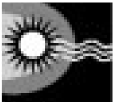

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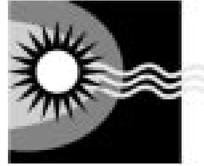

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Executive SUMMARY

Victorian households and small business electricity customers are anticipated to become 'contestable' customers - that is, able to choose their electricity retailer - from January 2002.

Electricity is widely recognised as an essential service required for a minimum standard of living acceptable to a developed nation like Australia.

In anticipation of 'full retail competition', as it is called, certain provisions have been made by the Victorian government and the Office of the Regulator-General to have minimum standards of consumer protection for these small customers.

However, breaking with the past and differing from the United States, the United Kingdom and New Zealand, the Victorian government has not mandated an *obligation to supply* to households. Rather, it has provided for a temporary *obligation to offer* (the standing offer) which lasts until December 2003. This 'safety net' provision requires a current host retailer to offer supply to small customers. The price, however, is to be set above the market in order to not undermine competition, which effectively means that vulnerable customers will be forced to pay a premium above the market. If they cannot afford to do so, they will be denied supply.

After 2003 there is no obligation to supply or offer. In markets, not all customers are equal, and therefore are not treated equally. Vulnerable customers - those on low incomes, with low consumption, in rental housing, in rural and remote areas or who have experienced payment problems in the past - will all be at risk of price/service discrimination in such a market. This discrimination is called 'redlining'.

The consumer protection framework for full retail competition or the 'minimum standards' do not protect vulnerable customers from redlining, but in many instances enable it to occur. The *obligation to offer* provision itself, as a legally sanctioned monopoly price, redlines all customers from the outset, achieving what it would take the market some years to achieve.

In addition, the regulation of the monopoly distribution businesses - the 'poles and wires' function which comprises between 60 and 80 per cent of the household bill - also permits redlining.

Redlining has been well documented in the insurance and credit industries in the United States, and is now a major concern in deregulated telecommunications, gas and electricity. Evidence of redlining has also emerged in the United Kingdom since deregulation of electricity. In Australia, the deregulation of telecommunications and banking has seen substantial changes that could be described as redlining. It is an economically rational strategy aimed at allocating costs onto customers who have the least capacity to avoid them, or to encourage low return customers to move to another supplier. In this way, a retailer can increase their overall rate of return.

This report recommends that there be a legal obligation to supply and that an anti-redlining consumer protection framework be developed for full retail competition.

It also recommends that:

- The *standing offers* be abandoned in favour of another mechanism to protect vulnerable customers who are unable to obtain benefits in the market;
- Substantial effort be made to reduce household consumption and that cross-subsidies for air conditioning load, in particular, be removed;
- Reduction in consumption of vulnerable households be linked to a safety net, with emphasis on retrofitting; and
- The governments oversighting the National Electricity Market address a number of serious flaws in the market as a matter of urgency. ■

ONE INTRODUCTION

Not every electricity customer is equally profitable to serve. Not every area costs the same to serve. In a deregulated industry, electricity service sellers that operate solely on a for-profit basis may be allowed to choose freely whom they will serve and the rate they will charge each customer. If they do, they can be expected to segregate customers by geographic area, past credit records and income level, and sell to the most attractive customers. If they do, what quality at what price can people in high-cost, difficult to serve, areas expect? How will people with lower incomes be assured they can afford electric service? Unless these questions are equitably resolved, deregulation will not benefit the whole nation (Alliance to Protect Electricity Consumers [US]: 1998).

In developed nations, fuel for heating, cooking and lighting are recognised as essential services that are fundamental to quality of life. Users do not purchase 'electricity' but a 'means' to provide heating for their homes, the capacity to cook, lighting for security and social participation. Electricity is the means by which key welfare goals are achieved and as such is considered a 'right'. In the Australian context, state ownership of electricity supplies for the best part of the last century was coupled with the objective of 'universal service obligation' - that all customers are entitled to supply at a fair and reasonable price. Universal service in areas like utilities, banking, insurance and health were underpinned by cross-subsidies between customer groups, localities and generations. Nevertheless, fuel poverty - deprivation or rationing of fuel - was and remains a social and health problem. It is caused by several factors: low income, poor thermal quality of the housing stock, poor appliances (especially space and hot water heating), tariff structures and lack of an appropriate welfare safety net.

The supply of electricity in Victoria has undergone radical reform over the past ten years, intended to transform the industry from a state owned monopoly business to a fully competitive market. The final act of the reform process is to deregulate the supply of energy to households in January 2002. 'Full retail competition' (FRC), as it is called, anticipates that residential users will be able to purchase their energy from a range of competing providers. This is a profound change. Not only is the concept of universal service to be abandoned, but there is to be no fundamental obligation to supply: the market is to determine the receipt of benefits. This report argues that, under the current arrangements for FRC, this will mean a change *from universal service to no service* for many Victorian households. It is also likely to mean that a great number will be effectively forced to pay more than they should for this essential service in order to secure supply.

Consumer participation in markets is reliant on two key factors: the consumer's ability to pay and the right to be served. Where a consumer cannot afford a good or service, they cannot obtain what is needed or wanted. Firms operating in free markets orientate their business towards consumer groups that are able to pay. In order to maximise the return on their investment, investors seek to increase the margin of profit on each sale or per customer. This involves particular pricing and distribution strategies and the minimisation of bad debt. It is self-evident why expensive luxury stores locate in wealthy suburbs and why shops in poor neighbourhoods tend to sell only everyday necessities. Where a consumer has no choice, firms in free markets are able to charge more than is fair and reasonable. **Markets work to segment customers and actively engage in discrimination.** It can be either a positive form of discrimination - commonly called 'cherry-picking' - and orientated towards affluent customers, or it can be negative and intended to deny service or over-charge for the service. In the United States, such negative economic discrimination - sometimes based on racial and other prejudices, but not exclusively so - is called 'redlining'.

The United States provides a useful contrast and a powerful lesson in market design. In areas such as insurance and banking, price/service discrimination has been rife for decades. Consumer organisations and low income advocates quickly recognised the emergence of a familiar pattern once the United States deregulated its telecommunications industry. As various states deregulate their electricity supply industries, redlining has already become a major issue. The United Kingdom, importantly, provides empirical evidence of redlining, post-FRC. Victoria stands in stark contrast to the United States, the United Kingdom and New Zealand, who all deregulated their electricity industries, in that each of these countries has maintained a legal obligation to the right of supply at a fair and reasonable price. Victoria does not and, as a consequence, the effects of the markets on vulnerable customers are likely to be much more severe.

Market segmentation in a deregulated electricity industry is a two-part strategy. Firstly, it seeks to discriminate in favour of those customers who can be encouraged to increase their consumption and those with attractive consumption profiles. Secondly, it

marginalises those with low consumption and/or low income because they contribute little to marginal revenues. These customers can be forced to contribute additional revenues simply through monopoly pricing. The problem is that the utilities have economic incentives to promote growth in consumption and, within a deregulated environment, a shorter timeframe in which to recover costs. Price discrimination does not reflect the cost incurred by the customer, but the customer's possible contribution to revenue. As such, the claim of economic efficiency that is used to justify discrimination is challengeable.

Not only are the traditionally 'fuel poor' likely to be targeted, but a new grouping of customers, including those in rural and remote areas, will find themselves with poorer access to this service at a more expensive price.

This report shows that the cost structure of the industry itself promotes discriminatory pricing. The regulation of the monopoly electricity poles and wires (the distribution function) is based on allowing economic discrimination against small customers, reflecting traditional utility pricing practices. Moreover, redlining is not so new to Australia. Privatisation and deregulation of telecommunications and banking has quickly and very publicly demonstrated the impact of markets on vulnerable customers of essential services.

This report closely examines the Victorian consumer protection framework for FRC, arguing that not only does it fail to recognise the inherently discriminatory nature of markets, but that the current arrangements actually facilitate such discrimination. Broader FRC implementation issues are given some attention, raising questions of how functional the model really is, whether competition will occur and at what price.

The inevitability of redlining of customers of essential services poses a serious policy and political hurdle for governments embracing market reform. This report outlines the measures that can and should be taken to protect vulnerable electricity customers. Such protection - indeed, the elimination of fuel poverty - is possible with a 'whole of government' approach. Victoria's electricity prices have traditionally been relatively cheap, but a focus on the causes of fuel poverty has been lacking. The existing welfare safety net has not served the needs of the most vulnerable customers. A 'whole of government' approach should address the poor housing stock and poor appliances, mandate appropriate tariff structures and match financial rebates with programs to reduce consumption.

To that end, this report seeks to encourage debate around the implementation of safety nets and whether these really are the solution to redlining, or whether there needs to be a fundamental shift in our thinking about the nature of competition. ■

TWO BACKGROUND

In the 1990s, following the recommendations of the National Competition Policy Report (Hilmer 1993), the Council of Australian Governments agreed to the reform of the state owned electricity supplies. A national grid was established from the state-based systems; competition between generation companies was envisaged and a separate retail market created. The outcome was the National Electricity Market (NEM) that formally started in 1998.

From 1993, the Kennett government in Victoria integrated the distribution and retail functions of eleven municipal electricity undertakings with assets from the State Electricity Commission of Victoria (SECV), then disaggregated and corporatised the various business units and later privatised all the businesses with the exception of the SEC shell company. The government considered that markets deliver greater economic benefits than public sector provision. **Promised benefits included lower prices, better customer service and greater reliability of supply.** This would derive from more efficient investment decisions made by private firms in generation, transmission and distribution, and by the customer focus of retail companies.

Retail competition was introduced on a staged basis, with the state's three largest consumers becoming contestable in 1995 and successive 'tranches' (groups) of smaller and smaller customers entering the market each year thereafter. In the initial years, contestable customers achieved considerable price cuts, primarily as a result of generators seeking to gain market share and the existence of the Master Vesting Contracts underpinning the Maximum Uniform Tariff (MUT) for franchise (captive small business and household) customers. Full retail competition (the entry of the smallest business customers and households into the market) was scheduled to commence in January 2001, but this was delayed by a year.

The NEM is oversighted by its five participating government jurisdictions: New South Wales, Victoria, Queensland, the Australian Capital Territory and South Australia. It is managed by the National Electricity Market Management Company (NEMMCO) that has the dual roles of operating the actual market (which is akin to the stock exchange) and ensuring system security. The rules of the market are contained within the National Electricity Code (NEC) administered by the National Electricity Code Administrator (NECA). Both NEMMCO and NECA are limited liability companies constituted under the Corporations Law and oversighted by boards appointed by the state jurisdictions. The Australian Competition and Consumer Commission (ACCC) has a role in authorising changes to the NEC by adjudicating access issues and determining transmission pricing. The monopoly distribution function is regulated at the state level; in Victoria, this is done by the Office of the Regulator-General (ORG). The customer interface rules for full retail competition are also being developed at the state level. Domestic customers are not directly engaged in any of these processes. The state-based Electricity Industry Ombudsman of Victoria (EIOV) scheme was established to handle consumer complaints.

The marketisation of the electricity industry must be acknowledged as problematic from the outset because **the industry does not have the characteristics that are held to exist in 'perfect' markets.**

For example:

- Electricity must be used as it is produced and cannot be stored in quantity as with conventional commodities;
- Significant parts of the industry (distribution and transmission) will always be monopolies;
- The purchase by households is non-discretionary (inelastic demand) and is in many instances non-substitutional;
- For large customers, it may be difficult or too expensive to substitute the fuel source; and
- Substantial public goods and merit goods are involved (welfare, rural development) and significant negative externalities exist (pollution).

A perfect market should have:

- Many consumers and suppliers;
- Perfect information; and
- Appropriate pricing signals to which buyers can respond and influence the market outcome.

The NEM lacks appropriate information levels for all customers, does not permit appropriate price signals, and generation ownership is arguably concentrated enough to allow market manipulation. The reliance on market discipline to deliver consumer benefits therefore is perhaps misplaced.

the industry does not have the characteristics that are held to exist in 'perfect' markets.

From a welfare perspective, an important aspect of the reform process has been the removal of 'social programs' from the utilities themselves and the re-creation of some of these programs as 'community service obligations' (CSOs). Victorian retailers, for example, are paid by the government to deliver its winter energy concession program. Other important programs such as demand management and retrofitting have been abandoned. However, certain utility practices both implicitly and explicitly contain social objectives. Tariff structures, for example, can be highly regressive (as they are currently) or progressive. The Kennett government intended to have the reform of the electricity industry result in cost reflective pricing or 'user pays'. In doing so, it was dismantling the central redistributive function provided by the SECV. FRC as it is currently being pursued is likely to achieve this end. It is therefore an oxymoron to suggest that vulnerable customers are protected, let alone that they will be beneficiaries of full retail competition.

The Financial and Consumer Rights Council argues on the basis of two sets of case studies (Benvenuti and Walker 1995; Kliger 1998) that vulnerable consumers are already worse off because of the emphasis on market objectives. As Kliger (1998: 2) said:

The only grounds on which customers are differentiated are economic grounds, the very grounds in which low income consumers are exposed to discrimination as they require flexibility in debt collection practices and credit management policies...this lack of understanding has resulted in many low income people having to go without energy, water or other essential services. Low income people experiencing difficulty paying their bills are confronted with disconnection or restriction, or they sacrifice essential expenditure, such as food and clothing, to be able to pay their energy and water bills.

Romeril (1998) presents evidence of the substantial increase in disconnection during the corporatisation and early privatisation phases of electricity reform. Economist Roger Colton (1995a: 1) also points to the rush to disconnect when California deregulated its electricity industry:

Southern California Edison has already cited competition as the primary reason to change its collection practices. In that case Southern California Edison chose to treble its service disconnection (up to one million customers in 1995 alone), citing competition as the main reason it was calling in debt.

