



10 May 2006

Review of Australia's Consumer Policy Framework  
Productivity Commission  
PO Box 80  
Belconnen ACT 2616

By email: [consumer@pc.gov.au](mailto:consumer@pc.gov.au)

Dear Sir/Madam,

**ORIGIN ENERGY SUBMISSION TO PRODUCTIVITY COMMISSION'S ISSUES PAPER**

Origin Energy (Origin) welcomes the opportunity to comment on the Productivity Commission's *Consumer Policy Framework* Issues Paper. Please find attached Origin's submission.

We have responded to the questions raised from the perspective of an energy retailer, where our responses relate to our experience in the regulation of retail energy markets.

As a first point, we suggest that policymakers need to see improving markets, and thus competition, as also improving the consumer policy framework. Consumer policy is not just about protecting consumers *from* the market, it is also about empowerment to make choice and participate *in* the market. While government support is often required to supplement the market, in the retail energy market government support has often been mistaken for direct intervention, and generally for political, rather than economic, reasons.

Our submission outlines the range of issues we encounter in the retail energy policy context, their effect on the market, and the effect on Origin as a retailer. Overall, we suggest that there are means of meeting government needs in a market that do not involve direct intervention, and we describe an approach that will both protect consumers from the negative effects of the market, as well as further empowering them to participate effectively.

If you have any queries please feel free to call Fiona Watters on 03 9652 5878.

Yours faithfully

[signed]

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*Consumer Policy Framework:  
Issues Paper*

Submission of Origin Energy

May 2007

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## Executive Summary

Origin Energy (Origin) welcomes the opportunity to comment on the Productivity Commission's *Consumer Policy Framework* Issues Paper. We have responded to the questions raised from the perspective of an energy retailer, where our responses relate to our experience in the regulation of retail energy markets.

### Unimpeded markets empower consumers

We suggest that policymakers need to see improving markets, and thus competition, as also improving the consumer policy framework. Consumer policy is not just about protecting consumers *from* the market, it is also about empowerment to make choice and participate *in* the market.

Obviously governments have a role to provide support where there is market failure, and governments also have a role where some consumers might otherwise be seriously disadvantaged. However, in the retail energy market, government support has often been mistaken for direct intervention, and generally for political, rather than economic, reasons.

### The problems with price controls in energy retail

The risks of market forces being seen to disadvantage some customers has caused governments to maintain reserve powers or direct control of retail energy prices for far longer than the initial industry reforms would have suggested. This has had the effect of penalising the many consumers whom the market could better benefit, in the purported interests of the few.

Origin understands this political need to manage risk; however, we believe that governments and regulators need to also address the political risks of *state price regulation*. State price regulation leads to embedded cross subsidies that are invisible to consumers and distort consumption signals. This works against competitive outcomes and the economic growth associated with robust markets.

### The best policy mechanisms to avoid disadvantage

It should be recognised that any need to provide for broader social outcomes can be handled quite separately from the market.

We suggest that the needs of vulnerable and disadvantaged consumers are best met through a combination of generic and targeted mechanisms, with the degree of targeting being highly dependent on the actual policy mechanism.

The generic approaches need to be light-handed and focussed on information provision and swift and efficient funnelling of customers who require support into the appropriate support mechanisms. They also need to address generic issues only, and not interfere in market prices.

Then the more targeted approach is the support mechanism itself, such as a specific hardship programme that assists the individual reach a manageable payment solution.

Origin has suggested to policymakers across various Australian jurisdictions that a number of their concerns about how vulnerable customers are dealt with by retailers could be addressed through an enhanced access approach.<sup>1</sup> This would entail all retailers who

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<sup>1</sup> This detailed in our submission to recent Ministerial Council on Energy consultation processes about national rules for the retail and distribution of energy. See <http://www.mce.gov.au/index.cfm?event=object.showSubmissionList&objectID=79BFB95D-C62B->

market to residential customers in a region to be required to provide a basic contract to all residential customers in that region, on request. The contract would cover all current basic customer protections, and such matters as payment in person would be guaranteed. The price would not be regulated, but all customers would have a guaranteed choice of basic contract. This would be in addition to the market contracts made available at retailers' discretion.

This is a generic policy (in the sense that it covers the whole domestic energy sector) but it does not interfere with market prices. This would essentially replace price regulation, but also depends heavily on competition in the market being effective (thus keeping prices efficient) and effective hardship policies from both government and industry (thus keeping bills affordable and sustainable).

### **The proliferation of regulation**

Origin believes that the costs of industry-specific regulation for the retail energy industry could be reduced, and this could occur through more principles-based regulation. However, we also recognise that regulation through principles can be difficult.

Our own experience of the industry is that the uncertainty of the environment has tended toward the ever increasing need to specify intent through more detailed regulation or contract. However, even though some increase in regulatory detail over time might be unavoidable, there should be stronger criteria around how rules and regulation are written, and how they are managed over time.

The rules and guidelines created to date are not subject to assessments of effectiveness, or public benefits tests. The regulation has been allowed to proliferate as new issues continue to be identified as not being 'clear enough' to some parties, and this has occurred since before the markets even opened. Other ways of managing problems are not addressed, such as self- or co-regulatory options, and obscure or ineffective regulation is rarely, if ever, stripped from the regime.

