

***WA Council of Social Service
Submission to the Economic
Regulation Authority's Draft Gas
Last Resort Supply
Arrangements***



wacoss

Western Australian
Council of Social Service Inc

*Ways to make
a difference*

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INTRODUCTION

The Western Australian Council of Social Service Incorporated (WACOSS) is the peak body of the community service sector across Western Australia. Since 1956, WACOSS has been developing and strengthening the non-government community services sector's capacity to assist all Western Australians. With over 286 members, WACOSS has strong relationships with the social services sector and seeks to represent their interests, and those of the disadvantaged individuals and families they assist at a service level. Given this relationship, WACOSS is in a unique position to comment on issues in our society that socially impact upon members of the community experiencing disadvantage.

WACOSS is respected within both government and non-government arenas as being an authoritative voice for consumers with regard to energy market reform in Western Australia. WACOSS has developed a strong network with utility policy workers across Australia, which provides us with information and expert opinion on these issues.

In January 2005, WACOSS commenced the Consumer Utilities Project. Building upon the utility policy work WACOSS has undertaken over the previous four years the Consumer Utilities Project works with consumers and representative organisations to achieve better outcomes in the provision of essential services.

WACOSS has direct access to the issues of disadvantaged consumers who are living on low incomes through our Consumer Reference Group, which includes representatives from the Emergency Relief sector, Unions, Financial Counsellors and Community Legal Centres. These agencies provide us with policy information and direction in relation to our work and look to us to represent the interests of their clients with regard to utility issues. We have taken on this role due to the level and severity of the utility issues being raised by community agencies and the absence of any other resourced body in Western Australia representing these issues.

WACOSS is pleased to provide a response to the Economic Regulation Authority's (ERA) Draft Gas Last Resort Supply (LRS) Arrangements Guidelines and Template Plan. The impacts on consumers of the withdrawal of a supplier from the market are potentially significant. Supplier of Last Resort (SOLR) regulation should serve to lessen the impact of retailer failure on consumers and should not impose additional costs. SOLR and LRS plans are one way in which consumers of essential service may be protected in the case of a volatile or failing market.

Within this submission, WACOSS has only commented on the sections of the ERA's Guidelines and Template Plan that were considered to be the most relevant. Absence of comment on any section of the Guidelines and Template Plan should not be taken as support for or opposition to any proposal by the ERA to amend or alter the existing regulations.

EXECUTIVE SUMMARY

The gas market in Western Australia is currently undergoing a significant process of reform. Aspects of this reform have the potential to greatly affect small-use gas customers. While technically subject to Full Retail Contestability, currently, all but a few gas customers are served by a single retailer – Alinta. Despite the lack of effective competition in the Western Australian small-user gas market, there still are significant opportunities to gain from the experience of energy (including electricity) markets in other states which have previously undergone processes of market reform, including those which have previously progressed Full Retail Contestability.

The ERA's Draft Gas Last Resort Supply Arrangements Guidelines

Mitigating the potential effects of market failure and negative impacts on consumers is an important aspect of essential service market regulation. To this end, the ERA states that it is progressing regulation in the area of Gas Last Resort Supply (LRS) as part of its mandate. In the context of gas, LRS providers provide services in situations where the incumbent supplier has failed and exited the market. Gas providers in this situation are also referred to often as Supplier of Last Resort (SOLR), Retailer of Last Resort (ROLRs) in the Eastern States of Australia or Provider of Last Resort (POLRs) in the United States.

Given Alinta's current, overwhelmingly dominant position in the WA small-user gas market, Western Australia may currently be said to be exhibiting some level of market failure regarding the existing level of competition. The need for careful consideration in this area is further highlighted by the exit of Energy One from the Queensland retail energy market in the first half of 2007, triggering a Retailer of Last Resort (ROLR) event. Energy One cited low levels of profitability and high wholesale electricity prices as being major causes of their exit from the market.

Price Caps

Governments across Australia have instituted regulated price caps for the sale of gas for smaller-use consumers. These caps are adopted to protect gas consumers in markets which are not yet mature or in areas of lower profitability and are intended to be set at such a level so as to not cause hardship or detriment to consumers. The imposition of SOLR fees (including a profit margin) in addition to the regulated tariff, on consumers of a failed supplier, has the potential to significantly impact on already vulnerable consumers.

Benefits for SOLRs for Business

SOLRs have a responsibility to ensure that the interests of consumers are protected under LRS plans. This general principle is reflected in the past recommendations of the Victorian Essential Services Commission¹. Additionally, it should also be recognised that despite short-term marginal costs, SOLR are likely to enjoy positive growth by way of increased clientele as a result of a SOLR event and therefore should not seek to gain

¹ Essential Services Commission of Victoria (ESC), 'Gas Retail Competition Retailer of Last Resort Consultation Paper', February 2002, p. 2.

short-term profit from consumers who have not exercised market choice in the selection of the SOLR.

