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Review Secretariat
8 Nicholson Street
East Melbourne VIC 3018
Lodged online

To whom it may concern:

Review of the electricity and gas retail markets in Victoria

Origin Energy (Origin) welcomes the opportunity to provide a response to the Victorian Government's Review of the electricity and gas retail markets in Victoria.

Origin believes that competition for residential and small business customers in Victoria's retail energy benefiting customers by providing them with a range of competitive prices, products and services. The end of retail price regulation in 2009 has resulted in a highly competitive retail energy market with high rates of customer switching and a large number of retailers active in the market. The highly competitive energy retail market provides a strong incentive for retailers to offer competitive prices, improve customer service and to drive product and service innovation. As we highlight below, customers have benefited from tangible improvements to services as a result of rivalry and competitive tension between retailers. There is also evidence from independent surveys that customers are satisfied with their retailer and are confident of their ability to make choices in competitive energy markets. We are also beginning to see indicators of a much greater level of product innovation in the near future.

Price competition, unlike regulation, drives retailers to discover and secure the lowest possible costs of supply, which in turn places cost pressure on the wholesale market. In a deregulated market, retailers set their own prices, and they are accountable to the market for their decisions because customers can switch—and in Victoria the high levels of churn mean that there is a genuine risk of retailers losing customers to other competitors. This places competitive discipline on retailers when offering products to customers.

Whilst price outcomes are an important part of assessing retail competition, it is difficult to find an acceptable benchmark against which retail prices can be compared in Victoria. One of the reasons behind the removal of regulated pricing was the difficulty of regulators accurately setting prices that reflect efficient pricing outcomes. The same challenge arises when trying to assess prices in a deregulated market to determine whether they reflect competitive outcomes. Origin suggests that prices are considered within a broader range of competitive indicators, including the barriers to entry in the market, customer participation and retailer rivalry. All of these indicators suggest that the market is highly competitive in Victoria and that pricing is a reflection of that competitive process.

With respect to some of the issues raised in the Discussion Paper and at the recent Hearings, Origin makes the following observations:

- Competition is encouraging customers from all segments of the market to be active. This includes vulnerable customers who are, in Origin's experience, more likely to be on a market contract than other segments of the market.
- The fixed component of a customer bill reflects the fact that some costs are not variable and do not depend on how much energy an individual customer uses.
- The ability of retailers to set their own prices is crucial to encouraging risk-taking and innovation.
- Retailers manage risks in the wholesale market on behalf of customers; this market is likely to become more volatile following the exit of Hazelwood.

- Price dispersion is a feature of most competitive markets and is explained by retailers responding to competitive dynamics by calculating more competitive rates to attract customers—a desirable outcome that is in the best interest of all consumers.
- Discounts are popular and survey evidence suggests they are well understood by customers.
- Experience in the UK demonstrates the perils of regulatory interventions that are designed to achieve preconceived outcomes—especially attempts to minimise price dispersion and limiting the number of tariffs or products.
- Significant interventions by the Victorian government have introduced costs to the supply of energy that have exceeded their benefit. This diminishes the efficiency of the retail market.

It is important that the Inquiry also considers the future development of competitive retail markets. The continued development of the market for behind-the-meter energy products is placing additional competitive pressure on to retailers and leading to more rivalry and product diversity in the market. The uptake of distributed generation is decentralising the market and taking power from energy businesses and giving it to the customer. New business models will result in greater customer choice and often act as a substitute for traditional grid-connected supply of electricity from distributors and retailers.

This transformation in energy markets will be customer led and customer focused; retailers need to be given the opportunity to respond to competitive market signals in order to develop new products and services to meet customer needs. Regulation risks constraining our ability to do so and may lead to sub-optimal customer outcomes. A reduction in competition in the retail electricity market, as a result of regulatory intervention, will likely have the flow-on effect of placing less competitive pressure on the market for new products and services. Origin believes that it is in the best interest of consumers to not intervene in either retail energy markets or those for new products and services.

Origin's response to the Inquiry's questions is set out in further detail below.

Should you have any questions or wish to discuss this information further, please contact Timothy Wilson, Regulatory Analyst, on (03) 8665 7155.

Yours sincerely



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Competition and the long-term interests of consumers

1. (a) Has the introduction of competition to electricity and gas retail markets in Victoria delivered improved efficiency and benefits in the long term interests of consumers? Please explain the reasons for your response.

(b) If not, what measures or alternative model(s) would you suggest for the efficient and effective delivery of electricity and gas in the long term interests of Victorian consumers? Please explain the reasons for your response.

2. How much have retail charges paid by consumers increased? What are the reasons for retail charge increases and does this demonstrate that the markets are not operating in the interests of consumers? Please provide detailed evidence to support your response.

Products and services in the long-term interest of consumers

Origin believes that competitive energy markets have been in the long-term interests of consumers by delivering tangible improvements to customer service and promoting more efficient prices that reflect the cost of supply. Recent customer surveys suggest that more than half of customers are positive about the level of competition in the market and only 8 percent are dissatisfied.¹ Some recent examples of improvements to customer service that have been implemented by Origin include:

- extended call centre hours from 7am to 9pm, Monday – Friday;
- opening a series of Customer Service Hubs and a dedicated webpage to listen to customer feedback;
- delivered improved electronic billing to allow for easy bill payment;
- established web portals to allow customers to access information about their account, and options tailored to their needs, at anytime;
- made it easy for customers to move home and establish their new connection arrangements;
- provided more flexible payment options which allow customers to pay their bills in weekly, fortnightly or monthly instalments;
- greatly improved the quality of customer correspondence through more use of tailored letters to address the customers' issue and adopting a straightforward tone; and
- improved bill management by promoting our bill smoothing solution (Easipay) and providing SMS bill arrival and payment reminders;

Origin believes that improvements to customer services are incentivised by competition generating rivalry between retailers (which we discuss further below). Similarly, the competitive process provides retailers with an incentive to align their competitive practices in line with customer preferences. Origin has responded to customer preferences by:

- removing exit fees from all residential plans;
- ending all door knocking and cold calling to households;
- improving our “customer transfer” process by better explaining the process upfront and keeping customers up to date with progress by email or SMS;

¹ Energy Consumers Australia, *Energy Consumer Sentiment Survey Findings—Victoria*, December 2016, p. 4. Accessed here: <http://energyconsumersaustralia.com.au/wp-content/uploads/Energy-Consumer-Sentiment-Survey-Findings-VIC-Dec2016.pdf>

A key area of engagement between retailers and their customers is billing. Given the comprehensive regulations about what must be included on a customer's bill,² it is a challenge to design bills that are comprehensible for customers. Despite this, the market provides an incentive for Origin to improve its bills so that customers are satisfied. Origin has conducted an extensive customer research program in order to redesign our energy bills so they are easier to read and understand. Customer feedback was used to focus on the key information and charges customers wanted to know, and helped Origin to reduce the amount of unwanted information. During 2016, we also increased our use of paperless billing, with approximately 1.6 million customer accounts across all markets having taken up e-billing at the end of the last financial year. Both of these improvements to services were achieved in response to competitive dynamics in the market which provide Origin with the incentive to satisfy our customers.

Another indication of a highly competitive market is that retailers are investing heavily in service delivery. An example of this is the improvements to billing systems that Origin and other retailers have undertaken in recent years. Billing issues are generally the highest single factor behind complaints to energy ombudsmen in each jurisdiction.³ However, following the upgrades to billing systems, and concerted effort to improve customer experience, Origin has seen noticeable reductions in ombudsman complaints; in Victoria, Origin's ombudsman complaints for gas and electricity have more than halved from 10,934 in 2012-13 to 3,664 in 2015-16.⁴ This mirrors the fall in overall electricity complaints by 34 per cent in 2015-16 compared to the previous year. The incentive to improve customer billing is a direct consequence of competitive markets: substandard billing systems impair the ability of retailers to efficiently collect revenue and they produce less satisfied customers, who in turn are more likely to switch retailers.