### **Discretion of jurisdictions might undermine national consistency**

The institutional factors in energy retail that have helped sustain regulation that does not provide a net benefit to the community have largely been due to:

- (a) the variations in energy regulatory frameworks across the states and territories - under the Australian Energy Market Agreement (AEMA) there is provision for divergence from the national approach, commonly called Jurisdictional Directions;<sup>2</sup> and
- (b) the political decision-making that has occurred at a jurisdictional level about such matters as retail price controls.

These issues are being addressed by the current national reform programme. Our only concern is the allowance for jurisdictions to keep some politically sensitive issues under their discretion. This is likely to leave key decisions to purely political criteria, with no reference to due process, market objectives, or actual consumer need. For example, statements made by key officials in the media and in private consultation would indicate that removing price controls in some jurisdictions will be particularly difficult, regardless of whether competition is effective or not.

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[0857-F6609BE926327F67](#).

<sup>2</sup> Although this is not a term used in the AEMA.

## 1. Introduction

Origin Energy (Origin) welcomes the opportunity to comment on the Productivity Commission's *Consumer Policy Framework Issues Paper*.

Origin is a major Australasian integrated energy company focussed on gas and oil exploration and production, energy retailing, and power generation. As a retailer, we have over three million gas, electricity and LPG customers in Australia, and as such, Origin is the second largest energy retailer in Australia. Origin is one of three incumbent, or 'host' retailers in Victoria and Queensland, an incumbent gas supplier in South Australia, and a second-tier retailer across all states with competitive retail energy markets.

Origin will respond to all questions in the Issues Paper as they apply to retail energy in Australia, and primarily in competitive markets. While we will address elements of non-price regulation, the key focus will be price regulation of electricity and gas retail services to small customers in the retail energy market. Price regulation applies to all contracts that consumers do not explicitly enter into as part of the market. See Appendix A for an explanation of how the energy industry works.

As an initial point, we suggest that policymakers need to see improving the market, and thus competition, as also improving the consumer policy framework. Consumer policy is not just about protecting consumers *from* the market, it is also about empowerment to make choice and participate *in* the market.

Obviously governments have a role to provide support where there is market failure, and governments also have a role where some consumers might otherwise be seriously disadvantaged. However, government support has often been mistaken for direct intervention in the retail energy market, and generally for political, rather than economic, reasons. This has had the effect of penalising the many consumers whom the market could better benefit, in the purported interests of the few.

We would also question how much some of the regulation - and price regulation in particular - truly benefits those whom it purports to protect, as the price governments set tends to then be the 'price to beat' for the market. This means they set a ceiling rather than reflecting the cheapest price.

Overall, Origin believes that as time progresses and the market develops, retail price regulation should be increasingly left to the market. The most important actions of government are to encourage the development of a competitive and sustainable market so that market forces can set efficient prices and protect consumers from price exploitation. In this context we note that regulators already have access to powerful statutory framework of anti-competitive conduct and unfair practice legislation.

With a national approach to retail and distribution market rules and to network pricing, there must be a national approach to the market itself and a commitment to the premise of the market, which is that it is there to *set prices and provide products that consumers want*. Any jurisdictional need to supplement this can be dealt with through jurisdictions' own CSO policies. There are always creative means for governments to achieve their social policy objectives that do not include direct interference in market price outcomes.

We are pleased to see the amendments to the Australian Energy Market Agreement (AEMA) which support this philosophy of relying on effective markets (rather than state regulation) to drive efficient consumer pricing, supplemented by transparent government CSOs to achieve relevant social objectives. In clearly distinguishing the issues of the removal of price regulation and achievement of social objectives, the AEMA represents a significant step forward that is strongly supported by Origin, and is a step that promises the optimal achievement of both objectives.

However, the actual achievement of the principles under the AEMA may be in some jeopardy. Jurisdictional governments are under no obligation to actually remove price regulation even if competition is found to be effective. The perception of these governments may continue to be that the political risk of removing price regulation outweighs any competitive benefits.

Section 2 addresses the specific questions raised by the Commission in its Issues Paper. For the sake of clarity, we have provided our response according to the same headings and order of the Issues Paper, and we have also numbered the questions.

Appendix A provides an outline of the structure of the energy industry.

Appendix B provides Origin's commentary on the phase out of retail price regulation clauses of the AEMA.

## 2. The rationale for consumer policy

*Question 1: What are the key rationales for government intervention to empower and protect consumers? What should be the balance between seeking to ensure that consumers' decisions properly reflect their preferences (empowerment) and proscribing particular outcomes (protection)?*

While the purposes of market reform and price regulation are generally well understood by theorists, we believe that practitioners can sometimes lose sight of the philosophy behind the approach, and the range of means by which they can achieve their objectives. We will restate the questions above in order to better address the issue for Origin, that is, the intervention of government in the retail pricing of a competitive market.

First, it is important to ask *what is the purpose of regulation?*

We suggest that regulation should seek to align the outcomes of retailer activity with the public interest, and not be more onerous than necessary to achieve this outcome.

While not stated through policy, it might be said that the overall public interest goal of the retail energy market is to provide for customer access to supply at the lowest efficient price, noting that this is without exploitation or material disadvantage. The issue is then how to best meet this goal in a manner which is efficient and sustainable.