The WACOSS Position

WACOSS continues to assert the role of gas as a form of energy that is, for small users, often put to essential uses such as space and water heating. For many of these users – particularly those living on lower incomes – the essential uses to which gas is put cannot easily or cheaply be substituted by electricity. Many consumers living on lower incomes – including those living in rental accommodation – are ‘locked-in’ to a particular mode of energy use and may not have the option, or capacity, to substitute it for other forms of energy.

While having FRC in the small-user gas market, Western Australia is dominated by a single, formerly publicly-owned monopoly. Despite this situation, in the anticipation of future, effective competition in the WA gas market, references and recommendations within this paper regarding SOLRs are intended to denote whichever supplier has been appointed in that role by the relevant authority.

For further information regarding this submission or the work of the WACOSS Consumer Utilities Project, please contact Aden Barker at aden@wacoss.org.au or (08) 9420 7222.

WACOSS RECOMMENDATIONS

RECOMMENDATION 1

That full cost recovery of additional generation, administration and other costs is not incorporated into any fee applied to an SOLR customer. The application of an SOLR fee effectively by-passes existing uniform capped tariff regimes.

RECOMMENDATION 2

In the event that an SOLR fee is applied, the ERA specifies the length of time for which SOLRs may claim costs within any proposed SOLR fee regime.

RECOMMENDATION 3

That SOLRs not be allowed to incorporate a profit margin into any proposed SOLR fee. The incorporation of profit into any proposed fee ignores the fact that SOLRs benefit significantly from an increased client base in the case of an SOLR event.

RECOMMENDATION 4

That the ERA presents a range of options regarding SOLR service pricing and the application of any proposed SOLR fee to customers, such as refunding additional costs applied to consumers as provided in the Victorian Essential Services Commission's Issues Paper Energy Retailers of Last Resort².

² ESC, op. cit. p.26.

RECOMMENDATION 5

That in the event SOLRs are allowed to apply an additional specified SOLR fee to SOLR customers, that there should be a cap on such fees, set by government, that reflects efficient retail operating costs³.

3. Guidelines for development of Last Resort Supply Plan

3.7 Last resort supply fee – Under regulation 7 of the Energy Coordination (Last Resort Supply) Regulations 2005, a last resort supply plan may make provision for a fee payable by transferred customers to the SoLR.

If a last resort supply plan makes provision for a last resort supply fee, the plan must specify:

- *The amount of the fee;*
- *The method used to calculate it; and*
- *When it is payable.*

The amount used to calculate the last resort supply fee must take into account:

- *The benefits that the SoLR forecasts it will receive; and*
- *The costs that the SoLR will incur,*

if the last resort supply plan comes into operation. Before approving a last resort supply plan that provides for a fee, the Authority must be satisfied that the fee reflects the reasonable costs of the SoLR in carrying out the arrangements and provisions in the plan.

Regulated Tariffs

Regulated tariffs have been set in place in various WA jurisdictions at different points in time to protect consumers from the unpredictability of the wholesale gas market and ensure the continued access of supply by groups that may not be able to participate in a less regulated market by virtue of their relative vulnerability or perceived risk they pose to suppliers.

WACOSS challenges the appropriateness of full cost recovery of administration and other costs via a separate fee in the case of a SOLR event. Tariff caps have been set by the Government in order to protect the needs of consumers. While not actually changing the tariff cap, the imposition of additional SOLR fees effectively does this by proxy. WACOSS believes that any additional costs should be borne by the retailer. In cases where the retailer is not able to incorporate these costs without affecting service to consumers, or their own financial sustainability, government assistance may be considered.. Any further discussion of SOLR fees within this submission is not intended to indicate support for such fees, but is instead intended to comment on consumer protection issues should an SOLR fee be applied.

³ Frontier Economics, '8 Allowance for retail operating costs', *Electricity Retail Market Review – Electricity Tariffs: Draft Recommendations prepared for the Western Australian Office of Energy*, Office of Energy, Government of Western Australia, 2008, viewed 24 June 2008, <http://www.energy.wa.gov.au/cproot/1147/9821/Frontier%20tariff%20report%20STC.pdf>.

RECOMMENDATION 1

That full cost recovery (including the cost of additional generation and administration costs) not be incorporated into any fee applied to a SOLR customer. The application of a SOLR fee effectively by-passes existing uniform capped tariff regimes.

The Duration of the SOLR Fee

Whilst the ERA's Guidelines refers to a SOLR fee, it is not specified as to whether this fee can only be applied on one occasion. Additionally, the discussion paper does not clarify as to what period the additional costs may be claimed for by the retailer. While it is acknowledged that retailers may experience 'one-off' administration and other costs involved in acquiring SOLR customers, there may be additional, ongoing costs. In the interest of clarity it is important that this period of cost capture for any possible fee to SOLR customers be included in the LRS Plan.

RECOMMENDATION 2

In the event that an SOLR fee is applied, that the ERA specify the length of time for which SOLRs may claim costs within any proposed SOLR fee regime.

