



**Review of the Effectiveness of
Competition in Electricity and Gas
Retail Markets in Victoria: First
Draft Report**

November 2007

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1. Executive Summary

Origin is pleased to see that the AEMC's comprehensive and rigorous review has found that competition is effective in Victoria for the gas and electricity markets, and while we recognise the preliminary nature of the Commission's findings, we are confident that the initial findings will continue to be supported by the evidence.

In this submission, Origin has provided further information in relation to specific areas as requested by the Commission, such as the role of the standing offer, the effect in the market of non-price inducements, and the spread of margins across segments.

The Commission's initial findings raise the critical question of how retail price regulation could be phased out, and specifically, how the needs of vulnerable customers can best be met. Origin recognises the challenge that this presents to policy makers, and has suggested an "enhanced access" approach to deal to the core of these issues. The key distinguishing features of our "enhanced access" model are:

- Creating a competitive market of standard universal access offers; and
- Ensuring transparency and ease of access to the various pricing offers

If the market is indeed demonstrating effective competition, then it will under the enhanced model be possible to de-link the role of a regulated price from the need to provide access to all consumers. Origin proposes an approach whereby retailers offer a price, determined by market forces rather than government, which is available to all consumers who request it. Together with retailers' hardship policies to assist customers actually in financial difficulties, this approach will continue to support a competitive market. Origin will provide more specific comment regarding the appropriate timing and other considerations for the removal of retail price regulation during the implementation phases of this consultation process.

2. Introduction

Origin Energy (Origin) welcomes the opportunity to comment on the Australian Energy Market Commission's (the Commission) *Review of the effectiveness of competition in electricity and gas retail markets: First Draft Report*.

We are pleased to see that this comprehensive review has found that competition is effective in Victoria, and while we recognise the preliminary nature of the Commission's findings, we are confident that the Commission's initial findings will continue to be supported by the evidence.

Given the positive view of competition taken by the Commission, Origin will not seek to significantly restate arguments made in our prior submissions. The focus of this submission is to:

- (a) provide responses to specific questions about competition and pricing asked by the Commission in its First Draft Report; and
- (b) address means by which the Commission might consider the removal of price regulation, and specifically with reference to the issue of assistance to 'vulnerable' customers, and how this can be better aligned with the obligation to provide a (non-price regulated) standing offer contract.

Our responses to the Commission's remaining competition and pricing questions are provided in Section 3.

Section 4 of this submission provides a more detailed description of Origin's proposed approach to removing price regulation should FRC be found to be effective in the Commission's final analysis.

3. Competition and pricing: Comments on specific issues raised by the Commission

In this section of our submission Origin has sought to address specific issues raised by the Commission in its First Draft Report.

3.1 Standing offer price as limiting scope for price competition or ability to offer more innovative, cost reflective tariffs (page 61)

The Commission has requested more detailed information from retailers as to whether the standing offer price is limiting the scope for price competition or their ability to offer more innovative, cost reflective tariffs.

The standing offer price provides the benchmark 'price to beat' for all retailers in the market and, in Origin's view, this has a definite effect on product innovation. In retaining a benchmark price, a retailer's selling proposition to customers is expressed in a simplified form as the new offer price can be indexed to what is seen as the 'standard price' (with perhaps some add-on features).

However, while this might be seen as a positive effect from a consumer perspective, a less positive aspect is that few retailers or their products diverge far from this standing contract price. This is because the proposition cannot be understood in terms of a discount to a set approved standard price but must be considered on its own merits relative to the multiple other prices available in the market. The opportunity for innovation is further constrained from the host retailer's perspective by the associated customer reversion rights to the standing offer contract.

The removal of price regulation should therefore see the emergence of different pricing approaches and associated products. The early signs of this can be seen, for example, in the Queensland gas market, which has recently removed retail price regulation. However, due to the particular market rules in Queensland, Origin is obliged to publish a deregulated 'standard contract price' in AGL's host area, while AGL is obliged to publish a 'standard contract price' in Origin's area.¹ A review of these different prices will illustrate that the two retailers have already adopted different approaches to pricing even when underlying costs are much the same, reflecting their various pricing strategies. Nevertheless, while different the fundamentals of the two prices are not complex and lend themselves readily to comparison by customers with different consumption patterns.

Further, with respect to the regulated standing offer prices, there is no guarantee that the standard or benchmark price is the best for consumers, or the most efficient. In some Australian jurisdictions the current standing offer contract prices have not been reflective of the underlying costs in either quantum or structure,² with some prices significantly varying from true cost reflectivity. Nevertheless, competing retailers have, in the main, been forced by consumer resistance to either price in line with the standard contract price, or simply not market in that area.

The lack of cost-reflectivity in regulated prices has also meant that cross-subsidies have been maintained for longer than they otherwise would have..

¹ More specifically, this requirement to publish a deregulated standard price in a given area is placed on any retailer who chooses to offer a retail market contract in the relevant retail area. As Origin chooses to retail in AGL's host area, and vica versa, both parties are obliged to publish a standard reference price in each other's areas (as well as in their own).

² This reflects the constraints on rebalancing prices as set by the pricing regulator. Thus, while network pricing reform was progressively implemented in various jurisdictions, retail standard prices failed to reflect these changes.

3.2 Retailer offers at a discount to the standing offer (page 62)

The Commission has noted that some retailers appear not to be advertising any offers at a discount to the standing offer at the current time, and suggested this may reflect recent changes in supply costs relative to the standing offer price.

Marketing activity will be cyclical and reciprocal at any time. However, we would agree with the Commission that at the time of the study, wholesale prices were both high and very volatile, with a good deal of uncertainty about the direction of future prices over the length of any retail market contracts.

Most retailers, consistent with their risk policies, chose to limit their general marketing and discounting activity during periods of wholesale price uncertainty, particularly when the regulated price is largely insensitive to real market changes. An examination of prices offered into the erstwhile highly competitive C&I market, and in the absence of any regulated prices, will illustrate the extent to which the wholesale market was flowing through to the retail market.