Origin measures the impact that these improvements to customer service through our Interaction Net Promoter Score (NPS). Our Interaction NPS is akin to a customer satisfaction score and it provides us with insight into how customers perceive their experience with Origin. To gauge this we ask our customers how likely they would be to recommend Origin to family or friends following their interactions with us. We seek customer feedback across all customer-facing teams in our retail, solar and LPG businesses, covering activity from phone calls, to LPG truck deliveries, and solar PV system installations. This information allows Origin to identify key issues with a customer's experience and to develop processes and solutions. Since we started tracking Interaction NPS in September 2015 we have seen an improvement from +6.3 to +13 as of our 2017 half-yearly results. The Interaction NPS is therefore an important tool in a competitive market for Origin to assess and publicly report on how its relationship with its customers is tracking and to identify steps to improve customer service.

Retail charges

In Origin's view, these improvements and innovations depend on open and competitive retail markets. Competition provides retailers with the incentive to supply energy, and related services, more efficiently than their competitors. Whilst price outcomes are an important part of assessing retail competition it is extremely difficult to compare any price in isolation. There is no particular counterfactual that exists for comparing prices in Victoria. It has been too long since deregulation to accurately extrapolate and compare regulated price levels. With respect to New South Wales and Queensland, both these states have only recently deregulated prices and they still somewhat reflect previous regulated determinations. South Australia is difficult to compare with Victoria due to particular features of its wholesale market that distinguish it from other states.

² Essential Services Commission of Victoria, *Energy Retail Code (Version 11)*, 1 January 2015, sections 25, 25A, 27, 27A, and 28.

³ Energy and Water Ombudsman of Victoria, *2016 Annual Report*, pp. 28-29.

⁴ *Ibid*, p.44.

Regulated pricing has proven to be fraught with difficulty and does not necessarily capture efficient pricing outcomes. Where regulators have incorrectly assessed wholesale costs, for instance, it has led to higher regulated pricing outcomes than might otherwise have been the case in a competitive market

It is more efficient if the retail component of prices is set by a competitive market rather than a regulator because competition provides retailers with an incentive to discover the lowest possible costs. In a deregulated market, retailers set their own prices, and they are accountable to the market for their decisions because customers can switch. In contrast, as the AEMC has acknowledged, there are asymmetrical risks in regulators setting retail prices too low or too high; the end result is that customers pay too much either as a result of a regulated price that is too high or because insufficient retail allowance does not encourage long term downward pressure on prices via new entrants in the market.⁵

Retail allowances that are set too low may also act as a cap on the extent to which retailers will be willing to take risks to further their competitive position. Where prices are regulated it constrains the ability of retailers to make investments in new products and services. For instance, the upgrades to billing systems mentioned above required a significant investment of capital by Origin. The competitive market not only provides us with an incentive to make these investments—because they lower costs by improving our efficiency—but the ability to set prices provides retailers with more control over how they manage the risk of recovering their costs. In a non-competitive environment, not only is the incentive reduced but so is the retailer's ability to assume the risk involved in planning these improvements. Origin therefore believes that the competitive market best facilitates the development of new products and services and that this is in the long-term interest of consumers.

Price rivalry

Given the difficulty in establishing effective benchmarks against which price outcomes may be compared, it is important that the Inquiry instead focuses on examining whether there is sufficient price rivalry among retailers. As the former Competition Commission in the UK has stated:

Competition is a process of rivalry as firms seek to win customers' business. It creates incentives for firms to meet the existing and future needs of customers as effectively and efficiently as possible—by cutting prices, increasing output, improving quality or variety, or introducing new and better products, often through innovation; supplying the products customers want rewards firms with a greater share of sales.⁶

It does not mean that all customers will seek this price but, rather, that customers that choose to enter the competitive market looking for a range of offers will be able to access them. This is the case in Victoria. There are no barriers to customers accessing information on better deals, whether it is from their own retailer or via price comparator websites and other information channels. The fact that a customer can often get a better deal from their own retailer indicates that price rivalry holds retailers to account; this is in the long term interests of customers who choose to find a better deal.

Product innovation and differentiation is a good demonstration of the presence of competitive rivalry in the market. Retailers must develop new products to meet shifting customer needs. The Victorian energy market is currently evolving to meet different customer expectations about energy. One of the ways Origin has responded to retailer rivalry is its Predictable Plan product for gas and electricity customers. Launched last year, this product enables customers to avoid bill shock by locking in the same cost each billing period for twelve months—regardless of how much customers use. Origin was

⁵ AEMC, *Advice on best practice retail price methodology*, Final Report, 27 September 2013, Sydney, p. 72.

⁶ United Kingdom Competition Commission, *Guidelines for market investigations: Their role, procedures, assessment and remedies*, April 2013, p. 7. Accessed here: http://webarchive.nationalarchives.gov.uk/20140402141250/http://www.competition-commission.org.uk/assets/competitioncommission/docs/2013/publications/cc3_revised_.pdf

able to invest the resources necessary to develop these product and services, including system upgrades to facilitate them, and to assume the risks of its success. Other retailers distinguish themselves by offering customers rate freeze products which guarantee no increase in rates for the duration of the contract (usually up to 24 months). Our product innovation is also extending to new products and services for renewable energy and storage systems. Origin's Solar as a Service product enables customers to access solar via a long-term power purchasing agreement, whilst our and Solar Boost product offers customers a higher feed-in tariff along with a different discount. Recently, Origin has moved into the battery market, offering customers a Tesla Powerwall. Origin offers these products because the competitive market provides the incentive and ability to do so by allowing retailers control over how we manage our risk—ultimately by setting our own prices in response to the market, and obtaining the benefit of those risks through additional revenue.

Regulatory intervention

Origin does not believe the current model based on competition between retailers, and founded on customer choice and service, requires change; an increase in regulation will weaken the fierce competition that the Victorian retail energy market is known for internationally. Origin agrees with the Independent Pricing and Regulatory Tribunal's observation about what effective competition is:

Some take the view that 'if you pay more because you don't shop around, the market isn't working'. We consider that if you can pay a lower price by shopping around, the market is working. A number of competitive markets demonstrate this. For example, customers can make substantial savings by shopping around when buying flights, consumer electronics, insurance, cars and mobile plans.⁷

A customer's price reflects the value they place on a product; those who are motivated will seek out a better deal. As IPART points out, customers will respond to price signals differently; what is important for assessing competition is whether customers are provided the opportunity to choose another deal. As has been stated as part of a review of the energy market in the United Kingdom (UK), "Competition is appropriately seen as a rivalrous discovery process"; examining whether a market functions well is not a

licence to specify a series of features that it would be "nice to have" but that may not be feasible to achieve or that may be achievable only at disproportionate cost, or with unintended consequences that harm customers and competition. Similarly, a realistic approach to assessing effects on consumers, and behaviour of customers, implies setting aside purely theoretical and empirically unsubstantiated assumptions about how consumers might or should behave, and focusing on evidence about how they actually do behave.⁸

Even well-intentioned regulatory intervention is more likely to have unintended consequences, such as increasing transaction costs, and the cumulative impact of them is to increase prices for consumers.⁹ This is particularly the case where this intervention is premised on assumptions of what consumers think, rather than allowing their preferences to become apparent through a well-functioning and efficient market.

Origin appreciates that regulators may be tempted to respond to particular complaints about the market by creating rules that attempt to respond to them. There is empirical evidence from the UK that interventions not only impact on the perceived problems in the market but also undermine the benefits

⁷ IPART, *Review of the performance and competitiveness of the retail electricity market in NSW*, Draft Report, September 2016, p. 4.

