graph 3 indicates the spread in the proportion of household income spent on standing energy relative to household energy costs for the Sydney region. While we were unable to find similar statistics for the whole of Australia, we expect that similar distributional impacts for various income classes would apply across Australia.

Graph 3 Energy bills as a share of disposable income, by income band (Sydney and surrounds)



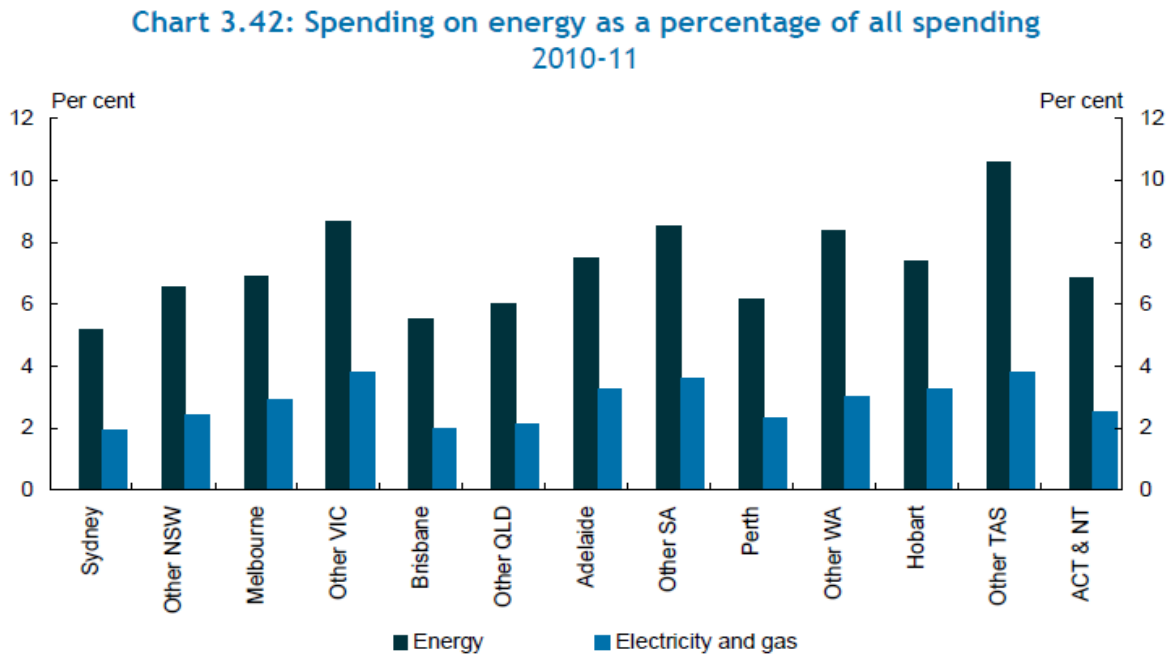
Graph 3 shows that for some very low income households, nearly 14% of the household income is spent on energy, with median expenditure on energy of 8%. There are households in the next two lowest income bands who spend over 8% of their household income on energy. Generally lower income households are lower energy use households, so a high proportion of income being spent on energy is more a function of income than energy use.

This graph is consistent with the experience of financial counsellors across the UnitingCare network, who identify significant growth in the number of clients presenting with major concerns about the capacity to pay rising energy costs, and an increasing number of middle income households accessing their services.

These lower income households are heavily affected by energy price rises above CPI and by price shocks in general and therefore are the households at greatest risk of adverse impacts as a result of any ongoing price increases.

Geography
Geography also plays a significant part in the distributional impacts of energy costs.

Graph 4, below, reproduces data from the Australian Treasury's Low Carbon Future reporting. It shows that spending on energy, including standing energy, is significantly higher in non metropolitan locations around Australia. The data reported is averages for the various categories of households, so applying the comments above about distribution impacts based on household income, we can conclude that lower and modest income households in rural and regional locations will be bearing a dramatically greater energy cost burden than higher income households based in capital cities.



Graph 4: Source Treasury, Australia's Low Pollution Future The Economics of Climate Change Mitigation, 2008

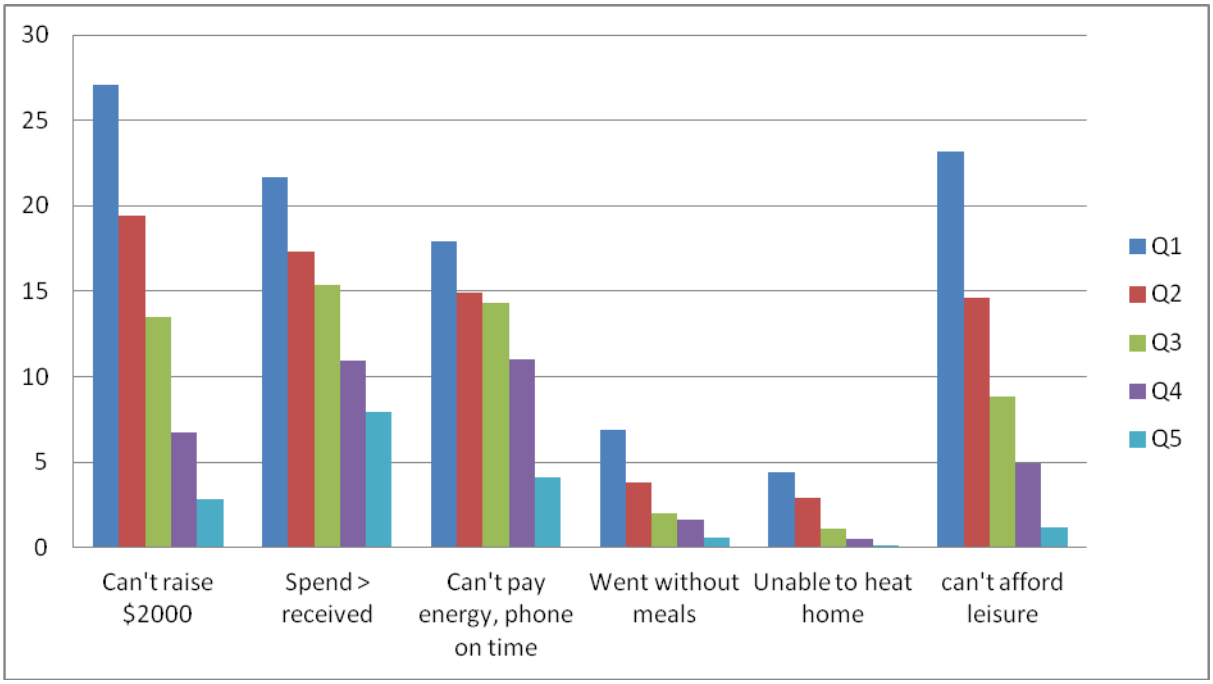
KEY CONCERNS

2. **Electricity pricing is highly regressive, with low and modest income consumers bearing a dis-proportionately high cost as a proportion of income**
3. **Energy Costs are considerably higher in rural and regional locations**
4. **Distributional impacts of energy pricing and other policy impacts must be given higher credence than averages as measures of policy impacts on consumers**

Household Financial Stress
What is the impact of rising electricity prices on residential consumers? The following graph taken from the ABS household expenditure survey, released in 2011, shows various indicators of household financial stress for equivalised household income quintiles.