3.3 Non-price inducements (page 65)

The Commission has invited retailers to comment on whether non-price inducements are currently offered and if so, why they are not actively advertised. Origin does actively market its non-price related products. For example, Origin ran its 'Go Green For Footy' campaign this year involving energy efficiency packs (energy efficient light bulbs and low-flow showerheads), a contribution made to a particular customer's nominated AFL club, a football, backpack and drink container. This campaign was extensively promoted via television advertising, radio and print media from early 2007.

In addition, Origin has previously offered magazine subscriptions with its energy offers as examples of other non-price inducements marketed to customers. Origin believes that non-price inducements have a role to play in the competitive energy market and are an example of innovation and differentiation adopted by retailers within the competitive environment.

Indeed, our bigger concern is that some of the "price comparators" offered as services to customers are not yet capable of incorporating the non-price factors into their models. This limitation encourages a focus on price only at the expense of non-price services that customers might value highly.

3.4 Margins across customer segments (page 138)

The Commission has asked whether there are customer segments where retailers would not expect to recover the marginal cost of serving those segments.

In Victoria Origin does not believe that this is a major issue due to the progressive rebalancing of customer tariffs, across the segments, which has occurred over the past few years and which has been facilitated by the form of price regulation that was put in place by the government in Victoria. The Victorian price regulation model has allowed restructuring such that margins (% return on sales) are now relatively stable across customer segments despite variations in consumption patterns

However, in our experience, margins associated with standing offer tariffs do differ across segments in some other jurisdictions. This outcome is, in Origin's view, largely a reflection of two factors, namely the 'starting' point of standard tariffs as at the commencement of FRC, and the scope provided by regulators to allow restructuring and rebalancing of retail tariffs.

For example, the previous pricing determinations in NSW set out detailed price constraints in electricity impacting on both tariff rationalisation and restructuring. While this was at the time perceived to be in the best interests of customers, it also meant that at the end of

6 years of price regulation there was still a significant level of price distortion that greatly constrained competitive market entry at a retail and generation level, an outcome that was not in the longer term interests of customers. It is noteworthy that NSW has now moved to allow much greater flexibility for tariff rationalisation and restructuring and indeed has set a clear mandate for the host retailers to achieve cost reflective pricing across the board by 2009/10.

More generally, when jurisdictions have limited the rebalancing and restructuring of prices, some segments of customers have been very unattractive, while others would appear to Origin to be paying significantly above marginal costs in their standard tariffs. Competition should drive some equilibrium in margins, however, to date, the costs of identifying and targeting these segments in a marketing campaign may be greater than the potential benefit.

Thus a very important role of any jurisdictional regulator in preparing a market for deregulation and reliance on competitive activity to manage prices is to ensure that historical distortions in margins are reduced by progressive reform of the regulated tariffs. In Origin's view, Victoria (as noted above) has come a long way to achieving this fundamental goal.

4. Phasing out price regulation

The Commission has noted that if the standing offer pricing arrangements were to be removed as part of the Government's response to the Victorian Review there "may be merit in a transition process that includes retaining the obligation to supply for host retailers, and a period of monitoring and reporting on market contract pricing" (First Draft Report, page 147). The Commission has invited views on this issue.

Origin has spent some time considering how price regulation might be removed or phased out while ensuring access to essential services, and is pleased to be able to address this issue in a more official forum.

In our view, stakeholders have historically had some difficulty coming to grips with what might be necessary to allow for the removal of price regulation. This has been for a variety of reasons, but we suggest that the range of policy and regulatory matters being addressed through MCE, ERIG, AEMC and jurisdictional processes has made a complex topic all the more difficult to prioritise, and thus understand and unpick.

Further, Origin has found that the external debates about price regulation and its removal have tended to confuse competition effectiveness and competition outcomes with affordability and access to contracts for domestic customers. In each case, addressing one element of the debate has meant that other elements have suffered, and resolving the issue as a whole has been generally deemed 'too hard'. This has meant that the status quo - a regulatory approach only ever intended as transitional - has been maintained for far longer than necessary. In this environment, the purported or anticipated experiences of 'vulnerable' customers, or those in financial hardship, has prompted a political and regulatory approach that has been decidedly risk-averse, particularly given it has not been supported by any evidence from the market itself. The AEMC's own surveys in Victoria have clearly demonstrated both satisfaction with the competitive market and broad access to and understanding of the market.

Origin believes that developing a means of removing price regulation that meets the needs of the range of stakeholders is possible, but requires a clear focus on the areas of real concern to consumers rather than the more ideological based arguments on price deregulation. It also requires a more creative and holistic view across the regulatory framework. Origin has sought to offer such an approach in this section of our submission, building on arguments we have already presented in previous submissions both to the Commission and in other fora.

While the approach described below is by no means the only way to respond to the problem, it does start to progress the issue in a way that meets both market and policy objectives, and in a way that we would hope governments, industry and consumer representatives could support within the competitive environment.

4.1 Creating a coherent policy mechanism

Origin is pleased to see the issue of the obligation to supply, or to provide a standing offer contract, de-linked from the issue of price controls. There is no reason why these cannot cover different populations, or why the obligation to offer (in addition to the deemed contract regime) should not remain when price regulation is removed. This is the approach used in the UK, where retailers must provide an offer to a domestic customer who requests one, yet the prices of these offers are not regulated by the state.

However, while Origin supports a policy approach which recognises that the provision of a standing offer contract is separate from the regulation of the price of that contract, we are concerned with any approach that de-links these two issues to the point where they are discussed and administered through completely separate processes.

This is currently the case, where the contractual rights and obligations associated with the standing offer contract are being addressed through the MCE’s Retail Policy Working Group, and the nature of price regulation is being managed separately through the AEMA and AEMC FRC processes. Table 1 below shows the elements of the standing offer contract and the responsible decision-makers.

