30 November 2016

Mr Joe Dimasi
Senior Commissioner
Independent Competition and Regulatory Commission
PO Box 161
Civic Square ACT 2608

Email: icrc@act.gov.au

Dear Mr Dimasi

RETAIL PRICES FOR SMALL ELECTRICITY CUSTOMERS FROM 1 JULY 2017 - ISSUES PAPER

Origin appreciates the opportunity to respond to the Independent Competition and Regulatory Commission's (Commission) Issues paper on setting retail electricity prices in the Australia Capital Territory (ACT) from 1 July 2017 to 30 June 2020.

Origin believes the ICRC's proposed pricing approach will materially understate the cost to retailers of servicing retail customers in the ACT. This is given that the pricing methodology does not propose to include an allowance for customer acquisition and retention costs (CARC). This approach fails to recognise the true costs of retailers operating in a competitive market and limits the progress to price deregulation. This will be to the detriment of consumers in the long term limiting price and service offerings in the ACT electricity market.

Origin believes that a change is required to the pricing methodology if the ICRC is to work towards a competitive framework and allow customers to access the benefits from the competitive market.

The benefits of competition have been evident in recent years with retailers broadening their focus from offering the lowest prices to improving customer service and experience. Retailers not only offer competitive price discounts, but customers benefit from added services such as metering solutions, distributed generation options (ie solar, batteries) and product offerings to assist with bill management (eg Origin's Predictable Plan offer). Effective competitive markets have seen significant improvements in customer service with customer complaints to Energy Ombudsman generally falling over time[1]. These benefits are noted by the AEMC in their review of competition.

The AEMC has recently found that competition in the ACT is not as effective as other jurisdictions and customers are not appropriately engaged in the energy market[2]. In our view, this is due to the risk that electricity tariffs will not reflect a retailer's actual cost of supply. If Retailers are confident that regulated retail prices will reflect a retailer cost to supply, retailers will enter the market and appropriately educate and engage customers on the best product option for them. The AEMC notes that the most cited barrier to entry in the ACT is retail price regulation[3].

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[1] AEMC, Retail Competition Review 2016 – Final Report, p86.
[2] Ibid, pii.
[3] Ibid, p95.

Origin has provided further comments on the proposed regulated pricing framework for electricity customers below.

1. ICRC's regulatory approach

Weighted average price cap

Origin supports the adoption of a weighted average price cap (WAPC) ahead of setting actual tariffs or capping revenues. A WAPC approach encourages more efficient formulation of cost-reflective prices. It also more closely approximates a fully competitive outcome and so is preferable since an underlying objective of all energy price regulation should be to move the market towards effective competition.

Term of determination

Origin supports a term of determination of three years with annual reviews of wholesale costs, including the SRES and LRET components of the energy cost.

Cost pass-through arrangements

Origin strongly supports a mechanism that allows retailers to pass-through unforeseen and uncertain cost imposts that cannot be determined at the time of setting retail prices. Failing to include robust cost pass-through mechanisms is likely to discourage retailers from market entry and competitive activity in the ACT, since it heightens the risk that retailers could be left unable to recover efficient costs.

2. Energy Purchase Costs

It is noted that the ICRC proposes to determine energy costs based on an average of a 23 month period using ASX forward price data. Within these constraints, Origin suggests the ICRC review the merits of utilising a trade weighted average instead of a simple average to reflect trades that occur in the market.

Further, Origin strongly supports an allowance for energy contracting costs as proposed by the ICRC.

3. Retail operating costs

Origin opposes the ICRC's proposal to exclude customer acquisition and retention costs (CARC) from its calculation of retail costs. Retail operating costs need to reflect the actual costs retailers incur in supplying customers in the ACT in order to encourage business efficiencies, innovation and thus competition in the ACT electricity market. In choosing not to include CARC departs from the AEMCs stated objectives for price deregulation and the Government's commitment to develop a pathway to electricity retail competition.

Origin would highlight that the approach of including CARC in retail operating costs has been accepted in all recent past and current regulated pricing determinations in other jurisdictions across Australia. Current determinations include the Queensland regional pricing determination whereby the Queensland Competition Authority has benchmarked retail operating costs which includes an allowance for CARC[4]. Further in Tasmania, where the market is the second smallest in the NEM, the Regulator has recognised that competition needs to be promoted and has allowed for

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[4] Queensland Competition Authority, Final Determination, Regulated retail electricity prices for 2016-17, p24.

the inclusion of CARC[5]. Origin thus cannot understand why, in this instance, ICRC has chosen a different theoretical approach to determining retail operating costs.

It should be noted that CARC is determined to not only allow for acquisition costs but also retention costs for a retailer defending its customer based in a competitive market. In all jurisdictions where Origin is an incumbent electricity retailer, it must use campaigns and discounts in order to win new customers and maintain an existing customer base. Origin anticipates that the same applies to ActewAGL in the ACT with these costs rising in recent years as competition is slowly increasing.

Origin thus believes the ICRC's requirement to determine *"efficient costs incurred by a retailer in providing retail services to its customers"*[6] requires the ICRC to include an allowance for customer acquisition and retention costs. Origin's preferred approach to determine CARC is to utilise the NSW benchmark data and to apply the appropriate annual escalation to 2017 dollar terms. To give the ICRC confidence in the benchmark, Origin believes the QCA could construct an indicative CARC allowance based on data provided by representative retailers.

In terms of the cost categories of the retail operating allowance, Origin supports the ICRC reviewing the costs that retailers will incur when they become responsible for meter replacement (on a new and replacement basis) from December 2017. These costs are not included in benchmark data and are legitimate costs which retailers should be able to recover.

In a national electricity market, retailers will seek markets where financial risks are low. If retail operating costs are set below a retailer's actual cost to serve, retailers will not enter the market with customers not being offered the myriad of price and service benefits that competition delivers.

Retail Margin

A retail margin needs to cover a retailer for its risk weighted investment. A low margin is a significant impediment to the further development of competition and to the future investment in the energy sector in the ACT.

Origin thus supports a retail margin based on a percentage of total costs as previously utilised by the ICRC. Origin believes the current margin of at least 5.7 per cent is appropriate.

Headroom

In addition to a retail operating cost and margin, the QCA has granted a 'headroom' allowance of 5 percent to the total cost for regulated prices in regional Queensland[7]. The headroom allowance is to stimulate competition and customer engagement in emerging deregulated markets.

Origin supports the ICRC including an additional headroom allowance of 5 per cent to the total cost of the different regulated tariff categories for the next pricing period in the ACT.

Closing

In summary, Origin is concerned that the ICRC's proposed pricing methodology does not take into account the long established direction of reform and the move to competitive energy market

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[5] Office of the Tasmanian Economic Regulator, Standing Offer Pricing Investigation 2016 - Final Report, p58
[6] ICRC, Standing offer prices for the supply of electricity to small customers from 1 July 2017 – Issues Paper, October 2016, p14.
[7] Queensland Competition Authority, Final Determination, Regulated retail electricity prices for 2016-17, p41.

frameworks. Regulated retail tariffs should be set at a level that is sufficient to protect and promote competitive market offers. We strongly urge the ICRC to reconsider its pricing methodology to further allow competition to develop in the ACT and for customers to access additional price and service benefits.

Should you have any questions or wish to discuss this information further, please contact Caroline Brumby on (07) 3867 0863.

Yours sincerely

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