The inability to pay energy and other utility bills on time is of major concern for all quintiles, with 13% of all households struggling to pay utility bills on time. Again, the impacts are more strongly felt by low income households, with about 18% of the first quintile reporting inability to pay bills on time. However, about 14% of second and third quintiles households are unable to pay utility bills on time, and even the fourth quintile of income distribution reports over 11% of this relatively high income group struggling to pay energy bills, in particular, on time.

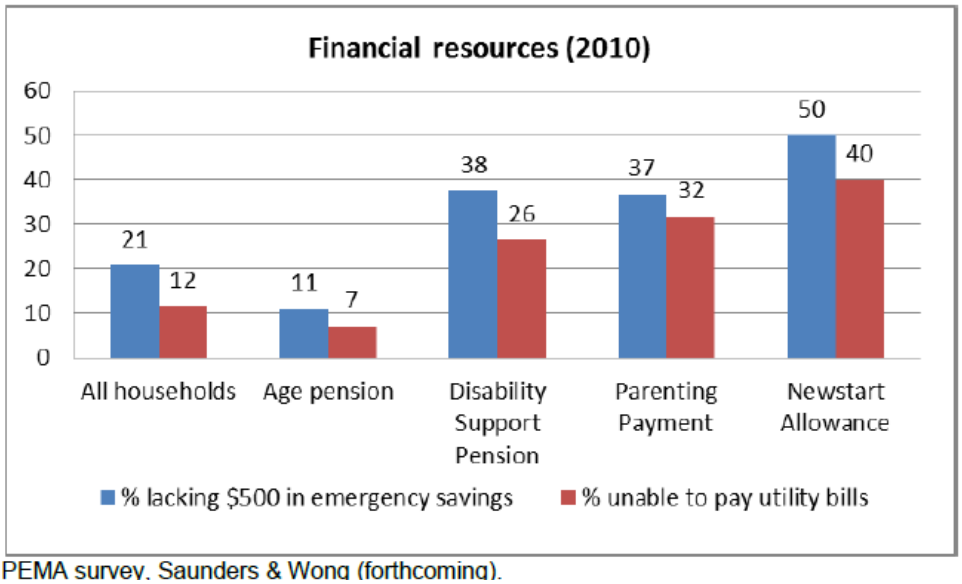
Indicators of Household Financial Stress



Graph 10: Source ABS Household expenditure Survey 2011

Once the domain of only low income households, UnitingCare services report an increasing number of middle and higher income households struggling with their energy costs.

In a deeper examination of the financial stress faced by low-income households, in 2010 the Social Policy Research Centre examined two measures of financial stress for households with various pension and allowance payments as their primary source of income. Graph 5 summarises the results of this work. The data is both a reflection of the inadequacy of current allowances, and the extent of difficulty these households have paying their utility bills, with 40% of Newstart Allowance recipients unable to pay bills and over a quarter of Disability Support Pension recipients in the same situation.



+- Source: PEMA survey, Saunders & Wong (forthcoming).

Graph 5, percentage of households unable to obtain financial resources. Source Poverty and Exclusion in Modern Australia (PEMA) survey, Social Policy Research Centre

Robbie

Robbie has lived on the northern New South Wales coast all of his life. Now in his 30's he is well known to the local community, and everyone loves his infectious energy, up beat personality and sense of humour.

Robbie has had a disability all his life, and has been supported by others, particularly his parents and close family. So it was a day of great excitement when Robbie moved into his new independent unit, having his own space while sharing facilities with other people he had known for much of his life. The generosity of the local community came to the fore with donations and gifts of everything that Robbie could possibly need in his own unit – even 2 fridges.

Support workers spent considerable time with Robbie explaining the need for him to pay his own bills which meant managing his own money, and using electricity when he really needed to. Hours were spent on budgeting which included the cost of running various appliances.

Robbie's first electricity bill was over $1600 for the quarter. "How can I ever pay this?" asked Robbie.

KEY CONCERNS

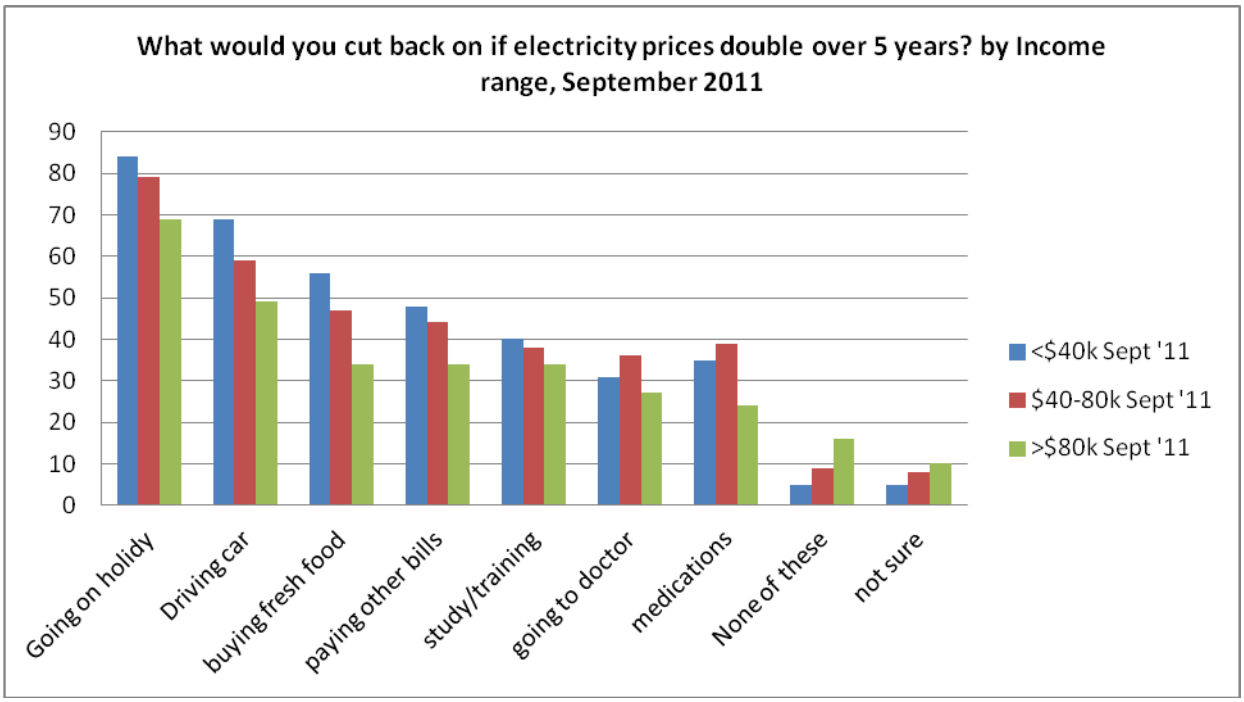
5. **A significant number of low and middle income households have trouble paying their energy bills on time.**
6. **People reliant on government allowances are most likely to experience difficulties in paying their utility bills, including energy bills.**