Table 1: Elements of the standing offer contract and the responsible decision-makers

Element of the standing offer contract	Issue	Responsibility
Provider of the offer: which retailer(s)	Deciding one retailer or many	RPWG/MCE
	Allocating the responsibility to provide a standing offer contract	Jurisdictional Governments
Recipient of the offer: which customers	Deciding which customers or customer group	RPWG/MCE
	Allocating the right to an offer	Jurisdictional Governments
Terms and conditions of the offer	Deciding minimum standards	RPWG/MCE
Pricing of the offer	Removal of government price regulation as FRC becomes effective	MCE/AEMC

We are concerned that under this approach the capacity for any one standing offer contract model to meet a specific policy objective is limited, and seek advice from the Commission about how it might be able to draw together the different elements of the standing offer contract in order to provide a coherent policy recommendation. Ideally the Commission is the one body that has the capacity to do this, and to provide a compelling argument to relevant policymakers.

4.2 Defining the policy objective of the standing offer contract

As a starting point, Origin believes that the policy objectives for the obligation to provide a standing offer contract should be revisited. The initial decisions taken by lead jurisdictions in this area were based on a pre-FRC assumption that the market would not provide for all customer types; however, the evidence since FRC commenced in various jurisdictions has not supported this, and the Commission’s own draft findings have also shown no customer group to be missing out on competitive offers. Further, policy innovation in this arena might actually not only support a customer protection stance, but also improve customer choice and retailer willingness to enter retail energy markets.

The current standing offer regime lacks a clear policy objective, and there still seems to be misunderstanding among stakeholders about whether the point of the standing offer contract in a general sense is:

- (a) to assist customers in the transition from a non-market environment to one with effective FRC, where once effective FRC has been determined, the standing offer contract will fall away; or
- (b) as a customer protection mechanism, because of a belief that the characteristics of some customers will make them unappealing to retailers, or perhaps they are seen as lacking the sophistication or other means to negotiate in the market. This version of the standing offer contract is a permanent feature of the market.

Across the jurisdictions and within jurisdictions, the current standing offer contract has been justified variously as transitional or customer protection or both without clearly distinguishing the two roles or the implications of these alternatives for the deregulation process. In particular, the compounding of policy objectives does not lend itself to evolution toward true FRC, that is, with no specific energy price regulation (versus general consumer protection legislation). In neither case has FRC been built into the model, either to demonstrate when, and under what conditions, the transition to no standing offer contract was necessary for (a), or to sit alongside the standing offer contract in (b) but also

allow for a shift to no price regulation. We believe the Commission can add real value in addressing this issue.

There has also been no clarity about whether the standing offer contract specifically addresses access, affordability, or both. A concerning, but common, belief among consumer advocates seems to be that the standing contract is there to ensure affordability, a view that has also received tacit support from some policymakers, and overt support from the MCE's Retail Policy Working Group legal advisors.³

Origin believes that the policy of using the standing offer contract as some sort of guarantee of affordability is misguided. While affordability of bills is important, it is not a relevant element of either the work of the Retail Policy Working Group, which only addresses terms and conditions of the standing offer, or the Commission, which addresses competition and means of phasing out price regulation should competition be found to be effective.

Further, and perhaps most importantly, it has not been an element of the price regulation decisions to date. In almost all Australian jurisdictions that have moved to FRC, standard contract/standing offer pricing has been directed at setting prices that achieve reasonable cost recovery. While jurisdictions have varied in terms of the time this might take, and the extent to which prices can vary in one year, the ultimate objective is efficient (i.e. cost reflective) retail prices.

Affordability has, however, been discussed at length through other fora, and has been the topic of recent jurisdictional moves to better formalise how customers in financial hardship are provided with assistance. This includes the creation and regulation of comprehensive retailer hardship policies as well as targeted CSO payments (usually via the retailer).

Origin would argue that the point of the standing offer contract was *never* to guarantee supply at affordable prices, and is, in fact, incapable of doing so. Affordability will depend, *inter alia*, on any individual's current financial position, consumption levels and budgeting approach. All that can be guaranteed by retailers is that prices should be at the most efficient levels when competitive forces are able to operate in the market without the hindrance of regulatory pricing interventions. While retailers can assist customers who require payment support through the various hardship programmes, any further means of assuring affordability of energy bills needs to be managed through government policy (including the social wage) and community funding; this is where government and community support are important as a service that runs parallel to the market. Government social programmes, community and industry initiatives have evolved considerably in recent years, along with their capacity to target those households undergoing genuine hardship. They can, and should, be depended upon by the society to provide the main source of support to those in hardship whether its in relationship to energy affordability or other fundamental service needs such as housing.

It should be clear that the standing offer contract regulatory approach must sit within, and be consistent with, market objectives and decisions taken elsewhere about shifting price setting and price regulation from governments to the market. Leading from this, the specific policy objective needs to ensure that the standing offer contractual framework *is able to provide for the removal of price regulation according to the AEMA without jeopardising customers' current access to supply on reasonable terms and conditions*. Origin believes this can be achieved by harnessing the market dynamics rather than regulating them.

³ See *National Framework for Distribution and Retail Regulation: Working Paper 1*, where on page 19 Allens Arthur Robinson states that:

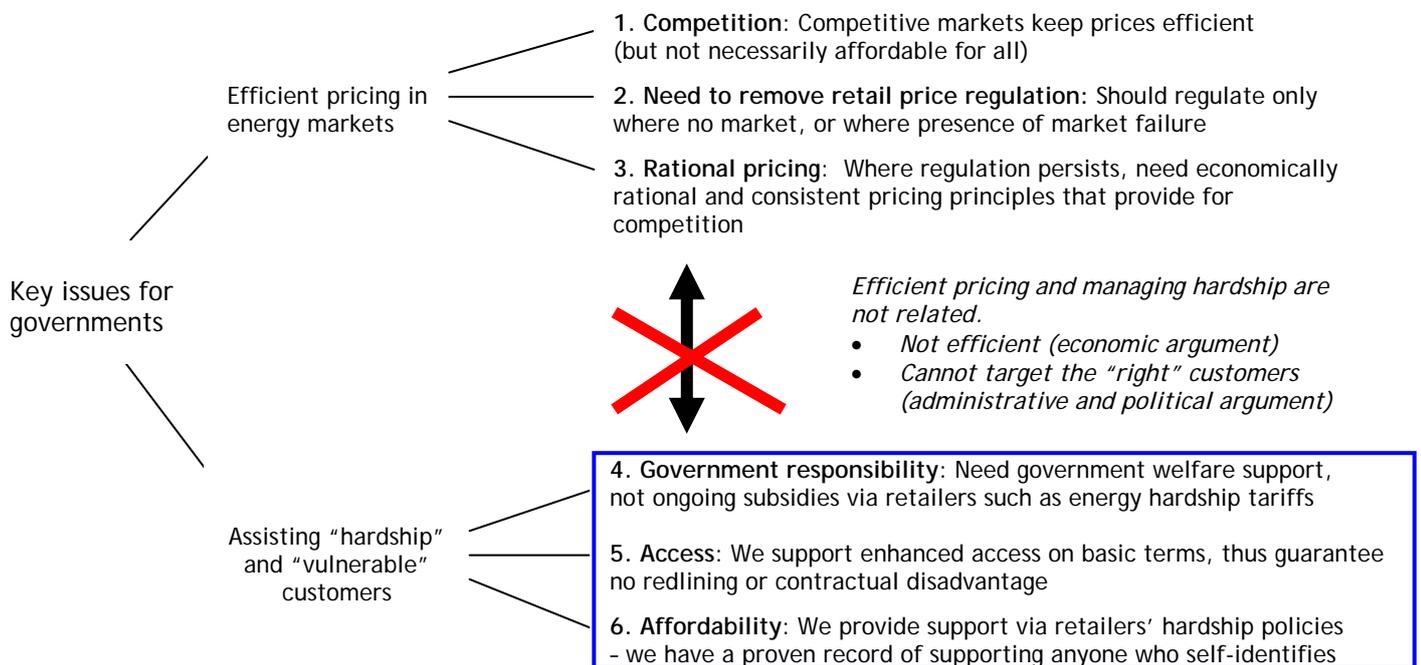
Clearly the objective of the [small customer who receives the benefit of the obligation to supply] definition is to capture those customers considered vulnerable in the sense that they may not be able to secure a supply of energy at an affordable price and on reasonable terms and conditions in the competitive market.

4.3 Key themes in the price regulation debate

The confusion that has occurred to this point in policy discussions about price regulation, and has largely been responsible for the lack of a clear policy objective, is because there are a range of issues involved, each valued differently from various perspectives. For example, while economists, retailers and some sectors of government value competitive outcomes, many low-income consumer advocates and other stakeholders prioritise affordable small consumer access to an essential service. While these values do not *necessarily* conflict, they are still often held to be incompatible. This has likely further reinforced governments' perception of political risk in developing policy responses.

In Figure 1 below Origin has separated the issues in the price regulation debate and dealt with them individually, as well as showing a means by which they fit together and the market can progress.

Figure 1: The separate issues in the price regulation debate



We have already commented at length on the issues 1-3 in previous submissions, and given the Commission's role and the outcomes of the First Draft Report, it would seem worth assuming these matters have been addressed sufficiently. Therefore, we will move to addressing issues 4 - 6, as outlined in the blue box. These are discussed below.

4.3.1 Government responsibility and retailers' role

We note that the Commission has acquainted itself with the work of the 2005 Victorian Committee of Inquiry into Financial Hardship of Energy Consumers,⁴ and with Origin's submission to that Inquiry. Given this, we will not reiterate the arguments covered in that paper, other than to state that while we take our obligations seriously as an energy provider, we also feel strongly that assisting customers in financial difficulty is a community responsibility which much be shared across all relevant stakeholders.

⁴ See <http://www.dpi.vic.gov.au/dpi/dpinenergy.nsf/childdocs/-844e6406280eb3d5ca25729d00101732-1ac2510a81322843ca2572b10014f827?open> for the papers released and government response.

In particular, Government bears the key social responsibility of ensuring customers in genuine financial difficulties continue to have access to those services seen as 'essential', including but not exclusively energy services. While energy retailers can do everything in their power to assist customers to manage their energy debts - including helping them understand that such assistance is available - this responsibility of retailers (and their shareholders) does not extend to subsidising the ongoing energy use of those who *cannot pay at all*, and certainly not for those who refuse to pay. Government welfare support needs to be adequate for its purpose.

As a somewhat related issue, Origin would like to address in more detail the prospect of a hardship tariff, that is, a regulated contract price that applies only to those believed to be vulnerable to financial hardship. While the Commission has not raised this as a potential policy approach, this has been raised enough times in the past by various stakeholders (including jurisdictional policymakers) and has been frequently confused with the standard offer/obligation to supply issue that it would seem worth addressing briefly here, if only to show why this is not a valid policy option and should not form part of the debate on the obligation to supply issue.

First, there are problems with such a 'hardship' tariff in principle. The notion of a hardship tariff might presuppose that there is a price that is available below cost for a particular group of customers. This very concept is inconsistent with a market found to be effectively competitive. Alternatively, it might presuppose that retailers' shareholders should shoulder the responsibility for these customers' financial issues (a distortion of the capital market), or that retailers should try to spread the cost of supporting these customers by levying a higher than appropriate charge across the rest of the customer base (a distortion of the energy market). None of these bases for a hardship tariff would appear to provide a reasonable rationale from a competitive or commercial standpoint.