This takes us to the second question: *what should regulation look like?*

It needs to be recognised that competition through a market and ongoing price regulation by the state are alternatives to achieving this public interest goal. Each is a form of regulation. Competition sets a market price through rivalry between competitors - it is regulation by market forces. In contrast, regulation by the state sets a political price based on judgements on the acceptability of outcomes to key constituencies.

The decision was made by the Australian federal government (and most state and territory governments) some years ago that competition in the retail energy sector would provide for more efficient outcomes than state control. To support this approach, much effort has been expended by governments, regulators, industry, and other key stakeholders to develop equitable and effective market frameworks that provide for market forces to set prices and allocate resources.

Given this, *it must be presumed that competition is the preferred overall means of regulating the retail energy market.* Jurisdictional governments have confirmed this view in public statements to date, and have explicitly made this claim to the industry. The federal government has also confirmed this intent through its Energy White Paper *Securing Australia's Energy Future*. Retail price control should thus be an interim measure that is unwound as competition starts to evolve within the sector.

A third question then needs to be asked: *what is the role of government in the market?*

Origin believes that the fundamental role of government is to develop policy approaches that balance the various needs/public interest goals relating to the economy, industry, community and environment. Only government can make (or is empowered to make) the necessary trade offs between various versions of what is in the public interest, and only government has at its disposal the full range of means to achieve its objectives. These include social programmes, economic incentives, direct subsidies and establishment of markets.

The market is thus a governance tool, with structure and high-level processes built upon



policy needs set by government, but outcomes set by market forces. Governments that desire to create markets need to constitute these markets with clear policy principles and a foundation of basic rules and expectations. They also need to establish complementary provisions, such as creating regulatory agencies which are tasked with monitoring and enforcing market rules.

Once a market framework is in place, a government needs to refrain from intervening in the market itself to influence prices. The market is thus what empowers consumers, both through the range of options to choose from, and by allowing consumers to avoid government set prices that might be unsustainably high or low. Direct government intervention in market prices will destroy the value of the market, as discussed in our response to Question 4. As long as there are no significant impediments to competition, market outcomes should be unimpeded by political decision-making. In any event, impediments to competition should be removed as a priority before any decisions should be taken about the need to set prices.

The important point to note is that *any need to provide for broader social outcomes can be handled quite separately from the market*. A retail energy market is only one of a suite of means of meeting community and consumer expectations of energy provision and social policy. A market can - and for an 'essential' service probably should - be supplemented with government policy in a range of areas, such as creating direct (and transparent) subsidies to those who are seen to require support. There are always creative means for governments to achieve their social policy objectives that do not include direct interference in market price outcomes.

Therefore, in theory, there is no compelling reason why Australian jurisdictions (that is, state and territory governments) need to maintain retail price regulation as a function. With a national approach to retail and distribution market rules, there should be a national approach to the market itself and a basic acceptance that the market is there to set prices and provide products that consumers want. Any jurisdictional need to supplement this can be dealt with through jurisdictions' own CSO policies.

***Question 2: What are the implications of developments in theory (e.g. behavioural economics) for consumer policy? Do they render some traditional views of the role for government in this area less relevant, or do they simply require more sophistication in the analytical framework and policy toolkit?***

The Commission has asked if consumers always act in their best interests, and points to the field of behavioural economics as demonstrating that consumers do not always act in what might be seen as truly economically rational ways. Consumers misjudge risk, and sometimes make inferior purchasing choices even when they have access to adequate information.

Origin believes the literature in this area can usefully inform consumer policy in general. However, the relevance to consumer policy in the retail energy market is less clear. Given the status of energy (and electricity in particular) as an 'essential' service, and the general (and inaccurate) presumption of market failure that has pervaded the policy outlook to date,<sup>3</sup> beliefs about consumers' potential inability to effectively or rationally engage with

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<sup>3</sup> The recent development of retail markets and corresponding regulation in energy has been the opposite of most other sectors, in that in each jurisdiction retail energy price regulation has been present from market start, with competition needing to be demonstrably 'effective' (that is, seen to be 'working') for regulation to then be reduced. Other industries usually need to have serious market failure *before* regulation is then imposed, with the onus on policymakers or regulators to prove this failure before intervening. Indeed, the whole thrust of the general post-Hilmer reform process places the onus of proof on those who wish to regulate the market to clearly state the objective of the regulation, the 'harm' that is to be addressed, the overall costs and benefits and, more specifically, the impact the regulation will have on the development of a competitive market.

the market have always been prevalent.

The default consumer advocate and regulatory position has been one that assumed consumer ignorance about choice of retailer, and a high degree of consumer inertia about purchasing services that are not seen as tangible or exciting as other services. There is some validity to this, and particularly from a historical perspective, as choice of retailer was still new when the consumer protection regimes were developed, and retailers' own experiences are also that consumers do not tend to find energy competition as engaging a topic as other matters.

However, the market has been open long enough for consumers to know they have choice,<sup>4</sup> and the market contract take-up rates in the states with effective competition (Victoria and South Australia) have surpassed rates from any international jurisdiction. There is clear evidence that consumers are capable of, and interested in, participating in retail energy markets, and the absence of serious market conduct issues would indicate that consumers are participating in an informed manner. While retail energy competition may never reach the heights of sales such as retail fashion or mobile phones, it is still a vibrant market with clear consumer value and effective consumer recall of brand. The current groundswell of consumer interest in environmentally sustainable lifestyles has also fed a growing interest in purchasing 'green' energy products and services.