Impacts on households

Since 2010, UnitingCare Australia has undertaken an annual survey of about 1300 Australian households to look at the impact of rising electricity costs. The survey also tests the assumptions that residential consumers who don't pay their bills on time are "won't payers" rather than "can't payers" and that households are seemingly giving lower priority to paying energy bills on time.

To examine the impact of increasing energy prices on households, we ask "if electricity prices doubled over the next 5 years, what will be the impact on spending on various other parts of your household budget?" Results are given in graph 6 and are given for three income levels, households with less than $40,000 per year (low), $40, 000 - $80,000 per year (medium) and over $80,000 per year (high).

Likely Impact on spending of a doubling in electricity prices, over 5 years, Australia, September 2011, n = 1300



Graph 6. Source: Survey conducted for UnitingCare Australia, by The Australia Institute

The proposition that electricity prices could double over the next five years is reasonable. The notion has had recent media coverage, for example "The recent media hype about moves by the Australian Energy Regulator to 'slash power bills' is at odds with new analysis

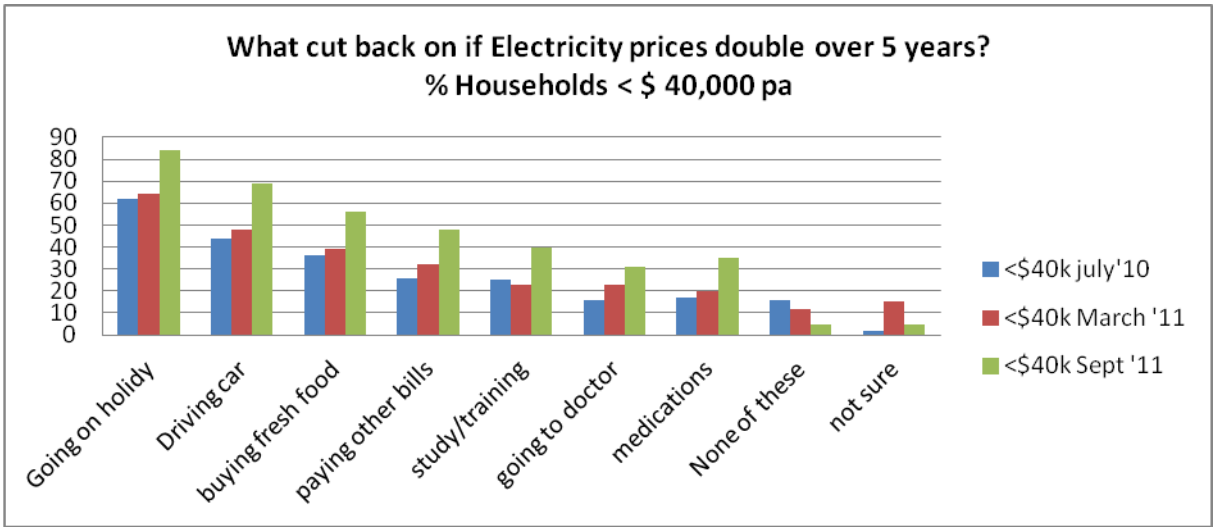
suggesting that electricity prices may double between 2011 and 2017, ” was written by Keith Orchison in the Business Spectator , 3 October 2011.2 On 22 May last year, the Herald Sun reported similar projections from TRU Energy.3

Of considerable concern is that about half of households with incomes of less than $80k per year, a majority of Australian households, have indicated that they would struggle to pay other bills and would cut down on purchases of fresh food if electricity prices increased.

Another major concern is that about 30% of households across the entire survey of about 1300 respondents said they would go without medicines or visits to the doctor if there were major electricity price increases, so there are adverse health impacts of rising energy costs. Nearly a third of people surveyed across all incomes also indicated that they would reduce spending on study and training. This has substantial economic implications. If rising living costs, including energy costs, are reducing spending on skills then the productivity and indeed employment growth, so central to overall economic growth, are hindered.

Another implication is that if lower income households are less able to gain skills for employment then they are further excluded from economic opportunity, extending divisions in our two-speed economy.

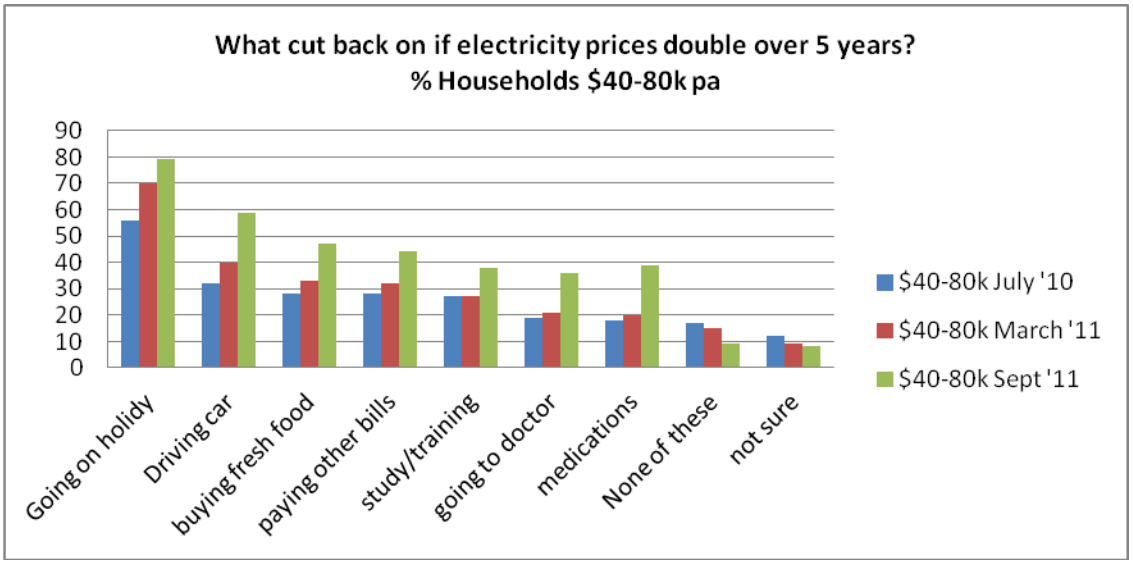
UnitingCare Australia was surprised by the relative similarity of responses across income groups, confirming that energy affordability is a concern that is community wide.
The following three graphs present the responses to the question of impacts on households of electricity prices doubling over the next five years, according to household income. The survey has been conducted three times, July 2010, March 2011 and September 2011. Each graph presents results from each of these three surveys.