Both Colton (1995a) and Kliger (1998) state that debt and disconnection policies need to recognise the requirement for repayment plans to be based on the customer's ability to pay in order to ultimately avoid disconnection. In some situations, Kliger argued, this will require moratoriums and waivers. ■

THREE REDLINING DEFINITION

'Redlining' is a US term that refers to the practice of literally drawing a red line around an area on a map in order to clearly delineate it for discrimination in the delivery of a service or good. This was the method by which credit providers and insurers in the United States identified neighbourhoods they wished to deny service because of views about the customers' credit worthiness or assessment of possible profits. Historically, this concerns a perception of financial risk correlating with race and/or crime, hence neighbourhoods that were generally black, ethnic and/or poor were targeted. In this sense, it has a geographical basis: all persons within a particular area will be discriminated against regardless of race, although the discrimination is effectively racist in origin. Property insurance, for example, may be denied because of a fear of civil unrest in poor predominantly 'black' neighbourhoods. Not only are the black people discriminated against, but so are any other groups who happen to live in the area. By and large, the practice is outlawed in the United States, but minority rights groups maintain that it continues and providers are still being taken to court. As new industries emerge, new redlining appears. Internet-based store Kozmo.com has already attracted the attention of the Equal Rights Centre for engaging in 'consumer racism' (ZD Net News 2001).

The state of Georgia (1997) provided the following definition in a bill supporting anti-redlining legislation for the insurance industry:

the term 'redlining' means a pervasive and consistent policy of discrimination, whether in the form of differences in rates charged, policy applications denied, policy cancellations, absence of offices or agents, employment practices, or any other indicia of a desire not to do business in any area defined by a population of African Americans, Latinos, Asians, or low income persons.

Colton (1999) proposed the following wording for legislation for the state of Colorado as it prepared for deregulation of its electricity industry:

It shall be unlawful for any electric service provider to discriminate against any person with respect to any aspect of a consumer transaction on the basis of race, color, creed, national origin, age, gender, religion, source of income, receipt of public benefits, family status, credit status, sexual orientation, disability, or geographical location.

These definitions reflect much of what is contained with human rights legislation in Victorian and Commonwealth statutes. The main distinction is the inclusion of matters pertaining to 'economic rights'. To this end, such a definition could be described as a 'bill of rights' for small consumers. But, as the state of New York Public Services Commission (2001) points out, a general legal obligation to supply removes the need to identify individually all the forms of discrimination that may be envisaged.

Price/service discrimination has a positive as well as a negative aspect. Competition for affluent (attractive) customers is known as 'cherry-picking'. In a market that will permit bundling of non-utility services with electricity provision, these customers have even greater attraction. It provides the scope for cross-subsidisation between different products or services as well as between customer classes.

Recognition of economic discrimination provides an important distinction between rational and irrational market behaviour. Colton (1999: 69) says:

Defining the type of market exclusion that one seeks to prevent is important for purposes of deciding upon the public policy responses establishing appropriate remedies for the objectionable behavior. If, on the one hand, the exclusion which one seeks to prevent involves irrational and uneconomic decision making (e.g. based on stereotypes and prejudice), the appropriate response might be simply to promote increased competition. This competition would increase the potential emergence of a firm that would serve this unserved, or under-served, yet profitable market.

If, on the other hand, the market exclusion which one seeks to prevent involves economically rational decision making, promoting additional competition would not be the appropriate public policy response. It was the economics of the situation that created the exclusion in the first place.

In the context of human rights law in Australia, irrational market behaviour based on racism, for example, is isolated. Colton's second point is highly relevant in the Australian context of market-based reform. The apparent objective of large banks to refuse service to small account holders directly relates to so-called rational economic behaviour. However, the rise of 'community banking' in rural areas subsequent to the withdrawal of commercial banking services may point to behaviour on the part of the 'big banks' that may challenge what is to be regarded as economically rational. Both are examples of economic discrimination, but the issue is one of degrees of profitability. Rural banking can deliver profits, but are those profits high enough to satisfy shareholders?

Later in this report we shall return in more depth to the issue of economic discrimination. ■

FOUR THE CONSUMER PROTECTION FRAMEWORK IN VICTORIA FOR FULL RETAIL COMPETITION

4.1 An Obligation to Supply?

The consumer protection framework for full retail competition in Victoria is mandated by the Electricity Industry Acts (Amendment) Act 2000. Section 169A provides for the creation of what are now called the standing offers and Section 169B for the deemed contracts. Both sections oblige the ORG to set the terms and conditions of supply, excluding prices. Prices are to be set by the retailers, subject to reserve pricing powers contained in Section 158AA. The deemed contracts simply transfer the franchised small business and residential customers from the MUT which expired on 31 December 2000 to a temporary tariff that will cease to exist after December 2003. The provisions of Section 169A require that retail licensees are obliged to offer a tariff (subject to ORG approval) to small business and residential customers until 31 December 2003. The government put both sections of the Act into effect by the Order in Council of 21 September 2000. However, the issue of how pricing oversight of deemed contracts and standing offers would be managed in practice was not subject to public consultation at the time, and the legislative and regulatory instruments are silent on the matter. It took until the middle of 2001 for the government to initiate the development of pricing guidelines by a 'Special Reference' to the ORG under Part 4A of the Act.

The following tables set out the three main contract types, their purpose and application.

Table 1: Deemed Contracts

Purpose	• Transfer all franchise customers from MUT (MUT ended December 2000) • Maintain near uniform prices across Victoria • Provide transitional arrangement, to avoid all customers needing to switch on first day market is open
Application	• Three year duration only (ending December 2003) • Subject to government reserve pricing powers • Prices must be gazetted 60 days prior to commencement • Fixed price (no pass-throughs) • Service standards/conditions must comply with ORG Retail Code

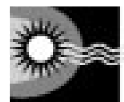
Table 2: Standing Offers

Purpose	• Provide a safety net for consumers (retailers required to make offer)
Application	• Subject to government reserve pricing powers • Prices must be gazetted 60 days prior to commencement • Fixed price (no pass-throughs) • Service standards/conditions must comply with ORG Retail Code • Opportunity to vary conditions as per Retail Code • Sunset provision (December 2003)

The deemed contracts and standing offers are currently identical in price and conditions, with the exception of Origin's internet-based standing offer.

Table 3: Market Contracts

Purpose	• Deregulation of customer/supplier relationship
Application	• Tariff negotiated between retailer and customer • No obligation to offer • Permits pass-throughs such as ancillary service payments • Tariffs/prices not required to be published • Compliance with Retail Code but self-regulation • Conditions can be varied



All residential customers are currently on a deemed contract but, as these are transitional, it is expected that customers will move onto either market contracts or a standing offer after the market opens. They will be able to go onto a market contract offered by any retailer or accept the standing offer(s) of Citipower, TXU, Origin, Pulse or AGLE. These **standing offers will cease to exist after December 2003** unless rolled over by legislation. Therefore only market contracts will exist from 2004. These will differ from the deemed and standing offers in that they allow greater discretion to the retailers about what is involved in the offer. For example, they may choose to shift the risk of ancillary service payments (ASPs) that are ad hoc wholesale market levies onto the customer. Victorian households have never previously been subject to such charges, and it likely that customer ignorance of them will result in many accepting contracts that provide for pass-through. It may mean an additional five cents on one bill, but an additional hundred dollars on the next. ASPs are unpredictable in timing and amount.

A highly significant change is embodied in Section 169A of the *Electricity Industry Acts (Amendment) Act 2000*. The consumer protection framework does not countenance any obligation *to supply*. Rather, the Bracks government has provided for an obligation *to offer only*, and even this is temporary in nature. The United States, United Kingdom and New Zealand reforms all maintain the obligation to supply. The standing offer only guarantees access to supply if the customer is able to pay the price being offered. As later developments have revealed, that price is to be higher than market contracts and, as such, is by definition discriminatory and harmful to those it is presumably intended to protect.

There is a very noticeable lack of policy articulation from government on this matter. An examination of the parliamentary debates, media releases and ministerial speeches shows an absence of specific engagement on the issue of obligation to supply. The government could be accused of misleading the parliament because it infers a protection that does not exist. The Minister for Energy, Candy Broad, made the following comments in her Second Reading speech when the Electricity Industry Acts (Amendment) Bill was introduced in the Legislative Council on 30 May 2000:

In addition, effective competition for domestic and small business customers must be matched with long-term consumer protections such as minimum standards, supplier of last resort protections, delivery of community service obligations and provision of minimum customer rights. The bill makes provision for both those and other matters too.

However, the government is concerned that the protection afforded by the competitive market may not be adequate for the last group of franchise customers including domestic and small business customers, particularly in the initial stages of the market's development.

These standing offers will cease to exist after December 2003

There are two reasons for this concern:

1. *the technical systems required to facilitate retail competition for that group of customers may not be fully implemented by 1 January 2001, so that, although legally entitled to choose between retailers from that date, it may not be possible in practice for the customers to do so; and*
2. *it is likely to take some time for those customers to become adequately informed about the choices available to them and how those choices can be exercised.*

As a result of these concerns, the government wishes to ensure that it has the necessary reserve power to regulate retail prices payable by this last group of franchise customers, or, possibly, a subset of those customers, as a transitional measure until a competitive retail market is adequately developed. Whether the power is exercised will depend on the extent to which the government is satisfied with the retail prices offered by the incumbent retailers to apply on and after 1 January 2001.

It is the government's view that the power should only be exercised if a de facto monopoly exists and that the party holding that de facto monopoly has or appears to have set retail prices that result in it obtaining a monopoly rent (Hansard, Parliament of Victoria, Legislative Council: 1415).

This speech was preceded by earlier debate in the Legislative Assembly on 24 May in which government Member for Dandenong North, John Lenders, said:

Another feather in the government's cap is the creation through the bill of fundamental consumer protection rights for domestic and small business consumers. The bill will put in place a supplier of last resort scheme to ensure that ultimately there is always a retailer from whom electricity can be bought. These are important features of the legislation. The bill also places obligations on electricity retailers to perform community services and provides for deemed contractors to carry over domestic and small business customers from January 2001 (Hansard, Parliament of Victoria, Legislative Assembly: 1719).

Broad's speech was followed in the Council by another government member, Glenys Romanes, on 31 May:

In addition, in putting forward a fundamental consumer rights protection regime, the bill provides for a supplier of last resort obligation on the retail electricity industry to ensure there is always a retailer from whom electricity can be bought. Further, it recognises and references obligations on electricity retailers to perform community services. Many of those community services are already in place, but the bill provides an opportunity to recognise them, reference them and ensure that they are maintained (Hansard, Parliament of Victoria, Legislative Council: 1490).

These two speeches seem to confuse the concept of retailer of last resort (which refers to the unplanned exit of a retailer from the market) with the obligation to offer (standing offer). Moreover, it is clear that neither member has understood that the legislation does not provide for the most fundamental right - that of supply. ■

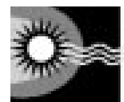


Table 4: ORG Final Decision Minimum Standards Framework for Full Retail Competition, August 2000 (excerpt of provisions)

Provision	Requirement: full retail competition	Comment
4.3.4 Graphs	The existing standard to display a graphical illustration of a customer's consumption will be retained, but customers can vary this standard when negotiating direct contracts with retailers.	Retailers will be able to encourage customers onto market contracts by offering a discounted price for omitting the consumption graph. Graphs not only allow the customer to manage their consumption, but provide a wider benefit in terms of demand management and greenhouse gas reductions.
5.1.1 Issuing of bills	The three monthly cycle should be maintained for FRC, with customers able to vary this cycle by agreement with their retailers when under direct contract, as long as explicit informed consent has been given. Deemed customers who currently receive monthly bills should remain on monthly bills.	ORG's usage of 'explicit informed consent' has been roundly criticised because it does not really mean explicit or informed, merely that the customer accepts the conditions. Whilst strictly speaking not necessarily a redlining provision, it may act to radically disempower certain customers. Retailers will be able to issue bills (as an example) once a year but direct debit more frequently. It is a likely tactic for dealing with low income households who may trade off receiving regular bills for some discount, but may find themselves with little practical control over payment or consumption.
5.3 Payment methods	As basic terms and conditions, customers must have the payment options of mail, direct debit and cash payment at a network of agencies or outlets. No transaction fees will be permitted for over the counter payments. Customers may be able to vary this range of choices by agreement. Retailers should be able to pass on the administrative charges of the various payment methods to recover costs.	The cheapest payment options are those predominantly available to affluent and educated households (e.g. internet). The second part of this clause in effect permits 'user pays'. As the number of people paying by a particular method dwindles, the cost per account grows (a common problem in residual markets). It is not difficult to see pressure from retailers to charge for over the counter payments. The aged are especially vulnerable if this was to happen.
6.4 Assessment of capacity to pay	Retailers will be required to: • Ensure timely assessment of capacity to pay; • Seek assistance from financial counsellors if they are unable to adequately assess capacity to pay; and • Document formal procedures on capacity to pay which is available to customers on request. Customers will be required to advise retailers when they experience payment difficulties.	Such clauses do not address fuel poverty issues. Unless there is recognition that payment must be based on the customers' capacity to pay and involve the potential for debt forgiveness, as well as retrofitting (to address the likely cause of problems), this clause is meaningless. Both price and consumption contribute to customers getting into debt and arrears.