To sum up, while we recognise that behavioural economics studies may cause pause for thought in other markets (specifically about consumers' true ability to act as self-interested, economically rational individuals), we would be surprised if this field of interest could paint consumer policy in the retail energy market in any worse a light than it has been painted to date through certain regulatory assumptions and special interests. In fact, the real value to our industry of this more scientific approach to customer behaviour and value rationality might be that it helps give governments comfort that their current levels of market intervention are *not* warranted.

***Question 3: Under what conditions are markets most likely to develop responses to the various impediments to the effective participation of consumers? To what extent will the actions of well-informed consumers drive outcomes across markets as a whole?***

Markets will develop responses to impediments to the effective participation of consumers where there is no significant structural barrier to doing so. 'Effective participation' needs some definition, but we would suggest it is where the bulk of the consumers are able to engage with suppliers either directly or through an intermediary, as they require, and on terms and conditions that are competitive.

However, 'effective participation' does not necessarily mean that all consumers will have access to the product or service on precisely the terms and conditions they personally require. 'Effective participation' also does not presume *affordability* of a product or service. The market merely ensures that the prices are efficient, not that they are fair. The market provides what most of the people want most of the time, it does not guarantee a complete fit for all personal circumstances.

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<sup>4</sup> In Victoria, the Essential Service Commission's (ESC) 2004 customer survey found that nine in ten electricity residential and small business customers (whether or not they had gas connected) and over eight in ten gas customers were aware that they had the ability to choose. This was similar to the ESC's 2002 survey results. In South Australia, the Essential Services Commission of South Australia (ESCOSA) had a similar result, with 79% of respondents aware of their ability to choose their electricity retailer, and the same awareness of ability to choose a gas retailer. See ESC (2004) *Final Report to Minister - Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity*, June, and ESCOSA (2006) *Monitoring the Development of Energy Retail Competition In South Australia: Statistical Report*, March.

The actions of well-informed consumers will significantly drive outcomes across markets as a whole. An effective market is responsive to changes in demand, and where the demand shifts the supply should follow.

*Question 4: What are the important costs of intervention? How significant are the hidden costs of intervention? How do these compare to the costs of not intervening?*

As noted by the Commission on page 13 of the Issues Paper, intervention is not without costs. In fact, the costs of government intervention in energy markets can be extremely high.

In non-price terms, the costs can be high in regulatory compliance, in that retailers need to comply with a range of jurisdictional regimes, all with slight differences in many areas, such as what must be on a bill, and times for cooling off periods. There are additional costs related to auditing and reporting requirements.

However, while the costs of consumer protections in non-price areas can be onerous, the real problem for the retail energy industry in Australia comes from state price controls in contestable markets. While the theory would require governments to stay out of market outcomes, this is obviously not the reality, with state price controls of basic contractual offers still present in all Australian jurisdictions that have retail energy markets.

The problem with unwinding price controls seems to stem from governments being unwilling to lose control over price outcomes for which they are still seen as responsible. Governments are often politically vulnerable to consumer backlash over utility prices irrespective of the private sector ownership of the businesses or presence of a competitive market. The most significant problem occurs where prices to some consumers rise significantly in a brief period (sometimes known as 'price shock'),<sup>5</sup> which is often the result of unwinding embedded cross-subsidies in existing prices. Unwinding cross-subsidies to show who is receiving support and who is paying more than their share is also rarely popular.

The risks of market forces being seen to disadvantage some customers, and those customers (or their representatives) then damaging government's legitimacy to govern at the next election, is thus enough for governments to maintain reserve powers or direct control of prices for far longer than the initial industry reforms would have suggested.

Origin understands this political need to manage risk; however, we believe that governments and regulators need to also address the political risks of *state price regulation* rather than just seeing the benefits of protecting customers from this public perception of market forces. State price regulation leads to embedded cross subsidies that are invisible to consumers and distort consumption signals. This works against competitive outcomes and the economic growth associated with robust markets.

As discussed below:

- price shock is often the outcome of years of state regulation;
- price regulation will stifle competition; and

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<sup>5</sup> The energy market is often marked by price shifts. These arise from such things as the prevalent weather patterns and their impact on supply and investment in generation and network capacity keeping up with the ever-increasing demand. Increases also occur from government policy, where the industry is expected to pass through government levies and the costs of environmental policy objectives around valuing carbon emissions. However, incremental increases are not the same as price shock. Price shock occurs when there is a large increase at one time that consumers find difficult to accept, and which make governments feel politically vulnerable.

- the costs of regulation can outweigh the benefits.

Most importantly, government intervention, and onerous or prescriptive regulatory programmes can discourage investment, as industry participants will view the sector as lacking opportunity, and possibly even presenting too much risk.

#### Price shock is often the outcome of years of state regulation

It should be recognised that any price shock felt by consumers in a competitive market (assuming the market is effective) is because market forces are providing for efficient outcomes, and there is a gap between what had been charged historically and what needed to be charged to recover costs. The reason for this gap is often actually the result of governments keeping prices to some consumers artificially low over many years (generally to obtain political goodwill from key constituencies) whether this is through depressing prices overall, or through maintaining cross-subsidies between consumers through the retail price. However, keeping retail prices low to some consumers by these artificial means provides only a short term fix, and only delays and exacerbates the effects of the inevitable price rise.