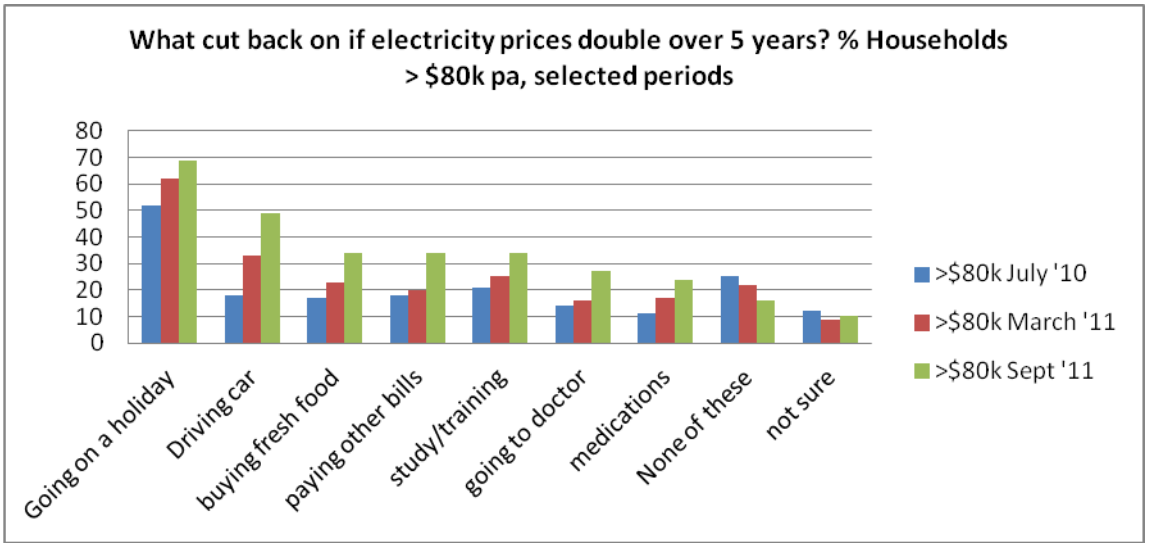
Graph 7 Source: Survey conducted for UnitingCare Australia, by The Australia Institute.

[2] http://www.businessspectator.com.au/bs.nsf/Article/energy-costs-power-bill-Australian-Energy-Regulato-pd20111003-M9URP?OpenDocument&src=rot

[3] http://www.heraldsun.com.au/archives/old-news-pages/power-bills-to-double-in-six-years-on-carbon-price-truenergy/story-e6frf7ko-1226060533782



Graph 8. Source: Survey conducted for UnitingCare Australia, by The Australia Institute

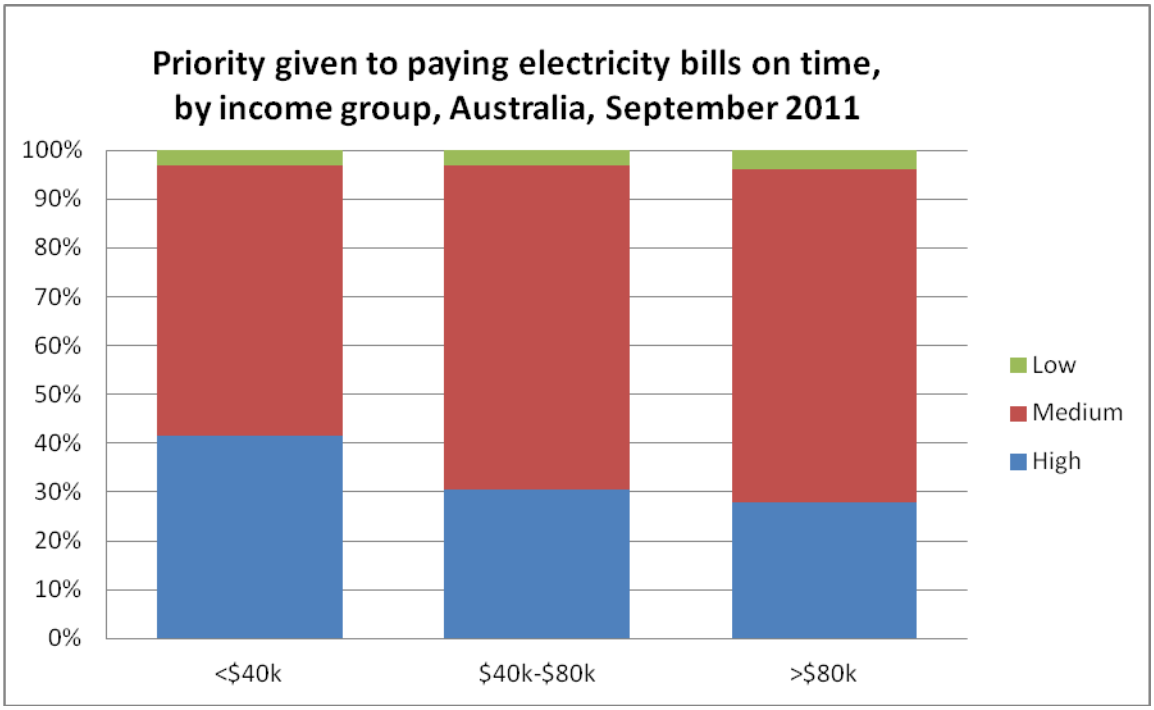


Graph 9. Source: Survey conducted for UnitingCare Australia, by The Australia Institute

In the 14 months from July 2010 to September 2011, there was a steep rise in the number of households who believed they would be adversely impacted by significant electricity bill increases, indeed, the changes from March to September 2011, at all income levels were considerable for such a short time period.

KEY CONCERNS

7. **Sharp increase in electricity price rises will have dramatic impact on household budgets, across all income levels**
8. **Sharp increase in electricity price rises will impact on health and well being of citizens as well as reduce economic opportunity**



Graph 10: Source, UnitingCare Australia survey, September 2011

The results presented in Graph 15 show that lower income households (we have determined household income below $40,000 pa as our benchmark for low income) placed the highest priority on paying electricity bills on time, compared to medium and higher income households. We also observe that energy retailers are generally accepting of this finding and are now much less likely to talk about "won't payers", and we respect their willingness to better understand the payment difficulties that their customers are experiencing.