The Significant Benefits to Providers of Being an SOLR

Further to the National Consumers Roundtable response to the RPWG Composite Paper, WACOSS firmly believes that consumers should not be disadvantaged by SOLR events which are effectively beyond their control and should therefore be protected by regulation⁴. Aside from the initial administrative cost of acquiring new customers, SOLRs are likely to experience significant economic benefit as a result of receiving a possibly large quantity of new customers without the attendant costs of marketing and sales⁵ as would be the case in a truly competitive market. Given this likelihood, it is unreasonable that SOLRs then be able to incorporate an additional profit margin into the SOLR fee as suggested by the ERA in the Guidelines.

The extent to which being a SOLR can provide business benefit has been demonstrated elsewhere where providers have actually had to outbid each other in a competitive process to achieve SOLR status⁶. The benefit may also be particularly evident in cases where there are no or few other suppliers in a given area. Such a situation raises other concerns regarding consumer disadvantage⁷.

⁴ National Consumers Roundtable on Energy et. al., 'Response to RPWG NEM Rules Composite Paper', August 2007, p. 35.

⁵ ESC, op. cit., p. 2.

⁶ Bowman, D., Coghill, D. & Hodge, G., 'Protecting Utility Consumers from Market Failure', Monash University, February 2004, p. 17.

⁷ Ibid, p. 4.

RECOMMENDATION 3

That SOLRs not be allowed to incorporate a profit margin into any proposed SOLR fee. The incorporation of profit into any proposed fee ignores the fact that SOLRs benefit significantly from an increased client based in the case of a SOLR event.

The SOLR Fee

WACOSS notes that there are many possible ways in which the cost to customers may be apportioned in the case of a SOLR event, only one of which has been presented by the ERA. The Victorian Essential Services Commission presented several different options in their Issues Paper on *Energy Retailers of Last Resort* in regards to electricity, including the possibility that additional funds charged over the cost of provision of electricity be refunded to the customer⁸. Although this paper focuses on electricity issues, its contents are relevant and similar to gas SOLR.

RECOMMENDATION 4

That the ERA presents a range of options regarding SOLR service pricing and the application of any proposed SOLR fee to customers such as refunding additional costs applied to consumers as provided in the Victorian Essential Services Commission's Issues Paper Energy Retailers of Last Resort⁹.

Given the essential nature of gas and electricity, it is unavoidable that many consumers will be distressed at the collapse of their energy provider and any resultant associated costs. Because of this, it is important that there be caps, in addition to the recommended level of transparency in any future SOLR fees and charges. The existence of a cap, set at a conservative figure, will provide a level of security and predictability for both customers of a failed energy business and providers. The need for caps has also been identified by the Victorian Essential Service Commission¹⁰.

RECOMMENDATION 5

That in the event SOLRs are allowed to apply an additional specified SOLR fee to SOLR customers, that there should be a cap on such fees, set by government, that reflects efficient retail operating costs¹².

⁸ ESC, op. cit., p. 26.

⁹ ESC, op. cit. p..26.

¹⁰ Ibid, p. 32.

¹² Frontier Economics, op. cit.

CONCLUSION

Last Resort Supply Plans and the appointment of Suppliers of Last Resort are important in ensuring the continued supply of gas to consumers in situations where a supplier has ceased trading because of business failure or the withdrawal of their operating license. WACOSS asserts that gas is an essential service and as such, its continued, uninterrupted supply without detriment to consumers should be a focus for regulation. WACOSS submits that without the appropriate regulation in place, markets sometimes have relatively little incentive to act in a socially responsible manner¹³.

The proposed SOLR fee and lack of additional detail regarding the purchasing of supply by a SOLR both have the potential to impact negatively on consumers who have already been disadvantaged by the withdrawal of their supplier from the market. If an SOLR event is triggered in Western Australia, the government must assist the SOLR provider in order to maintain current tariff caps for small-use consumers. These caps are in place in order to protect consumers from undue hardship and should not be exceeded in the case of an SOLR event.

Western Australia has a unique opportunity to take advantage of the experiences of other jurisdictions regarding the appropriate regulation of essential service markets. Given events in the Eastern States wholesale energy market and the recent collapse and subsequent withdrawal from the market of an energy retailer, WACOSS recommends that the impacts of SOLR events on consumers be properly studied in order to progress further SOLR regulation.

REFERENCES

Bowman, D., Coghill, D. and Hodge, G., 'Protecting Utility Consumers from Market Failure', Monash University, 2004.

Essential Services Commission of Victoria (ESC), 'Energy Retailer of Last Resort Issues Paper', 2004.

Frontier Economics, '8 Allowance for retail operating costs', *Electricity Retail Market Review – Electricity Tariffs: Draft Recommendations prepared for the Western Australian Office of Energy*, Office of Energy, Government of Western Australia, 2008, viewed 24 June 2008,
<http://www.energy.wa.gov.au/cproot/1147/9821/Frontier%20tariff%20report%20STC.pdf>.

National Consumers Roundtable on Energy et. Al., 'Response to RPWG NEM Rules Composite Paper, 2007.

¹³ Bowman et. Al., p.41.