Where there are such price gaps, there are means of avoiding price shock in the transition to a truly competitive market (that is, with no state price regulation and competitive markets driving cost reflective pricing).

First, sometimes inventive approaches to price regulation can start to create a more level playing field rather than just reinforcing price inequities. For example, prior to full competition, developing a price path over a clear period of time can support the unwinding of cross-subsidies while also providing some certainty to customers and governments about the extent of any price increases. This provides a politically manageable compromise in the short term and at least establishes a more sustainable foundation for the longer term.

Second, if governments seek to protect some customers through ongoing subsidies they can still achieve this in a competitive market environment. However, subsidies must be provided transparently from Government, and thus be separate from the market itself. The community has a right to be informed about the cost of subsidies. While Origin recognises that transparent subsidies are also sometimes politically damaging, we believe this risk can be managed. There are always innovative means for governments to achieve their desired political outcomes and alleviate the risk of damage without resorting to heavy-handed or interventionist approaches.

There is also the possibility that the political cost of being seen to provide subsidies to some consumers is actually far less than the eventual political damage of undermining the market through price intervention. As discussed below, price regulation damages investor confidence, and, if unsustainable (as it frequently is), will eventually result in an energy sector that is unable to meet the expectations of the wider community.

Overall, any of the means available to governments to manage their risks should not be undertaken at the expense of the legitimate commercial interests of energy retailers. Any approach should be a cooperative programme funded by the state with the retailer assisting as appropriate in its implementation.<sup>6</sup>

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<sup>6</sup> For example, the Victorian Network Tariff Rebate is an example of this cooperative approach which still protects the legitimate business interests of the retailer, while unwinding cross subsidies over an extended period.

### Price regulation will stifle competition

It is important to point out that any consideration of price regulation should have some perspective about the way effective markets work.

To be effective, markets require price signals between demand and supply. The price is the ultimate means by which all the information across all market segments and players (necessarily limited for any one player) in the complex environment is condensed into a form all can access and understand. Market participants use this information to drive their own behaviour, and thus the market is a dynamic system which arrives at efficient outcomes through the constant interplay of buyers and sellers using prices as their currency of communication.

State price regulation generally dilutes price signals between the market and consumers. In fact, concealing the true costs to consumers is sometimes its primary purpose. This sends inaccurate and inappropriate messages to consumers about the costs of their consumption, and also reduces the power of any policy initiatives relating to demand side management or energy efficiency programmes.

Further, competition will be limited, or even non-existent, where regulated price levels provide limited or non-existent margins. It is logical that if there is no profit potential, retailers will not seek to participate in the market. This has been a common issue across Australian jurisdictions, where some regulated prices to certain customer segments *still do not even allow for basic cost recovery*.

Even where low margins do not stifle innovation across the board, price controls and interventionist approaches from regulators and governments to date have had a dampening effect on the competitive mindset of the industry players.

Fundamentally, a presumption of the need for state price protection must be avoided, particularly where there is no evidence of this need. Making this presumption increases the risk of Type II regulatory errors (to regulate where state regulation is not warranted), and becomes a self-fulfilling prophecy where the resulting regulatory approach stifles competition. For example, if jurisdictional governments or regulators are waiting for competition in any one jurisdiction to significantly 'prove itself' through high churn rates before removing price controls, they may have created a vicious circle (particularly if prices are set below cost of supply).

### Regulatory decision-making can be more costly than beneficial

In arriving at retail price decisions, jurisdictional regulators face a complex task of attempting to determine 'efficient' costs and resolve conflicting objectives, particularly given the dearth of relevant information to guide them. Regulators have, for instance, struggled to develop an appropriate methodology to assess the efficient cost of electricity, and are exposed to the very real threat of creating a California-type crisis situation in which large retailers are driven to bankruptcy, squeezed between wholesale prices and retail price controls.

The conflicting retail pricing objectives and approaches include:

- short term customer protection from price shock, versus economically sustainable pricing for retailers;
- encouraging competition by allowing an additional allowance in the retail prices, versus setting the lowest possible costs (sometimes, but inaccurately, claimed to be the efficient cost);
- explicit pass-through of regulated costs (such as network costs) with controls only on the retail component, versus controls on the bundled price; and

- providing broadly based price controls, versus detailed and specific prices for narrowly defined customer segments.

Jurisdictions have typically adopted different priorities, differences that in turn have been important factors in the very different competitive market outcomes. If any regulation of retail pricing is to continue, a national retail pricing framework is needed to refine these objectives.

In any event, we have real concerns about governments or regulators continuing to believe that they can somehow determine the 'right' or efficient price for a good or service in place of market forces. Given that market prices are the most efficient because *only the market can order all the necessary information*, any price setting by other means will naturally be inadequate. This is potentially dangerous to the industry if prices are low and not sustainable. This outcome ultimately does not benefit consumers.

Administration costs for regulation can also be high, including compliance costs for regulatees, enforcement costs for the regulator, and the costs of developing and managing regulatory arguments for both sides. Any form of price regulation chosen must be able to be matched by resources to collect and manage the required information, and to enforce regulation.