KEY CONCERNS

9. Low income households place the highest priority on paying energy bills on time. A very small minority of all households place low priority on paying energy bills.

Candice & John

Candice and John recently purchased a house in Adelaide's Northern suburbs. Having no real knowledge of energy efficient design, ongoing and increasing energy costs were not taken into consideration at the time of purchase. Once they had moved into the house Candice and John discovered that it was extremely hot as there were a number of windows in the living areas exposed to the sun during the afternoon.

The couple purchased and installed a reverse cycle split air conditioning system believing they were getting something that was efficient to run based on the information the salesperson had given them about the "Energy Star Ratings", only to find that their next electricity bill was almost double the previous billing period. At the same time Candice was due to give birth to their first child and had to give up work earlier than expected due to health issues.

With only one wage coming in and having accumulated a large energy bill the couple are in financial distress.

Energy Price Impacts on Community Services Organisations

As a network of over 400 organisations across over 1300 sites across Australia we are also acutely aware of the cost pressures that rising energy prices place on community service organisations. While growing numbers of UnitingCare agencies are being proactive in applying energy efficiency measures to their sites, the reality is that for aged care and services supporting people with disabilities there is no way that resident / participant well being would be compromised by reducing air conditioning use. However, every increase in energy prices puts pressure on service providers. In aged care, for example, the services most likely to be pared back by rising utility costs are services like art therapy, activities coordinators and the like: the very services that improve quality of life for residents, beyond physical well being.

Response to the Terms of Reference

(a) identification of the key causes of electricity price increases over recent years and those likely in the future;

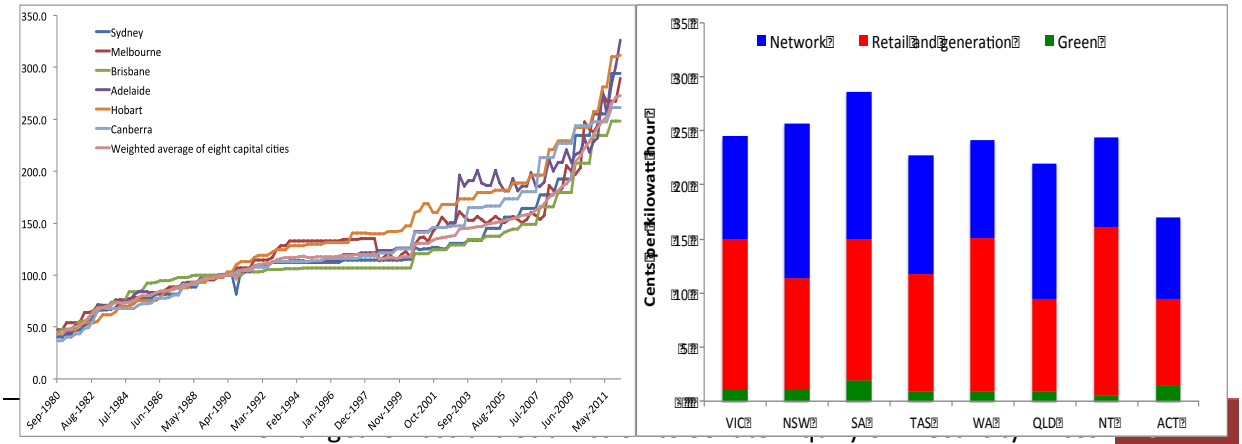
Retail margins and their contribution to higher prices

The Inquiry is seeking to understand the reasons for rising electricity prices. It is well documented that network costs have been a very significant factor in price rises. We believe it is also important not to lose sight of the impact of retail margins in accounting for higher prices to households. This seems to be a significant factor in Victoria but may occur elsewhere as well.

Electricity prices in the National Electricity Market (NEM) have risen around 70% since 2007. This is shown in Graph 10 which charts the Electricity component of the Consumer Price Index compiled by the Australian Bureau of Statistics from 1980 to March 2012. The chart shows that the rate of increase in prices since 2007 has been similar in the capital cities in the five states that make up the NEM.

The Australian Energy Market Commission (AEMC) has provided estimates of the average household electricity prices (on regulated standing contracts) in the NEM. Graph 11 shows that, except for the ACT, household prices are similar despite significant differences in the relative mix of network and retail plus generation/wholesale costs.

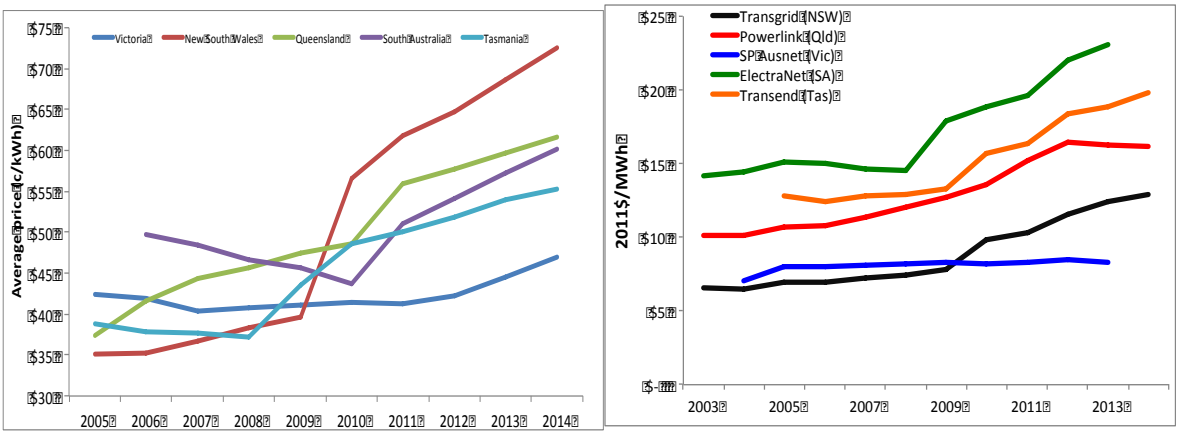
ABS electricity price indices (left);
AEMC estimate of components of household standing tariffs in 2011 (right)



Graph 10 and 11: Sources: Australian Bureau of Standards and CME analysis (left chart); (Australian Energy Markets Commission (2011) (right chart).

Network prices have risen very much more in South Australia, New South Wales, Queensland and Tasmania than they have in Victoria. This is shown above, and in Graphs 12 and 13 below.