⁸ Littlechild, McCarthy, Marshall, Smith, Spottiswoode, *Submission to CMA*, 7 August 2014, p. 3. Accessed here:

<http://www.eprg.group.cam.ac.uk/wp-content/uploads/2014/08/Submission-to-CMA-7-Aug-2014.pdf>

⁹ *Ibid*, p. 3.

of competition that are otherwise taken for granted. Since 2008 in the UK, the Office of Gas and Electricity Markets (Ofgem) has introduced various regulations to try and engineer particular outcomes in the market. From 2012 this has included strict requirements around limiting the number of tariffs that suppliers could offer to four for each fuel. This essentially involved the banning of what Ofgem deemed to be complex tariffs and the increased regulation of cash discounting.¹⁰ In response, retailers withdrew tariffs that were not as popular or economically viable as their main tariffs; the result was that niche and innovative tariffs were withdrawn to satisfy the requirements of regulation.¹¹ Whilst the intention of these policies was to encourage engagement by simplifying the products, the opposite occurred. A review into these policies was eventually conducted by the Competition and Markets Authority (CMA) who found

that certain aspects of the 'simpler choices component' of the [Retail Market Reform] rules have the effect of dampening price competition between suppliers by either (a) directly restricting their ability to compete to acquire or retain customers through the tariffs or discounts they offer or (b) adversely affecting the incentives suppliers have to compete by making it more costly to offer customers cheaper prices or discounts (the effect of which is to reduce the competitive pressure suppliers exert on their rivals). We also consider that these rules restrict the ability of suppliers to compete through innovation.¹²

In several cases, measures that were designed to lower prices and increase competition had the exact opposite effect, the impact of which ultimately fell on consumers. This was reflected in the CMA's findings, which noted that Ofgem's policies on regional non-discrimination and simple tariffs had harmed customer engagement, restricted choice and had an adverse effect on competition.¹³

There is also evidence of regulatory interventions in the Victorian market through the Advanced Metering Infrastructure (AMI) program. The Victorian Government intervened to mandate the roll out of smart meters across the state from 2009 onwards. The Government's 2005 business case suggested net benefits of \$79 million to the state; the result was that by the end of 2015 customers had spent approximately \$2.239 billion for the program.¹⁴ The total average residential cost was estimated at \$760 per household in 2015.¹⁵ For these costs, it is estimated that consumers will receive at best 80% of the expected benefits, meaning that they will not recover the full cost of their investment.¹⁶

To date no other jurisdiction has followed Victoria's example of mandating smart meter installation via distribution network service businesses. Instead the AEMC has implemented a rule change that will allow for competitive market forces to encourage new metering infrastructure in other states.¹⁷ As the Auditor-General noted in his report on the program, "The reality of the smart meter rollout is that the state approved a program, many of the costs of which it could not directly control, nor drive many of the benefits ascribed to it."¹⁸ The same can be said for other potential interventions in the market that assume the Government or its agencies are better informed than consumers about their long-term interests.

In the area of feed-in tariffs, the Victorian government maintains regulation of a mandated minimum rate. This is despite deregulation of the feed-in tariff occurring in New South Wales and Queensland,

¹⁰ Competition and Market Authority, *Final Report: Energy Market Investigation*, p. 569. Accessed here:

<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

¹¹ *Ibid*, pp. 571-572. See also Steven Littlechild, *Regulation of Retail Energy Markets in the UK and Australia, Report Prepared for the Energy Supply Association of Australia*, 26 September 2015, pp. 5-7.

¹² CMA, *Final Report*, pp. 573-574.

¹³ *Ibid*, pp. 576-577.

¹⁴ Victorian Auditor-General's Report, *Realising the benefits of Smart Meters*, September 2015, p. x.

¹⁵ *Ibid*, pp. 29-30.

¹⁶ *Ibid*, x.

¹⁷ AEMC, *Expanding competition in metering and related services, Rule Determination*, 26 November 2016, Sydney.

¹⁸ Victorian Auditor-General's Report, *Smart Meters*, p. viii.

where customers have demonstrably not been worse off as a result of such reform. As of 1 January this year, South Australia has joined those states after its Essential Services Commission found that the costs of maintaining regulation outweighed the benefits in a competitive market.¹⁹ Regulating feed-in tariffs constrains the ability of retailers to determine the efficient cost for that energy, and potentially creates additional costs that must be met by all consumers.

The Victorian Government recently increased costs of solar energy when it announced new feed-in tariff arrangements. The feed-in tariff will incorporate a value for avoided emissions, despite consumers already receiving an upfront payment to compensate them for this value under the Renewable Energy Target. In Victoria, for a typical 3kW system, this represents a subsidy of \$2,014 over fifteen years. As a result of these changes, the feed-in tariff in Victoria will increase by an additional 2.5 cents from 1 July 2017.²⁰ This additional cost will ultimately be recovered through energy prices to all consumers. Additionally, the Government will be changing the structure of feed-in tariffs, so that retailers will now need to offer flexible export tariffs with a critical peak component.²¹ As Origin has argued in its public submissions, the effect of these changes is to require upgrades to billing and other systems, the cost of which will be met by consumers regardless of whether they have solar PV.²²

In light of the above, it is clear that even well-intentioned regulatory intervention can have unintended consequences, such as increasing transaction costs, and their cumulative impact is to increase prices for consumers. This is particularly the case where this intervention is premised on regulators assuming they know what consumers want, rather than allowing their preferences to become apparent through a well-functioning and efficient market. A better approach than regulatory intervention is to focus raising awareness about how to switch energy plans and where to access information to make informed decisions (e.g. access to the Victorian Government's Energy Compare website). Seeking to manufacture particular market outcomes (e.g. lower standing prices or regulating discounts) for consumers that do not engage in the market will likely constrain competition and impede product choice and discounts more broadly.

Market structure and regulation. Restraints on competition

3. Are there any features of market structure or regulation that inhibit the market from delivering outcomes in the best interests of consumers?

16. Are there any features of Victoria's retail electricity and gas markets that restrain competition from delivering benefits to consumers?

17. Are there any issues that have not been considered in this discussion paper that you consider should be considered during the review?

Origin believes that, overall, the market structure in the National Electricity Market (NEM) delivers beneficial outcomes for customers. The Australian Energy Market Commission's (AEMC) Retail Competition Reviews have consistently found that there is effective competition in Victorian energy markets. The Victorian market is characterised by high churn between retailers; this suggests that customers are engaged and willing to churn if it suits their needs. A good indication of this is the gradual decline in customers on standing offers: as recently as 2014, around 25% of electricity

¹⁹ ESCOSA, *Retailer feed-in tariff—Review of Regulatory Arrangements, Final Decision*, December 2016, pp. 12-13.

²⁰ ESCV, *Minimum feed-in tariff value to apply from 1 July 2017, Final Decision*, 28 February 2017.

²¹ Victorian Government, *Response to the Essential Service Commission's Energy Value of Distributed Generation*, 2016, pp. 4-6.

²² Origin Energy, *Submission to The Energy Value of Distributed Generation—Distributed Generation Inquiry Stage 1, Draft Report*, 3 June 2016, pp. 12-13. Accessed here: <http://www.esc.vic.gov.au/wp-content/uploads/2016/06/Origin.pdf>

customers in Victoria were still on standing offer contracts.²³ In the most recent AEMC Competition Review, this number had declined to 10%, meaning that 90% of electricity customers are on a market contract.²⁴ Customer churn is persistently above 25% of the market annually,²⁵ and this rate excludes customers that stay with their retailer whilst obtaining a new or better deal. One of the reasons for this level of activity is the low barriers to entry that characterise the Victorian market. Between 2014 and 2016, the number of retailer brands grew from 18 to 25, meaning that even more competitive market offers exist for customers that decide they want to switch.²⁶ This demonstrates that low barriers to entry over a long period of time gradually produce increased levels of competition, which customers will benefit from through better prices, products and service delivery. Accordingly, given the low barriers to entry and competitive dynamics, Origin believes that the market structure is delivering outcomes that are in the best interest of consumers.

