How do you solve a problem like fixed charges?

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By Mark Byrne February 23, 2018

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Everyone hates the fixed or daily charges on their electricity bills, right? So why do they keep going up? Because retailers take us for mugs, right?

What to do about fixed charges represents one of the gnarliest issues in relation to transforming the way consumers pay for the cost of the grid as we grind slowly but inexorably towards a decarbonised and decentralised energy system.

It is an issue even if (like me) you think that the value of networks that are being used less thanks to rooftop solar and batteries should be written down accordingly. But that's another, even gnarlier issue.

With over $100 billion of capital invested in networks around Australia and annual revenues of around $14 billion, clearly the issue of sunk costs isn't going away any time soon.

The retailer's fixed charges, which range from under $200 to over $500 per year, are typically double the underlying network fixed charge. Retailers justify their margin on the basis of their overheads – staff, office space, billing systems – which don't vary much from day to day.

This article is about the underlying network fixed charges, which vary between networks from a mere $75 (Citipower) to a whopping $700 or more (hello, the network formerly known as Ergon) per year for households.

(Alarm bell #1: does it really cost ten times more for networks to service some customers than others? When you compare inner city apartments with homes on isolated rural lines,

yes it can. But alarm bell #2: does it really also cost retailers more than twice as much to service rural as urban customers?* The small added cost of meter readers aside, that's debateable.)

Networks justify fixed charges on the basis that they are not selling energy but access to the grid, and that their costs vary little whether you are sleeping like babes in the wood or chilling out in front of the aircon while glued to the plasma tv screen with the dishwasher purring away in the background.

To explain: networks have three kinds of costs:

1. Sunk costs: the cost of building the network, including the ongoing cost of the money they borrowed in the past to build infrastructure.
2. Present or short term costs: the ongoing cost of operating the network (staff, IT, vegetation management, etc.)
3. Future or long term costs: the cost of building more poles, wires and substations to meet increases in peak demand and/or higher reliability requirements; and possibly also the cost of replacing them as they wear out.

Future costs are what demand tariffs are intended to reflect. How much of your total bill they constitute should depend on how heavily constrained or close to capacity different parts of the network are, as well as the timeframe over which calculations of the cost of meeting future demand are made.**

Where there are significant network constraints, up to half your network tariff could be related to the cost of investment to meet future increases in demand. Where networks are relatively unconstrained, due to flatlining demand or past overinvestment, future costs may be negligible within the next 10-15 years (the typical timeframe for these calculations). In these areas (most of NSW and Queensland in particular), most network costs may be past or sunk.

Network tariffs have traditionally been composed of fixed and variable charges. With the recent need to also consider future costs, a convenient form of shorthand has emerged, whereby networks primarily seek to recover sunk costs through daily fixed charges (per day); present costs through variable charges (per kWh); and future costs through demand charges (per kW).

Where present and future costs are low, if they could get away with some networks would ramp up their fixed charge so that it constitutes nearly all of your network tariff. That's one reason why they are creeping upwards. The other main one is that networks recover less revenue from energy charges whenever consumers do laudable stuff like install PV, solar hot water, LEDs or energy efficient appliances, so they ramp up everyone's fixed charge to make up the difference.

This is bad. It is regressive, because low and high income households pay the same. It is also environmentally irresponsible, because it doesn't encourage us to conserve the energy we import from a grid that is still 84 per cent fossil fuelled. And it doesn't comply with the rules about cost reflective pricing, which state that recovery of sunk costs should not distort

the price signal for efficient usage coming from a tariff based on future costs. A charge that encourages consumption because much of your bill is fixed obviously distorts another price signal that encourages lower peak demand.

(One network is proposing to *double* its fixed charge between 2019-2024. If retailers also double their fixed charge accordingly, that's an extra $200 per year before you flick a single switch. They say it's revenue-neutral because they'll reduce energy charges correspondingly, but by their own modelling you'll be worse off if your total consumption is below average.)

There is nothing sacred about recovering sunk costs through fixed charges. As the AEMC put it in 2014, 'this principle [minimising distortions to efficient usage decisions] does not require that residual costs are recovered though increases to fixed charges.'

Instead, recovering sunk costs through a combination of fixed, energy and demand charges may be the most equitable solution. The ideal way to spread these costs around will vary, and this approach needs more research.

It is unlikely that we can avoid fixed charges altogether. Think of holiday houses. If the grid costs almost the same to run year-round, would it be fair for them to only pay for access a couple of months a year?

But energy consumer advocates are united in resisting the shift to higher fixed charges. Networks and the regulator need to recognise that ramping them only sends a signal to the wealthy, the angry and early adopters to go offgrid. Under revenue caps, this just places more financial pressure on those of us who choose or are forced to remain on the grid.

Whether we will prevail will become clear when the regulator responds to the first tranche of tariff structure statements (from the NSW and ACT networks) mid-year. They are close to being finalised now, and the signs are not good for anyone who expects networks to introduce innovative tariffs that support decarbonisation, distributed energy or demand management.

Meanwhile, if others have better ideas, feel free to contribute to the discussion. For instance, in the long run maybe the cost of access the grid should be tied to property values, so the wealthy pay more?

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* Ergon retail aside, since its service area is covered by a massive cross-subsidy from urban consumers to the tune of $700 million per year.

** Here I am avoiding discussion of the finer points of long run marginal cost (LRMC), but invite an economist to step into the breach.)