



1 February

Australian Energy Market Commission
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Attention: Dr John Tamblyn

Dear Dr Tamblyn

**REVIEW OF THE EFFECTIVENESS OF COMPETITION IN ELECTRICITY AND GAS RETAIL
MARKETS IN VICTORIA - SECOND DRAFT REPORT**

Origin Energy Retail Limited (Origin) welcomes this opportunity to comment on the Commission's *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria - Second Draft Report* (the second draft report). Overall, Origin supports the advice set out in the second draft report and the analysis that the Commission has undertaken to support its conclusions.

In this response, Origin provides specific comment on those issues upon which the Commission is seeking stakeholder input and on other matters identified within the second draft report.

Recommendations regarding how retail price regulation can be phased out

Requirement to publish standing offers

Origin agrees with the Commission's view that all retailers should be obliged to publish standing offer prices and associated terms and conditions. We further support the view that retailers should not be required to publish all of their prices (market contract offers). While the Commission considers that the publication of all offers may facilitate price coordination, Origin considers a more important reason for not doing so is that such a requirement is likely to add little value to consumers because:

- For retailers, it would be administratively burdensome; and
- For consumers it would not appreciably lower transaction and search costs.

In fact, given that many market offers are qualified and feature a limited validity period, it may add to the complexity facing consumers seeking clear, relevant information.



Guideline regarding the format for publication of standing offers

Origin does not agree that publication requirements need to be formalised through the application of a guideline. In Origin's experience, guidelines and price disclosure requirements have had the effect of inhibiting innovation. This will impact on standing offers, which are likely to vary between retailers in any event, since retailers will perceive different risks to be captured in the standing offer price. In addition, such a guideline would be susceptible to regulatory creep over time, increasing the reporting burden placed on retailers.

A guideline may set parameters that may constrain retailer innovation and could become counter productive, since format requirements may distort comparisons between retailers.

For example, the specification of annual expenditure based on defined levels of consumption does not and is unable to address the impact of seasonal pricing or the potential introduction of time of use pricing given different demand profiles. For instance, with the roll-out of interval meters, it can be expected that network and retail pricing (including standing offer prices) will be sculptured in different ways. A customer's bill will no longer be a simple reflection of their annual consumption (nor should it be if demand management objectives are to be achieved).

Further assumptions would then be required and, over time, "bill" information provided in standardised formats will be typically relevant to only a small fraction of customers distributed around the predefined consumption levels and ignore factors such as demand management response, energy efficiency and insulation levels, appliance mix and number of persons occupying a dwelling or the nature of a small business's operation.

Regulating the format (or content) of the presentation of offers is problematic and becomes less practical as the market develops. To illustrate a current example of guideline application and the difficulties created by regulation, Origin would raise the example of product disclosure requirements in some jurisdictions that highlight the ineffectiveness of regulation in this area. At present, some guidelines require retailers to disclose the amount of any loyalty rebates, but ignore other (non-price) benefits such as voucher programs.¹ Such inconsistency is borne out of the inability of such requirements to capture to accommodate the potential combination of offerings made by retailers.

In essence, a guideline is unable to capture the potential product structures that could emerge among standing offers. A guideline would effectively require retailers to offer the same format and structure of standing offer prices, which is not appropriate in an increasingly sophisticated marketplace. We contend that it is precisely because of the innovation described by the Commission on page 18, any such guideline will fail to accommodate the wide range of scenarios that it would be designed to address.

Origin believes it is more appropriate for each retailer to present its standing offer prices and terms in the clearest possible manner, in order to maximise consumer understanding and allow them to make judgements that best reflect their circumstances.

Should the Australian Energy Regulator (AER), or the Essential Services Commission (ESC, if responsible) determine that tariff information is not easily understood, then

¹ See for example section 1.2.3 of the Energy Price Disclosure code in South Australia: http://www.escosa.sa.gov.au/webdata/resources/files/041223-D_EnergyPriceDisclosureCode.pdf



recommendations might be put to address such deficiencies. In any event, Origin believes that retailers themselves will have an interest in improving their standing offers over time to suit customer needs and their own commercial objectives.