Restraints on competition

Despite the overall market structure working effectively, there are regulatory interventions that have impacted on competition. Government interventions do add cost to the market place and may contribute to rising customer prices. A notable example in Victoria has been the AMI program which, as we noted above, has added at least \$760 to the average residential bill since 2009.

Another significant policy decision by the Victorian Government is not implementing the National Energy Customer Framework (NECF), as it had agreed to do, and the significant derogations that exist from the national frameworks. While the retail code has been somewhat harmonised for consistency with the NECF, the derogations from the national scheme continue to add costs to retailers and potential new entrants who participate in the Victorian energy retail market. Some of the derogations from the NECF include:

- a prohibition against late payment fees;²⁷
- customers must be compensated by the retailer for wrongful disconnection, with a maximum penalty of \$3500 (or otherwise as prescribed under regulation);²⁸
- the billing of bulk hot water has its own specific billing requirements according to formulas that are prescribed in the Energy Retail Code;²⁹
- different disconnection times—up until 2pm in Victoria and 3pm in NECF states;³⁰
- specific requirements for the disclosure of Greenhouse Gas Information on customer bills,³¹ and
- compliance audits are undertaken by the ESCV, rather than the Australian Energy Regulator, and with different reporting requirements. NECF jurisdictions do not audit on a regular reporting cycle, mainly deferring to the AER, unless they wish to determine compliance with state-specific derogation.³²

These Victorian specific consumer protections exceed the level of regulation than those in other states. Another example that is not part of the NECF is the large number of customer concessions. With eight concessions, Victoria has by far the most of any state, and each has its own specific eligibility requirements.³³

²³ AEMC, *2014 Retail Competition Review*, 22 August 2014, p. 153.

²⁴ AEMC, *2016 Retail Competition Review*, 30 June 2016, p. 197.

²⁵ *Ibid*, p. 197.

²⁶ *Ibid*, p. 197.

²⁷ Sections 40C of the *Electricity Industry Act 2001* and 48B of the *Gas Industry Act 2001*.

²⁸ Sections 40B of the *Electricity Industry Act 2001* and 48A of the *Gas Industry Act 2001*.

²⁹ Section 20A and Schedule 6 of the *Victorian Energy Retail Code*, 1 January 2015.

³⁰ Section 108 and clause 14 of the *Victorian Energy Retail Code*, 1 January 2015.

³¹ ESCV, *Guideline 13: Electricity Industry—Greenhouse Gas Disclosure on Electricity Customer Bills*.

³² ESCV, *Guideline 22: Electricity and Gas Industries – Regulatory Audits of Energy Businesses*.

³³ AEMC, *2014 Retail Competition Review*, pp. 233-234.

Similarly, in the area of hardship policy, Victoria has decided to maintain its own obligations rather than to assume NECF. There are likely to be further derogations following the Essential Service Commission's recent Payment Difficulties Safety Net Draft Decision, increasing the gap in regulatory consistency between Victoria and NECF jurisdictions.³⁴ This will necessitate additional system upgrades and resourcing to meet Victorian requirements. In addition, certain proposals in the recent Payment Difficulties Safety Net Draft Decision will mean that retailers will need to carry even more customer debt for much longer than they already do in NECF jurisdictions.³⁵ As a consequence of longer collection cycles, smaller retailers are incentivized to screen out these hardship customers that require additional resources and longer credit periods. One tier two retailer has publicly estimated that they reject about 20% of all customers on the basis of credit checks.³⁶ The burden shifts onto Financially Responsible Market Participant (historically, one of the first tier retailers), who have an obligation to supply to customers and must therefore agree to take on these customers. Accordingly, Victorian specific hardship and consumer protection derogations invariably increase operating costs for retailers, and this will in turn constrain their ability to invest capital and resources to improve their hardship programs.

Pricing, costs and margins. Hazelwood.

4. What factors need to be considered by the review when conducting an analysis of retail charges and margins?
5. To the extent that analyses of retail pricing and/or margins indicate a trend of increasing retail charges and/or margins, what are the explanations for this? Please provide evidence to support your claims.
6. Please provide any other information or evidence you consider may help the review to accurately assess retail charges and margins or pricing outcomes for consumers.
19. What factors should the review consider in assessing price increases as a result of the expected closure of Hazelwood? What methods should the review consider to determine the likely impact of the Hazelwood closure on wholesale prices and the associated impact on retail prices?
20. What is a reasonable level of expected retail price increase resulting from the closure of Hazelwood? Please provide detailed evidence to support your response.

Retailer component and margin

The retailer component and margins cannot be assessed in isolation to determine whether a market is competitive because, as we discuss above under "Retail Charges", there is no effective benchmark against which a suitable retailer charge or margin can be compared. Retailers apply different cost structures and varying strategies to participate in the market for retail energy services. Some retailers have a degree of vertical integration and this helps them to manage wholesale risks and costs; this vertical integration impacts on a retailer's cost structure and the risks it needs to mitigate against. In contrast, smaller retailers may lack generation capacity in that market and have a different set of risks to manage—namely exposure to the wholesale market and seeking long-term contractual arrangements to guarantee a competitive supply.

³⁴ ESCV, *Safety net for Victorian energy consumers facing payment difficulty—Draft Decision*, October 2016.

³⁵ See divisions 3-5, ESCV, *Safety net for Victorian energy consumers facing payment difficulty—Amendments to the Energy Retail Code*, October 2016.

³⁶ Note that this figure is not Victorian specific. Saskia Pickles, "Contestability comes at a cost, says Alinta," *Business News Western Australia*, 14 March 2014. Accessed here: <https://www.businessnews.com.au/article/Contestability-comes-at-a-cost-says-Alinta>

These challenges are illustrated by shifts in the wholesale market in Victoria over the last few years. As a member-state in the National Electricity Market (NEM),, Victoria is not a unique or isolated retail energy market; its electricity and natural gas transmission systems are interconnected with all other states on the eastern seaboard of Australia. As such, the final retail price paid will reflect the supply and input costs of a retailer operating across the NEM. Until 2016, Victoria and the NEM more broadly has been characterised by an oversupply of generation. This is attributed to a number of factors, including declining small customer demand and decreasing manufacturing and industrial load; these factors were exacerbated by the Renewable Energy Target introducing new generation into the market at a time when additional generation of any type was not required. As recently as 2014 the Australian Energy Market Operator (AEMO) declared that

*For the first time in the National Electricity Market's (NEM) history, as a result of decreasing operational consumption, no new capacity is required in any NEM region to maintain supply-adequacy over the next 10 years.*³⁷

In this market, wholesale costs were low because of excess supply. Retailers that are not vertically integrated can competitively purchase energy on the wholesale market and secure hedging contracts at reasonable cost. These risks allow them to compete in the market, and are ultimately factored into both the retail component and their margins. Similarly, integrated retailers need to factor the costs of maintaining and financing generation assets into the retailer component of the bill and their margins.

Volatility and retailer margins

The exit of generation capacity across the NEM has tightened demand and supply balance in the wholesale market, with increased price and volatility as a consequence. Retailers generally assess the cost of energy by setting prices according to a forecast price and then take steps to protect themselves against higher prices —this is usually through hedging contracts. If retailers are wrong in this assessment then they lose money either on the spot market, through excessive hedging costs and ultimately by losing customers.