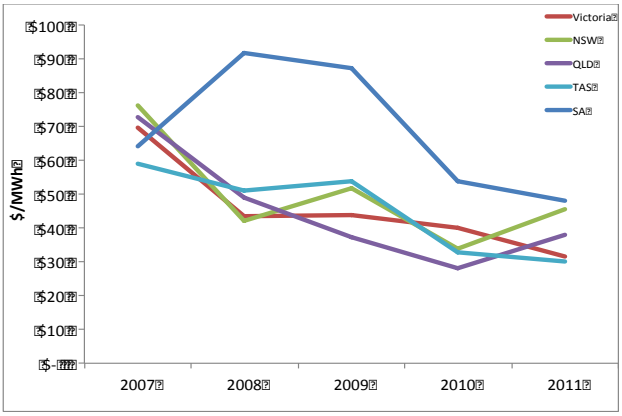
Average price ($/MWh) received by distribution service providers (left) and transmission service providers (right) in the NEM



Graphs 12 and 13 Sources: CME analysis based on network service provider regulatory accounts and AER and jurisdictional regulator decisions

Other than in South Australia, the wholesale price of electricity (in the mandatory spot market) has been similar in the NEM regions, as shown in **Error! Reference source not found.** 14.

Demand-weighted average spot prices



Graph 14 Source: CME analysis based on NEM half-hourly prices

Bringing these data together suggests that household electricity users in Victoria are paying more because of higher retail margins, not because of higher generation or network costs.

This raises concerns about the level of competition for retail users in Victoria (and possibly elsewhere), as it indicates that competition is inadequate, enabling retailer providers to

obtain higher margins. We would like to bring this issue to the Inquiry's attention for its further investigation.

(b) Legislative and regulatory arrangements and drivers in relation to network transmission and distribution investment decision making and the consequent impacts on electricity bills, and on the long term interests of consumers

Regulatory design: five year price / revenue controls

We would like to encourage the Inquiry to take a careful look into the use of five year price controls, and the contribution that this regulatory design had to rising costs in the provision of network services.

The main regulatory mechanism used in the regulation of electricity network service providers (NSPs) in Australia is a form of control that entails fixing prices or revenues for five years. This regulatory design is also used in the economic regulation of water utilities. It was first adopted in Australia in the mid 1990s in Victoria for the economic regulation of its privatised electricity distributors. It was subsequently adopted in the regulation of the privatised network service providers in South Australia and the government-owned electricity network service providers in NSW, QLD and TAS. It has also been adopted in the regulation of water companies.

The Australian application of this form of regulation – typically known as "price cap" regulation – followed its initial application in Britain from the late 1980s following the privatisation of their electricity network service providers. It had been applied even earlier by the British Monopolies and Mergers Commission in the regulation of the prices to be charged by then newly privatised British Telecom. Even earlier applications of this regulatory form can be found in the regulation of rail-road in the United States around the turn of the century.

More generally, fixed-price contracts of many different forms are well accepted commercial contracting practice – and have long been so.

It is important to understand the philosophy underlying the use of fixed price / revenue controls in economic regulation, how it works in practice and the evidence of its successes (in Britain and amongst the privately owned network service providers in Australia) and failures (in the regulation of government-owned service providers in Australia).

Philosophy

By fixing prices or revenue for a period of time – such as five years (and in some cases a little longer or shorter) – a profit maximising NSP is able to increase the profit it makes, by reducing its costs. In principle, the regulatory scheme therefore creates an incentive for NSPs to discover their efficient costs. The intention is that the regulator will have regard to these efficient costs in setting subsequent five year price / revenue controls. In this way, the regulatory scheme is meant to create incentives: for NSPs to reduce expenditures and "reveal" their efficient costs; for the shareholders of the NSPs to capture the benefits of the profits created by reducing expenditure during the fixed price period; and then for the NSPs' regulated customers to share in the benefit of lower prices (as a result of the lower costs) in the subsequent regulatory period.

This form of regulation is promoted as “light-handed” regulation – as distinct from “heavy-handed” regulations that rely on regulators trying to define the efficient costs (through detailed forensic cost assessment).

Practical application

Price / revenue cap forms of regulation create incentives on NSPs to over-estimate their expenditure requirements over the duration of the price/revenue control period. If they can successfully convince the regulator that their expenditure will be higher they will be allowed higher prices / revenues during the regulatory period. NSPs also have an incentive overstate their labour and capital costs for the same reason.

The regulator needs to be able to set expenditure allowances that take account of this incentive to make ambit claims. This is a big ask of a regulatory institution and it demands good quality analysis and the institutional strength and political support needed to make tough, commercial decisions despite the wishes to the contrary of well funded and organised monopoly network service providers.

The implementation of price / revenue cap controls is achieved through the determination of “building blocks”. The elements of this are:

- **Opex:** an allowance for operating expenditure during the regulatory control period
- **Capex:** the determination of an allowance for expenditure that is to be capitalised for each year in the regulatory control period
- **Regulated Asset Base (RAB):** This is the value of the regulated assets on which regulated returns and depreciation is calculated
- **Allowed return on regulated assets:** This is the calculation of the rate of return that is then applied to the RAB to provide a revenue stream to compensate the cost of finance and also to provide profits for the provision of services.
- **Depreciation of the RAB:** This is the calculation of the income stream to compensate the “consumption” of the fixed assets over their useful lives.

The calculation of the allowances for each of these “building blocks” is complex and has becoming increasingly detailed.

Outcomes

In their early years, the practical application of price/revenue cap regulation in Britain and in Australia kept true to the intention that it should be a “light-handed” form of regulation that placed reliance on efficiency incentives created when prices / revenues were fixed for a period of time. Regulators did not strive to predict the efficient expenditure. Regulatory processes were quite quick and reasonably straight-forward, and there was a willingness to rely on incentives to reveal efficient expenditure.

In Britain there have been five price control decisions and in 2010, the Office of Gas and Electricity Markets undertook a detailed review of the successes and failures of price cap regulation. The conclusion of this review was generally positive: services had improved and the prices charged by network service providers had reduced considerably. However the regulatory process had continued to become ever more detailed, as regulators have sought to ensure that NSPs do not receive excessive compensation (and that the security of supply is maintained). Various changes have been made to adapt this form of regulation in Britain.

In Australia the success of price cap regulation is less encouraging, as set out in detail in Mountain (2012). The privately owned NSPs in Victoria and the privately owned distributor in South Australia have delivered satisfactory levels of supply, and costs initially reduced (when subject to jurisdictional regulators) although they have subsequently risen (subject to AER regulatory decisions). Nevertheless these increases have not been nearly as large as for the government-owned NSPs.

