



10 March 2009

Mr Paul Baxter
Independent Competition and Regulatory Commission
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CANBERRA ACT 2601

email: icrc@act.gov.au

Dear Mr Baxter

RETAIL PRICES FOR NON-CONTESTABLE ELECTRICITY CUSTOMERS 2009-10

Origin Energy (Origin) holds a retail licence in the Australian Capital Territory (ACT) but currently only supplies electricity to large and small business customers. Origin does supply electricity to residential customers in New South Wales, Queensland, Victoria and South Australia and will continue to monitor the viability of marketing electricity to mass market customers in the ACT. Origin is therefore most pleased to respond to the Issues Paper published by the Independent Competition and Regulatory Commission (ICRC) in February 2009 with a view to ensuring the transitional franchise tariff (TFT) is set at a level to encourage competition in the ACT market.

Origin generally supports the current cost component calculation formulated by the ICRC and utilised to calculate previous Price Directions. Origin has the following preliminary comments on the Issues Paper. However, we also look forward to making some more substantive comments upon release of the draft report in April 2009.

Competition

Origin takes the view that if there are no significant barriers to entry and customers are free to make an adequately informed decision about their choice of retailer, retail price setting should be left to the market.

The ICRC recognises in its Issues Paper that "the current arrangements whereby the ICRC plays a significant role in determining the price for both negotiated and non-negotiated contracts in the market is not sustainable or economically efficient and may in fact be reducing the long-term competitiveness of the market." Origin appreciates the ICRC's understanding of the risks of price regulation and our experience in retail markets in a number of jurisdictions accords with this view.

As stated in the paper, the number of small customers on negotiated contracts in the ACT has reduced from 34,000 to 30,000 from 30 June 2007 to 30 June 2008 and this clearly suggests the offers available in the market are not sufficient to encourage customers to take up or remain on a negotiated contract. The ICRC also recognises the competitive market will be distorted by an incorrect setting of the regulated price as market offers tend to be based on a discount measured against the regulated tariff. From these results, it may be deduced the regulated price is not sufficient to encourage competitive offers.

The ICRC has listed the licensed electricity retailers in the ACT and notes few of those retailers are currently active in the service of the residential customer market. Many of the licensed parties are active retailers with customers spread across different State jurisdictions. This also suggests that the market does not present sufficient opportunities to encourage retailers to enter the retail market for residential customers.

In 2006, the ICRC recognised the benefits of the removal of price regulation and concluded the retail market in the ACT was sufficiently competitive to support the removal of the transitional franchise tariff. However, there were impediments due to the nature of the franchise customer's contracts requiring legislative changes which did not eventuate.

Origin believes to encourage licensed retailers to enter the ACT market and improve competition, the removal of the TFT to let market forces determine the efficient price for residential customers is necessary. Origin would highlight the competition review process being undertaken by the Australian Energy Market Commission (AEMC) in accordance with the Australian Energy Market Agreement (AEMA). This process has been successfully conducted in Victoria and South Australia with price deregulation implemented in Victoria and the AEMC recently supporting the removal of price regulation in South Australia. In each instance, however, the AEMC acknowledges the need for the regulator to retain reserve powers and the requirements for deregulation to occur in the context of an effective price and market monitoring scheme, price transparency and appropriate supporting arrangements for hardship customers. Origin believes the principles set out by the AEMC in their recommendations are appropriate transitional steps to reassure consumers and regulators alike.

Technical Matters

Whilst a regulated price remains in place in the ACT, the price must be set at a level that provides cost reflectivity including an effective retail margin. Origin generally supports the cost build-up and the individual cost components utilised by the ICRC to establish the annual real price change to the TFT. Having said this, Origin will consider in greater detail the analysis of the individual cost components prepared by the ICRC when released in its draft decision.

In regard to the retail operating costs, Origin requests the ICRC review its previous position to exclude the cost for acquiring a new customer or retention costs. In a previous submission ActewAGL¹ noted competitive activity had declined over the 12 months since the ICRC had elected not to incorporate customer acquisition costs and retention costs (in 2007). In fact, competitive activity in the ACT has further declined since July 2007. Origin considers that for the ICRC methodology to be able to set an efficient price, there must be consideration of all true retail operating costs.