The exit of Hazelwood has affected forward contract prices, not only in Victoria but also neighbouring states that receive energy from Victoria through interconnectors. Higher wholesale costs will need to be factored into customer prices. These higher prices are evident in higher forward market prices (Victorian base futures trading on the ASX at above \$70/MWh for Cal17 and Cal18) and recent modelling by ACIL Allen Consulting for the Essential Services Commission of Victoria. ACIL Allen's estimate is that the average pool price in 2017-18 will be \$77.22 MWh.³⁸ The previous estimate for calendar year 2016 was \$40.19 MWh, demonstrating an expectation that the exit of Hazelwood will increase spot prices in the wholesale market.³⁹

External costs

As we have discussed under the “Regulatory Intervention” heading above, additional external costs have been imposed by government policy decisions and changes to the retail market. In Victoria, these changes are cumulative, particularly in the retail component where derogations from NECF build in cost and inefficiencies to retailer processes. In terms of policy costs, as we discuss above, Victorian government policy has significantly impacted on customer bills through the AMI roll-out. Not only were metering charges quite significant but retailers had to invest in upgrading their own billing systems to facilitate these metering changes. Under the AMI program, customers went from having

³⁷ AEMO, *Electricity Statement of Opportunities for the National Electricity Market*, August 2014, p.1. Accessed here: https://www.aemo.com.au/-/media/Files/PDF/2014_Electricity_Statement_of_Opportunity_Complete_Document.pdf

³⁸ ACIL Allen Consulting, *Wholesale electricity spot price 2017-18 Projections. An Input into the Essential Service Commission's Consideration of the Victorian Feed-in tariff*, 22 February 2017.

³⁹ ESCV, *Minimum electricity feed-in tariff to apply from 1 January 2016 to 31 December 2016*, August 2015, p. 16.

four meter reads a year to 48 each day. Our billing systems and IT processes were upgraded in order to accommodate this.

Other government policies impact on the retailer component of the bill, such as administering and participating in trading schemes such as the Victorian Energy Efficiency Target (VEET) and the proposed Victorian Renewable Energy Target. In relation to the VEET, the Victorian Government has continued the scheme despite the fact that a previous Government analysis found that its costs outweighed its benefits; the scheme merely acted to transfer costs from participating households to non-participating ones.⁴⁰ The lack of net benefits relative to costs is demonstrated by the lack of significant reduction in energy consumption that is attributable to the scheme has added \$177.6 million to cost of energy in Victoria.⁴¹ In assessing the retailer component of bills, the Inquiry needs to be cognisant of not only the direct costs to retailers of these interventions but the drag on efficiency that they also create for the broader energy supply chain. This inefficiency is ultimately reflected in higher input costs across the wholesale, network and retailer components of energy prices.

Costs associated with retail competition

7. Which costs have been introduced or significantly increased as a result of the introduction of retail competition? How much cost has retail competition added to the electricity and gas supply chains?

8. What cost reductions and other benefits to consumers have resulted from the introduction of retail competition? Are there characteristics of the electricity and gas retail markets or supply chains that inhibit retail competition from delivering cost reductions or significant other benefits to consumers?

As we refer to above, some of the costs associated with competitive markets are in fact inefficiencies introduced by external government intervention.

In relation to competition, the commencement of Full Retail Contestability (FRC) had significant set up costs to establish market infrastructure. These included, for instance, customer transfer systems, updates to billing systems, business to business systems and protocols through the National Electricity Market Management Company (AEMO's predecessor) and the Victorian Energy Networks Corporation, and marketing infrastructure that previously existed in only limited form prior to FRC. Most of these are sunk costs and a new entrant to the market is undoubtedly acquiring these systems at a more efficient cost given they are now well developed and can be outsourced as required.

Competition invariably produces costs associated with marketing, customer retention and customer acquisition. Origin's recent half-yearly results indicated an increased cost in our national cost to acquire customers, which we attribute to higher acquisition activity and success at growing our customer base.⁴² Increased costs to acquire are an indication that customer rivalry is strong in the Victorian market. Customers enjoy the benefits of competition through retailers offering competitive products, prices and services. We have outlined above the steps that Origin is taking in this regard. It is also worth noting that as a result of higher acquisition costs, retailers will place a higher premium on retaining customers in order to maintain a downward pressure on costs. If retailers are inefficient or spend too much on acquiring new customers then they risk losing customers by having to raise their prices. This is the discipline of the competitive market.

⁴⁰ Victorian Government (Department of State Development, Business and Innovation), *Business Impact Assessment: Victorian Energy Efficiency Target*, February 2014, pp. 34- 56

⁴¹ *Ibid*, p. iv.

⁴² Origin Energy, *2017 Half Year Results: presentation to investors and analysts*, 16 February 2017, p. 10. Accessed here: <https://www.originenergy.com.au/about/investors-media/reports-and-results/half-year-results-201702161.html>

In Origin's case, part of our customer retention effort occurs when a customer's energy plan benefits period expires. At this point we communicate with our customers to advise them of this fact and to tell them that we have a new offer available. Customers need to contact Origin to take advantage of this offer because we need to obtain their explicit informed consent for a new market contract.

Similarly, retailers will seek to drive down costs in order to obtain a competitive advantage over other retailers. One way Origin seeks to achieve cost savings is through increasing the digitisation of customer service delivery. In part, this refers to more efficient billing and IT systems that can reach customers through digital platforms, such as text messages and emails. As expected, the AMI roll out has created benefits for customers and retailers by enabling the creation of online portals. Origin's My Account allows customers to monitor their energy use, pay bills and update customer preferences. This extends to customers being able to set up payment plans, direct debit, choosing a new energy plan, or arranging a new account when a customer moves in or out. Origin is seeing some growth in our digitisation strategy. Nationally, online sales have increased 21% as noted in our most recent half-yearly results and our e-billing capability is up by 55%.⁴³ We believe that the competitive discipline of the market provides retailers with a greater incentive to deliver customer services more efficiently.

Price dispersion and discrimination. Consumer awareness, understanding and engagement

9. Why do prices remain so dispersed in Victorian electricity and gas markets? Does price dispersion indicate that some consumers are not obtaining the price benefits of competition? Why or why not?
10. When do consumers end up on standing offers or higher priced (typically undiscounted) market offers? What happens to consumers at the end of their contract period?
13. What are the key drivers of active consumer participation in retail energy markets? What barriers prevent consumers, or certain groups of consumers (including vulnerable consumers), from engaging in the market and/or selecting a product that best meets their needs?
14. Does the requirement on retailers to offer standing offer contracts lead to poor outcomes for consumers, or groups of consumers such as vulnerable consumers? If so, why?
15. What implications does discounting raise for consumer outcomes, including consumers' ability to compare offers and for retail competition more generally?

Customer engagement

Origin considers that price remains the key driver of customer participation in the market. Energy retailers seek to raise customer awareness through marketing campaigns (television, radio, online); these advertising campaigns are predominantly arranged around price and discounting. Information from the government can also be a call for consumers to participate (e.g. Victorian Energy Compare/Your Choice), as can be information from third parties like energy brokers. Previously, door knocking was a strong motivator for customer participation and churn, although Origin ceased doing this in 2013.

There is also a wide variety of information sources available to customers including free and impartial sources like Victorian Energy Compare as well as commercial channels through comparison services catering for in situ and customers who are moving premises. It is in a retailer's interest to explain the

⁴³ Ibid, p. 21.

benefits of a product or service to customers in simple and plain language, particularly as the conversation occurs when acquiring or retaining a customer.

It is important to recognize, however, that some customers don't think about their energy supply unless something goes wrong (power outage, high bill, billing error). In these cases, customers are motivated to seek a better deal in terms of both price and service. As we have outlined above, Origin has invested in improvements to billing and other services to retain our customer base and to build loyalty.