4.2 MINIMUM STANDARDS FRAMEWORK: The Terms & Conditions of Supply

The ORG was required by Sections 169A and 169B of the *Electricity Industry Acts (Amendment) Act 2000* to develop the terms and conditions of supply for the deemed and standing offer customers. In addition, it has undertaken to develop the broader consumer protection framework for small business and residential consumers, including a revision of the former Sale and Supply Code in order to make the provisions technically applicable to full competition. The Sale and Supply Code in its new form is called the Retail Code. Other wider regulatory decisions are contained within the Minimum Standards Framework for Full Retail Competition (Minimum Standards).

Part of the revision has been an assumption that monopoly provision requires a more prescriptive consumer protection framework than when competition exists. As markets provide choice, there is a belief that market discipline will prevent market abuse. Hence, the Minimum Standards incorporate a view that retailers and customers should be able to negotiate some aspects of the supply/consumption relationship. Retailers require 'regulatory space' to innovate, and customers will display their preferences by willingly exchanging certain protections in order to secure an alternative (and presumedly better) benefit.

In providing the opportunity to innovate, **the Minimum Standards framework does not merely permit redlining, but actually provides an institutional framework in which it is encouraged.** The following tables describe the clauses that establish such a framework.

Market contracts will aim at improving the cashflow position of the retailer. Retailers will seek to increase the usage of direct debit, minimise the necessity for meter readings and shorten the collection cycle. Customers are likely to be offered some financial incentive to move from the current three monthly cycle. Discounts for the adoption of **direct debit are of particular concern for low income households.**

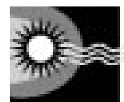


Table 5: ORG Electricity Retail Competition for Small Customers Position Paper: Obligation to Offer Terms of Supply, Default Retailer and Price Information Disclosure, November 2000 (excerpt of provisions)

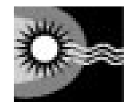
Provision	Requirement: full retail competition	Comment
3.1 Which retailers have an obligation to offer?	There should be a general obligation applying to all retailers to offer terms of supply on request within their licensed supply area (i.e. the state of Victoria). But, as an interim measure, no obligation for second tier retailers to offer terms of supply to customers using below 160 MWh from 1 January 2001.	This clause allows non-host retailers to cherry-pick the more affluent customers and increases the likelihood of residual (poorer) customers being captive to their host retailer - and hence subject to monopoly pricing.
3.2 Which customers should be protected by an obligation to offer supply?	Once all customers have a choice of retailer, the obligation to offer terms of supply should apply to all customers below 160 MWh. ORG will consider whether it is appropriate to roll back the application of this obligation once it considers competition to be fully established, and will provide advice to the government in this regard. This obligation is also currently subject to a sunset clause of 31 December 2003.	If the obligation to offer is removed, some customers will not be able to secure supply, because no retailer will be obliged to do so. More than any other group, the 'hard to serve' customers - those with debt and/or poor payment history - will be refused service.
5.1 To what extent should retailers be obliged to publish all prices?	All retailers should be required to publish their Standard and Default Tariffs in the Government Gazette under Section 35 of the Electricity Industry Act 2000. Retailers should be permitted to offer wider selection of tariffs tailored to individual customer groups without a requirement to publish these. For published tariffs, retailers should include sufficient information, e.g. breakdown of the component charges, to allow a customer to calculate total cost given their consumption level/pattern.	Only the deemed contracts and standing offers are required to be published. The lack of obligation for market contracts to be published denies the customer the opportunity to know the market clearing price. The very existence of undisclosed prices and customer specific offers is a redlining provision: It allows retailers to choose their customers, rather than allowing the customer to accept a generally offered deal.

Direct debit removes the discretion to choose between competing financial demands. Moreover, lack of control over timing places considerable risk of bank dishonour fees on the account holder. Cost per user of the 'old fashioned' system rises as fewer customers use it (an increasingly expensive residual market). After a period it is likely to be abandoned for cost reasons, forcing all customers into the 'modern' system - a regime that does not necessarily meet their needs. Besides issues of accountability in adoption of highly automated systems (One-Tel is a relevant example where direct debits continued after the company's collapse), new technologies are capable of delivering efficiency gains, but this particular innovation is most suited to customer groups that are well off, educated and internet literate. For customers who need longer collection cycles because of small disposable incomes or who want to pay over the counter because it is what they understand, a premium will effectively be charged to have this option. Discounting of certain payment methods introduces another level of discriminatory pricing practices.

The Retail Code and Minimum Standards conceive of competition in electricity retailing as it has been conducted since contestability was introduced - as an individual client-based relationship. This may be reasonable given the smallness of the market to date and the nature of the demand of individual large customers (and the requirement for real time communicative interval metering, required by the NEC). However, this does not mean that it is appropriate for mass contestability. The ORG has been very concerned to provide the retailers with the opportunity to innovate. But, combined with lack of obligation to supply and the lack of emphasis on information disclosure, the ORG's approach could be regarded as naïve.

It is difficult to reconcile the creation of standing offers, and their consequent treatment by the ORG in setting the Minimum Standards, with another requirement of the *Electricity Industry Acts (Amendment) Act 2000.* Section 163(8) states:

If a licence is subject to conditions of a kind referred to in sub-section (3)(k) -



From Universal Service to No Service? The Redlining of Vulnerable Electricity Customers in Victoria

5.3 What ability should retailers have to negotiate against the published tariffs?	Retailers should not be prevented from reducing the price of their Default or Standing Tariffs to meet competition. However, ORG does not believe that retailers should be allowed to charge different prices to different customers for tariffs incorporating exactly the same terms and conditions. This would not preclude retailers from developing a range of Standard or Market Tariffs incorporating different terms and conditions at varying prices.	Having a disclosed standing offer and an undisclosed market contract is the mechanism that permits redlining. Retailers can tailor tariffs to the customers they want (they are under no obligation to offer market contracts). Customers they do not want can be relegated to the more expensive standing offers.
5.4 Which customers should be protected by the obligation to publish prices?	All customers in the <160 MWh/year tranche. ORG will also consider, however, whether it is appropriate to roll back the application of the obligation once it considers competition to be fully established.	Markets only function properly when the customers have perfect knowledge. If there is no obligation to publish any prices and it is difficult to obtain pricing information, there is a clear potential for market abuse.

Table 6: ORG Draft Electricity Customer Transfer Code, 17 August 2001 (excerpt of provisions)

S5.1 valid objections on the ground of certified debt held by the retailer	Must be aggregated debt of more than $200; not be in dispute; be outstanding for at least 40 business days; customers have been offered restructured payment terms; and other than debt for which restructured payment terms have been agreed to and adhered to for at least three months.	This provision recognises that blocking transfer, and hence the possibility of a customer accessing a cheaper price, is a major impediment for vulnerable customers participating in the market. However, like the Retail Code itself, the restructured payment option fails to be defined in terms of what is affordable to the customer. This provision is likely to mean that the most vulnerable are locked into their existing retailer or are denied supply.

(a) The Office must monitor the licensee's compliance with the customer-related standards, procedures, policies and practices developed by the licensee in accordance with the conditions; and

(b) if the Office considers that any of the customer-related standards, procedures, policies and practices, or compliance by the licensee with any of them, disadvantages, or may disadvantage any class of its customers, or all of its customers, the Office may make a determination requiring the licensee to modify or revoke any part of the standards, procedures, policies or practices.

Sections (a) and (b) appear to impose upon the ORG an obligation to identify and remedy disadvantage. The redlining provisions of the Minimum Standards, however, mean the ORG will permit licensees to engage in such discrimination. The generic nature of the government's statements in regard to their legislation does help us to interpret this clause.

It is also difficult to see how the standing offers do not conflict with the objectives of the proposed Essential Services Commission (ESC). Objective (1) states:

In performing its functions and exercising its powers, the primary objective of the Commission is to protect the interests of Victorian consumers with regard to the price, quality and reliability of essential services.

And (2) states:

...the Commission must have regard to the following facilitating objectives...

(f) to ensure that users and consumers (including low income or vulnerable customers) benefit from the gains from competition and efficiency.

However, the ESC legislation is to be subservient to the *Electricity Industry Act 2000,* if there is any conflict between the two. ■

4.3 The Reserve Pricing Powers

Section 158AA of the *Electricity Industry Acts (Amendment) Act 2000* provides the government with the right to intervene and set retail prices for the deemed contracts and the standing offers. These deemed contracts and the standing offers commenced on 1 January 2001 with prices (as a consequence of not being over-ridden) which can be said to have been approved by the government (ORG 2001a). The prices were in line with the previous MUT, with the exception of Citipower who delivered cuts of approximately 6 per cent. The government did not release any guidelines circumscribing the conditions for the use of this reserve power. In the parliamentary debate, the potential for monopoly pricing as a result of a lack of competition in the early period of contestability was mentioned. The desire to maintain prices in line with the MUT was cited in a number of speeches.

By June 2001, three host retailers had sought to raise their deemed contracts/standing offer tariffs. Citipower sought to bring its price back up to the MUT, while TXU and Origin sought increases above it. The government was forced to address the issue of process in the exercise of the reserve pricing powers. It referred the three requests to the ORG for advice under the Special Reference provision (Section 34A) of the *Electricity Industry Act 2000,* with further instructions to develop general guidelines for retail pricing.

It became rapidly apparent that the deemed contracts and standing offers are, by definition, set at rates that are above the likely market price. The government and the retailers are concerned that without adequate 'headroom' between the cost of supply and the deemed contracts and standing offers, there would be little incentive for retailers to offer lower prices. If they are set too close to the market price, customers will not switch. Lack of competition would mean consumers would forego the efficiency dividends that are said to be created through competition. The experience of many US states has been a lack of competition, primarily because of the safety net tariffs being set too low. Rosen, Sverrisson and Stutz (2000) cite the Pennsylvania default provider service being priced without the inclusion of retail costs, and how this has deterred competition from alternative providers. Some states auctioned small customers in an effort to deliver universal service whilst maintaining some kind of competitive pressure. Consumer advocates are concerned that these prices reflect loss-leading bids intended to deter new entrants, and fear the eventual consequences of lack of competition (Patrick 1998).

The Pricing Reference currently being undertaken by the ORG is considering of what order the headroom should be. The exercise is one in which the market price must be identified, and then a premium over and above that agreed upon. **The standing offer,** therefore, **is a state sanctioned monopoly price** that discriminates against those customers who are unable or unwilling to move onto market contracts. The government has, in effect redlined all residential and small business customers. It does for the retailers what would have taken them some years perhaps to achieve. The existence of monopoly priced standing offers at the outset of competition, moreover, provides the scope for price cuts to be delivered to the most attractive customers. Such price cuts will be acclaimed as successful competition.

How the ORG's inquiry is supposed to reconcile the stipulation in the Terms of Reference for the Special Reference that the standing offer tariffs must prevent market abuse (monopoly pricing), when by definition standing offers are monopoly prices, is an indication of poor policy formulation.

The customers who are likely to be adversely affected are those with low consumption, low income, poor payment history, pre-existing debt, in rural localities, living in poor housing stock, and tenants (both public and private). Lack of competition will mean retailers will have an effective monopoly over these customers. Standing offers will mean a decline in affordability, and reduced access to supply as households will be unable to accept the offer at the price at which it is tendered. There will also be an increased burden on social services in terms of increased demand for emergency relief and with the health and social consequences of households going without supply. ■

4.4 The Concept of the Standing Offer as a Safety Net Mechanism

Consumer rights consultant Barbara Alexander, who has developed a model consumer code for competition which has been utilised by a number of US states, observed in regard to US deregulation that the adoption of 'default' tariffs (standard offers, provider of last resort, basic generation service) has been the result of two conflicting policy objectives. These default tariffs are the equivalent of Victoria's standing offers. Alexander (2001) identified that:

- *If you believe that the prime imperative that must govern the decisions surrounding the implementation of retail competition is the need to create a competitive market as soon as possible, Default Service is a tool that should be wielded to achieve that end.*
- *If you believe that the competitive market is unlikely to develop in the near future or when developed, is likely to result in higher prices or less stable prices for residential customers, Default Service is viewed as a tool to maintain important consumer protections and maintain the longstanding acceptance of the universal service aspects of basic electricity service for residential and low income customers.*

Disregarding the imperatives behind the default service, she notes that, as the vast majority of US residential consumers have opted not to enter into the market, the 'Default Service decisions have [therefore] been the primary factor in determining the price and identity of the provider of basic electric service for the overwhelming number of customers in states that have implemented retail electric competition'.

The approach of most jurisdictions in the United States that have opened competition to households is significantly different to Victoria's. By and large, they priced the default tariff at the wholesale energy price, effectively undermining competition. A number of observers noted that there is a political interest in delivering price cuts to ease the way for deregulation (Alexander 2001; Rosen, Sverrisson and Stutz 2000). A default tariff at a discount price was broadly accepted by consumer advocates. The only attempt to introduce a default tariff above competitive rates was 'roundly criticized and withdrawn' (Alexander 2001: 5). Despite the 'protection' provided by these tariffs, most states have consequently faced decisions about raising prices in response to wholesale market pressures. Alexander concluded that 'default pools' as residual markets diminish the capacity to deliver reasonably priced service to their customers and (keeping in mind that she advocates anti-redlining provisions in the consumer protection framework) that:

> *there is experience that demonstrates that residential customers can be provided with rate decreases or rate caps, and the opportunity to shop for lower prices in a competitive market IF the wholesale market is relatively stable and utilities do not incur risks that threaten their economic viability (Alexander 2001: 6).*

Paul Fenn (2000), representing Local Power - a consortium of Californian consumer representatives - in his testimony before the Joint Hearing (Senate Energy, Utilities and Communications and Assembly Utilities and Commerce) said the default supplier arrangements for California's deregulation and customer inertia meant these suppliers had a monopoly over the customers:

> *Under AB1890, these companies are designated as 'default suppliers' of Californians who do not find their own power suppliers. As I mentioned before, 95% of Californians have not found a supplier. By allowing these deregulated former power suppliers to hedge the state pool or California Power Exchange (PX) and offer hedged 'service packages' to their former power supply customers, they are in effect being unofficially reinstated as default aggregators, which in effect amounts to re-monopolisation.*
>
> *The Power Exchange is not - as some revisionists have recently argued - the competitive market that Californians were promised for their $30 billion in 1996. It was created as a backup system for the unprofitable consumers (hence the term 'default service'), much as many states have created property insurance redlining pools for poor people in 'high risk neighborhoods' who often cannot find an insurer who will offer them coverage. The fact that this redlining pool includes 95% of Californians does not make it a market.*

Fenn identifies one of the key problems with default suppliers, that being the inappropriate allocation of risk onto the customer:

> *Community Choice offers significant consumer security against fluctuations in wholesale power prices by transferring the risk to the private sector rather than to the consumers. In the Cape Light's power supply contract the winning bidder was required to provide performance bonds that are left in escrow in case the power supply is in default of contract. Under the agreement, if the supplier pulls out of a contract and the Compact must find a new supplier at a new price, the bonded supplier must pay the difference. In this way, Community Choice offers a method of assigning risk to the private sector where it belongs.*

Many US states have deferred or stopped full competition on the basis that wholesale market problems cannot deliver the required stability and price constraint required for political acceptance by the residential sector.