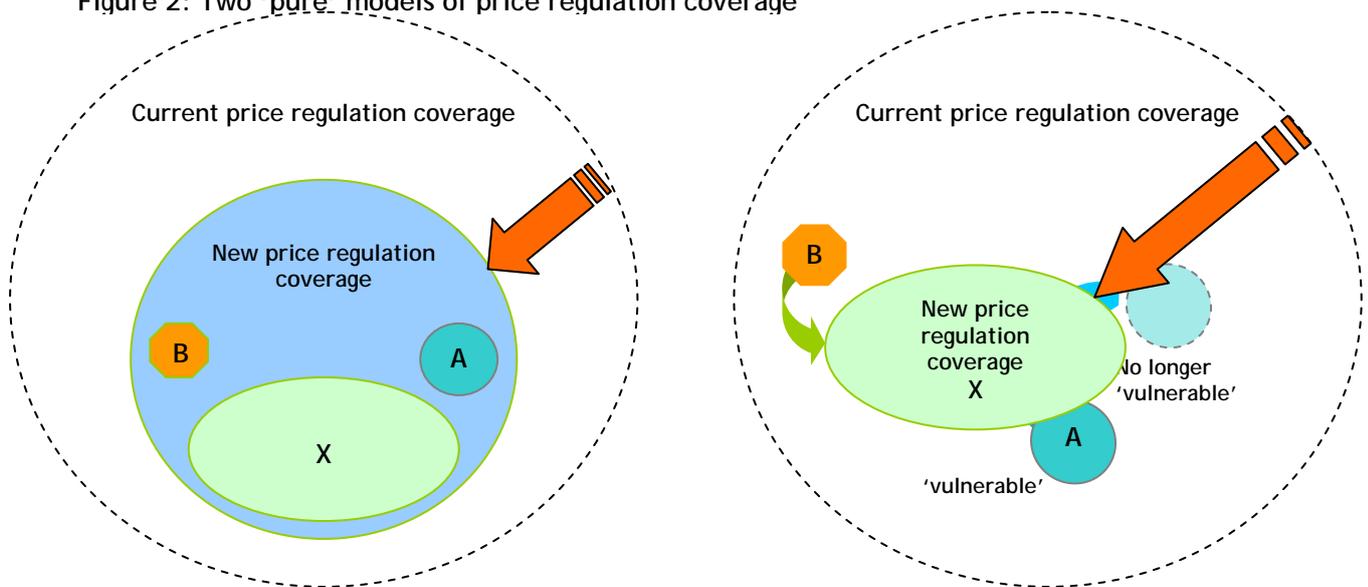
Second, there are issues with any practical application of a hardship tariff. As Origin noted in its submission to the Commission's Issues Paper, and we have discussed in detail in previous submissions to consultations on this issue,⁵ defining the group of customers who may require financial assistance in any operational sense is problematic. As there is no common definition on this customer population, and there are no specific proxies for financial pressure or hardship that retailers might use to better identify and target this customer group as a whole either through hardship programs or through a specific hardship tariff. The causes of hardship or vulnerability are many, and most do not relate specifically to energy consumption.

Even if a decision is made to create a proxy for default coverage of hardship initiatives/tariffs, there are ongoing problems with implementing targeted price protection. These include the management of transition for some customers - those who are not included in the core default ('passive') group, but who need to be effectively captured (swiftly and sensitively) and also need to be able to be shifted out when appropriate. This adds costs to the system, and if the number of these potential customers is high, and/or if the costs to the retailer of processing them (and reviewing their status after a period on the regulated contract) are high, greater 'passive' contract coverage may be warranted.

This issue of needing to trade off various costs and benefits is represented in Figure 2 on the following page. This shows two 'pure' models of regulated offer coverage. In each model, Type X customers are those covered by default; customer Type A represents customers who need to be captured by the regulated offer in a temporary capacity (they should be shifted out when appropriate); and customer Type B represents the (inevitable) group of customers who are not captured within the default group (they may possess exceptional characteristics that warrant protection) but should be covered in an ongoing sense.

⁵ See the Origin (2005) submission to the Victorian Committee of Inquiry into Financial Hardship of Energy Consumers, and our more recent (2007) submission to the Productivity Commission.

Figure 2: Two 'pure' models of price regulation coverage



Model I - greater default or 'passive' coverage to minimise political and administrative costs

Model II - targeted 'passive' coverage to minimise over-capture, with additional manual 'active' processing expected

The key message is that if the political or administrative costs of identifying and managing customer Types A and B in Model II outweigh the benefits of the reduced safety net coverage, it may be more politically effective to opt for the broader coverage approach of Model I.⁶ This is also why broader customer protections, such as price regulation, are in place in competitive retail energy markets. The political risks to government of misidentifying those who require support are sizeable, and the administrative costs are also significant. It has been easier to over-regulate than take the risk of under-regulating.

To provide a more concrete example of the issues involved, Table 2 below sets out a range of customer types often considered to require 'protection' (that is, potentially members of the 'vulnerable' customer group) and seeks to tie these to objective criteria to establish means of targeting standing offer contracts.

Table 2: Options for the optimal coverage of regulated contracts

	Options	Coverage and Issues
Consumption	Medium consumption (e.g. 8MWh/yr, 70GJ/yr)	<i>e.g. 50% customer base</i> <ul style="list-style-type: none"> Useful as an interim measure but unlikely to suit a longer term approach given its lack of targeted coverage. While significant proportion of customer base covered, still leaves out those high usage consumers who might require support.
	Only 'low' consumption (e.g. 3MWh/yr, 25GJ/yr)	<i>e.g. 5% customer base</i> <ul style="list-style-type: none"> Does not adequately cover 'hardship' cases or credit risk customers - these may be high consumers. Problem of arbitrary number of 'low' consumption - retailer approaches to this may not be the same.

⁶ However, the Model I approach is flawed for the purposes of determining price controls, for the economic efficiency reasons described earlier, which can be summarised as *an effective market in a good or service cannot have a politically determined end price*. In fact, neither Model I nor Model II is an effective means to manage the provision of, and affordability of, contracts to small consumers.

	Options	Coverage and Issues
Concessions customers	All concessions	<p>~40% customer base</p> <ul style="list-style-type: none"> Comes closest to capturing socio-economic status (if this is seen as primary issue), and also covers low use customers. However still not targeted: covers large amount of customer base but covers customers who are not in hardship, and in fact may have less difficulty paying than the average (e.g. old age pensioners). There are still customers who are 'vulnerable' but who are not on concessions.
	Health Care Card holders	<p>~20% customer base</p> <ul style="list-style-type: none"> Better proxy for hardship, given card covers unemployment, financial hardship. However there are still customers who are 'vulnerable' but who are not on concessions. These cards can be issued on a 3 monthly basis: how to remain updated?
Credit risk	Credit risk customers	<p>~6% customer base</p> <ul style="list-style-type: none"> Covers customers who may be less likely to obtain a market offer. However, also covers people who are not in hardship, and who may be fraudulent or criminal. Does not address 'vulnerable' issue satisfactorily and retailers will have different views on what is a risk.
Other	Income or proportion of income spent on energy	<ul style="list-style-type: none"> Covers those who have low income or likely to have payment difficulties Not feasible, as would not want to asset test people, and not really possible.
	Annual spend	<ul style="list-style-type: none"> Sub-optimal compared to consumption as tariffs mean not applies with apples across customer base.