According to recent research by Newgate, the number of unengaged customers does not represent a large portion of the market. In fact research by Newgate on behalf of the AEMC suggests that the number of people that are aware that they can choose their energy company is over 90%, and 86% and 84% of people are aware they can choose from different electricity and gas plans respectively.⁴⁴ This indicates a high degree of awareness about customer choice. Additionally, Energy Consumer Australia's recent research indicates that 69% of customers are confident in their ability to make choices about energy products and services; this makes Victorians the most confident energy consumers in the NEM.⁴⁵

At the same time, Newgate's research has indicated that less than 10% of customers are dissatisfied with their gas and electricity company, and that more than 70% of customers were somewhat or very satisfied.⁴⁶ Research conducted by Energy Consumers Australia also reports a similar number: 69% of customers give retailers a positive rating (that is, 7 out of 10 or higher).⁴⁷ This level of satisfaction will invariably produce customer loyalty and some inertia in the market. The most common reason offered for customers not investigating their options was that they were happy with their retailer.⁴⁸ The Energy Consumer Australia report also states that 57% of electricity and 64% of gas customers likely to recommend their current retailer to a friend or colleague.⁴⁹ Overall, these surveys suggest that customers are generally satisfied with their energy retailer.

This does not mean that all customers are satisfied. The Newgate survey indicated that two thirds of the market did not investigate their options in the previous 12 months, and around 15% of the total market chose not to engage because of a lack of trust or knowledge, or a belief that it would make no difference.⁵⁰ Whilst it would be desirable for this number to be lower, nevertheless only a relatively small portion of the market is not engaging.

Standing offers

Welfare and consumer advocates are often concerned about higher prices falling unduly on vulnerable customers. This is despite customers (including vulnerable customers) routinely navigating similar choices in the telecommunications and finance industries. While not all consumers are able to easily make assessments of the products available to them, the low number of customers on standing offers suggests that most people have successfully compared products and entered the market. In Origin's experience, a significantly lower percentage of our hardship, payment difficulty and concession customers are on standing offer contracts than the general residential market and SME customers.

⁴⁴ Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets*, Prepared for the AEMC, June 2016, p. 159.

⁴⁵ Energy Consumers Australia, *Consumer Sentiment Survey*, p. 4.

⁴⁶ Newgate, *Consumer Research for 2016*, p. 159.

⁴⁷ Energy Consumers Australia, *Consumer Sentiment Survey*, p. 2.

⁴⁸ Newgate, *Consumer Research for 2016*, p. 161.

⁴⁹ Energy Consumers Australia, *Consumer Sentiment Survey*, p. 4.

⁵⁰ Newgate, *Consumer Research for 2016*, pp. 160-161. The 15% is an extrapolation of the total market. 24% of people that do not investigate switching do so because they don't trust companies (4%), find it too confusing (4%), believe it would make no difference (6%), or it is too much of a hassle (10%). The 24% figure applied to 64% of the total market that have not investigated their options, making it approximately 15% of the total market.

This suggests that the burden of disengagement does not necessarily fall disproportionately on vulnerable customers and that they may in fact be more engaged than other sectors of the market that would be expected to engage (namely SME).

There has been some suggestion that standing offers should be abolished. Origin is agnostic about such moves but note that standing offers are more than merely the price a customer pays. The standing offer is an outcome of retail energy market regulation and sets out the terms and conditions that a customer must have access to on a universal basis in absence of negotiating anything better. The standing offer and its terms (including price) reflect the standard that energy market regulation deems appropriate as a safety net for customers who receive supply on a deemed basis or do not wish to sign a market offer with a retailer.

The evergreen nature of standing offers means that a paying customer will be able to access a contract without a termination date. A legacy of the standing offer is reflected in Financially Responsible Market Participant being required to offer customers energy supply. Customers can therefore always obtain a publicly available offer for the supply of energy.

As we have noted above, Origin contacts its customers at the end of their energy plan benefit period to offer them a new contract. It is necessary for customers to contact Origin to take advantage of these offers as explicit informed consent is required prior to any new market retail contract. A small segment of the market remains on standing offers. Both full retail contestability, and then price deregulation, have assisted with the decline in the number of standing offers to around 10% of the market. The standing offer rate is available on Origin's website (as is required by regulation), and through price comparator channels, though it is unusual for a customer to choose it over product market offer. A common way a customer may shift from a market offer to a standing offer is when a new property is constructed. Energisation takes place prior to the customer taking possession so that the builder can complete construction. At this stage, the customer moves into a new home that is generally placed on a standing offer by the Financially Responsible Market Participant. Given the low numbers of standing offers, however, we expect that most of these customers would subsequently enter the market for a better rate.

Discounting

Discounting from published market contract rates is a common marketing approach employed by retailers for many years. Origin believes that customers are familiar with discounting and in fact have a reasonable enough understanding of how it works to be able to assess whether an energy contract is more favourable to them. Aforementioned research undertaken by Newgate supports the contention that around 60% of gas and electricity customers find comparing offers to be easy; the figures for those that find it difficult is less than 20%.⁵¹ This suggests that customers are able to compare the standing and market offer prices of a retailer and the discounts associated with these for market offers. In practice, discounting has been popular among energy consumers, as demonstrated by the fact that customers tend to choose discounted products over non-discounted ones—including, in Origin's case, discounted products still being preferred to our Predictable Plan, Rate Freeze, and standing offer rates.

The removal of exit fees from a large majority of retail offers means that most customers who are dissatisfied with their new offer once they get a bill can in fact switch again without any penalty. Whilst an increased bill is undesirable, the market has responded to competition by opting to lower this barrier for consumers. This is a sign that retailers believe that customers are likely to understand and choose a discounted offer with which they are satisfied and are prepared to bear the risk of them leaving.

⁵¹ Ibid, p. 165.

It is important to note that many customers do not consider the rate (in cents per kilowatt hour or megajoules) that is charged for energy, but are more interested in an annual cost. Victorian Energy Compare comprehensively offers such comparisons instantaneously across all retail offers available to customers. It is appropriate that the government continues to maintain this resource.

Price dispersion

There has been some suggestion that the variety of prices in the market means that competition is not effective because the “law of one price”, where goods sell for the same price in one location, is not being obeyed. In fact, experience suggests “that price dispersion is the rule rather than the exception in many homogenous price markets.”⁵² It is not reasonable to conclude that the presence of price dispersion indicates that the market is not functioning efficiently or that it is contrary to interests of consumers. Indeed, it is ironic that the retail petrol industry is sometimes perceived as non-competitive due to price convergence.

In the Victorian gas and electricity market, the number of discounts and offers has resulted in price dispersion. Origin believes that this is explained by retailers responding to competitive dynamics by calculating more competitive rates to attract customers—a desirable outcome in a competitive market and one that is in the best interest of all consumers. In other words, price discrimination is a result of competitive behaviour because

“... in a broad range of market types and conditions, where consumers can be separated into distinct groups with different demand elasticities and in which the market’s commodity cannot easily be resold by one group to another, market pressures will prevent any equilibrium in which the product price is uniform. Not only will each firm be forced to adopt discriminatory prices, but each firm is likely to be forced to adopt a unique vector of prices, each of which is dictated by the market. Thus ... price discrimination may occur – and may occur frequently - not despite relative ease of entry (of other competitive pressures) but because of it. In fact, I will show that in highly competitive markets, firms may have no choice. Competition can force them to adopt the vector of profit-maximizing discriminatory prices.”⁵³

The Victorian market is characterised by very low barriers to entry and a high churn rate. This means that retailers are at risk of losing around quarter of their customers each year to a growing number of competitors entering the market. With such a high customer turnover, retailers are forced to respond to market pressures by offering different discounts and products (such as fixed price products like Predictable Plan).⁵⁴ In such an environment, the dispersion of prices is explained by the reasonably high rate of customer turnover combined with a large number of active market participants.