It is vital that there is a clear view of the materiality of the risks of exploitation of market power in the absence of regulation, compared with the costs of regulating away these risks.

#### Price regulation will discourage needed investment

Further, and most importantly, the cost of 'getting it wrong' with decisions related to price regulation can mean damage to the industry, and ultimately the economy.

The objective of the National Electricity Market, as stated in the National Electricity Law is:

To promote efficient investment in, and efficient use of, electricity services for the long-term interests of consumers of electricity with respect to price, quality, reliability, and security of supply of electricity and the reliability, safety and security of the national electricity system.

Price regulation, and, in particular, getting price regulation 'wrong', will undermine each element of this objective.

First, it will have a negative effect on generation investment. There may be price signals in the wholesale market to build new plant (that is, wholesale prices are high), but these price signals are of no use if they cannot be profitably acted upon by either independent power producers or vertically integrated retail-generation entities.

To build new generation capacity, independent power producers need to be able to sell to retailers (or direct to large industrial consumers) and they will be less likely to do so if retailers do not want to purchase power from them because retail prices to end users do not allow for cost recovery for the energy bought (which includes the capital costs of building plant) and also provide a retail profit. As an alternative generation option, retailers can choose to build their own supply, and thus hedge their supply. However, once again, they also need to be able to pass through the costs of supply and remain commercially viable. If they cannot do so, they will not seek to build new plant.

What this means is that over time there will be insufficient generation to meet demand at peak times, and as consumption grows, wholesale prices will continue to rise. Thus the second negative effect on investment will be felt: investment in retail. In a retail price-regulated environment with little room to move, the pressure on retailers will increase as

they incur greater costs from contracting with generators (or going through the Pool) yet are only able to retail to customers to a externally determined retail price ceiling.

Perhaps the view of policymakers is that if the pressure is great enough, retailers *will* build their own generation capacity, and this is the market 'working'. However, the effect of these higher costs for retailers may not be further investment, but exit from the market. This is because the longer term benefits to shareholders from further investment in the already risky environment will be less apparent than the immediate benefits of limiting further losses by simply ceasing retail activity. New investment will also be less likely.

One way of handling this situation from a policy perspective would be to further encourage demand side management, and thus reduce pressure on the generation sector at peak times. However, without a clear price signal to end users to reduce electrical load on the system at these times - a signal which retail price regulation will stifle - demand management initiatives will be limited in their effectiveness.

Inadequate generation obviously undermines security of supply and increases the risks of power outages, which is not a good political outcome and actively contradicts the NEM objective quoted above. Inadequate retailer investment means competition will be less effective, and the worst case scenario is that a viable retail sector is not possible. Where a retail market has already been established, this outcome is also likely to be unsatisfactory from a political perspective. Government might need to step in, which incurs significant financial costs and political damage.

These are the potential outcomes from intervening in the end price of a vertically integrated industry. Such intervention *short circuits the very mechanism that markets depend on to allocate investment and efficient use of resources.*

### 3. Market trends and developments

*Question 5: How have recent market trends changed the requirements for Australia's consumer policy framework? For example, has the growth in e-commerce made it more difficult to enforce regulation, thereby reducing its effectiveness? Or has the internet empowered a greater proportion of consumers? Has greater product complexity made it more difficult for consumers to participate effectively in markets? What are the impacts of the greater use of product bundling and standard-form contracts? What other new developments are likely to have material implications for the policy framework over the next decade?*

The growth in e-commerce and the internet has been extremely positive for retail energy markets in Australia, and has empowered consumers a great deal.

First, it means that retailers get a better chance to provide information to interested customers about their brand. Energy is a low involvement service: while customers use energy every day, they do not tend to engage with retailers except where there is a problem. The internet is a useful way to engage with customers at their own pace, and it provides useful visual ways for customers to understand the service without (a) having to take a too generic approach (as per other visual media) or (b) having to take a bill specific approach.

Second, and leading from the above, the internet provides customers with better access to information from regulators and retailers about their rights and responsibilities. This information is transparent and can be perused at length.

Third, the internet has provided customers with better means to participate in the competitive market. Internet cost comparators, guides on purchasing energy and provision of retailer contact details all assist customers to understand the offers available and how to best access the offer that is right for them.

Another development that is likely to have material impact on consumers' engagement with the energy market is the roll-out of 'smart' electricity meters to allow the introduction of time of day pricing. This provides for consumers to better understand and manage their demand for peak power. The use of innovative technologies such as in home displays can greatly enhance consumers' involvement in their own energy consumption.

Victoria is embarking upon a roll-out of smart meters across the state, and companies have trialled or are planning to trial metering technologies across most other jurisdictions. The Commonwealth's 'Solar Cities' programme (where Origin is the lead proponent of the Adelaide Solar City consortium) will also demonstrate the application of integrated smart meter, renewable energy and energy efficiency technologies. CoAG has also now agreed to an implementation strategy to facilitate a national smart meter roll-out.<sup>7</sup>

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<sup>7</sup> For background information about the national roll-out, see <http://www.mce.gov.au/assets/documents/mceinternet/SmartMetersInfoPaper20070123163300.pdf>.