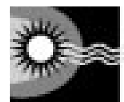
When the Victorian government introduced the standing offers, such little explanation accompanied it that it is only possible to provide conjecture as to why they thought it was a necessary measure. It is possible to infer from the speeches of Mr Lenders and Ms Romanes that a fear existed that not all customers would be able to access supply in a market situation. The ORG (2000a: 11), in interpreting the government's intention, suggested:

> *It must be recognised that not all customers will be equally attractive to competing retailers; therefore there is a need to ensure that those customers who for whatever reason, are less commercially attractive to retailers, are protected by having access to supply on reasonable terms and conditions.*

Despite what appears here to be an explicit recognition of the inherent discrimination that occurs in markets and the need to protect vulnerable customers, the subsequent formal position (**ORG** 2000b) adopted **at best fails to understand how such discrimination would operate** and at worst repudiates the earlier view. The framework that has resulted contains many measures that do not merely permit the market to operate in a discriminatory fashion, but enable and legitimise redlining. The standing offers, following Fenn's analysis of California, put all the small customers into the redlining pool at the outset. ■

4.5 Residual Market or No Supply?

Without the standing offer obligation, retailers would have the choice to rid themselves of these 'hard to serve' or marginal profit customers entirely. The provision ends on 31 December 2003. From 2004, retailers will be able to refuse to supply households. In New Zealand, where full competition has already commenced, David Russell (2001), Chief Executive of the Consumers Institute, reported the fall-out of recent high wholesale prices on unhedged retailers: 'One company in particular, has been, without compassion, disconnecting residential consumers who are behind with their payments, making it clear that they do not want them as customers again in the future'. Faced with the stark choice of not being supplied at all, many customers will be forced into contracts that exploit them. Firms will seek to allocate costs onto the less competitive



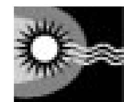
customer segments in favour of the more competitive customer segments where they can. Where the purchase is non-discretionary such as with electricity, this strategy is not just possible, but probable.

In markets, retailers seek to increase the margin per customer. They may make a healthy profit from dealing with affluent customers, but the overall rate of return will be less if they have too many low return customers on their books. A retailer could introduce a policy, for example, that they will not offer supply to customers holding a health care card, based on the assumption that people on limited incomes will not use much electricity and will not have the disposal income to purchase other products the retailer may be seeking to sell. Or **a retailer may not wish to supply customers living in public housing because they regard such customers as a credit risk.** People living in rural areas may find there is little competition because of the overhead costs involved in servicing a small number of customers over a vast territory.

The state of New York Public Services Commission (2001: 52-65), in grappling with the notion of a 'provider of last resort', concluded that with sufficiently robust competition this would not be needed. Despite this, the Commission acknowledged that, unless the law imposes an obligation to serve all customers, some customers would not be served. It argued further that 'the greater concern is the price a poor customer would have to pay to receive service from the market'. The Commission regarded rational economic discrimination (providing price signals for load management) as allowable, but discrimination based on the customer's income 'should not be permitted for the supply of these essential services'. It was basically saying that a vulnerable customer's lack of economic power should not be exploited. The Commission also discussed the problem of creating residual markets to supply vulnerable customers as these spread the cost of supply over a smaller customer base, effectively lifting the cost of supply to each customer in that residual market.

The experience of the FAIR law enacted by the US congress to counter discriminatory property insurance practices is valuable to the current debate. Colton (2000) explains that, after urban rioting in the 1960s, property insurers withdrew from inner urban neighbourhoods. The FAIR law resulted in insurers covering customers with good profile and leaving the rest to a residual public market. This public market offered less insurance coverage at higher rates:

> *It was widely believed that the FAIR plans would make insurance available to all insurable risks. Regrettably, this did not come to pass...Denied coverage in the voluntary [private] market for whatever reasons, rejected applicants found themselves paying appreciably higher premiums for less coverage. Some of the plan's rate were over three times those of the voluntary market with the result that risks often were 'written out' by the voluntary market and then 'rated out' by FAIR plans.* ■



FIVE ECONOMIC DISCRIMINATION

5.1 Distribution Tariffs in Victoria

In Victoria, the monopoly distribution systems or 'poles and wires' businesses are regulated (by the ORG) because competition is not practically possible. In a post-reform environment it is distribution, rather than generation or retailing, which most reflects traditional pricing practices. It is important to understand the traditional thinking in regard to the allocation of costs on customer classes and the resulting pricing structures in order to understand some of the assumptions that underpin price discrimination and, subsequent to disaggregation, why these assumptions must be revisited.

The traditional view is that small customers require extensive infrastructure to serve them and that each customer (consuming relatively little) therefore returns only a small margin on this investment. In contrast, large customers require far less extensive infrastructure and provide greater margins. This is illustrated by the fact that there are only around 17,000 contestable (large) electricity customers in the entire NEM who represent about 60 per cent of the total demand for electricity. In Victoria alone there are around two million small business and residential customers who account for less than 40 per cent of the state's demand. It is assumed that, if all customers paid the same price, this would involve a cross-subsidy from large users to small users. Utilities as a consequence have engaged in 'Ramsey pricing' which involves marking up the prices (that is, adding a premium) to those customer classes which display the least elasticity of demand. In other words, residential prices are set at a higher rate than tariffs for larger customers because households can do little but pay and are unlikely to alter their consumption in response. In the context of state ownership of utilities, governments balanced the interests of large customers wanting cheaper electricity and the political consequences of rating domestic tariffs too highly. In Victoria this has meant that domestic prices have been higher than industrial and commercial tariffs, but within bounds acceptable to the community.

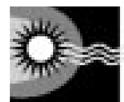
It has been argued in the Victorian electricity distribution pricing review and more generally that retailers and distributors need the flexibility to 'rebalance' their tariffs to make them more cost reflective. Cost reflectivity or 'user pays' is a cornerstone of neoliberal economic thinking as it presumes customers need the correct pricing signal in order for the market to achieve the most efficient allocation of resources. In concrete terms, this means that a customer may choose differently between two locations if the price they paid for electricity reflected the difference in the cost of supply to each locations, or a customer may choose to run machines at different times as the cost of supply varies over the day, week or season.

Three central issues emerge. Firstly, is the assumption about which customers contribute to what costs correct? Secondly, what are the implications of assigning (or reassigning) costs to particular customer classes? The third involves other cost variables such as location.

As Australian consumer rights advocate Lisa Carver (1995: 19) noted:

1) **The various methodologies available for quantifying costs of production are highly arbitrary** *(e.g. marginal and avoidable costs, fully distributed costs and stand alone costs); and*
2) *The discretion inherent in how pricing may be composed (e.g. the use of marginal cost pricing in volumetric usage and access and minimum charges to recover capital costs) can have a dramatic effect upon equity of access. Further the potential for discrimination between classes of consumers (e.g. Ramsey pricing) and regressive pricing packages in the exercise of discretion is considerable.*

Colton (1996) distinguishes between the contribution low income households make to cost of supply and the general domestic demand profile. He challenges the assumption that domestic users as a whole are in receipt of subsidies from non-domestic users. The subsidies flow, he says, from low income users to affluent residential customers. Because poorer customers generally do not have appliances such as air conditioners, they are penalised by being forced to pay prices that reflect the cost air conditioning imposes on the electricity system at peak times. Growth in demand from the less well-off customer segment is less than in the more affluent segments of the residential class. This means that **poorer customers are paying for new capacity that is not justified by their consumption patterns.** Colton argues that, as low



income households are effectively over-charged, programs designed to remedy fuel poverty are economically justifiable. There are of course low income customers who do have high consumption, but in Victoria there is often a strong correlation between these households and the thermally poor housing stock/poor appliances (Backman et al. 1987; Deasey and Montero 1983). Households often have no control over the stock because of lack of property ownership or inability to secure capital for improvements. It is vitally important to appreciate the economic powerlessness of these customers. Not only do they shoulder a greater proportion of costs than they should, but this is frequently in the context of quite a punitive attitude towards debt and disconnection.

In the United Kingdom, licence conditions on distributors prohibit discrimination between customers or customer classes (OFGEM 2000a). The *Utilities Act 2000* mandates that the new regulator, the Office of Gas and Electricity Markets (OFGEM) - created by merging the former separate electricity and gas regulators - shall have regard to (amongst other objectives):

- The interests of consumers who are disabled or chronically sick, consumers of a pensionable age, consumers with low incomes and consumers residing in rural areas; and
- Guidance issued by the Secretary of State in respect of social and environmental policies.

The basis of the non-discriminatory pricing is that prices 'should not differ between customers or groups of customers except in so far as these differences reflect reasonable differences in the costs of providing those services'. However, the Act does not countenance rural users facing higher charges on the basis of a higher cost of supply. In its consultation paper, OFGEM argues that marginal cost pricing may be seen by some as the appropriate price signal, but that it was unlikely to deliver the revenue required to fully recover costs. The alternative suggested is the application of 'mark ups'. Even so, OFGEM (2000b: 8) acknowledges the difficulty of that approach, including the social and environmental implications of Ramsey pricing: 'it is often difficult to determine what proportion of fixed costs should be allocated to each customer group'.

The allocation of costs onto individual customers and classes of customers is fairly arbitrary and involves a number of other considerations besides the relationship between customer classes. It is at this point that the Victorian reforms become a little nonsensical. For a start, t**here is no publicly available data to demonstrate what subsidies exist post-1992.** Discussion of tariff rebalancing is on the basis of assumptions, and no credible attempt has been made to establish the veracity of such claims. The assumptions underpinning the cost allocation and tariff structures of the SECV cannot be used for the post-disaggregated businesses. The creation of postage stamped distribution franchises (DBs) in its own right has led to much distortion. Each has a distinct geography and customer profile. Allocation of costs to each customer class within each DB therefore has no historical reference point.

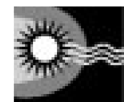
For example, the Kennett government instigated the unwinding of the estimated $100 million per annum locational cross-subsidies between urban and rural users in the early 1990s through the Grid Equalisation Fund. The fund, however, only addresses the subsidy between urban and rural DBs. A significant proportion of the subsidies going to rural customers is funded by the urban customers of the two rural DBs (Electricity Markets Research Institute 2000). Moreover, this scheme also involved asset write-ups and write-downs for the DBs as temporary offsets, so the situation is far from clear.

Cost to the system depends on the location of the customer, their consumption profile, the age of the assets (intergenerational equity) and the time of use, whether it be day or week or season (temporal issues). Variables other than tariff rebalancing are either ignored, or are deemed too be to hard or somebody else's problem. For distribution, locational cross-subsidies became a case of being 'half pregnant', and the compromise it involved is largely entrenched in the physical structure of industry and the regulatory framework. Transmission is subject to ongoing decision making regarding allocation of costs (including location and line losses). The fact that most electricity assets are long lived and involve intergenerational equity has been lost in the need for the new owners to recover costs in a much shorter time frame than under public ownership. And because - **like 'greed' - consumption is good,** whatever price signals exist involve cost smearing (indiscriminate allocation of costs onto customers) that has the effect of encouraging more consumption.

If economic efficiency requires proper assignment of costs, then tariff rebalancing is of limited use. It is extremely crude to suggest that the only variable in assigning costs is the class of customer - in itself a crude categorisation that involves intra-class subsidies.

Tariff rebalancing is a reassignment of costs, but it is challengeable whether or not it results in 'economic efficiency'. Electricity production can be conceived of as a closed system. Reallocation of costs amounts to rearranging the deck chairs on a ship. Some customers will be better off but, if they choose to spend their new gains on additional consumption of electricity, there is a point where that additional consumption imposes new costs on all users. If more electricity is consumed, the unit cost declines until the point where marginal revenue meets marginal cost. After that, the cost of all units must rise to fund the new investment required to satisfy the new demand.