Additional publication requirements

The Commission has recommended the publication of standing offers in newspapers. This is proposed in place of the current publication in the Government Gazette and is in addition to retailer publication on the internet and responding to customer requests for information about standing offers.

Origin does not support the publication of offers in newspapers because of the administrative burden and cost it imposes on retailers (also identified by the Commission) and the large number of published prices required due to different network tariffs, zones and meter types. Even small retailers are likely to have customers spread across a wide range of electricity and gas regions, and a requirement to publish a large number of standing offers in the newspaper may be particularly onerous for them.²

Related to publication and price monitoring, Professor Yarrow's report to the Commission provides some insights on the impact of widespread publication of energy prices (through the Price to Beat [PTB] regulation applied by the Texas PUC):

Given that one of the persistent concerns about deregulated energy markets is that they might be prone to such co-ordination, the recent developments in Texas suggest that, following the ending of PTB tariffs, the market structure there has evolved in a positive direction, toward a set of market conditions that are more favourable to vigorous competition than has been the case in the past.³

Professor Yarrow has suggested that innovation in the retail energy market increased following the removal of the PTB. Newspaper publication may have the impact of reinforcing the notion that this price is somehow the benchmark or legitimate price, reducing a customer's likelihood that they will engage with the market.

In Origin's view the customer information benefits of newspaper publication are questionable as:

- the lifecycle of information published in a newspaper is extremely brief;
- circulation of print newspapers is declining due to online news services; and
- the quantity of data consumers would be required to filter through is considerable.

More importantly however, is the question of *who* such publication would benefit. Customers remaining at the same premises will be informed of tariff changes via bills, inserts or other communication as a matter of routine. Customers who have moved into new premises will receive information from the financially responsible market participant (FRMP). Newly connected customers will receive information from the retailer who has responsibility for their connection. For customers whose contracts are coming to an end, there are existing regulatory requirements for notification of the tariffs, terms and conditions that will apply following the conclusion of their contract.

² The alternative of a single price across many zones may create unacceptable risk to the relevant retailer (and/or higher costs to customers) given the considerable differences in network prices and NSLP profiles across different regions.

³ Yarrow, G., (2008), *Report on the impact of maintaining price regulation*, page 52



For these reasons, Origin suggests a better approach may be for retailers to report their standing offer prices to the AER on a regular basis (at a minimum, when these prices are changed).

Price monitoring

Origin believes that further clarity of the purpose, objectives and the benefits to consumers and other interested stakeholders provided by a proposed price monitoring regime is required prior to the development of guidelines or reporting requirements.

With regard to the rationale for introducing price monitoring, the Commission states on page 22 of the second draft report that customers remaining on standing and deemed energy supply arrangements are "...the most exposed to the *potential* exercise of localised market power". Further, the objective of price monitoring is described in section 3.4 as being:

...to identify and publish trends in standing offer prices with a view to providing a timely indication of any future deterioration of the effectiveness of retail competition in the energy retail sectors.⁴

Relying on particular trends in prices and interpreting these as indicators of the effectiveness of the competitive market is not an appropriate application of price monitoring. Analysis of the effectiveness of competition should rely on market conditions for entry and exit, rather than the level or movement of prices in isolation. Origin would also suggest that reliance on industry concentration ratios and more sophisticated measures such as the Herfindahl Index are not instructive if the credible and genuine threat of new entry exists in a contestable market.

Particular trends in energy prices may be caused by a range of factors, only one of which may be a deterioration of the effectiveness of competition. Changes in outcomes or trends may also be due to changes in demand, supply-side constraints and the impact of externalities such as the price of carbon. Origin would suggest that any reassessment of the effectiveness of competition would require a desktop review of the market that goes beyond the results of price monitoring.

