

Well Connected

THE NEWSLETTER OF THE UTILITY CONSUMERS' ADVOCACY PROGRAM (UCAP); A PROJECT OF THE PUBLIC INTEREST ADVOCACY CENTRE (PIAC)

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Welcome to the first UCAP Newsletter "Well Connected"

Welcome to the first newsletter of the Utility Consumers' Advocacy Program (UCAP), a project of the Public Interest Advocacy Centre (PIAC). Since our establishment we have:

- launched UCAP at Parliament House;
- held a number of seminars and workshops (see below);
- written a number of submissions (see below);
- participated in working groups convened as part of the Independent Pricing and Regulatory Tribunal's (IPART) Electricity Industry Consultation Group;
- addressed a number of forums.

This newsletter will be published quarterly and will be distributed to our mailing list. If you do not want to receive the newsletter, please contact Sarah Mitchell at PIAC on 02 9299 7833 or via e-mail at:
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PIAC's Electricity Pricing Submission

In late 1998, the Premier asked the Independent Pricing and Regulatory Tribunal (IPART) to prepare a Report on electricity pricing by end-April 1999.

In preparation for our submission we conducted seminars with customer council members in February 1999 (see report on pages 2 & 3). This enabled us to reflect the views of customer council members in our submission and to take advantage of the additional information which came from the seminars. We also circulated a draft of the submission to all members of UCAP's Reference Group for comment.

The submission also incorporated material which was obtained from various IPART Working Groups, of which Trish Benson and Jim Wellsmore are members. Our submission, lodged in early March, makes 24 Recommendations.

The broadest recommendation is that IPART should show how its conclusions reflect its understanding of the Australian economic situation. We are very concerned that Australia is likely to experience a recession later in 1999. Unless the IPART Report (which will have implications for the next five years) takes this into account, its conclusions may be totally inappropriate for the recessionary environment. And if IPART does not believe that a recession is likely, they should say why.

Another set of recommendations deals with a major regulatory issue: the complexity of the NSW electricity regime was mentioned by everyone at the customer council seminars. We have asked IPART to tell us what they think the regulatory regime should look like. While IPART itself does not design the regulatory system, they have considerable experience and IPART is a key member of the Public Utility Regulators Forum.

NSW is the largest state, and IPART's views carry a great deal

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of weight nationally. We have a right to know what IPART thinks about this important structural issue.

We went on to argue that consumers need more resources to be able to properly respond to changes taking place in the utility industries (electricity, water, gas). We recommended that the electricity distributors pay a levy to support a consumer voice.

On the vexed issue of capital valuation (a very important component of the pricing system) we argued that capital should not be valued using the system advocated by electricity companies, that is, the system known as Optimised Depreciated Replacement Cost (ODRC). The more familiar term is DORC - Depreciated Optimised Replacement Cost. If they were permitted to use this system, their capital values would be massively increased overnight. Advance Energy's capital, for instance, would be valued one third higher than it is currently. Regardless of the how this would be dealt with, it would mean large increases in price.

We also said that IPART should retain control over residential customers' prices after July 2000, when residential consumers are supposed to be able to choose their electricity supplier. We made this recommendation because the international experience (as reported in a major study commissioned by IPART) is that very few people actually change their supplier.

There are also certain classes of consumers who may not even

be given the chance of changing supplier (for example, low income consumers). In this situation, it is important that price regulation continue for this class of customer to protect them from predatory pricing behaviour by their suppliers. We called this the 'default price'.

Reflecting a long-held position at PIAC and in the consumer and community sectors generally, we recommended that security deposits for residential consumers be abolished except where there is a proven poor payment record. On non-price charges generally, we also recommended that the application fee and the late payment charge be abolished. Apart from the equity considerations (fixed charges have the greatest impact on low income consumers) we are also concerned that they not be left in place if the industry is privatised. We are concerned that private operators will simply use the charges to keep their revenues up when (as expected) the price of electricity falls.

We acknowledged the difficulties which some distributors have in connecting customers due to distance from lines etc. We also recognise that, for greenhouse reasons, it would be better and cheaper for some of these people to be provided with stand-alone generators, possibly incorporating solar and wind power. We also argued very strongly that because the distributors are required by the Act to connect people, the costs of connections are not

Community Service Obligations (CSOs). Rather, they are a regulatory requirement on all distributors.

There is much more to our submission than space permits here. The submission can be obtained from the IPART web site (www.ipart.nsw.gov.au), and copies are available from PIAC. We would welcome any feedback.

Capital Valuation Seminar

The inception of its Utility Consumers' Advocacy Program has allowed PIAC to engage much more closely with the economics of the large industries and the intricacies of regulatory choice. In order to raise its own knowledge base and be mindful of the need to increase the skills and knowledge of consumer representatives in the utility industry, PIAC organised a one day seminar titled *Calculating Capital, Rating Returns and Providing Price*, held on 24 February 1999.

This seminar was an important and timely opportunity for consumers and their organisations to delve into the mysteries of such things as WACCs, DORCs and DACs.

Scott Young from IPART and Mark Pearson from the Australian Competition and Consumer Commission (ACCC) gave presentations on the different methods used for calculating the worth of utility businesses. The value of each business flows through to the prices paid by end consumers which makes debate

over these models an important area for PIAC and others to be involved in.