Discrimination, on the other hand, on the basis of the customer's consumption pattern (the only thing in this market that distinguishes one electron from another is the time of its use) provides the customer with a choice - with the ability to respond by either accepting a deal that gives a lower price for shifting or reducing consumption, or paying a higher cost when cost of supply is higher. Price discrimination on the basis of income maintains the customer firmly in the role of price taker. Markets require the



customer to have choices - the right to exercise choice in the face of reasonable and legitimate options. If a customer is in the position of being a price taker, then in economic terms there is market failure. ■

5.2 The Electricity Distribution Pricing Review

Victoria has adopted the use of a 'tariff basket' approach to setting of distribution tariffs. The ORG imposes an 'x' factor (being a price cut in percentage terms) to the total of the tariffs, that is, to the 'basket' as opposed to each individual tariff. It is left up to the DBs how they wish to allocate the price cut explicit in the 'x' to each customer class (tariff). The 2001 Electricity Distribution Price Review by the ORG determined that an 'x' factor of 12 to 22 per cent apply to the tariff basket (depending on which DB) in the first year of the regulatory period (2001) and 1 per cent in each of the subsequent years of the regulatory period (2002 to 2005) for each DB. That is, the ORG mandated a price cut (after an adjustment for inflation) of 12 per cent across the board in the first year and of 1 per cent in each subsequent year. So long as there is a total price cut of 12 per cent (or 22 per cent, depending on which DB) in 2001, the ORG is not concerned about which customers are the recipients. In effect, it allows for domestic tariffs to lift by the rate of inflation, while other users receive cuts of 12 per cent. The tariff basket approach is ostensibly to allow the rebalancing of tariffs.

The only constraints imposed were that each tariff should represent a point between 'avoided cost' (the amount the business would save if it did not serve that customer class) and 'stand-alone' costs (the amount it would cost if the business only served that particular customer class). As the table below demonstrates, there is a huge difference between the boundaries and between the cost allocated to each customer class.

Table 6: Distribution Charges

Tariff category	Avoidable cost c/kWh	Stand-alone c/kWh
Small single rate	1.6	0.3
HV demand metered	6.7	2.4

Source: Citipower 2001 Distribution Price Review Submission, App. 7: 247

The other constraint was that rebalancing (increases) should be smoothed over a number of years, avoiding price shock for the customers involved. This approach provides the DBs with tremendous scope to tariff rebalance even within the constraint of the 'x' cut to the tariff basket.

As Victorian home occupancy is close to 100 per cent and as people do not choose where to live on the basis of electricity prices, it is rational for the DB to load costs onto the residential class in favour of their larger customers who can relocate and have a stronger interest in electricity prices. Only time will tell if this is the case, but the imposition of an effective price cap on residential retail prices as a result of the deemed/standing offers is possibly constraining rebalancing of distribution tariffs for the moment. However, the view that residential customers may be more profitable than frequently assumed is supported by credit rating agency Fitch (2000) who highlighted in one of their regular market updates the significance of the domestic sector for distribution profits.

The Energy Action Group was critical of the 2001 Electricity Distribution Price Review Determination because it allowed discriminatory pricing and could not guarantee that households would receive fair and reasonable prices. In addition, the methodology embedded substantial air conditioning cross-subsidies that harm low income households. Consumer groups were also critical of high standing charges. Jeff Washusen of Pareto Associates, a consultancy engaged by the ORG on behalf of small electricity consumers, noted the impact of standing charges on equity:

- **Standing charges support marketing strategies to increase consumption;**
- *Standing charges tend to collect disproportionately more revenue from low income quantity consumers than the costs these customers impose on the network;*
- *Lowest income households use, on average, less electricity than other consumers and pay higher prices with a standing charge (Pareto Associates 2000: 6)*

The Pareto report was scathing in regard to the ORG's approach to pricing principles, describing its faith in regard to DBs behaving reasonably within the economic incentives provided as 'naiveté'. It concluded that, without explicit policy constraints, 'unfair price discrimination' would occur and tariffs would not be 'aimed at cost-reflectivity', rather that

> *the DBs will...behave as the monopolists they are...the DBs can be expected to [sic] everything within their power to optimise any opportunities they find to appropriate monopoly rent including, setting anti-competitive tariffs, setting upper and lower bounds on tariff [sic] that are not consistent with economic efficient principles and practicing unfair price discrimination (Pareto Associates 2000: 35).* ■

5.3 Discrimination: A Cost Structure Issue?

Economist and low income advocate Eugene Coyle argues that economic discrimination between classes of customers is fundamental to the recovery of costs in industries such as electricity. In *Price Discrimination, Electric Redlining, and Price Fixing in Deregulated Electric Power,* he points to the history of undifferentiated commodity markets in the United States that demonstrate cooperation rather than competition has maintained profits in these industries, including electricity. Secondly, he says that large overhead costs put pressure on plants to practise 'yield management':

Selling all output at a single profitable price, i.e. at average costs or higher, is also not feasible. The full price might be so high as to discourage sales. If sales were not large enough to fully employ the capacity of the plant, or come close to that, then total costs would not be recovered. The solution, long understood and employed by electric utilities, is price discrimination and cross-subsidization (Coyle 2000: 19).

Proponents of deregulation and competition argue strenuously that it is highly desirable to obtain price signals based on the system marginal cost as this is the means to the most efficient allocation of resources. Coyle disputes this view that competition will mean utilities will price output at the system marginal price, because to do so would bankrupt them. This view is supported by OFGEM (2000b) in relation to distribution networks. Coyle (2000: 30) says that utilities traditionally do not price on the basis of marginal cost but engage in Ramsey pricing, which is 'difficult to distinguish from simple textbook monopoly pricing, where the profit maximizing rule is to squeeze each customer for the maximum revenue possible'.

Coyle (2000: xi) maintains that it is essential to understand the cost structure of the industry itself, because it is this that provides the pricing incentives. The incentive he summarises is price discrimination:

The largest electric customers will have options such as fuel switching, self-generation and relocation, and will be offered low prices to lock them in as customers. Those with fewer options - small business and residential customers - will be charged higher prices. Within the small-business market and among residential customers, further discrimination will take place. Emulating the airlines, which try to price each seat to yield the maximum revenue, sellers of electricity will charge the highest price they can obtain from each customer. Within this group, those willing to buy a bundle of products from the same vendor may get a better deal on electricity than those who do not, without regard to the cost of production.

Other jurisdictions have approached the issue with an acknowledgement of the current inadequacy of methods of determining cost contribution and the equity considerations involved. The Independent Pricing and Regulatory Tribunal (IPART) in New South Wales established a working work to develop pricing principles for distribution charges. In doing so, it recognised that regulation should be 'balanced between the interests of the stakeholders' and that the objectives of pricing are to achieve:

- *Economic efficiency;*
- *Revenue sufficiency; and*
- *Equity.*

These pricing principles should reflect economic costs by:

- *Being subsidy free;*
- *Reflecting the level of available capacity;*
- *Signalling future investment costs;*
- *Discouraging uneconomic bypass;*
- *Allowing negotiation to better reflect the economic costs of specific services;*
- *Returning the allowed revenue stream while recovering the gap between marginal and average costs in the least distorting manner possible; and*
- *Promoting equity, stability and consistency of outcomes by:*
  - *Having regard to the impact of price changes on the customer;*
  - *Being transparent; and*
  - *Being based on published costs and methods (IPART 2000: 4).*

Despite the inclusion of 'equity' as a pricing objective, its application is not dissimilar to the ORG approach. **'Equity' is defined as 'limits [in] the annual change in some prices'** (IPART 2000: 5). However, IPART recognises that there is 'considerable debate over the measurement of the upper and lower bounds for the range of subsidy free prices' and that 'the requirement for revenue recovery may conflict with the requirement for economic efficiency' (IPART 2000: 4, 6). Nevertheless, it chose to not sensitise the pricing principles to reduce the scope for market abuse by the DBs.

In contrast, Dunedin Electricity (1999: 1) in New Zealand has the following objective (amongst others):

2.2 Fairness
As a supplier of essential services, Dunedin Electricity intends to set fair and reasonable prices. Delivery charges as a whole are cost based and the recovery of those costs will be spread fairly over users of the network. The application of fairness to delivery pricing is one of the most difficult objectives to achieve as users will have varying views on what is fair, based to a large extent on how pricing policies impact on their individual delivery process. ■

5.4 Retail Discrimination:

The disaggregation of the industry means the retail functions are ring-fenced from distribution, if not formally separated under different ownership. Likewise, generation assets were separated to encourage competition. This was the case in Victoria in the immediate post-privatisation period, but that has changed recently as retailers seek ownership of generation as a natural hedge. The separation of electricity retailing means that it is no longer tied to a capital intensive business and is therefore likely to adopt a different strategy in relation to customers than formally vertically integrated utilities or even DBs. In this sense, they can operate much more like retailers in other commodity markets. The distinction is that, with Ramsey pricing, even the smallest accounts contribute something because, having built the network and generation plant for all the other customers, any contribution this small customer makes to costs helps. Or, to put it another way, not supplying the customer would not lower the cost of supply to the other customers, but doing so - even at a 'loss' - benefits all users. Retailing is not a capital intensive business; rather, each additional customer adds new costs. A particular set cost needs to be recovered from each customer. Small account holders represent high cost/small return. **The strategy for retailers is to concentrate on accounts that involve a higher volume of sales** and not carry too many low volume accounts, otherwise the overall rate of return falls.

The market segmentation in electricity retailing is a two part strategy. Firstly, it seeks to discriminate in favour of those customers who can be encouraged to increase their consumption. Secondly, it marginalises those with low consumption and low income because they contribute little to marginal revenues. These customers, being equally unattractive to all retailers, can be forced to contribute additional revenues simply through monopoly pricing. Therefore, retail price discrimination will not reflect the cost incurred by the customer, but the customer's possible contribution to revenue. Ernst (1994: 45) warned that the lack of economic power of domestic customers 'could result in the introduction of tariffs for the domestic sector well in excess of those necessary to meet marginal cost requirements, with virtual impunity'.

The idea that firms will segment the market in order to maximise yield is not new. The Consumers Federation of America (Cooper and Kimmelman 1999) claims that there is a 'digital divide' in which telecommunications customers are segmented and some are discriminated against. Stepanek (2000) and Bowers (2001) explore the emergence of another form of redlining - 'weblining', the use of the internet to segment markets - and its potential for abuse.

The New Jersey Board of Public Utility Control (n.d.) has explicitly provided for anti-economic discrimination measures in its Interim Retail Choice Consumer Protection Standards for electricity competition:

Redlining means a procedure which involves unreasonable discrimination based upon race, color, national origin, age, gender, religion, source of income, receipt of public benefits, family status, sexual preference, or geographical location.

In doing so, the New Jersey Board of Public Utility Control (1997) also acknowledged the distinction between the *opportunity and the actuality* of obtaining benefits from competition. However, as Coyle (2000) notes, governments may recognise economic redlining as a problem, but they are failing to understand the distinction between active exclusion and omission.

There is increasing evidence that generators in the National Electricity Market are engaging in market abuse

The following three scenarios describe why redlining is problematic and broader than welfare.

Case 1

In terms of retail costs, low income customers may cost more (they may need to negotiate more often with a customer services officer, or pay more frequently over the counter), but this is because the service is inherently discriminatory towards them (Kliger 1998) . Because much fuel poverty in Victoria derives from poor housing quality, they are penalised when they may otherwise cope. By allowing double discrimination, we are entrenching the poverty and removing their capacity to remedy the situation. The 'investment' the customer is required to make in obtaining electricity should in part be going to fix the housing quality. It is economically inefficient to allow this mismatch of investment need to investment capacity.

Case 2

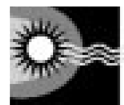
An affluent customer has invested in energy efficient appliances, insulation and a solar hot water heater and is therefore a low consumption user. This customer has avoided contributing to the requirement for new investment in the electricity system. Yet, because their consumption is low, a retailer will discriminate against them. The margin available to the retailer is low; the competition for this customer will be little or nothing and they will find themselves in the 'residual pool' paying more than they should. They will be financially penalised for having invested in energy efficiency.

Case 3

If we look at the life cycle of a household, we can see that usage is generally high while families occupy, but drops as children move away and particularly at retirement. Households contribute differently to costs over time. Price discrimination means that the retailer will seek to have the retired householder pay a greater contribution (not recognising any previous higher contribution) because they want the return on capital within a shorter period than used to be the case. These households, being income limited, tend to resist higher bills even if they involve consumption sweeteners. The solution as demonstrated by the Kennett government was to increase the standing charges. These are unavoidable and almost impossible to counter by lowering consumption. It also highlights the lack of pricing signal as being advantageous for the utility. Allowing for discrimination between residential customers means that intergenerational equity is distorted.

The ORG assumes that tariff rebalancing will only occur to the extent that prices will reflect the contribution the customer makes to costs, but this is manifestly wrong.

How generators will recover their costs is beyond the scope of this paper. However, Coyle (2000) argues that there will be price wars and then corrections involving mergers and collusion in order to support the 'correct' amount of capacity. Such a wave of mergers has already taken place in the United Kingdom (Unison 2001) and is even underway in the United States, despite the recently mandated disaggregation of vertically integrated utilities. The Victorian industry is already experiencing its first wave of reintegration (each of the three planned gas fired power stations involves retailers and generators as owners) and increases in horizontal market power (permitted by the recent relaxation of the cross-ownership provisions in the *Electricity Industry Act 2000).* There is increasing evidence that **generators in the National Electricity Market are engaging in market abuse** intended to drive up the average price of electricity. ■



5.5 CUSTOMER INERTIA?

Colton (1999) states that the failure of a competitive industry to protect the interests of low income consumers flows from two general types of problems: the failure of competitive markets to compete for such consumers, and the inability or unwillingness of such customers to participate in the competitive market. Referring to Stutz's Californian study that posits that small consumer participation in competitive energy markets is limited, Colton says:

- *First, some consumers are simply not interested in making market decisions. This customer behavior involves routinized decisions, often based on habit purchases.*
- *Second, some customers do not seek to maximize their economic benefits. Instead, these* **customers engage in what is called 'satisficing'.** *These customers engage in a process that 'after considering to some degree the potential exchange, they conclude that the status quo is good enough, albeit not necessarily the best possible deal that they could get.' This process of 'satisficing' is particularly prevalent amongst small users, where maximizing benefits would nonetheless still yield small gains.*
- *Third, market barriers exist that impede customer participation in the competitive market. These barriers include high information and transaction costs, the uncertainties involved with making assessments, and the efforts needed to be expended to switch providers.*

International experience has seen very low 'churn' (customers changing retailers) rates in most jurisdictions where full competition has occurred. Colton (1996) cites work undertaken by the US General Accounting Office which reports that only about 4 per cent of small gas customers had opted for a new retailer. Baker (2001) reports United Kingdom churn rates are higher but related to the take-up of dual fuel deals. However, low income consumers were actually paying more for fuel purchased dually than if they had purchased each separately, which reflects marketing strategies and poor consumer awareness. Unison (2001) question the ability and incentive for small customers to switch, citing possible savings of as little as £5 per year.