During the Inquiry’s recent Hearings it was suggested that price dispersion has not worked in the interest of all consumers because not everyone is on the lowest prices in the market. In other words, the fact that some people are on the highest price in the market is used to demonstrate that dispersion does not support the general welfare of all consumers. Origin strongly disagrees with this logic. Price dispersion indicates that competition is placing strong downward pressure on all prices in the market—including the standing offer price (which for many retailers acts as an effective ceiling on prices). In other words, the standing offer prices are lower than they might otherwise be because price competition places downward pressure on *all prices*. This was acknowledged by Ofgem in the UK:

⁵² See Michael Baye, John Morgan and Patrick Scholten, *Information, Search and Price Dispersion*, 31 October 2005, p. 2 and tables 1a and 1b. Accessed here: <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.482.7461&rep=rep1&type=pdf>

⁵³ William J Baumol, *Regulation misled by misread theory, Perfect competition and competition-imposed price discrimination*, 2005 Distinguished Lecture, AEI-Brookings Joint Center for Regulatory Studies, Washington DC, 17 March 2006, pp 2-3.

⁵⁴ AEMC, *2016 Retail Competition Review*, 30 June 2016, p. 197; Littlechild, *Regulation of Retail Energy Markets in the UK and Australia*, p. 17.

“where suppliers have different strong and weak markets to each other, price discrimination can lower prices universally by increasing competition in every market segment. In these circumstances, prohibiting price discrimination could increase prices for all consumers.”⁵⁵

Accordingly, even those customers on a standing offer benefit from price dispersion and competition because of the downward pressure it creates. Removing that pressure may lead to price increases for all consumers rather than reducing the higher end prices.

Origin also believes that in efficient markets prices are determined, in part, on how much people are willing to pay for a particular product or service. People make judgments based on a range of motivating factors—including price, service, brand and loyalty. Any of these factors may result in a customer being more or less willing to pay a higher or lower price; certain customers benefit by being more active in shopping around, but other customers simply do not have the motivation or need to do so. As we indicate above in relation to standing offers, Origin’s experience is that our hardship, payment difficulty and concession customers are less likely to be on standing offer contracts than other segments of the market; it should not be assumed that these customers are not accessing market offers simply because they are socially vulnerable. Accordingly, price dispersion does not indicate that customers are not obtaining the benefits of competition.

Regulation of discounting and price dispersion

Origin does not believe that it would be beneficial to intervene in the market to regulate discounting or to alter the level of price dispersion. Doing so would impact on competition and result, most likely, in generally higher prices—both at the standing offer level and the highest discount (or lowest price). It was suggested in recent Hearings by the Inquiry that regulatory intervention is necessary because customers do not understand the market. The aforementioned Victorian findings of the Newgate research contradict assertions that customers are generally disengaged or distrustful, and that discounting takes advantage of customer’s ignorance of how it works. In fact, whilst there are some customers that do not engage, the research suggests that a lot more of them do engage and that many have a better and more sophisticated understanding of the market than they are given credit for. Origin therefore believes that the Newgate research is not consistent with arguments in favour of regulatory intervention to protect customers from their own disengagement or lack of understanding.

In fact the evidence overseas suggests that interventions in the market to regulate or constrain discounting would more likely have an adverse impact on competition more broadly. In the UK, Ofgem proposed changes to the market to address price dispersion. Stephen Littlechild has summarised the steps taken by Ofgem:

In 2011, as part of its new Simpler, Clearer, Fairer policy, Ofgem proposed a uniform standard tariff where Ofgem would set a common monthly standing (customer) charge and the suppliers would compete only on the unit charge. Ofgem later withdrew this proposal but instead, in 2012-13, restricted each supplier to a maximum of four different residential tariffs per fuel, and prohibited various forms of discounts and tariff variants.⁵⁶

In other words, all retailers would compete on the basis of a variable component of the bill, and that those variations would need to be based on cost reflective principles.⁵⁷ The impact of these policies on the UK market was to reduce price differentials but not prices or retailer profits; the lower end prices in

⁵⁵ The Office of Gas and Electricity Markets, *Addressing undue discrimination – Impact assessment*, Ref 43/09, 15 April 2009, p. 17. Accessed here: https://www.ofgem.gov.uk/sites/default/files/docs/2009/04/addressing-undue-discrimination---impact-assessment_0.pdf

⁵⁶ Stephen Littlechild, *Promoting or restricting competition?: Regulation of the UK retail residential energy market since 2008*, Energy Policy Research Group Working Paper 1415, 20 August 2014, p. 1.

⁵⁷ *Ibid*, p. 5.

the market lifted and this diminished the overall downward pressure on prices.⁵⁸ A large increase in the average bill of customers was observed and switching rates fell because there was less price differentiation to motivate it.⁵⁹ A reduction in competitive rivalry among the big retailers meant less downward pressure on prices for all consumers. Thus, interventions in the market to reduce price dispersion are more likely than not to increase the price of consumers, including the most vulnerable ones, rather than to introduce more consumers to more moderate pricing. Regulation that might impact the availability of discounts would reduce choice and narrow the range of offers available to consumers. Origin does not believe this is in the long term interests of customers in the energy retail market.

Rather, it is best to allow retail competitors (including less traditional participants offering emerging technology solutions) to develop products and services that customers want. We discuss below the changes occurring in energy markets with the introduction of new products and services behind-the-meter. It is worth noting here, however, that any interventions that impact on the competitiveness of the retail market will also have flow-on consequences for the uptake and development of these innovative new products and services. A reduction in competition in the retail electricity market will likely have the flow-on effect of placing less competitive pressure on the market for new products and services. Accordingly, we believe that interventions that impact on retail market competition will likely be contrary to the interests of consumers more broadly in the market for behind-the-meter technologies.

Fixed supply charges

11. What factors influence the level of fixed charges imposed by retailers? What are the implications of fixed charges for consumer outcomes?

Fixed charges imposed by retailers (which are represented as dollar per day charges in the tariff) generally recover the fixed costs associated with retailing in a competitive environment. Origin's fixed tariff charges for the General domestic tariff range from 84.69 cents per day in the United Energy area to 117.42 cents per day in the Ausnet Services area.⁶⁰ This disparity is reflective of the associated network and metering costs across these distribution zones. On average, uncontrollable charges (comprising network and metering costs) account for close to half of fixed costs recovered in the retail supply charge.

The network component of fixed costs is represented in underlying network tariffs; these consist of fixed charges that are passed through to retailers from distribution network service providers (DNSPs). Network fixed charges are not explicit in what costs DNSPs recover; some distributors choose to only pass-through Distribution Use of System charges, others also include Jurisdictional Scheme recovery (such as feed-in tariffs). Fixed network charges may be as high as 34c per day for a General Domestic tariff. Retailers pass these regulated costs through to customers and are responsible for paying these costs to networks. That means that in practice the retailer must pay the network their share of costs regardless of whether or not they are paid by the end customer; retailers therefore bear the risk of non-payment by the customer, including the DNSP's risk.

In addition to these network charges, metering costs apply to all mass market customers in Victoria. These too range significantly in value from 17 cents a day for a United single element meter, or 59 cents a day for an Ausnet Services Multiphase meter with transformer. As with network costs, these metering charges are regulated fixed costs that are passed directly through to customers by retailers

⁵⁸ Ibid, pp. 13-16.

⁵⁹ Ibid, p. 14.

⁶⁰ Energy price fact sheets can be accessed here: <https://www.originenergy.com.au/for-home/electricity-and-gas/pricing/energy-price-fact-sheets.html>

on behalf of networks—and are paid by retailers regardless of whether a customer pays their bill.

In addition to these uncontrollable costs, retailers are subjected to further fixed costs associated with providing retail services to customers. These include:

- costs associated with call centres, billing and associated IT systems;
- regulatory costs (such as licencing and compliance costs);
- staff costs, customer acquisition and retention costs;
- and corporate overheads.