The 'owner's perspective' on valuation was provided by Professor David Johnston of the University of Wollongong, who gave a very entertaining critique of the role accountants and consultants can sometimes play in privatisations. Related to this was an interesting description of the 'cycle' of public and private investment in the economy, and utilities in particular, from Rahoul Ray of the NSW Auditor-General's Department.

Broader 'consumer', 'environmental' and 'business' perspectives were provided by, respectively, Norm Crothers of the Australian Consumers' Association, green consultant Francis Gray and Roman Domanski from the Energy Users Group based in Victoria. Roman put forward the view that in a number of areas business and consumers might find their interests served simultaneously.

The last speaker for the day was Richard Denniss, a lecturer in economics at the University of Newcastle. He critiqued the economics of the Green Power scheme presently operating in NSW.

The seminar was notable for the attendance of the Honourable Ron Phillips, MP and Deputy Leader of the Opposition. Mr Phillips gave a spirited presentation of what he saw as the strengths of the Coalition's election policy on electricity privatisation. Unfortunately, the Government declined an

invitation to provide their own speaker at the seminar.

Seminar for Consumer Representatives on Customer Councils

The day after the Capital Valuation seminar (25 February 1999), UCAP held a day for representatives on customer councils in the gas, water and electricity industries in NSW. This was the first time that customer council representatives had met each other and discussed in some detail the workings of their respective customer councils. More importantly, how customer councils, as a consumer protection mechanism, could improve the way they work and by doing so, have better outcomes for customer council members and the utilities.

There were a number of speakers including Nivek Thompson from the NSW Department of Fair Trading and Phil James from AGL. Nivek spoke about the legislative bases and role of customer councils from the Department of Fair Trading's point of view and Phil James spoke about how AGL had gone about setting up their customer council. Both speakers provided the seminar participants with important information which promoted vigorous discussion in the workshops. The workshops came up with some creative ideas about how customer councils could be improved and areas where customer council members need training.

As a result of the seminar undertook to develop a best practice guide for customer councils. This is expected to be available at the end of April.

A report from both seminars will be available soon from PIAC.

PIAC also undertook to send out the report from the seminars to all customer council representatives.

PIAC's Submission to IPART on the Australian Gas Light (AGL) Networks, Revised Access Arrangement Information for NSW Network

PIAC submitted their views to IPART on AGL's access arrangement, which outlines the terms and conditions that other companies can gain access to AGL's pipes to transport gas to end users, including residential consumers. Residential consumers will be able to choose their gas supplier from July 1, 2000 and this access agreement (for five years) will cover the introduction of competition to residential consumers.

The following issues are covered in the submission to IPART:

1. Information provided by AGL

The information provided by AGL is jargonistic, poorly organised and internally contradictory. The PIAC submission outlines a number of instances that demonstrates this point. PIAC is seeking clarification of information contained in the Revised Access Arrangement provided by AGL during the

course of the review of the Access Arrangement, which will continue for the next twelve months.

2. Overvaluation of Assets

AGL appear to have overvalued their assets by 26.3% which is the increase in their asset valuation from 1997. AGL is also proposing to use a valuation methodology called the Depreciated Optimised Replacement Cost (DORC) which usually overvalues assets, in preference to the Depreciated Actual Cost (DAC) which is a methodology which has the following characteristics:

- easily understood by all participants, including consumer and community organisations;
- straightforward;
- simple to implement; and,
- based on actual costs.

The higher the value of a utility's assets, the higher the prices they need to charge consumers.

3. Rate of Return

AGL are proposing a rate of return on their capital Weighted Average Cost of Capital (WACC) of 8%. PIAC considers that this is too high and recommended that IPART consider a WACC of between 7-7.75% which is consistent with the draft determination and the determination made by the Office of the regulator general in Victoria.

4. Allocation of Costs

PIAC have recommended that IPART seriously consider that AGL

move to fully distributed costs for their networks. These costs would also be shared between all the participants in the industry, including gas producers and the pipeline and network companies. PIAC have argued that for equity and environmental reasons costs be allocated up to a certain point where communal pricing needs to be applied because the supply of gas to regional areas would be prohibitive.

5. Cross Subsidies

AGL have argued that there is a cross subsidy between large users and the residential markets. However they do not supply any evidence that this cross subsidy still exists (in the 1997 IPART Determination on Access Arrangements for AGL, IPART determined that there was a cross subsidy from the large users to small users). As a consequence AGL are proposing that prices for the residential market be increased to recoup \$17m between 2001-2004. PIAC said that there was no longer a cross subsidy and that these price increases are unjustified.

6. Competition and Small Users

PIAC have made a range of recommendations about the need for consumer protection measures if the tariff market is to be opened up to competition and one of the most important issues is that price regulation be maintained. Many consumers will not change their gas supplier (and this is for many reasons) and these consumers need protection from price

increases that could eventuate from AGL trying to recoup losses in other markets.

The PIAC submission is available from the IPART website and from PIAC. PIAC welcomes any comments on the submission.

Enhanced Electricity Services

During the course of IPART's Review, a Working Group on Enhanced Services was established and chaired by energyAustralia. Trish Benson, PIAC's Senior Policy Officer was the consumer representative on the Working Group. The Working Group was set up to look at an energyAustralia proposal to put electricity wires underground or use ABC (a technology for overhead wires) which would increase the reliability and visual amenity of the electricity network. This upgrading of the network would incur a cost. There are a number of significant issues raised by this proposal and these are documented in a report released by the Working Group. The report is available from the IPART website or contact PIAC and we will send you a copy.

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