## 4. How well is the current framework and suite of measures performing?

### 4.1 Overall framework and approach

*Question 6: Is the current consumer framework fundamentally sound? Does it simply require fine-tuning or are more comprehensive changes required? What measures could be used to assess whether it is delivering for consumers?*

*Question 7: Does the current framework focus on the right issues and areas? Are there significant gaps or imbalances in coverage, or particular objectives that are not well catered for? Is there any significant duplication of policy effort?*

The current consumer framework for retail energy is currently being reviewed by the Ministerial Council on Energy (MCE) a national body comprised of Energy Ministers from Australian jurisdictions, established by CoAG. The MCE, and sub-groups established under it, have spent the best part of the past two years addressing such matters as:

- The governance of the national energy market across all sectors, including the creation of a national policy body (the Australian Energy Market Commission, or AEMC) and a national regulatory body (the Australian Energy Regulator, or AER).
- The harmonisation of the current state and territory based regulatory provisions for distribution and retail services, to create national law and rules to be managed and enforced by the AEMC and AER respectively.
- Other key issues for the energy sector that impact consumer access and prices, such as responses to climate change, interval meter policy, and gas market development.

We would argue that many elements of the current consumer framework for retail energy are not fundamentally sound, and we have reflected this view through the various MCE stakeholder consultation processes. This work is ongoing, and outcomes from the various review processes are expected in the coming months.

In some cases fine-tuning may be all that required, such as the bulk of the current retail non-price contract provisions currently in place. These are generally bureaucratic in their design, and in some cases duplicate existing generic market conduct laws around fair trading. However, we believe most of these provisions can be retained in principle.

In other cases, the protections in place for consumers would seem unnecessary, and are bad policy. Price regulation where there are competitive markets (with clear hardship policies) is an example of this. This situation tends to occur when governments step in to create rules to further their political interests, in the absence of any evidence of wrong doing. Further, some policy has been created before any assessment has been taken of existing regulatory approaches; the preference has been for increased general regulation of the industry 'just in case' rather than specific enforcement of existing provisions that would stop specific market offenders.

This has meant that mechanisms for testing regulatory provisions, such as reviews of effectiveness and regulatory impact statements, have not applied to the retail energy industry. The consumer policy framework has instead been created over time by a patchwork of influences, including Ministers and other stakeholders seeking political wins. In most jurisdictions the framework was also largely created before competition had even

opened, and so was the result of general concern about what *could* go wrong in a worst case scenario. There were presumptions made about retailers' desire to leave certain customers out of the market that have never been supported, and yet continue to prevail as the common belief of certain influential parties.

We have hope that the shift to the AEMC and AER (the latter being a constituent of the ACCC) might see a change to the regulatory approach to date. We would like to see an assessment of the current approaches not only focus on harmonisation (the politically expedient approach), but on evaluation against clear objectives and getting the *right* outcomes for the market of today, and for the future. While the timeframes provided make achieving the latter look increasingly difficult, we remain optimistic that it is possible.

However, political influence of jurisdictional governments has not, and likely never will be, eradicated. Given the political risk of handing over control of an essential service to national bodies, the various governments can be expected to keep significant parts of the framework to themselves, and this appears to have been enabled by the governmental agreements to date. For example, the intergovernmental Australian Energy Market Agreement provides for jurisdictional discretion (referred to as Jurisdictional Directions in an earlier MCE consultation paper,<sup>8</sup> and addressed in our response to Question 25).

***Question 8: Has the inclusion of new objectives, such as strengthening the position of small businesses in their dealings with larger enterprises, impacted on the effectiveness of the framework? Should consumer policy be further extended to cover small businesses as consumers?***

In energy, all protections for residential consumers are currently afforded to small businesses.

In fact, we would argue that a number of these protections - developed for energy as an essential service - are not, in fact, required for small businesses. Small businesses' energy requirements are no more 'essential' than their basic stock requirements, and they need to make energy purchasing decisions as a part of doing business.

***Question 9a: Is the balance of responsibility between governments, business and consumers broadly appropriate?***

The balance of responsibility between governments, business and consumers is generally appropriate for some elements of retail energy consumer policy, but it is also subject to concerning developments based on political concerns. Energy retailers often bear the brunt of the government consumer policy approaches; with our regular access to almost all consumers' homes, we are frequently an easy target for policy initiatives, even when these initiatives are not specifically related to retail, or even energy related.<sup>9</sup>

In particular, we are the focus for concerns about customers' financial capacity to pay their energy bills. Governments have concessions programmes and provide government assistance to customers, but this does not meet all (or even most) of the needs of energy consumers who require support.

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<sup>8</sup> See Gilbert + Tobin, NERA (2005) *Public Consultation on a National Framework for Energy Distribution and Retail Regulation*, Consultation Paper. The term Jurisdictional Directions is common parlance in the current MCE circles but currently seems to have no legal power as a definition.

<sup>9</sup> For example, in Queensland payments for community ambulances are collected through electricity bills.