The performance of the government-owned NSPs under price/revenue cap regulation has been very problematic. Many NSPs have spent considerably more than the regulator had allowed in the determination of their fixed revenues/prices. Almost all of the additional cost has been passed on to consumers. The AER has also allowed significantly higher expenditures, building on increases that jurisdictional regulators had determined in their last price/revenue control decisions.

In addition the regulatory process has become extremely burdensome. The process has moved very far from its light-handed intentions.

Finally there has been a big gap between several of the regulatory parameters that have been used to set fixed prices, including demand projections and the cost of capital – most notably the "Risk Free Rate". This has led to very significant windfall profits for the NSPs at the expense of their captive consumers. The gain has been the greatest for the government-owned NSPs.

In summary, it would appear that the use of five year price / revenue caps in the NEM has simply not worked for government-owned NSPs.

Next steps

We are aware that the AEMC has proposed several changes to the implementation of price / revenue caps by the AER and are participating in the consultation on these changes. However these changes are perhaps best characterised as relatively minor changes to process and regulatory focus. The fundamental regulatory design remains unchanged. For the reasons set out in this section, we suggest that a careful review by the Inquiry into the continued application of price cap regulation should be undertaken.

(d) investigation of mechanisms that could assist households and business to reduce their energy costs, including:

(i) the identification of practical low cost energy efficiency opportunities to assist low income earners reduce their electricity costs.

UnitingCare agencies are committed to empowering people to improve their lives, through the provision of effective community services, and addressing issues of social and economic hardship.

As outlined above, significant numbers of low income households struggle to afford the modest energy they need to live a decent life. UnitingCare agencies providing financial counselling, emergency relief, and family support services of various kinds have identified fuel poverty as a significant issue for many of their clients, and a number of innovative programs have been designed to assist them.

Kildonan UnitingCare's energy efficiency program is based on an empowerment model and has been developed over the last 10 years. The program aims to lower future energy bills and increase comfort for participating households. Research undertaken in 2009 and based on program data found the program was:

> *…highly successful, yielding substantial savings in both energy and dollars for audited households, even in the face of considerable situational and systemic barriers for many of the client group.*

The program has greatly expanded in response to demand and is now provided directly by Kildonan throughout Victoria and contracted to partner UnitingCare agencies in South Australia, Queensland and New South Wales. As a combined network we provided more than 1500 energy efficiency visits to vulnerable households in 2011. This national model involves strong partnership and collaboration with energy retailers. Households are identified and referred to Kildonan and partner agencies through the retailers respective hardship programs.

Kildonan Energy Efficiency Program Model

Key features of the national model:

- Collaborative partnerships with energy retailers to identify and refer households via the retailers respective hardship programs.
- A focus on energy audit through a behaviour change lens as the initial driver and where appropriate access to retrofit items.
- A focus on financial stability, advocacy and access to relevant community and government support programs (eg relief grants, mental health services, tenancy advice services, ombudsman, etc)

Program Aims

- To increase energy affordability for individuals and households, particularly those who are disadvantaged or in hardship
- To assist individuals and families increase energy efficiency and reduce energy consumption
- To enhance consumer's rights and access to utilities
- To enhance clients' comfort, health and quality of life as relating to their energy consumption/or facilitate equitable access to energy related health and comfort

Program outcomes

- Average saving of $207 per year on electricity bills alone across the three years (2004-2006). ***This translates to more than $400 dollars in electricity savings according to current day tariff charges***. Further, the mean annual saving in kilowatts was 1,637 across the three year period
- Reported additional savings in water, gas and waste
- Clients empowered to take the necessary steps to advocate for themselves, understand and stabilise their energy use to work towards financial stability
- Increase linkages for clients with community service organisations, government and industry schemes
- Informed and educated utility retailers regarding issues affecting the energy affordability of their consumers

Energy Efficiency Visit Components

An assessment of energy efficiency is conducted by a skilled team of Energy Workers who engage householders in a discussion and review of the following:

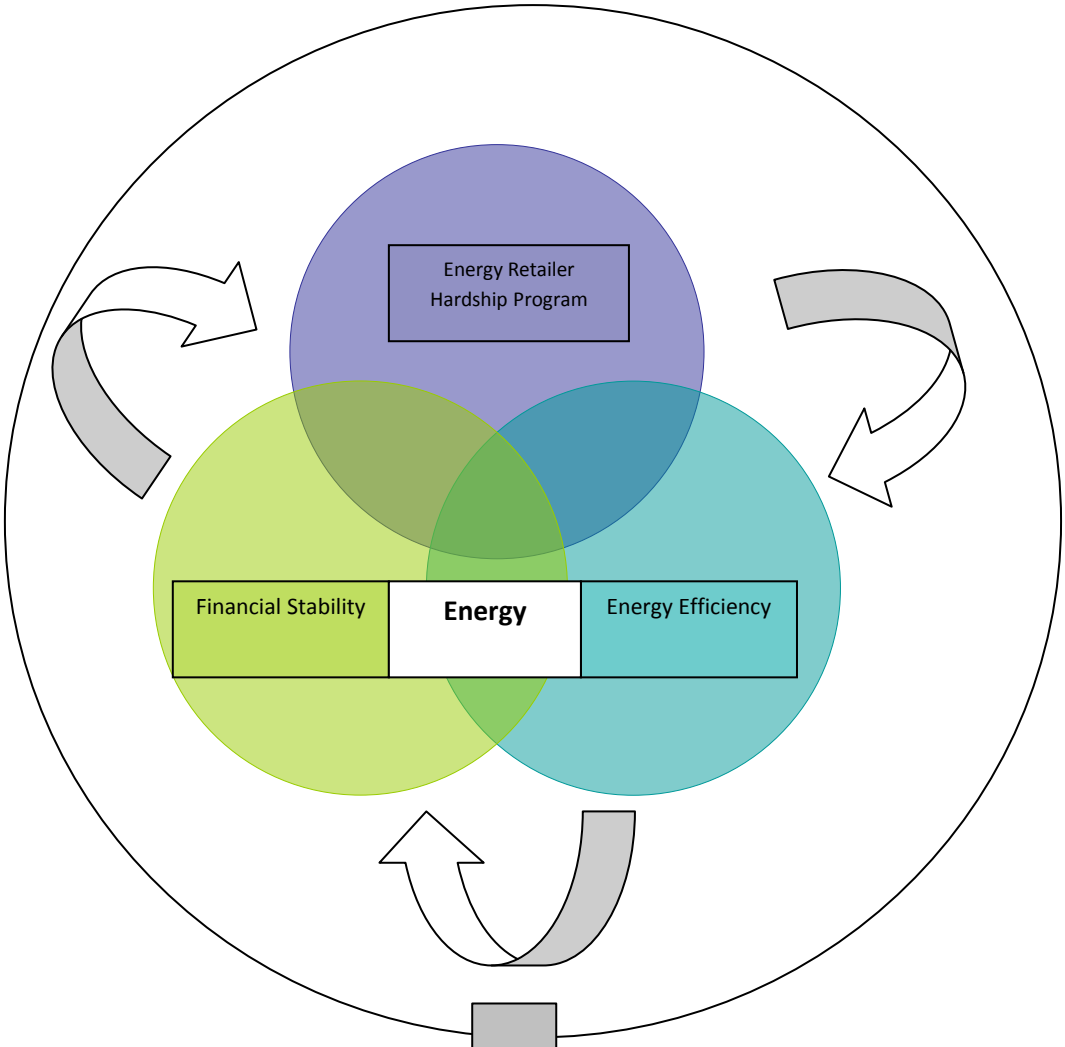
- *Households* – the people and their specific circumstances, and how they live in the dwelling, incorporating how appliances are used. This focuses on how behaviour can be changed to increase the efficiency/comfort with which energy is used in the home
- *Homes* – the physical assessment of the house, flat or property, and its thermal capacity. This focuses on identifying what modifications are required to improve the efficiency of the house by reducing summer heat gain and winter heat loss
- *Appliances* – the identification of inefficient appliances that require replacement/repair