This table demonstrates again that there is no meaningful proxy for 'vulnerable' customers. Middle to higher consumption levels are the only way to capture all the customers who might require the standing offer contract, but also capture far more than the required customer base.

To summarise, Origin believes that efforts to improve the capacity of 'vulnerable' customers to participate in the market, or at least better guarantee no disadvantage, will be fraught with difficulty as long as the mechanisms for achieving this rely on somehow objectively identifying the customers concerned, and while there is a confusion of policy objectives (some which actually reduce competition).

So how might those customers considered 'vulnerable' be better assisted through regulatory policy? We argue that this can happen:

- (a) without explicit price regulation being required;
- (b) without the need for generic or objective identification of customers who may be 'vulnerable';
- (c) without significant increased funding or assistance from governments, and with minimal political risk;
- (d) in line with retailers' commercial rights and objectives;
- (e) in a way that enhances competition.

This is possible by viewing the various elements of the regulatory framework as each achieving a specific policy objective, where each policy objective is defined, and works in a complementary way with other objectives and the market as a whole. The key elements relate to access, minimum standards, and hardship initiatives, including various government subsidies and the social wage. Each of these is already in place, but we suggest possible enhancement to access through the obligation to supply and information disclosure about the standing offer contracts available.

4.3.2 Access: The obligation to supply

As discussed above, Origin believes that the policy objective of the standing offer contract needs to be clarified. We suggest that the policy objective for the standing offer contract needs to be *broadened* beyond any expected coverage of 'vulnerable' customers (although as we note above, the policy objective was never clear and we argue against it ever being able to be targeted to vulnerable customers in the first place), but *limited* to issues of access and conditions of supply. Among other reasons, this is because if the policy objective is to address 'vulnerable' customers through a targeted standing offer or 'universal' contract, the impossibility of defining this customer group effectively will render the whole approach meaningless.

Origin supports a broader policy approach that sees the standing offer contract as providing a 'back up' contract market for FRC, where the essential nature of energy might warrant this. In this model, 'vulnerable' customers as well as the larger residential customer group, will have guaranteed access to supply on reasonable terms.

Customer coverage

Origin's approach is to make a standing offer contract available to *all* residential customers. That is, notwithstanding that we may have various more targeted market offers available to customers in a given area, we will also have a 'universal' offer that is available to any customer in that area - as discussed in the next section below.

However, general coverage of the standing offer contract will only make policy sense if, in addition to the policy objective being redefined, the following is in place:

- There is a genuine commitment by jurisdictions to fulfil the requirements of the AEMA regarding removal of price regulation; that is, where there is effective FRC there is no need for government regulation of retail energy prices.
- The terms and conditions of the standing offer contract should be more concise and aligned with the general market contract form (including therefore all the key minimum conditions of the market contract).
- All retailers operating or seeking to operate within a specified region are subject to this requirement.

The last caveat is discussed further below.

Retailer coverage

Across the jurisdictions there is currently only one retailer per geographic region (largely based on the distribution networks) that has the obligation to make an offer to the regulated customer base. This is generally the 'host' retailer, or the former incumbent retailer for that region.

To begin with, Origin is strongly opposed to the continuation of the concept of a 'host retailer', that is, a retailer who carries some ongoing obligation because at some point in time it was the primary retailer in that region. Competition is simply making the concept of a host retailer less and less relevant. The next few years will see less than 30% of customers on the original host retailers' regulated offer, at least in Victoria and South Australia.

There are other models that provide for one retailer per customer without necessarily invoking the concept of an 'in perpetuity' host - for instance, there is the concept of the Financially Responsible Market Participant (FRMP) entity taking on that role. The current proposal through the MCE Retail Policy Working Group forum is for there to be only one retailer per small customer who is required to provide a standing offer contract, while the means of allocating that responsibility is left with jurisdictions.

In our view, however, the notion of having more than one retailer provide a standing offer has not been explored in any detail.

After considering all the alternatives, Origin believes the alternative of having multiple retailers each with responsibility to provide at least one 'universal' offer in a specified segment/region should be seriously considered. The great benefit of this approach is that it establishes a parallel competitive market in universal offers. Even customers who are confused by the variety of traditional market offers can make choices at this basic level. More importantly, it introduces competitive forces and therefore reduces the regulatory burden of 'price monitoring' standard contracts

While we agree that extending the current regime to all retailers has raised some concerns, this is more due to how the contract is comprised, and the regulatory regime supporting it, than the principle itself being flawed.

The current standing offer has onerous regulatory obligations attached to it in several jurisdictions (such as the Victorian ESC's requirement to review each proposed contract to make sure it is 'not inconsistent with' a lengthy Retail Code), and the ultimate price is still regulated. However, with a review of the other elements of the standing offer contract, as is occurring through the MCE's process, it would seem reasonable to also assess the option of all retailers providing a Published Standard⁷ offer to the defined customer base, under a regulatory regime that is more jurisdictionally consistent, less onerous (including no regulation of the price itself) and perhaps more transparent.

In summary, Origin considers that there are four possible approaches to retailer coverage of an obligation to offer a standing contract:

- 1) One retailer (allocation of which of the below left to jurisdictions):
 - The current approach, where the only obligation is on the host retailer to supply a standing offer contract on request to customers in its region - this potentially involves a transfer back to the host from a second-tier retailer.
 - The financially responsible retailer for the site must make a standing offer (on request) to the customer occupying the premises. This will mean that where the site has transferred retailer, a second-tier retailer will have the obligation for the premises.
 - Government contracts out the 'right' to be the standing offer contract provider.

- 2) All retailers who have chosen to market into a particular area⁸ have a contract for any residential customer who requests it. This will mean that customers will have a choice of Published Standard offers.

The pros and cons of each of these approaches are discussed in Table 3 below.