Consumer inertia is clearly an issue even if there is a robust competitive market. The experience in the United States for both gas and electricity is the extent to which energy companies actually compete in the residential market. Successful markets have many competing firms and the threat of new entrants provides discipline on prices and service. The decision by a potential new competitor to enter will depend on assessment of the likely profits (rate of return) and the period over which investment can be recovered. If potential competitors do not materialise, that leaves incumbent firms with significant market power. Work by Costello (quoted in Colton 1999) revealed that the cost of acquiring a domestic gas customer was $200, while the margin per annum was $25 over an eight year payback period. Enron, the world's largest energy trading company, pulled out of residential gas retailing in the United States, citing profit margins as being too low. After surveying the field of electric providers on the eve of the opening of the Californian market, UCAN (1998) found that 'few legitimate businesses are interested in entering the small business or residential market'. The cost of acquiring residential consumers was also expensive for Enron when this market opened, reflecting experiences in other markets such as New Zealand.

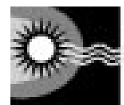
Coyle (2000) believes that the high cost of acquiring small business and residential customers and the low rate of return increases the need to discriminate between affluent customers to whom bundled products can be targeted and low income, low consumption households who are to be avoided. This, he says, can be achieved via data mining technologies and the substantial lack of personal privacy. Moreover, new technologies such as the internet, which in terms of personal use correlate heavily with affluent households, provide a remarkable tool for such discrimination. The internet also provides a possibility for overcoming some reasons for discrimination, such as the geographical disadvantage experienced by rural and remote customers, but this depends on access to equitable telecommunication services which is subject to similar discriminatory strategies.

Either lack of competition or customer inertia provides incumbent firms with the market power. An effective monopoly allows prices for captive customers to be subject to undue price increases. Rosen, Sverrisson and Stutz (2000: 56-7) state:

When price discrimination is not based on the willingness to pay but, rather, on the consumers' inability to negotiate the terms of the sales contract, or some other manifestations of market power that turns a particular customer class into price takers, particularly for a necessity of life, then it is clear that price discrimination has taken a negative turn. It is also clear that such price discrimination is likely to hurt small customers, while large customers are likely to benefit [author's emphasis].

Stutz, quoted in Colton (1999: 36), warns that small customers face the risk of 'cost shifting and lack of market power [that] will result in small captive customer rates increasing'. He makes the comment that existing programs, many of which do not afford adequate consumer protection 'would need to be strengthened and expanded'. Fear of cost shifting, price discrimination and market failure were central to the Consumers Union / Consumers Federation of America 1998 report, *The Residential Ratepayer Economics of Electric Utility Restructuring: Balancing All the Costs and Benefits.*

The move from universal service to markets has also been identified as resulting in the withdrawal of services from particular regions. The University of Newcastle upon Tyne (2000) found evidence that **energy providers were withdrawing services from disadvantaged neighbourhoods.** Customers in such areas were more likely to have pre-payment meters and as a consequence pay more for their electricity. The study concluded that 'Privatisation and restructuring have left less affluent neighbourhoods and social groups with only limited access to services which could be considered essential for full participation in contemporary society'. ■



From Universal Service to No Service? The Redlining of Vulnerable Electricity Customers in Victoria

SIX BUNDLING AND MULTI UTILILITES

Market contracts will be not just be about energy prices. They will also be about branding and selling other products. Bundling of products and services, however, is yet another means of redlining and can actually result in anti-competitive behaviour.

Unless carefully regulated, bundling decreases transparency. As indicated earlier, Baker (2001) found that customers taking bundled packages for gas and electricity were paying more for fuel than those who purchased each separately. If the objective of energy industry reform is to seek efficiency gains that result in lower prices to consumers, then pressure must be maintained on prices and performance. Bundling can involve inappropriate cross-subsidisation between electricity and non-electricity products. The benefits of these kinds of arrangements tend to flow to wealthier households who are targeted for the non-utility goods.

Regulators should also be wary of claims that bundling will reduce costs. It may mean one billing system, but it will need to be a very complex system. Victorian retailers are having difficulties with billing systems now, as evidenced by the EIOV Annual Report (2000). Substantial customer servicing will be involved with selling other products, and what may be saved by having common billing systems may be offset by additional service requirements. To this end, it is possible that those purchasing only electricity will cross-subsidise those purchasing other goods and services. ■

SEVEN UNITED KINGDOM

EMERGING EVIDENCE OF REDLINING

There has been a considerable change in the regulation of electricity in the United Kingdom since the election of the Blair Labour government, which after extensive consultation introduced new legislation *(Utilities Act 2000)* to strengthen protection of small customers. The new approach is summarised by the Department of Trade and Industry (2000) as:

- Providing a fundamental right to energy (obligation to supply);
- Recognising that markets do not treat all customers equally and that small, poorer customers may be disadvantaged;
- That, to date, vulnerable customers have been discriminated against;
- That, at a general level, the market has provided benefits;
- That, in order to address fuel poverty, a 'whole of government' approach is required; and
- That households should not face price discrimination on the basis of geography (specifically, Scottish households are protected).

Some of the actions that the government is taking include:

- Establishment of a Ministerial Group to oversight a 'whole of government' taskforce on the elimination of fuel poverty;
- Improving information and understanding of consumers to enable them to participate in the market;
- A reserve power to provide for the cross-subsidising of particular groups of disadvantaged customers;
- Requirements on electricity licensees to provide energy efficiency improvements;
- Direct investment by government in the energy efficiency of housing stock (£300 million over the next two years);
- Additional payments to pensioners for fuel bills;
- Additional funds to local government for maintenance and improvements to social housing (£3.6 billion in 1999-2002);
- New social security measures specifically for fuel poverty;
- Decreases in the VAT on energy bills;
- Seeking to increase the number of customers with bank accounts so that they can take advantage of direct debit offers that involve lower prices; and
- Linking fuel poverty elimination with achieving reductions in greenhouse gas emissions.

As its principal objective, OFGEM is required by Section 9 Part 4AA of the Act to protect the interests of consumers, having regard to:

- Individuals who are disabled or chronically sick;
- Individuals of pensionable age;
- Individuals with low incomes; and
- Individuals residing in rural areas.

Among the work OFGEM is undertaking to fulfil these objectives which are of interest here are:

- Monitoring the development of new tariff options including low user tariffs;
- Limiting the use of standing charges; and
- Researching the extent of rationing and self-disconnection (OFGEM 2000a).

The *Utilities Act 2000* and the subsequent Social Action Plan developed by OFGEM is not without critics. National Energy Action (NEA) (2001) point out that much is being left to interpretation; that, despite the legal obligation to supply, insufficient guidance is provided to protect vulnerable households from disconnection; that programs are too narrowly targeted; and that energy efficiency measures need to be directed towards all consumers. In its Response to the United Kingdom Fuel Poverty Strategy Consultation,

NEA (2001) stated that that no new initiatives or new resources are identified to achieve the objectives and that the energy efficiency measures spread too few resources over too many households. NEA (2000b) also expressed concern about the lifting of price controls, arguing that 'from the perspective of prepayment customers it will be difficult to view such developments as non-discriminatory'.

OFGEM (2000a:13) acknowledges the consumer groups' argument that blocking customer transfer on the basis of prior debt contributes to low income customers being unable to access the benefits of competition and is a mechanism that marginalises these customers.

Two important studies have been published recently on users' experience of the deregulated energy market in the United Kingdom. The School of Architecture, Planning and Landscape at the University of Newcastle upon Tyne (2000) examined privatisation and restructuring, and found that for disadvantage neighbourhoods:

- ...there was evidence of [now private] service providers either physically withdrawing from an area or distancing themselves from customers there...
- While disconnection from services was uncommon, use of services, particularly energy, was very restricted. Households often experienced difficulties with a range of services at the same time, compounding financial problems
- Generally, **the poorer the access to a service, the more it cost.** The higher costs of using pre-payment meters... exacerbated the difficulties of managing on a low income.

The observation that privatised services were withdrawing from low income neighbourhoods reflects the experience of private sector service provision in US cities. Colton (1995b) cites research by Zidek comparing banking services available to poor black neighbourhoods and those available to nearby wealthier white neighbourhoods which found the white areas had three times the services, and those branches had more tellers and loan officers. Redlining involves not just the refusal to serve, but a refusal to provide the same level of service.

The second study, *Competitive Energy Markets and Low Income Consumers* by Baker (2001), involved a three year longitudinal survey of the experience of low income households in the competitive energy markets. Commissioned by the National Right to Fuel Campaign and the Centre for Sustainable Energy, it found that many people had been lifted out of 'marginal fuel poverty' as a direct result of lower prices (acknowledging that gas input prices had declined substantially over the period), but that **the number in severe fuel poverty had actually increased.**

Baker (2001: 8) noted that:

New suppliers were continuing to 'cherry-pick' the more affluent consumer. Most companies were competing on price for certain consumer groups, primarily Direct Debit payers, rather than 'added value' services. Special services to vulnerable groups, such as disabled and pensioner households, were not improving.

The study referred to this disparity as 'uneven development'. This is characteristic of economic discrimination or redlining:

they [fuel suppliers and OFGEM] argue that Direct Debit consumers are much cheaper to service than prepayment meter and frequent cash payment customers. Competition, encouraged by regulatory action, leads to cost reflective pricing and the elimination of cross-subsidies. This means that previously 'hidden cross-subsidies' of certain payment options are revealed. Suppliers seek to gain competitive advantage by attracting consumers who pay by more cost effective payment options. However, these trends exacerbate existing inequities between affluent and low income households since prepayment meter and frequent cash options are more commonly used by low income households (Baker 2001: 14).

Many full-time workers were found to have switched suppliers, but pensioners and those of ethnic background had not. Many households were not aware of the costs associated with the various payment methods, for example, that pre-payment meters were the most expensive option. The study cited the demand made by suppliers that price controls on pre-payment meters be lifted, arguing that the price cap is too low and the customers are costly to service. In response to the inequity faced by users of these meters, OFGEM (2000a) is seeking greater uptake of other payment methods such as direct debit. In contrast to Australia, many people in the United Kingdom do not have a bank account, and the greatest proportion without accounts are poor. The strategy to introduce no-frills bank accounts and to extend universal banking services at post offices so direct debit can be utilised reflects, from the Australian experience, little awareness that deregulated banking industries discriminate in exactly the same way.

Importantly, the study recommended that energy efficiency investment and advice be integrated with debt management as few people in hard to heat housing reported receiving such advice or help from their energy supplier.

Baker's conclusions are supported by the House of Commons Select Committee on Public Accounts (2000):

(v) A key reason why prepayment meter customers pay higher prices appears to be that price competition amongst gas suppliers for prepayment customers is weaker than in other parts of the market. Of the 21 companies seeking to sell gas to such customers in January 1999, ten offered tariffs costing about the same as British Gas Trading and five had tariffs costing more. Only six had tariffs producing a saving, the largest being no more than £18 a year. By contrast, all of the companies that have entered the market since competition was introduced are offering prices for consumers using other payment methods that are lower than British Gas Trading's...

(viii) OFGEM want to ensure that the process charged to prepayment meter customers reflect the costs of supplying them, and reviews by OFGEM of these costs have resulted in lower prices for prepayment meter customers.

Approximately 80 per cent of customers using pre-payment meters did so because they owed money to British Gas Trading, which prevented them from switching suppliers:

We are very concerned that...customers using an average amount of gas pay...around 30 per cent more if they pay by a prepayment meter than paying by monthly direct debt. ■

EIGHT ANALOGOUS INDUSTRIES IN AUSTRALIA

Key observations about deregulation in telecommunications and banking in Australia are as follows:

- Banks have substantially raised their overall rate of return, and Telstra has recorded record profits;
- Banks have sought to jettison their small account holders or have increased fees for these customers;
- Banks have withdrawn services from rural areas;
- Telecommunications services are poorer in rural areas;
- Telecommunications competition works on a mass marketing strategy, but customers are being increasingly profiled (selective/strategic advertising); and
- Telecommunications call rates are dropping for highly competitive calls (long distance and overseas), but other fees and charges (in particular, line rental) are rising.

The economic discrimination practised against small account holders has become the focus of national political debate in recent months, with the Commonwealth government and opposition appealing to the banks to adopt 'social charters' or face possible regulation. Chief Executive Officer of the Commonwealth Bank, David Murray, threatened to dump the Commonwealth's small account holder, inspiring public wrath and substantial media attention. In an article in the Age entitled 'Banking on the rich and famous', Anne Lampe (2001) said:

Essentially they [the banks] want these so-called low-value, income diluting or negative-contributing customers to go elsewhere - and to take their unprofitable transactions with them.

