28 February 2014

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

[lodged by email]

Dear Mr Pierce

RE: 2014 RETAIL COMPETITION REVIEW, APPROACH PAPER, RPR0002

Origin appreciates the opportunity to comment on the Australian Market Commission's Approach Paper for the 2014 Retail Competition Review.

Effective retail competition benefits all customers by allowing for discovery of efficient costs, improved service levels and greater innovation in products and service delivery. Regulation of prices is costly, prone to error and unnecessary in markets where competition is effective. Following the AEMC's detailed and comprehensive study of New South Wales completed in 2013, the review of competition in 2014 will play an important role in informing the Queensland Government's views on deregulation in that south east Queensland, currently planned for July 2015.

We broadly support the AEMC's proposed approach. As outlined in our response to the AEMC's review of competition in NSW, we have doubts about the value of seeking to measure retailers' profit margins, as these are difficult to measure accurately, fluctuate depending on factors that vary independently of competition, and because there is no appropriate or target level for profit margins in a market where all other indicators show competition to be effective.

1. *AEMC's proposed approach*

We support the approach adopted by the AEMC in its final report on Competition in NSW. We do not believe that conditions in retail energy markets have changed markedly in the intervening period and hence our responses reflect this position.

Market definition

In the specific context of the Terms of Reference provided to the AEMC to assess competition in retail energy services, Origin supports the AEMC considering each NEM jurisdiction as a single geographic market with electricity and gas representing separate product markets, with the exception of Queensland where the Energex and Ergon regions should be considered separately.

Competitive market indicators

Origin supports the competitive market indicators proposed by the AEMC. Origin also supports the indicators of customer activity in the market. We would highlight that as outlined by the

AEMC in its review of competition in New South Wales[1] switching rates are a necessary but not sufficient indicator of effective competition, for reasons including:

- Switching is defined as a customer changing their electricity provider, so these figures do not capture customers that may move off a regulated tariff onto a market contract with the same retailer, even when this may have involved the customer receiving a discount in order to stay with their retailer;
- The figures do not capture those that considered moving but determined their deal was satisfactory, and this may be an efficient choice for some customers depending on their personal preferences and the time each customer wants to spend.

Barriers to entry, exit and expansion

Origin supports the measures the AEMC has proposed to measure barriers to entry in the electricity and gas markets, highlighting also that uncertainty regarding future outcomes under price regulation can stifle the development of competition and has in the past been a barrier to entry in NEM markets.

Customer satisfaction

Origin supports the AEMC reviewing the incidence of complaints and carrying out customer surveys. However, we also concur with the AEMC's finding with respect to NSW that in markets where competition is effective customers will still encounter difficulties and need to raise complaints. The measure of an effectively competitive market is that these complaints are resolved.[2]

Retailer outcomes

Origin understands that the AEMC has an on-going role in monitoring prices in the various NEM jurisdictions. However, we have doubts about the value of seeking to measure retailers' profit margins in deregulated markets. Wholesale costs fluctuate considerably, which makes it difficult to determine an appropriate margin at any time. Profit margins also vary over time according to a number of variables that are independent of the effectiveness of competition.

If levels of competition fall this will be apparent from the other indicators the AEMC has proposed, such as changes in prices, market share, the number of offers, the number of competitors, the scope of marketing activity, customer churn and the size of discounts. These indicators are easier to assess and generally considered adequate by the Australian Competition and Consumer Commission when assessing competition in other sectors.

Origin notes the AEMC proposes to measure "competitive retail market costs".[3] It is unclear if this refers to retail end prices (which Origin accepts the AEMC should monitor) or retailers' own costs in order to estimate gross or net margins (which Origin does not believe the AEMC will be able to measure effectively, nor would this contribute meaningfully to the assessment of competition).

2. *AEMC's questions*

> 1. *Is there evidence to support alternative market definitions to those that we are proposing to use for the review? We plan to base our analysis on separate markets for electricity and gas in each NEM region (ie two markets per region), except for Queensland where South East Queensland will be treated as a separate geographic market to the rest of Queensland.*

[1] AEMC, Assessment of competition in the electricity market, Draft Report, May 2013, p.38

[2] AEMC, Assessment of competition in the electricity market, Draft Report, May 2013, p.233

[3] AEMC, 2014 Retail Competition Review, Approach Paper, January 2014, p.3

Origin supports the AEMC's proposed approach.

2. *Are small customers able to access energy related information that is easy to understand, relevant and up to date, that supports their decision-making process to choose an energy offer?*

There is a variety of sources of information for customers seeking a better deal, foremost of which are the national and state-based government-run comparators, which are of particular value as they are impartial and perceived to be so by customers. Origin expects that the AER's website will become more popular as the role of jurisdictional regulators in price deregulation is removed in multiple jurisdictions over coming years. Origin notes that work by the AER is underway to better understand how customers would like to use the web site and improve the web site functionality accordingly.

Retail competition has also led retailers to seek to engage more meaningfully with customers as a source of competitive advantage, with Origin now maintaining an Energy Explorer website focussed specifically on providing customers with meaningful information about their energy use.