Support provided to assist householders increase financial stability includes:

- Discussing the affordability of utility bills and current payments facing the householders
- The provision of information and advocacy (e.g. letters to landlords requesting maintenance, the identification of billing anomalies, promoting access to government assistance etc)
- Referrals to other support services

Program Evaluation

Kildonan's energy efficiency program incorporates an evaluation framework which seeks to measure the impact of the program for the consumers, stakeholders and broader community. It provides information to develop the program through a focus on impact measures using a range of evaluation methods which include data collection, pre and post utility bill comparisons, client questionnaires, feedback in team meetings, regular liaison with retailers and other key stakeholders. Finally, from time to time, Kildonan undertakes more formal research, such as the research project completed in 2009.



Follow up work by Energy Auditor to link household to relevant external supports and programs – examples include

- Appliance assistance
- Utility relief grants
- Mental health services
- Negotiation with Landlords
- Microfinance
- Matched Savings

(ii) the opportunities for improved customer advocacy and representation arrangements bringing together current diffuse consumer representation around the country,

Consumer engagement

Regulation of network service providers in the NEM has become bureaucratic, inflexible, drawn-out, opaque, adversarial and susceptible to lobbying. The regulator and the industry have become focussed on each other, rather than the needs of users. The industry and its regulator claim to be acting in the best interests of consumers but both do little to ask us what we want, and neither seem to value real consumer participation.

We suggest significant gains are achievable through empowering consumers in regulatory processes. In advice to the AEMC on the AER's rule change proposals, Professor Littlechild suggested that:

> "*there is one important factor that is increasingly playing a role in other regulatory jurisdictions, but is not mentioned in the present proposals and discussion. It was not particularly current at the time of writing the NEM Rules but may be relevant now. That factor is the potential role of customers and users in the regulatory process for determining network price controls. Some possibility for that potential role seems worth exploring here, rather than focusing entirely on variants of the AER's proposed rule changes*".

We agree with this and suggest that genuine empowerment that ensures consumers are decision-makers in regulatory processes is needed.

Negotiated settlements (in the context of network service provider (NSP) regulation) entails energy users (and other network users) negotiating with NSPs in order to settle issues such as prices, revenues, expenditures and service standards. Where settlement can't be reached, regulators would then determine. Traditional regulatory determinations become the approach of last, rather than first, resort.

The argument for negotiated settlements are that they are quicker, less expensive and adversarial, that they promote better understanding, more accurately reflect the views of the parties and allow more creative solutions than regulatory commissions are capable of delivering.

There is substantial evidence of the operation of negotiated settlements in the regulation of transmission and distribution network service providers in the United States. For example:

- The Federal Energy Regulatory Commission (FERC) in the United States has a statutory obligation to give preference to settlement. It is required to make decisions on rates only "to the extent that the parties are unable so to determine a controversy by consent". The conduct of the settlement practice is governed by regulations promulgated by FERC itself. The majority of rate cases (i.e. reviews to determine prices, revenues or tariff controls) are settled. Since 1980, settlements were reached in approximately two-thirds of all electricity rate cases. In the period from 1994 to

2000, 38 out of 40 applications to change tariffs brought by large natural gas pipelines during 1994-2000 were settled in whole or in part.

- In Canada, since 1994 all tariff applications by oil pipelines have been settled by negotiation, and most applications by gas pipelines have been settled in processes arranged by the National Energy Board. The settlements generally included incentives to reduce costs, and provisions to share savings between the pipeline and its shippers, but often went further. All market participants (including shippers) support the principle of negotiated settlements, and have continued to renew them.

- Negotiated settlements have established the price and revenues controls for Florida's five vertically-integrated electricity utilities since the mid-1990s.

- Evidence of negotiated settlements in utility regulation in California is described in the annual report of the Division of Ratepayer Advocates (DRA). DRA is an independent consumer advocate within the California Public Utilities Commission (CPUC) that advocates solely on behalf of investor owned utility ratepayers. It is the only state entity charged with this responsibility. It employs 142 staff and has an annual budget of US$27m, and reports to the Californian legislature. Negotiated settlements evidently occur in both revenues controls as well as other regulatory decisions. The biggest negotiated settlement in DRA's 2011 annual report related to a settlement with Pacific Gas and Electric (PG&E), one of California's largest vertically integrated utilities. In May 2011, the CPUC issued a decision which adopted the settlement agreement of seventeen parties, including DRA, with PG&E. In 2009, PG&E had originally requested a 3-year, cumulative revenue increase of nearly $4.2 billion for its electric distribution, gas distribution, and electric generation operations. After a detailed analysis of PG&E's request, in 2010 DRA released report which found that only a $1.0 billion cumulative increase in revenues was reasonable for the three year period. Settlement was achieved (and certified by CPUC) at a $1.7 billion cumulative increase.

Where they have been adopted, negotiated settlements are now increasingly pervasive, and have won support from end users, the industry and regulators. In summarising the evidence of negotiated settlements by the Federal Energy Regulatory Commission in the United States (one of the earliest adopters of negotiated settlements), Professor Littlechild concludes:

> *"The proof of the pudding is in the eating. The parties involved have increasingly preferred settlement to litigation over the course of the last half-century. This is a remarkable record of survival in an activity – utility regulation – that has been characterised by no little reform and change over this period … Traditional litigation has become essentially a method of dispute resolution limited to novel or exceptionally difficult rate case issues".*

Negotiated settlements can take many forms and be extended into many areas of regulation, working along-side conventional regulatory processes in some cases. Wide-spread adoption of negotiated settlements will be a large change from the current approach.