A recent article in Perspective, the PricewaterhouseCoopers magazine, pointed to a European survey, which revealed profit margins of 35 per cent in funds-management activities. This beats the 16 per cent interest earned on credit cards, or the 7 per cent on a home loan, and provides a great incentive for financial institutions to devote resources to attracting that sort of business rather than dealing with Australia's poorer retirees, pensioners and students...the banks close branches in areas where a lot of pensioners and poor people live. Country areas were the first target, but increasingly it is also branches in suburbs not considered to hold enough bottom-line contributions or wealth-management targets...the banks tell them to use telephone or Internet banking or ATMS...customer who stick with the bank...are hit over the head with rising fees.

In the *Sydney Morning Herald,* Matt Wade (2001) reported 'Fury as banks grab record $6.3bn in fees':

private customers bore a heavy fee burden last year, with banks earning $2.1billion from households, up from $1.8 billion in 1999. The growth in these fees has averaged 49% a year between 1997 and 2000, and they are growing faster than fees for business.

Loans were the biggest source of fee income from households, accounting for 43 per cent, but income from transactions has been growing faster.

Webb (2001) in the *Sunday Age* said the Reserve Bank had found that banking had become cheaper since deregulation, but the benefits had not been distributed equally. Webb explained that the banks claim that competition from non-bank mortgage lenders is responsible, and has:

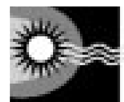
forced Australian banks to reduce the money they made on home mortgages. To off-set this they lifted fees. They argued that mortgages were cross-subsidising bank fees before deregulation and that the situation was now much fairer. [However,] household fees jumped 18 per cent last year against a 12 per cent rise in business fees. It [the Reserve Bank report] found that the fee rise hit the householders who were least well off - the elderly, unemployed and low income earners.

Telstra's attempt to appease Melbourne urban fringe customers who have been paying long distance charges for calls into the metropolitan area was welcomed as overdue but not as altogether positive. In the *Age*, Annabel Crabb (2001) said in 'Telstra's new pitch to bush, city fringe':

Telstra customers living on the fringe of cities and in regional areas were offered flat-rate STD calls for as little as 25 cents, in a along awaited response by the carrier about its call zones...But the new rates will not be automatic, and consumers 'opting in' to the cheaper calls will face higher prices on other products in fine print - a situation that the Australian Consumers Association yesterday labelled as confusing.

This 'good news' story was followed around two months later by an announcement that line rental on ordinary household accounts would rise by $2.40 to over $20 per month (including GST). The increase was disclosed to account holders in a letter announcing a special '1 cent Saturdays / 10 min International $1' offer (Telstra Retail 2001). The increases provoked ACCC chair Allan Fels to investigate Telstra's promotion of its 'low use' tariff. His findings suggested that Telstra had not done enough to ensure those eligible were taking it up.

Carver (1995) says that pricing oversight is required to prevent captive residential customers from footing a greater than proportional contribution to sunk costs: 'Competitive parity between market



participants ought to be an objective of the regulatory environment in which utilities operate'. She recommended that a pricing oversight board be established as part of the market reforms taking place, suggesting that such a board must consider the issue of 'competitive parity' but should also include:

- Maximum prices that monopolists can charge should be set through a transparent and independent process such as a statutory tribunal;
- Legislation must provide explicit criteria for the factors to be taken into account in setting maximum prices;
- Efficiency, equity and ecologically sustainable development should be incorporated into those criteria; and
- Price regulation should promote least-cost planning and demand management as tools for achieving ecologically sustainable development.

Jeannette McHugh (1995), Federal Minister for Consumer Affairs, in her opening address to the Consumer Protection and Utilities Reform seminar, said:

Public utilities...must not discriminate against customers who are suffering financial, physical or geographical disadvantage...these obligations [must be] enshrined as part of the basic framework of competition policy and privatisation practice.

Referring to the Consumers Telecommunication Network's research *For Whom the Phone Rings,* she noted that:

The CTN demonstrates the need for social policy to be integral to the general policy framework for telecommunications. It recommended (among other things) that social policy objectives be given equal weight in telecommunications competition with narrow economic efficiency objectives and that evaluation of the effectiveness of telecommunications competition include assessment of social policy objectives. ■

NINE FULL RETAIL COMPETITION

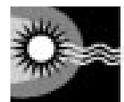
IMPLEMENTATION ISSUES

Between 1995 and 2001, small customers were franchised (not subject to competition) and prices were regulated accordingly. They were supplied by host retailers who had mandated Master Vesting Contracts (MVCs) with Victorian generators. This arrangement provided small customers, retailers and generators with price stability, but has probably masked underlying wholesale market problems that are now only emerging with the expiry of the MVCs. For example, because they ensured supply for franchise customers at an assured price, they also limited the extent to which generators could manipulate the wholesale market. The MVCs underwrote competition for large contestable customers, giving perhaps an unrealistic picture of competition. In theory, the small customer classes no longer provide such stability. Specialist credit rating agency Fitch (2001) believe that the MVCs hindered the development of a secondary hedging market.

To date, the number of customers in the contestable part of the market has been relatively small. This has meant that the information technology (IT) requirements for customer settlement and transfer have also been limited. The infrastructure cost per customer in relation to the profit margin per customer therefore has been realistic. Moreover, the retailers have been able to spread these costs across all their customers, not just those who are contestable. The IT requirements for mass contestability (full retail competition) are likely to be enormous. The cost per customer in relation to the profit margin available per customer is vastly reduced. Victoria's host retailers (Citipower, Pulse, TXU, Origin and AGLE) will need to recover these costs at the same time as competing for customers.

The Energy Action Group has sought estimates of the IT costs, but none of the official authorities have been willing to make any such analysis public - if indeed any such analysis has been undertaken. On the basis of the publicly known data, the Energy Action Group estimates the implementation and running costs of FRC (on the basis that current retailers operate in each jurisdiction - i.e. that it is a 'national' market) as somewhere between $1.5 billion and $4 billion over the next five years. Unison (2001) argue that the computer costs for FRC in the United Kingdom will be £726 million (£30 per customer) over the next five years, threatening the retail profit margins on small customers. These are overhead costs incurred whether or not a customer switches. If FRC costs are combined with the costs of acquiring small customers, then the return on investment may actually be negative. If not, the existing tariff rates for small customers are clearly excessive (raising further issues for the setting of standing offer rates). FRC IT costs effectively mean that the margin for every customer is reduced, even the larger customers. Some firms may engage in competition in order to achieve market share (there is a view that retailing businesses require something in the order of 500,000 customers to be financially viable in the future), but it would be a strategy that is likely to involve substantial initial losses. [1]

1 The holding of deemed contracts/standing offer prices to the former MUT has meant an un-level playing field between host retailers. The gap between the cost of supply and the price charged (the headroom) to the customer differs between retailers. The two rural retailers do not have much, if any, headroom. On the other hand, Pulse has substantial headroom and may be able to engage in a price war without losses. Short-term gains for consumers will be rapidly diminished by a longer-term reduction in competition.



One of the reasons why the implementation costs of FRC are likely to be so high is that, contrary to the intention of a 'national' market, the metrology (metering for customer transfer and settlements) procedures are being developed by each individual jurisdiction and **a 'rail gauge' issue has already emerged.** Each retailer will be required to have different IT build for each jurisdiction it operates in. This escalates the cost and is clearly inefficient. One may ask how this could happen, and it goes back to a fundamental flaw in the NEM in which there is no proper governance. As industry commentator Robert Booth (2000) says, it allows the states to behave as 'warring tribes'. The result in terms of FRC is that retailers will choose a jurisdiction rather than operate in the national market. It is likely that only host retailers will serve formerly franchised customers. Non-host retailers can continue to serve large customers because the IT they currently have will suffice; this capacity also allows them to cherry-pick the largest domestic users, leaving the host retailers with a residual residential and small business class.

Citipower recently sought increases to the deemed contracts/standing offers on the basis of FRC costs. Their case is instructive. They have a quite small residential base, but their IT costs are basically the same as those of a retailer with three times as many residential customers. This immediately puts Citipower in an uncompetitive position vis-à-vis other retailers; moreover, it will be difficult for them to compete and recover costs at the same time. Combined with the current and probably continuing wholesale market volatility, it is little wonder that Citipower is once again up for sale. The outcome is likely to be that the customers are sold to another retailer, as occurred when AGL exited the New Zealand market after heavy losses.

FRC is being driven by the jurisdictions. Each jurisdictional participant is able to determine when that state will proceed with 'competition' reform. Both Queensland and South Australia recently elected to defer FRC. Host retailers, on the other hand, have little option but to proceed if their state government mandates FRC. For the two states that are proceeding - Victoria and New South Wales - **the development of the IT and 'back room' processes has proved far more difficult and complex than envisaged,** leading to a delay of one year in Victoria's case. Technical difficulties and lack of certainty about recovery of FRC costs have meant that the Market Settlements and Transfer systems (MSATS) and Customer Administration and Transfers (CATS) are at only 20 per cent of total required build and allow an interface with NEMMCO but not much more. This 'portal' will not permit automated transfers on the scale required by mass contestability. At the time of writing (September), the MSATS-CATS was at the closed trial stage for a market that is intended to open to five million small customers in January 2002. The portal may be ready, but it is highly unlikely that the retailer IT needed for these customers to switch in a timely and cost effective manner will be. In the absence of a cost/benefit analysis in which both retailers and customers can perceive sustained benefits, it is questionable whether the systems will ever be put in place. The Victorian government is due to begin its advertising campaign in September 2001 to promote and prepare small customers for the opening of the market in January 2002. There remains a possibility that competition will officially exist, but that the ability for customers to switch will actually be extremely limited.

In markets where transfer has been possible, customers have been reluctant to switch. In the United Kingdom, low churn rates and lack of competition - especially for smaller customers - prompted calls by the National Electricity Consumer Council (2000) for a mass roll-out of interval meters as a means to foster greater competition. Similar calls have already been made in the United States. New Zealand is cited an example of high churn rates by Fitch (2001) (although they have steadied at about 10 per cent a year), but they do not see FRC as resulting in even this level in Australia due to the advantage of incumbency by existing host retailers. ■

9.1 Lack of Demand Response

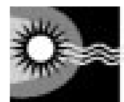
A key impediment to competition in the NEM is a lack of ability for the demand side to drive price or service delivery. The current franchise load, around 42 per cent of the Victorian demand, receives no price signal and therefore cannot be held responsible for the impact of their demand. In addition, the experience of contestable customers strongly suggests that the mechanism for demand side bids is not functional. Wholesale market problems need to be addressed to deliver the correct signals to the retail market. Rebidding by generators, physical withdrawal of plant and the poor liquidity of the hedge market have all been identified as significant problems. Whilst generators can engage in market manipulation, new investment in capacity will fail to make much impact on the security of supply problem and the prices such scarcity promotes.

The lack of demand side response embeds intra-customer class cross-subsidies for air conditioning, the major factor driving peak summer demand and high prices. This market failure is exacerbated by the ORG's determination on distribution tariffs in which air conditioning is also heavily cross-subsidised.

There is a serious conflict between the objectives of protecting consumers and maintaining industry viability in such an environment. Fitch identified a perverse incentive in the New Zealand market in which retailers who were afraid of losing market share if they raised retail prices in response to wholesale market volatility actually increased their financial risk (and loss of margins) because 'consumers have no incentive to lower demand'. Fitch (2001: 3) argue that, because the price signal is not present for the consumer to reduce consumption, it would be likely that retailers would not have appropriate hedge coverage for their entire load. Price spikes and lack of hedge coverage 'can have disastrous consequences'.

Retailers face considerable financial risk as a result of having no half-hour demand profile of their customers' load and no ability to control their customers' consumption. Without smart 'interval' metering, they have no means to manage this risk and must pass it on to customers - with large cost smearing involved. Interval meters would allow, as Rosen, Sverrisson and Stutz (2000) describe it, 'negotiating' rights or, as mentioned earlier, 'choice'. Washusen (2000) suggests:

low consumption households look unattractive to retailers from a margin perspective, but a low consumption household using little high cost power is a different kettle of fish entirely to a retailer looking at hedge coverage; and a low or marginally profitable household that commits to load



manage during high price periods will be worth up to 1-200 times more to a retailer than a conventionally 'profitable' high volume consumer who won't load manage.

Fenn (2000) also argues that demand responsiveness is a key to protecting small consumers from wholesale price risks. He suggests consumer controlled aggregation, noting the conflict between the incentives for growth in consumption on the part of the industry and the interest of consumers in controlling consumption in order to control prices:

Community Choice of public Energy Efficiency and Renewables funds is also critically needed to mainstream existing summer spike-levelling technologies that will continue to remain marginal to the power supply market as long as the state's wires companies continue to control the hotly contested energy efficiency and renewables surcharge funds that are currently collected from every Californian.

The Sacramento Municipal Utility District (2000) in California provides a very recent example of the benefits of load control. It has a program called Voluntary Emergency Peak Corps who agree to have their air conditioning remotely turned off during peak load crises (which have become something of a feature of electricity supply in that state). One hundred thousand customers participated in the program, which enabled delivery of system security to the wider grid on six occasions and also a tenth consecutive price cut at a time when other Californians were experiencing price shocks.

One attraction of interval meters in the context of full retail competition is that the remote meter reading function alleviates the geographical cost differential between customers. **Rural customers therefore would start looking more attractive to serve.** Whilst electronic handling can marginalise some customers, it is also capable of remedying other forms of disadvantage, and geographical disadvantage may be one of them. In order to create an anti-redlining consumer protection framework, it is essential to make retailers 'blind' to the location of their customers.

Competition requires the right price signals and the proper allocation of costs. Neither of these conditions are going to be met for FRC. ■

TEN ANTI-REDLINING STRATEGIES

SAFETY NET ALTERNATIVES?