3. *What motivates small customers to switch from a standing (or regulated) offer to a market offer?*

In Origin's experience customers are motivated to move to a market contract foremost by savings available from a cheaper offer. Other considerations include non-price benefits attached to market offers and the opportunity to secure green energy offers.

4. *What motivates small customers to switch retailers?*

In Origin's experience customers switch retailers foremost to get a better price. Other considerations include customers seeking access to a better level of service with a different retailer, or because they have a positive association with a retailer due to its ownership or position on policy issues.

5. *What are the reasons behind some small customers remaining on a standing (or regulated) offer rather than shopping around for a market offer?*

In Origin's experience customers may remain on a standing or regulated offer because they are satisfied with the price and level of service they currently receive, because their energy bill makes up only a small portion of their overall expenditure, because energy is a very low involvement product, or because they do not believe that the savings available are worth the time required to investigate other offers.

6. *Are there any barriers preventing customers from switching energy plans within their current retailer or offered by an alternative retailer?*

Origin does not believe there are barriers to customers switching between energy plans or retailers, evidenced by the fact that churn in the four major NEM markets is generally in the range of 15 to 30 percent, with the majority of customers having moved to market contracts.

The exceptions are the ACT, where regulated prices are not cost reflective, Tasmania where the Government's wholesale purchasing arrangements constrain competition, and regional Queensland where subsidy arrangements preclude effective competition.

7. *Are there any current or expected barriers to entry, exit or expansion that impact on the development of effective competition in small customer electricity and natural gas retailing?*
8. *Have the barriers referred to above dissuaded retail businesses from entering, expanding within, or exiting the market?*
9. *Are the barriers referred to above likely to persist or abate in the future?*

There are no barriers to entry, exit or expansion from the electricity or gas market, as the AEMC found in NSW. There are a large number of second tier retailers active in the four major NEM markets. The recent acquisition of APG by AGL demonstrates that businesses have effectively exited the market.

There are barriers in Tasmania, the ACT and regional Queensland for the reasons outlined above.

10. *To what extent do energy retailers compete with each other in terms of price or product/service differentiation to acquire new, and retain existing, small customers?*
11. *What sort of product and/or service improvements have retailers delivered to small customers in electricity and natural gas retail markets?*
12. *In those jurisdictions where price regulation is in place, has retail price regulation encouraged, or impeded, tariff innovation or product/service innovation in small customer electricity and natural gas retail markets?*
13. *In those jurisdictions where price regulation has been removed, has retail price deregulation encouraged, or impeded, tariff innovation or product/service innovation in small customer electricity and natural gas retail markets?*
14. *What types of marketing practices, or business behaviours, have small customers experienced in different electricity and natural gas retail markets?*

Retailers actively compete for customers in all NEM jurisdictions except Tasmania, the ACT and regional Queensland. This is evident in high churn rates and the large numbers of customers on market contracts. Retailers have offered a range of price and non-price benefits to customers as well as flexible tariff packages where metering technology allows this.

Price regulation is one factor impeding tariff innovation and product/service innovation in all jurisdictions where regulation is still in place. Victoria has been deregulated the longest of any jurisdiction and has the broadest variety of innovative tariffs and offers.

Marketing in retail energy markets has become more sophisticated as it has moved on line, with the major retailers withdrawing from door to door marketing.

15. *Are customers satisfied with the service quality they receive from their energy retailer(s) and the value for money?*
16. *Are customers satisfied with the level of choice available in the market?*
17. *Are customers satisfied with the ease and speed with which they can switch retailers?*
18. *Is there evidence of any long term jurisdictional or cross-jurisdictional trends in the*

number and nature of customer complaints to retailers or ombudsman?

Based on Origin's research and the research of consultants to the AEMC in prior reviews, in the four markets where competition is effective the large majority of customers are satisfied with:

- the service quality and value for money they receive from their retailer,
- the level of choice available in the market, and
- the ease and speed with which they can switch retailers.

19. How does the presence of price regulation affect retailer risk profiles and retailer risk management strategies?
20. Are energy retailers to small customers able to recover their efficient costs and an appropriate return at current standing (or regulated) offer contract tariffs or at current market offer contract tariffs?
21. Is there evidence of a material divergence in the level of competitive market costs between any of the jurisdictions where market offers are available?
22. Is there any evidence to explain the underlying cause(s) of any material inter-market divergence in retailer costs (ie the costs faced by the retailer)?

Price regulation increases regulatory risk and thereby overall costs. When prices are set below cost reflective levels retailers must either reduce their exposure to the relevant market or seek to recoup these losses in later years if prices return to cost-reflective levels.

Regulated retail tariffs in NSW are currently largely cost reflective in Origin's view. In Queensland retail tariffs understate wholesale cost for reasons that relate to the QCA's decision to exclude any reference to long-run marginal cost in its calculation of the energy allowance.

There is no evidence of a material divergence in the level of competitive market costs between any jurisdictions where market offers are available, except to the extent that wholesale energy costs vary by state depending on dynamics in the NEM sub-markets.

If you have any questions regarding this submission please contact me in the first instance on (02) 9503 5674.

Yours sincerely,

Keith Robertson
Manager, Regulatory Policy