These costs are fixed or semi-fixed in the sense that the same cost applies regardless of customer usage. This is not dissimilar to other industries, where these overheads are incorporated into product prices. As part of the regulatory pricing determination for Queensland notified prices, ACIL Allen has observed that fixed costs for retailers may be as high as \$175 per customer –which equates to 48 cents per day if represented in terms of the retailer component of a daily service fee.⁶¹

The presence of a fixed component of the bill does not demonstrate a lack of competition in the market or that consumers are not being well served by the market. In response to competitive markets placing pressure on prices, Origin has sought to be transparent and cost reflective in its tariff setting. In January 2017, Origin reduced its fixed costs for Jemena and United General domestic tariffs by over 10c per day – a direct allocation of the reduction of the associated fixed metering costs. Other retailers may prefer to design their products differently by increasing their supply charge but lowering the unit price of energy; in a competitive market, these distinctions will form in response to consumer preferences.

Product and service innovation

12. What product or service innovation has been introduced by Victorian electricity retailers? Are there any barriers preventing the entry of new, innovative energy business models or products and services in Victoria?

Changing role of retailers and their business models

Competition continues to heighten in response to new energy products and services. We expect products to develop over time and increasingly provide alternative forms of additional supply for customers. This places retailers under competitive pressure to formulate product offerings that compete with these substitute products. To properly review retail electricity markets it is necessary to consider the impact of this disruption on retail businesses and to consider what regulatory model best suits customers in the future.

The increased uptake of distributed generation (solar PV and battery storage) is likely to transform the nature of energy services. It will empower consumers to own, generate and store electricity themselves and therefore consume less energy from the centralised grid. In 2016, Origin collaborated with Tesla to offer customers a 6.4kWh Powerwall product. These are designed to be integrated into new or existing solar systems. We expect storage systems to continue to decline in price and to compete as a partial substitution with traditional retailer supplied energy products. The increased uptake of battery systems will see retailers, in the longer term, offer customers that remain on the grid different energy supply products that complement their storage system. Technology is also allowing

⁶¹ ACIL Allen, *Regulated retail prices for 2016-17 Estimating the efficient retailer costs. Final Report to the QCA*, 13 May 2016, p. 55.

consumers to understand and manage their power usage through smart appliances, with the emergence of the connected home and home energy management providers having the potential to disrupt the existing utility relationship with consumers. In a competitive market, Origin is responding to changing customer preferences by offering new products and services that meet their needs.

The continued development of the market for behind-the-meter energy products is placing additional competitive pressure on to retailers and leading to more rivalry and product diversity in the market. The impact of solar PV is felt across the breadth of the NEM. The NEM is predicated on a formal regulatory delineation between wholesale, network and retail functions. The installation of solar PV directly impacts on the operation of each of these markets:

- rooftop solar displaces the need for households to purchase energy from the wholesale market;
- as distributed generation, it uses the local network to export power and reduces demand for transmission; and
- this impacts the retailer market either by reducing the amount of energy a retailer sells to its customers or (in the case of SPPA models) acts a substitute source of supply.

By operating across all three areas of the NEM, solar PV presents a fundamental challenge to the existing regulatory framework and the competitive neutrality within the regulated energy market. Whereas participants in the wholesale, network and retail markets are constrained by existing rules, solar is unimpeded.

How to regulate the evolution of contestable energy markets

The important point for regulators is to allow competition to occur between both retailers and emerging businesses. Origin's view is that customers will be best served by open and competitive markets because retailers will be incentivised to respond to price signals from customers about their future energy preferences. In contrast, regulating certain aspects of the market will diminish this competition by giving non-regulated entities (for example, behind-the-meter solar PV) a competitive advantage. Intervening in the market will constrain the ability of retailers to respond to customer needs.

The uptake of distributed generation is decentralising the market and taking power from energy businesses and giving it to the customer. New business models will result in greater customer choice and often act as a substitute for traditional grid-connected supply of electricity from distributors and retailers. This transformation in energy markets will be customer led and customer focused; retailers need to be given the opportunity to respond to competitive market signals in order to develop new products and services to meet customer needs. Regulation risks constraining our ability to do so and may lead to sub-optimal customer outcomes. Retailers will ultimately need to respond to these technologies by developing products that allow them to remain competitive. This may be in the form of 'bundling' these solar and other emerging technologies with tariffs and other retailer products; or it may be by developing products that appeal to customers who already possess solar PV systems from a non-retailer entity. Origin anticipates that this will be an important aspect of market competition in future years. In turn, the competitive tension will benefit new products and services by forcing them to develop products that appeal to customers over traditional retail energy.

To maximise the benefits of competition and maintain competitive neutrality in this environment, it is important to ensure the regulatory framework governing the provision of such services reflects the shift from a centralised system to a more dynamic and diverse network. Even well-intentioned regulation can impede competition and ultimately lead to higher costs for consumers. For instance, there is a trend among some consumer groups that behind-the-energy products should be treated as the regulatory equivalent of traditional retail energy. Origin disagrees. We believe that the most appropriate solution to this problem, from a competitive perspective, is to reduce regulation so that consumers can access greater choice.

This does not mean that relevant protections are wound back entirely but, rather, regulations better reflect the degree of choice a customer has in accessing energy and the price they are willing to pay for those services. All Australian energy consumers are covered by the Australian Consumer Law and *Competition and Consumer Act 2010* (CCA). Energy-specific consumer protections, like those under *Victorian Energy Retail Code*, are quite prescriptive in how an energy supplier needs to deliver that protection. For example, the ACL includes core consumer protection provisions prohibiting misleading or deceptive conduct, unconscionable conduct and unfair terms in standard form consumer contracts. The *Victorian Energy Retail Code*, however, specifies what terms and conditions must be included in a standard form energy consumer contract, like the aforementioned requirements of what information must be contained on a customer bill and the a requirement to bill an electricity consumer every three months unless the retailer has explicit and informed consent to bill another frequency. For voluntary behind-the-meter products, mandating the billing cycle and a bill's content through regulation puts in place an unnecessary regulatory burden, for no benefit to the consumer. Most likely, it would increase the cost of delivering the product, which impedes effective competition. In Origin's view, this is not in the long term interests of consumers.

Given the rapidly evolving nature of the electricity market, Origin would strongly encourage the Inquiry to focus its efforts on reviewing the applicability of the *Victorian Energy Retail Code* more generally to traditional grid-supplied energy, rather than seeking to transpose these protections on to behind-the-meter technologies. The *Victorian Energy Retail Code* was drafted with conventional energy supply as its basis. Evolving energy market dynamics due to changing customer preferences and emerging technologies question whether this founding assumption continues to apply. Consequently, it is timely to consider whether the extensive energy regulatory framework that applies in Victoria will, over time, become increasingly incongruous with the market reality of consumers locating their supply from a diversity of sources. Origin believes that the most appropriate solution to this problem, from a competitive perspective, is not to lift regulation on PV and other behind-the-meter services but to reduce regulation overall so that consumers can access greater choice.

Experience in other jurisdictions. Possible initiatives to improve consumer outcomes

18. Are there examples of other retail electricity and gas markets that deliver strong outcomes to all consumers? What are the key characteristics of these markets, their regulatory frameworks, and/or examples of policy initiatives implemented that have helped improve consumer outcomes?

21. What potential policy options and measures exist to address any issues with the operation of retail electricity and gas markets? Please explain how these policy options and measures would improve outcomes for consumers and identify any potential risks arising from these options and measures

Our submission has already detailed above experiences in the UK when regulators sought to intervene in the market to create better outcomes. Origin believes that a careful examination of the market does not support the conclusion that it is "broken" or not working in the interest of consumers. The evidence from the UK is that interventions in the market to correct price dispersion or discounting will create more problems than they will fix.