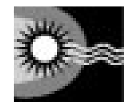
10.1 ELIMINATING FUEL POVERTY

IT SHOULD BE THE OBJECTIVE OF GOVERNMENT TO ELIMINATE FUEL POVERTY IN VICTORIA.
Electricity prices are not expensive by international standards and the climate is not severely cold. Fuel poverty could be easily and fairly cheaply eliminated given a 'whole of government' approach to the issue. The government currently spends between $50 million and $60 million per annum on energy relief grants and winter energy concessions. This income relief addresses in part people's incapacity to pay, but does nothing to resolve non-income related causes of fuel poverty. In particular, programs to address consumption are noticeably absent. This lack is economically irrational because the concessions budget (by no means small) is an ongoing liability to government, whereas retrofit programs are a one-off investment that, in a great number of cases, will preclude any further material assistance by the state. Moreover, there are obvious welfare benefits of the customer being able to increase spending on energy (these customers typically self-restrict) or other essentials. In addition, retrofit programs will result in the reduction of greenhouse gas emissions. Government can use its welfare spending and environmental mandate to assist vulnerable electricity customers. It can also ensure that the economic regulation of the industry does not encourage increasing consumption, or marginalise those who cannot afford to pay for an adequate level energy or those who invest in energy efficiency. From a market perspective, it will be extremely important for government to ensure that all customers can exercise choice in the market and that the demand side is capable of influencing market outcomes.

Whilst markets have been held up as delivering economic efficiency and hence lower prices and better services to consumers, the fact that they do not treat all consumers equally has rarely received attention from our governments in the Australia. This is also probably true of the other English speaking democracies that embraced market reform over the past twenty years. This is now changing in countries such as the United Kingdom, and increasing pressure is coming to bear on Australian governments as consumer disadvantage becomes more apparent. It reflects perhaps a shift from 'disadvantage' as it traditionally understood to a greater number of ordinary consumers being made poorer as a result of the removal of universal service in sectors that have been deregulated. Programs orientated towards ameliorating this traditional disadvantage can be characterised as safety nets, where only 'a few will fall between the cracks' and need assistance. Disadvantage is believed to be isolated and the exception, hence programs need only apply to the few. Deregulation will alter what we mean by 'disadvantage'. In attempting to produce a consumer protection framework for a deregulated industry such as electricity, it is important to ask what are the underlying assumptions.

Equity holders, particularly in the share market, **have greater expectations of higher rates of return than in previous eras.** This change has taken place since the widespread deregulation of the economy. In part this is attributable to the promotion of reform by governments and the private sector. Debt holders, particularly in privatised assets, were in many sale processes given very clear signals about the rate of return that they would be permitted to extract from former government trading enterprises - such expectations being capitalised into the sale price.

This has engendered a restructuring dynamic in which low profit centres and non-performing areas of these businesses are being identified and removed. If it is not possible to move the business away from these areas of service provision, then strategies are being developed to limit exposure to them and increase the contribution these



customer segments make. This involves removing explicit and implicit cross-subsidies, imposing higher prices, utilising alternative technologies, seeking government subsidies and reducing service quality. In some cases, 'captive' customer segments may afford a business the opportunity to create cross-subsidies going from marginal customer groups to the profit centre of the business.

When David Murray, Chief Executive Officer of the Commonwealth Bank, threatens to 'dump' small customers, he is asserting that the bank will be judged in the share market as under-performing. These customers, despite the fact that they may not actually be incurring losses for the bank, are dragging its overall profitability down. As a consequence, the share value will decline.

Universal service meant:

- Explicit cross-subsidies and redistribution of wealth to the smallest customers, promoting greater inclusiveness. This policy recognised the requirement for certain infrastructure to be in place and to be accessible to enable industrialisation and other economic development, especially in regional areas; and
- Servicing of low profit customers because it was economically feasible to do so, given the lower rate of return.

It could be said that the policy preference itself for deregulation and privatisation has created an insatiability for profits that necessitates social and economic exclusion (Kliger 1998, citing Teeple). Government and regulators need to thoroughly address market segmentation issues and the implicit rate of return for the utility (in total) and for each market segment. They need to develop regulatory strategies to guarantee social and economic inclusion.

Mass contestability, particularly if participation is an issue (which, given electricity is an essential service, it is), requires a market in which the buyer chooses the seller, not the other way round. Moreover, it requires mandatory disclosure of, and a high level of understanding in regard to, pricing. This is necessary:

- To provide a publicly known market clearing price;
- For delivery of non-discriminatory pricing;
- For market surveillance; and
- For promotion of competition.

Competition in the electricity market for the already contestable customers can be characterised as a market where the seller (the retailer) finds buyers and is typical of client-based relationships. This is rational when there are a small number of customers and the margin per customer is significant, and where a detailed understanding of the customer's needs is required. It is, however, impractical for a mass market. Mass markets typically involve the seller attracting buyers via advertising, and a less customised relationship. With two million small customers in Victoria who each represent only a small profit margin for the retailer, it is clearly a mass market. There is only one reason why the non-disclosure of price/service offers would be sought as a right by retailers, and that is to avoid scrutiny and to enable discrimination between customers.

How the poor fare in markets has long been understood (National Consumer Council 1977; Scottish Consumer Council 1994). The National Consumer Council (2000) in the United Kingdom has recently sought to understand the process more fully, describing 'consumer disadvantage' as a persistent shortfall in 'consumer benefits' and identifying the causes as:

- Lack of purchasing power;
- Exploitation;
- Discrimination;
- Social exclusion;
- Other people's transactions; and
- Provision deficit.

Their analysis provides an understanding of how these 'vulnerability factors' combine with 'supply features' (the characteristics of a particular market) to cause consumer disadvantage. Provision 'deficits' can be identified by plotting vulnerability factors against the supply features of the industry or service in question. In developing a consumer protection framework, provision deficits should be identified to provide the conceptual basis.

The vulnerability factors and supply characteristics of the electricity industry quickly highlight the need for a legal obligation to supply at a fair and reasonable price, in the context of a framework that prohibits redlining of customers. The obligation to supply removes the need to define types of discrimination, but a prohibition on discrimination is required in addition to that obligation. The framework would also require the remedying of fuel poverty.

National Energy Action (2000a: 130) in the United Kingdom, in *The Case For An Energy Universal Service Obligation,* says:

- Sustainable energy services should be provided at an affordable price;
- Should be set in terms of people's needs for actual services e.g. heating, lighting, cooking, power;
- There should be a cap on inequality - the definition of need should relate to society's expectation, rather than an 'absolutist' notion of minimal need (i.e. social inclusion);
- No energy supplier should be able to seek competitive advantage by excluding significant sections of the community.

Colton (1999) proposed that Colorado adopt a 'cap the gap' principle in which tariffs for residential customers and industrial/commercial customers cannot exceed a predetermined differential. Tariff rebalancing therefore would be limited, reflecting social and welfare objectives. Taking this concept further, regulators such as the ORG could assess retailers' offers in order to determine the implicit rate of return and the period over which it is anticipated. This way the regulator could see how each class of customer was being treated vis-à-vis other classes. It could also provide an understanding of how competitive the market was in actuality, and some insight into what segments may need some regulatory change/incentive. Coyle (2000) outlines the ease of calculating the basis of returns per customer segment.

In any framework on pricing, the total cost to the customers needs to be examined. Analysis must be sensitive to the imposition of penalty charges that are applied mainly to low income customers and can quickly increase the actual price paid for service provision. The imposition of such charges should be closely scrutinised as they are one method of effectively allocating costs to the low income segment of the customer base. ■

10.2 Market Surveillance

The use of advanced IT to data mine, sort and analyse personal information provides substantial opportunity to utilities seeking to selectively target consumers, especially in relation to bundling of services. It allows profiles of customers and potential customers to be developed and put to a number of uses. This includes selective marketing and identification intended to exclude or deter customers (Coyle 2000; Bowers 2001). It is a quantum leap from the days in which zipcodes (postcodes) were used as identifying tags by credit providers and insurers engaging in redlining. For example, it is possible to identify a street address as public housing or cheap private rental. Armed with such knowledge, the retailer can then refuse to offer anything but the standing offer (on the assumption that poor tenants are either of poor creditworthiness or warrant little attention in terms of bundling of services). However, there are similar technologies that provide the capacity to identify such discrimination. Ralph Nader's Essential Information's Geographic Information Systems Project 'allow[s] traditional database queries to include the ability to analyze data based on locality'. This is used by Essential Information 'as a tool for advocacy purposes...to analyze a variety of databases highlighting patterns of discrimination' (Essential Information n.d.).

It is absolutely clear that the creation of residual markets is to be avoided. An alternative is aggregation schemes such as the Community Choice programs proposed by US advocates. These involve the designation of the municipal government as the provider, but permit customers to opt out. The city secures the supply through contracting. However, as Fenn (2000) has indicated, the city would have a strong interest in, and capacity to undertake, management demand. Another option is for the state to be the provider. A 'pool' arrangement using the state's own purchasing power in the market could secure reasonable deals for vulnerable customers. Systems benefits charges - or levies on the more affluent customers - are common in the United States as an explicit cross-subsidy intended to benefit low income households. In the United Kingdom, the *Utilities Act 2000* provides for reserve power to take a similar measure should disadvantage become pronounced. ■

ELEVEN RECOMMENDATIONS

Recommendation 1
That the Victorian government provide for a legal obligation to supply electricity at a fair and reasonable price in amendments to the *Electricity Industry Act 2000*. Further, that the Essential Services Commission develop and enforce a consumer bill of rights that provides for a prohibition on redlining. Such a bill of rights would include:

- Pricing guidelines providing for non-price discrimination;
- A 'cap the gap' principle; and
- Pricing guidelines to remove cross-subsidies for domestic air conditioning.

Recommendation 2
That the Victorian government scrap the standing offer provisions and develop an alternative safety net. This may be a state purchasing pool, especially if it was linked to low income programs. If the standing offers were to be retained, they should be linked to government programs that will work with the customers to reduce their consumption on a permanent level. Such assistance should involve actual retrofits and should not be merely advice. Secondly, the standing charges or service to property charges should be significantly lowered to permit the customer greater discretion over their consumption.

Recommendation 3
That the Victorian government ensure effective demand side response to prices and enable fast and efficient customer transfer process by mandating a mass roll-out of interval metering as a regulated distribution asset.

Recommendation 4
That the NEM jurisdictions quickly address issues of generator gaming (price manipulation), transmission constraints and the growth of ancillary service payments.

Recommendation 5
That the Victorian government adopt a least-cost planning framework for distribution regulation.

Recommendation 6
That extensive publication and promotion of prices and packages be required by legislation. The opening of the market should involve an initial period of standardised packages. Consumers also need to be made aware that there is a distribution price differential.

Recommendation 7
That the ORG undertake extensive market surveillance and reporting, and resources be provided to consumer advocates to undertake their own market reporting.

Recommendation 8
That the Victorian government provide adequate resources to consumer advocacy organisations.

Recommendation 9
That the Victorian government review its own welfare safety net and orientate it towards addressing consumption as a means of increasing affordability and participation in the market.

Recommendation 10
That the Victorian government implement non-price measures (for example, taxation measures, rebates, regulation) for demand management.

Recommendation 11
That the ORG and the Victorian government undertake a review of whether or not bundling of energy services with non-utility products is appropriate.

Recommendation 12
That the ORG instigate a longitudinal study to examine the impact of the market on vulnerable customers and on customers more generally.

Recommendation 13
That individual investors be encouraged to think about whether or not utilities can be regarded as ethical investment if they engage in redlining. Investors should seek to have these companies adopt a social charter that precludes redlining. ■

TWELVE GLOSSARY

Cherry-picking
Competing for the most attractive customers while not competing for the unattractive customers.

Demand (Load)
The consumption of the customer.

Distribution Business
The 'poles and wires' business that distributes energy via the low voltage network.

Franchise Customer
The customer of a monopoly supplier prior to the opening of the market to full competition.

Full Retail Competition
The opening of the electricity market to all customers regardless of size.

Hedge
An action designed to militate against risk. Financially, hedges can involve a number of instruments such as futures, swaps and other derivatives.

Host Retailer
Retailers who supply customers prior to competition. The Victorian host retailers are Citipower, TXU, AGLE, Pulse and Origin.

Interval Meter
A meter that is capable of recording consumption on an interval basis (e.g. every half an hour), as opposed to simply accumulating the total that is read on a periodic basis.

Marginal Cost Pricing
The setting of the price at the 'marginal cost' (the expenditure actually incurred by producing the next unit of product or service).

Master Vesting Contract
The government-negotiated contracts between the Victorian generation companies and host retailers which underpinned the prices to franchise customers in the period up until 2001.

Maximum Uniform Tariff
A tariff that assigns the same price to customers irrespective of location and that incorporates a maximum price to be paid.

Monopoly Pricing
The price a monopoly supplier can charge over and above what a competitive market would deliver.

Price Taker
A customer who accepts prices which they have no market power to affect.

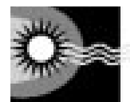
Ramsey Pricing
The marking up of prices to customer classes who display inelastic demand, in order to deliver lower prices to customer classes whose demand is more discretionary.

Redlining
Price/service discrimination against certain classes or types of customers.

Retrofit
An energy efficiency make-over of a building by replacing inefficient appliances, installing insulation, weatherisation etc.

Tariff
The price schedule for electricity services, generally including a per kilowatt hour consumption charge and a standing charge or service to property charge.

Universal Service
The supply of a good or service to all customers.


From Universal Service to No Service? **The Redlining of Vulnerable Electricity Customers in Victoria**

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