Elements of a price monitoring regime

To the extent that a price monitoring regime is put in place, Origin supports that its focus should be on the simple factual observation of published standing offers. Price monitoring or price reporting should be undertaken on the basis that the standing offer is a unique product, not directly comparable with market offers.

Again however, Origin believes that relying on simple benchmarks (such as the impact on bills by consumption levels) may ultimately diminish, rather than enhance, the effectiveness of price monitoring (for the reasons described above).

Origin does not support the statements made in the fourth bullet point on page 22 of the draft report, which states:

⁴ AEMC (2007), *Second draft report*, page 20.



...the Government may request a further review by the AEMC (under the provisions of the AEMA) if there are concerns in the future in relation to the direction of the standing offer prices that may indicate changes in competitive market behaviour and outcomes.

As indicated above, trends in standing offers are not a sufficient indicator of the performance of the market when considered separately from other features of the retail energy market.

Trends and direction in standing offer prices also require some clarification. For example, in monitoring "the direction of the standing offer prices", what will constitute the critical parameter or measure? For instance, will the AER (or ESC):

- consider whether prices in a particular area are converging or diverging?
- define what constitutes a particular area (suburb, locality, network zone)?
- examine each sub category of standard price (for example, GD, controlled load, time of use for each network pricing area for each licensed retailer)?

Origin believes there is considerable complexity involved in monitoring standing prices for each FRMP, and relying on information on standing offers to assess if the market is effectively competitive is not a robust regulatory approach.

In terms of the agency responsible for the monitoring role, Origin believes this should be the AER from 2009 (if monitoring is implemented). We discuss this matter in our general comments below.

Retailer of last resort (RoLR) prices

While Origin agrees with the Commission's caution that "determination by the ESC of different RoLR prices may introduce a regulated benchmark price", we do not agree with the Commission's assessment on page 27 of the draft report that "...retailer's own published standing offer prices may be appropriate RoLR prices".

Origin believes that the costs and risk of supplying customers of a failed retailer need to be reflected in RoLR prices and charges. Under the Commission's proposal, customers on standing offer prices set by a "host retailer" (only) would have to effectively pay for the risk (if this risk had to be embedded in the host retailer's standing offer price). This is clearly inequitable on many levels.

Moreover, the Commission's suggested approach does not clearly explain whether it includes the additional fixed fee proposed by the ESC. The ESC's approach of charging the relevant customers a fixed fee in addition to the standing contract price was developed through detailed analysis of wholesale energy costs (for both gas and electricity).

Origin notes here our concerns with the fixed fee approach that have been set out in our submissions to the ESC. For instance, the mechanism of a fixed fee disproportionately places the burden of additional cost on smaller customers, without reference to their relative contribution to wholesale energy procurement costs.⁵ Furthermore, the criteria

⁵ For example, a prescribed customer (covered by the RoLR scheme) with an annual bill of \$4,000 for electricity faces an increase in costs under a RoLR event of around 1 per cent (based on a RoLR fixed fee of \$44 per account). Conversely, a customer with an annual bill of \$400 faces an impost tenfold greater than this in relative terms.



applied by the ESC to the determination of RoLR prices are not, in our view, appropriate and are even contradictory.

We understand that it is not within the Commission's scope to provide a detailed review of these RoLR criteria while recognising it remains an important issue to re-assess in the context of price deregulation. As an alternative, Origin believes that RoLR policies require further analysis as part of the Retail Policy Working Group's efforts in relation to a national framework for retail regulation.

Obligation to supply

Origin generally accepts the rationale for the maintenance of a condition obliging retailers to supply energy to customers following the removal of price regulation, at least in a transitional period. However the suggestion on page 29 that access to the market for some customers may be adversely affected by "the perception that they are unprofitable to serve" is an output of the maintenance of price regulation (which potentially distorts pricing structures), rather than any inherent lack of profitability on the part of the customer.

While Origin supports the defined area model (because it enhances customer choice and resolves issues around new connections), we acknowledge that the Commission has recommended that the FRMP approach be adopted. We believe the FRMP model is an improvement on alternatives (such as the retention of the host retailer model). Should any concerns arise in the future over the appropriateness of an adopted model, Origin believes that alternative approaches should be considered before any regulatory intervention is made.