Origin submits a retailer's cost include the acquisition cost. Whilst these costs are excluded from the franchise price second tier retailers are unable to compete on a level playing field and/or incumbent retailers are not able to retain scale. All other jurisdiction regulators have decided to make an allowance for customer acquisition costs as part of retail operating costs.

¹ 23 May 2008, ActewAGL Response to ICRC Draft Decision
http://www.icrc.act.gov.au/Submission_3_ActewAGL_TFT_Draft_Decision_23-5-08.pdf

In addition to acquisition costs, the costs of implementation of new Government driven schemes are legitimate costs for inclusion within a retail operating cost. As such Origin believes the costs associated with the new ACT feed-in tariff regime should be included in the cost build-up.

The consideration of acquisition costs is particularly important in a relatively small market like the ACT given that many of the costs are fixed costs and relate to the establishment of retail capability and retail brand in the community.

Social Impact Consequences

Origin agrees with the ICRC's statement that "the TFT was never intended to be a safety net measure for vulnerable customers". Consequently, customers that require some assistance in paying electricity costs are best placed addressed by government agencies that distribute targeted rebates or concessions to assist identifiable customers.

A particular feature of the electricity retail market at present is the volatility in cost components, this is due to the nature of the product as well as the various measures undertaken to address climate change and its relationship with energy consumption. Retailers manage aspects of price risk on behalf of customers but do not control many of the individual cost components from year to year. To assist consumers cope with annual price changes and in addition to government programs, Origin is one of many national retailers that have targeted policies to assist customers that may be in temporary or permanent hardship and provide advice to all customers on energy efficiency and energy conservation techniques.

Pass-through Arrangements

As the price direction is limited to 12 months, it is unlikely that an event will arise requiring a pass-through arrangement. A pass-through arrangement will be necessary to take account of uncertain, unexpected or unforeseen events. However, it is important a retail business is not exposed to unexpected increases in costs and therefore a price direction should provide a pass-through arrangement. The expected announcement in June 2009 of an extension of the feed-in tariff scheme to larger scale projects during 2009-10 was an unexpected event which will increase a retailer's cost to serve.

Origin believes a general pass-through event for unforeseen events should be included within the price direction as such events are not predictable nor is the extent of their impact upon a retail business. Accordingly, it would be prudent to include a general pass-through arrangement as a matter of course.

The CPRS and Preparing for Price Deregulation

Origin has expressed its deep concern in a number of recent submissions to regulators regarding the application of current jurisdictional regulatory pricing regimes following the introduction of the CPRS². It is our view that ensuring full cost-recovery post the introduction of the CPRS will be extremely difficult while failure to do so will place a significant and unsustainable risk on retailers, consumers and, in time, the broader energy industry. Origin considers that the best option in these circumstances is for the

² For instance, see Origin Energy's response to the AEMC paper: *Review of the Energy Market Frameworks in light of Climate Change Policies. 1st Interim Report. 23 December 2008.*

market, rather than the regulators, to determine price and drive efficiencies through the energy value chain.

While the proposed price direction covers the period prior to the expected introduction of the CPRS (that is, up to June 2010), the issue of the CPRS is still relevant to the current year. For instance:

- Irrespective of whether price regulation continues beyond 2009-10, it is essential that the 2009-10 year is used as a based year to establish prices on a cost-reflective basis, removing cross-subsidies and ensuring adequate retail margin;
- Similarly, we believe regulators need to place a policy focus on maximising competition in the retail market in the 2009-10 year based on a careful examination of both price and non-price barriers to competition;
- The expectation of the CPRS has already had an impact on the liquidity and dynamics of the forward contract market. The regulated pricing assessment process should examine carefully the effects these factors might have on pricing and price volatility for 2009-10.

If you would like to discuss the issues raised please telephone Ms Beverley Hughson, National Manager Regulatory Relationships on 03 9652 5702.

Yours sincerely



Duncan Permezel
Retail Executive Direction and Growth