

3. FEASIBILITY STUDY INTO ESTABLISHING AN ELECTRICITY RETAIL TRUST

Officer responsible Director of Finance	Author Bob Lineham
Corporate Plan Output: Community Advice	

The purpose of this report is to consider a request from Tim Barnett, MP for Christchurch Central, for funding a feasibility study into the establishment of an Electricity Retail Community Trust.

BACKGROUND

Tim Barnett has publicly proposed that a possible solution to the increasing electricity charges for residential consumers is the establishment of a trust which would purchase electricity from generators and retail it to residential consumers at competitive prices so that residential consumers can have access to more moderately priced electricity.

He has requested that the Council fund a short sharp feasibility study of this proposal. A copy of Mr Barnett's letter is attached.

AMOUNT REQUIRED

Mr Barnett has not indicated the amount which is likely to be required for the feasibility study although he has been requested to provide that information prior to the meeting of this committee if possible.

In my opinion a well researched study would cost at least \$20,000 and most likely more. Establishment costs of any trust which followed the study are not included in this amount and would be significantly more. Any feasibility study would need to address this issue.

THE VIABILITY OF THE CONCEPT

The concept of a non profit making entity providing a lower cost product to residential consumers is on the surface attractive. It is also probably a legal and technical possibility and is naturally attractive from the point of view of small consumers. The key issue is whether it can be made to work financially and therefore consideration must be given to whether the concept is likely to work in the market it will have to operate in.

It is not the intention of this report to pre-empt the outcome of any feasibility study but in order for Council to determine whether it is worth committing funds to the study it is sensible to consider whether such a feasibility study has the potential of producing a positive result, otherwise the funds could be wasted.

Some of the challenges and issues which a trust would confront are:

- Customer Base – quickly establishing a significant initial customer base would be essential to the viability of a new entity. This would not happen easily given the normal lethargy with customers switching supplier as witnessed by the slowness of people moving to other current alternatives. Many analysts contend that 300,000 customers are necessary to make a retail operation commercially viable. Even if a substantially lower number would be satisfactory to achieve minimal economies of scale it will be difficult to amass the required number in a short time frame.
- To succeed the trust would need to act commercially – seeking larger customers and being strict in its practices of collecting accounts, disconnecting customers etc. would be essential.
- The business of the trust would be high risk especially since it would have no natural hedge against wholesale price increases as the competition has with their investment in generation. The trust may be forced to buy its electricity on the spot market which is very volatile. While hedging instruments are available these are likely to have competitive disadvantages.
- Trustees may have difficulty reconciling their obligations to sell low cost electricity with the need to act commercially in a high risk industry. Retailing by itself is more risky compared to the previous regime of traditional line company/retailers.
- It would take several months from completion of a feasibility study to make a trust operational. In this time frame the other alternative retailers (which have been slow to begin performing well against Transalta) are likely to have become more effective in the market. There is a recognition in the energy industry that these other retailers are gradually getting their systems organised and so we should see more movement to competitors soon.
- The outcome of the Government's response to the Caygill Report is not yet known and may provide relief to residential customers through regulation of fixed charges.
- Initial capital requirement – this could be of the order of \$5 million in order to establish the business, hire staff, acquire billing systems, pay deposits with energy suppliers etc. Where would such funding come from?

RESTRICTIONS ON COUNCIL INVOLVEMENT

The Electricity Industry Reform Act 1998 required the separation of distribution from retailing and generation and contains complex clauses which prevent this Council having any involvement in a retailing activity owing to the Council's interest in Orion which is a network operator. These provisions are complex and for the purposes of this report have not been researched thoroughly. However, a quick review of the legislation indicates that it is designed to ensure that the Council not be able to "materially influence" any retailing business while it remains as ultimate owner of the network in Christchurch. There are also complex clauses referring to not establishing any such trust or "members of the trust substantially comprising people or organisations in the community of a local authority" which owns a network company.

While it may be possible for the Council to fund a feasibility study it seems extremely doubtful if this Council could fund the Trust or appoint trustees. It is also doubtful if other members of the community could be involved. This may not be a problem if the trust is established on a nationwide basis and there may be ways through these provisions but the Council should be aware of these probable restrictions.

SOURCES OF FUNDING

There is no specific source of funds available from which to fund a contribution to this study.

CONCLUSION

While there could be benefit for the community from a successful trust selling competitively-priced electricity, to be realistic such a trust would have difficulty operating in this highly competitive and risky industry on a viable long-term basis.

Any retailer which has to acquire its electricity on the spot market is going to find it extremely hard to be competitive with three other major retailers which also have an interest in generation and remain viable in the long run.

Establishing a retail trust is clearly going to be a complex process and require substantial funding for it to commence on a viable basis and this Council is likely to be prevented by law from providing any of the commencing capital.

There have been initial teething problems with competitive alternative retailers becoming established but there is an expectation that given sufficient time this will be overcome. Time should be given to enable the effects of competition or government regulation to produce reduced prices for the residential customers before embarking on the establishment of a retail trust which is likely to encounter greater problems than those encountered by Meridian and First Electric in gaining a share of the market and creating competition against the dominant retailer.

Recommendation: That the Council not fund the feasibility study.

The Chairman comments:

I concur with the views of the Director of Finance that it would be a daunting task for a trust to establish a retail electricity operation in its own right with all the necessary purchasing contracts, administration and billing systems. However, it might be possible for the trust to act as an intermediary, contracting out the administration to an existing retailer. Another possibility would be for the trust to specialise in one modest segment, such as that of the plastic card/power manager system.

Chairman's

Recommendation: That the Committee make a decision on the request following the presentation by Mr Barnett.