Obligation and responsibilities for new connections

As noted above, the defined area model addresses the specific challenge of newly connected customers. If the FRMP model is chosen for general customers, we would support the retention of the host retailer model for new connections as a practical transitional mechanism. In support of this, we note that the current approach in Victoria does not automatically result in the host retailer connecting a new customer and there is an established competitive market in connecting new premises both within and outside of host retailers' former franchise areas.

Origin opposes a tendering process conducted by energy distributors, since this may result in limited participation in the tender process. The tender itself might be bypassed by other means and may be subject to regulatory oversight to ensure equitable and competitively neutral tendering processes. There is also some concern that the value of securing an area from a retailer's perspective will be diminished if there is a likelihood that customers will move to a market contract with an alternative retailer, shortly after connecting. At present, this risk is managed by each retailer individually, without the cost of administering a tender process.

Consumer protection provisions

The distinction between price regulation and more general consumer protection issues is again highlighted by the Commission's statements on page 42. Origin in particular supports the Commission's view that price regulation is unable to address examples of marketing misconduct, identified in some of the submissions to the first draft report.



Origin believes that the retail industry is committed to complying with its marketing conduct obligations and take very seriously allegations of misconduct.

General comments

Relating to our comments above, Origin strongly supports the views set out in 2.3 of the second draft report. In particular, the comments made on the distinction between competition issues and non-competition issues highlighted on page 6 effectively summarise Origin's long-held view that the role of regulation in effectively competitive market should not be directed toward addressing issues of affordability and issues confronting vulnerable customers.

We also believe that the role of market oversight (including fact based price monitoring) should reside with the AER. While non-economic retail regulation is yet to become the responsibility of the AER, there is no reason why the comparatively simple task of monitoring prices and the ongoing performance of the retail energy market could not be undertaken by the AER from the beginning of 2009. To the extent any amendments to the Victorian *Electricity Industry Act* and *Gas Industry Act* are to be made in order to implement the advice provided by the Commission, such amendments could reflect that the AER is the relevant regulator for the purposes of price monitoring.

Conclusions

The Commission's analysis and advice in general is appropriate to the removal of retail energy price regulation in the Victorian market. Our views on matters raised in the second draft report upon which we retain some concern are summarised below:

- Origin does not believe the publication of standing offer prices by each potential FRMP retailer in newspaper media adds to consumer's understanding of alternative offers but rather carries a high administrative burden and cost and in any case, is largely irrelevant since information is provided from other sources as a matter of routine.
- Relying on price monitoring as a proxy measure of market power should not be an objective of its implementation or operation. Should price monitoring be implemented, it should feature clear objectives and rely on factual assessments. The price monitoring regime should avoid developing into quasi price regulation over time, which has the potential to create the kinds of distortions identified in Professor Yarrow's report.
- The application of standing offer prices for customers of a failed retailer by their last resort supplier does not recognise the particular circumstances that present themselves in the market following a failed retailer event. Origin believes significant and nationally coordinated work is required to address the appropriate allocation of risk following the failure of a retail market participant.
- While Origin prefers the defined area model with regard to obligation to supply, the FRMP model is superior to the current host retailer approach.
- The obligation to supply newly connected customers should not depend on a tender process. The existing host model can suffice as a transitional device, and does not prevent non-host retailers connecting new customers.

Finally, Origin supports robust processes that place the onus of proof of market failure upon those stakeholders who seek any re-regulation of prices, particular now that the market has found to be effectively competitive. Price re-regulation must be regarded as



a last resort after alternative strategies to address any identified market failure have demonstrably failed.

Origin would welcome further discussion of issues raised in this response with the Commission. Please contact Randall Brown on (03) 9652 5880 or myself.

Yours sincerely

A handwritten signature in black ink, appearing to read "Bev Hughson". The signature is written in a cursive, flowing style.

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