Table 3: Options for the provider of the standing offer retail contract

Provider of an offer to a customer	Pros	Cons
Host retailer only	<ul style="list-style-type: none"> • Administratively easy. 	<ul style="list-style-type: none"> • Concept of 'host retailer' will become meaningless over time. • Administration may mean transfers for people least able to understand/cope.

⁷Published Standard Contract- A contract offer that is available to any customer upon request for the particular area priced by each relevant retailer independently.

⁸ It would be too onerous to expect all retailers to supply to all areas if they did not already intend to do so, and such an obligation may in itself restrict competition particularly for niche retailers. The issue of whether all retailers are willing and able to obtain suitable gas supply contracts to all areas should be accommodated.

Provider of an offer to a customer	Pros	Cons
		<ul style="list-style-type: none"> Keeps risk with hosts. Customer only has one offer (relevant if competition between standing offers is valued).
Financially Responsible retailer only	<ul style="list-style-type: none"> Avoids concept of 'host' retailers, which will become meaningless over time. Avoids need to transfer. Spreads risks more efficiently. 	<ul style="list-style-type: none"> Second-tier retailers will have to be regulated where they have not before - may be some consultation/ learning issues. Customer only has one offer (relevant if competition between standing offers is valued).
Contracted out	<ul style="list-style-type: none"> Retailers who bid will be those who can manage the risks. Avoids concept of 'host' retailers, which will become meaningless over time. 	<ul style="list-style-type: none"> May avoid 'host' retailer but replaces with something reasonably similar. Will retailers want to bid where the means to remove price regulation are still unclear? Would this even allow for the removal of price regulation? Administration may mean transfers for people least able to understand/cope. Customer only has one offer (relevant if competition between standing offers is valued).
All retailers	<ul style="list-style-type: none"> Avoids concept of 'host' retailers, which will become meaningless over time. Spreads risks more efficiently. Customer has a number of standing offer contracts to choose from. 	<ul style="list-style-type: none"> Second-tier retailers will have additional obligations where they have not before - may be some consultation/ learning issues. Potentially higher administration costs for regulator, but less relevant if contracts are concise.

(Once again, it should be noted that some of the pros and cons above will vary in significance according to the substance of the offer itself, as well as the effectiveness of the regulator. Further, with a move to a national regime there will naturally be fewer offers for a national regulator to assess. Most retailers operate across jurisdictions, and Published Standard offer contract conditions would be unlikely to vary significantly across markets.)

Origin's enhanced access proposal supports a shift from the notion of only the incumbent retailers being obliged to provide access to standard offer contracts to customers, to all retailers operating within a region and marketing to residential customers having this obligation,⁹ with the offers extended to all residential customers. Given most universal pricing is set up via internet sites, the approach should not prove a difficulty, even for smaller retailers. Each retailer could choose the extent to which they disaggregated this offer (for example having different Published Standard offers for different distribution regions, or only one for a state).

Currently Origin will provide an offer to anyone who requests it, regardless of whether Origin is the designated provider of the standing offer contract. We would be comfortable to continue doing this, and to even guarantee this, if we had more comfort about the nature of the offer itself, and the assurance that retailers themselves sets the price according to their perception of the associated wholesale and retail credit risks of a universal offer.

As noted in Table 3 above, this approach avoids the concept of 'host' retailers, which will become meaningless over time, and it spreads risks more efficiently. We suggest that this is, in fact, the only model that is meaningful in the FRC environment, and provides for real

⁹ Note that we are not suggesting this in the separate context of deemed contracts. We support deemed contracts as reverting to the retailer financially responsible for the site.

competition and 'apples with apples' comparisons. It also ensures customers have a choice of contract; there is a market contract level of involvement but also a 'mirror' Published Standard offer contract level that provides *all* customers with guaranteed supply from a range of providers on the basic terms and conditions that they expect. This level of choice is not currently available under the single host retailer concept.

However, as noted above, this approach will only be meaningful in a policy sense, and also be consistent with the national market and regulatory objectives, if prices are not regulated by the state, in line with the AEMA. The alternative of increasing the regulatory obligations of retailers within a price regulated environment would be a retrograde and deeply concerning move. The focus must be on reducing energy specific regulation and increasing reliance on general consumer and competition legislation, with any additional regulation designed only to increase the transparency and accessibility of information on the Published Standard offers.

In terms of the substance of the Published Standard offer contract under the Origin model, while we would not support a contract which is as complex as the current Victorian standing offer, we would offer to residential customers a simple contract with some universal options, such as a range of payment methods. Market contract terms and conditions would therefore be a subset of these.

The Published Standard offer contracts would be transparent; we would publish prices for this offer, and would commit to publishing by set periods, so that prices across all retailers for the Published Standard offer contract can be accessed easily and transparently via an external reporting mechanism. Means of publication can be negotiated: our concept of publication is not limited to the Government Gazette, and we can discuss with the Commission options to provide for optimal customer access, including on line price comparators.

As per the approach used in the UK, where price regulation was removed several years ago, this type of published universal offer will ensure customer access to supply, at terms and conditions which are unlikely to be able to lead to any disadvantage. If it is also offered by all retailers, each residential customer will then have a 'right' to a range of published universal offers, which is an enhancement to the current regime.

Origin's approach therefore ensures universal access - but goes beyond the current host retailer/regulated price obligation because it:

- provides a parallel competitive market in standing offer contracts, as all retailers operating in the region (however defined) will have to make a Published Standard offer available on request. Published Standard offer prices will be highly visible and therefore subject to competitive forces; retailers will be encouraged to ensure their prices are sharp;
- removes the regulatory risk associated with regulators second-guessing wholesale market trends in their attempt to set prices; and
- provides all consumers with a real choice.

4.3.3 Affordability: Hardship assistance

As we have noted previously, no retailer can objectively identify customers who are 'vulnerable'. This is because there is no precise definition of 'vulnerable', and no evidence that any specific group is being disadvantaged by competition (and while there is a belief that competition is effective at keeping prices efficient).

To assume that all low income consumers, all people from non-English speaking backgrounds, all older consumers, or those in public housing are 'vulnerable' and therefore require protection from the market (and further, do not want choice, as one submission to the Commission's Issues Paper suggested) is paternalistic and disregards the lack of

evidence that the market has not been failing these customers.¹⁰ We are pleased to see that the Commission's market analysis has not supported these claims, as they (and similar arguments) have tended to be provided to policymakers for some time, with little contextual or evidential support.

Origin continues to believe that 'vulnerability' is a term that cannot be used in any meaningful policy sense, although it may be a politically useful concept. Without any real definition and without any clear link to customer attributes or behaviour, it will always be a term that can be used to meet specific agenda, and it cannot readily lend itself to any policy or market mechanism. As it is, the term has already shifted in the public debates from a term mostly used to denote bill affordability concerns, to a term used to argue failures in fair and reasonable marketing practices. (It must be recognised that these issues are already regulated; there are hardship programmes and initiatives in place to assist customers who require bill support, and there is a robust system of regulation in place - which we might argue is in fact *too* onerous - regarding marketing practices. At the risk of being repetitive, *neither has been found to be deficient.*)

We know that some people will need assistance in the market, for a range of reasons. The reasons will vary from customer to customer, and will also change for any one customer who might re-present to a retailer with a need for support. We, as retailers, then provide the support the customer needs, in a way that is targeted to their specific circumstances. This assistance may include payment plans, extensions of time to pay, appliance assistance, links to government and other support areas, and debt waiver. We suggest that, as per our arguments to the 2005 Victorian Committee of Inquiry into Financial Hardship of Energy Consumer,¹¹ the only way that consumers in difficulty can be identified is when they advise the retailer of the need for support.

As we noted in our submission to the Commission's Issues Paper, since the market opened our approach to providing support to those in need has far eclipsed what happened under the pre-competitive arrangements. Hardship policies created by retailers have often preceded any regulatory requirement, and Origin's own *Power On* programme actually predated the Victorian government's hardship policy by a couple of years. Our responses to customers in hardship have been validated by independent commentators and the community sector. In any event, these are no longer voluntary schemes; as the Commission is aware, hardship programmes have been mandated across the Victorian retail industry. There is little room for error or for careless behaviour in how we respond to customers who are in hardship.

We believe that policymakers must separate the issue of the causes of financial hardship or vulnerability from the issue of retail competition. Customers' bill affordability are being handled, and they are being handled well. There seems to be no case for further managing customer 'vulnerability' or hardship issues through any form of price regulation.

4.4 Summary: the benefits of Origin's proposed approach

Overall, Origin's arguments can be summarised as follows:

1. **Effective competition keeps prices efficient:** There is effective competition in Victoria, and this keeps prices at their most efficient (i.e. effective competition does not allow for price gouging).
2. **An enhanced standing offer contract obligation to supply keeps contracts accessible and guarantees 'reasonable' terms and conditions:** Access to contracts on reasonable terms can be managed, and we will support a more regulated

¹⁰ It further ignores that consumers' circumstances are different and generalising is not helpful to the development of the market or achieving safe and secure supply of energy.

¹¹ See <http://www.dpi.vic.gov.au/dpi/dpinenergy.nsf/childdocs/-844e6406280eb3d5ca25729d00101732-1ac2510a81322843ca2572b10014f827?open> for the papers released and government response.

environment with the obligation to offer a contract if there is a concurrent decrease in state price controls or intervention. These offers would be provided by all retailers operating in the residential market, to all residential customers (subject to any exceptions that would seem sensible). The offers would be published and provide customers with a 'right' to a range of contracts. Terms such as an ability to pay in person through Post Offices ensure that consumers cannot be forced on to payment by direct debit, and other issues of relevance to more 'vulnerable' consumers can also be addressed.

3. **Affordability is best managed through direct government welfare support, supplemented by retailers' hardship programmes and other government schemes:** Financial hardship is not a new issue, and is managed well by retailers. The matter needs to be separated from discussions on competition. As long as people have access to standing offer contracts (as above) and are also provided support when they have payment issues (as we do), there is no specific need to regulate retailers further. Price regulation to 'guarantee' affordability is not only a poorly focussed regulatory tool, it is destined to fail both consumers and the market as a whole.¹²

It is important to note that under Origin's enhanced obligation to offer approach, all retailers active in an area will have a Published Standard offer contract on offer, as well as their specific and more targeted market offers. Consumers are then free to:

- compare the Published Standard offer contracts of the different retailers; and
- compare the Published Standard offer contracts with the specific market offers they have received (including any value added features in the market offers).

Similarly, regulators and community entities are also readily able to establish price comparator systems to facilitate consumers making comparisons and to provide greater confidence to consumers in making choices between retailers. This approach in many ways simply builds on the pricing comparator systems already established in some jurisdictions and by some third party intermediaries.

The enhanced obligation to offer approach also gives confidence to consumers and their representatives that the current (in principle) contractual terms and conditions that are valued by consumers (such as methods of payment) are not going to fall away.

The key difference, however, is that the retailers themselves set their own prices for the Published Standard offer contract, and the price comparators facilitate the operation of a competitive market in Published Standard offers.

If Origin's proposed approach was adopted, all domestic customers within the competitive market would:

- have a right to a range of universal offers that each guarantee reasonable terms and conditions such as payment provisions, as well as the usual billing information and disconnection/reconnection provisions;
- be provided a quote for a market contract (also subject to minimum standards) from their retailer of choice if they request one;
- have a right to give their explicit, informed consent to contracts as per regulatory provisions, and are similarly protected from misleading sales practices;
- have access to payment plans if they require support paying a bill and advise us of the need for this support;
- have access to retailers' complaint handling mechanisms and a free Ombudsman scheme;
- have access to additional government support through the concessions and grants

¹² See Origin's submission to the Commission's Issues Paper where we describe in some detail the problems with price regulation and the effects it has on investment both in retail and upstream.

regime supported by DHS; and

- have access to retailers' hardship programmes to assist with more serious hardship issues, including energy efficiency advice and appliance assistance.

This means that all residential customers, whether vulnerable or not, would have access to the market, and also have access to financial and other support services if they require them. The market keeps prices at their most efficient, regulation ensures fair practices, and government and retailer support is provided to supplement consumers' payment of bills. The need for price regulation as a further form of support for customers who may be 'vulnerable' in some way has not been demonstrated.