It is worth recognising that customers in chronic financial hardship<sup>10</sup> usually have several differing debts. Payment of these bills is often not the greatest challenge, and payment of an energy bill might represent only a small fraction of household expenditure (e.g., the average weekly household expenditure on domestic fuel and power is 4%; for people in the lowest income brackets it might be up to 15%).<sup>11</sup> The matter of affordability of services for customers in hardship seems to warrant a more comprehensive investigation than just via the lens of energy service provision, and certainly warrants deeper assessment of what may constitute 'chronic' financial hardship. However, this has not occurred in the energy sector, with energy retailers expected to manage the bulk of their customers' bill payment issues.

While Origin takes its obligations seriously as an energy provider (see our response to Question 14 for how we provide support to our customers), we also feel strongly that assisting customers in financial difficulty is a responsibility which much be shared across all relevant stakeholders.

In particular, Government bears the key social responsibility of ensuring customers have access to those services seen as 'essential'. While retailers can do everything in their power to assist customers to manage their energy debts - including helping them understand that such assistance is available - this responsibility of retailers (and their shareholders) does not extend to subsidising the ongoing energy use of those who *cannot pay at all*, and certainly not for those who refuse to pay.<sup>12</sup>

We believe that retailers can only manage customer issues and deliver social policy and hardship programmes within our own sphere of influence, that is, the provision of energy services. We cannot resolve customers' other lifestyle affordability or money management issues (and should not be expected to) and we cannot compel customers contact us to advise of hardship.

Therefore it must be recognised that even the best industry practices will not resolve all the problems experienced by people who require support, and will probably not even solve the problems experienced with energy bills. There will sometimes be people who find their energy bills unaffordable or unmanageable, no matter what retailers do to prevent this.

While most within our industry understand these facts, including many consumer advocates, they are sometimes forgotten when governments or special interests are seeking political mileage from issues related to consumer financial hardship.

*Question 9b: Does the framework pay sufficient regard to the costs of intervention for consumers and businesses? Does it promote certainty and clarity for consumers and businesses and is it sufficiently evidence-based? How well has it coped with the changing circumstances identified earlier?*

*Question 10: What broad changes to the framework could be made to deliver greater benefits or more cost effective outcomes for the community? In this regard, what can Australia learn from the experience of other countries?*

*Question 11: Are the right tools being used to meet the objectives of consumer policy? Is the current range of tools sufficiently diverse?*

<sup>10</sup> See our response to Question 13a for a discussion about definitions of hardship.

<sup>11</sup> Australian Bureau of Statistics (2000) *1998/99 Household Expenditure Survey, Australia: Detailed Expenditure Items*, Catalogue Number 6535.0.

<sup>12</sup> Before privatisation of certain of the Australian jurisdictions' energy industries, the state electricity and gas authorities were able to deliver social policy objectives. However, privatisation of the energy industry caused it to cease to be a public service and able to absorb the costs of Government's social policy.

*Question 12: What sort of considerations should guide choices between different instruments? How well do current choices reflect such considerations? Is there too much emphasis on particular approaches and, if so, why? Are there examples of where the use of an inappropriate instrument has either given rise to significant net costs or led to ineffectual intervention?*

We have already commented on a range of issues related to energy policy in the responses above. Most of our remaining responses will focus on price controls in energy retail markets, the reasons they exist, and the alternatives to price control. We believe that the framework as it applies to price regulation *does not* pay sufficient regard to the costs of intervention for consumers and businesses. It does not promote clarity for consumers and businesses, and it *not* sufficiently evidence-based. The right tool is not being used to meet the objectives of consumer policy. Use of government intervention across a whole market to address the perceived needs of very few is a very blunt policy tool.

As noted above, governments tend to maintain price controls to mitigate the risk of some customers being disadvantaged under competitive circumstances, particularly as cross-subsidies are unwound. The customers that governments (and regulators) primarily seek to protect are those who have difficulty paying their energy bills (for a range of reasons, but generally linked to low income) - these are the 'hardship' or 'vulnerable' customers, as further described below in our response to Question 13a. This is also the customer group that regulators are asked to look at specifically to evaluate if they will be negatively affected by unwinding state price controls in the competitive environment. It is worth noting that the presence of competition to keep prices down is not valued in itself, as it does not guarantee access or affordability.

In practise, customers who have difficulty paying their bills are not disconnected, and are instead provided support in some form to assist them to get back on track and manage their ongoing consumption. Retailers achieve this outcome in conjunction with government and welfare agencies. We believe that if customers also have access to a range of offers, and the matter of price shock has been managed, any concerns that customers will be disadvantaged by removing state price control in a competitive environment can be addressed.

However, some stakeholders (specifically some low-income consumer advocates) appear concerned that the affordability problems for some customers may be exacerbated if price controls are unwound. A smaller subset of consumer advocates appears against competition in principle, and believes it to *necessarily* further disadvantage these consumers. The view seems to be that the characteristics of these low income customers are likely to render them unattractive to retailers, who will not want to compete for this customer segment. The resulting absence of market discipline on price will mean that retailers who serve these customers can (theoretically) increase their prices, and thus amplify the financial pressure on the customer.<sup>13</sup> Retailers may also put these customers on contractual terms and conditions which create further disadvantage.

There are several ways to respond to these concerns.

First, we need to separate the issue of the causes of financial hardship from the issue of retail competition. Retailers have always been faced with the problem of how to reveal the differences between customers who cannot pay and customers who will not pay, and how to deal appropriately with customers experiencing problems with affordability of energy use. This has nothing to do with competition.

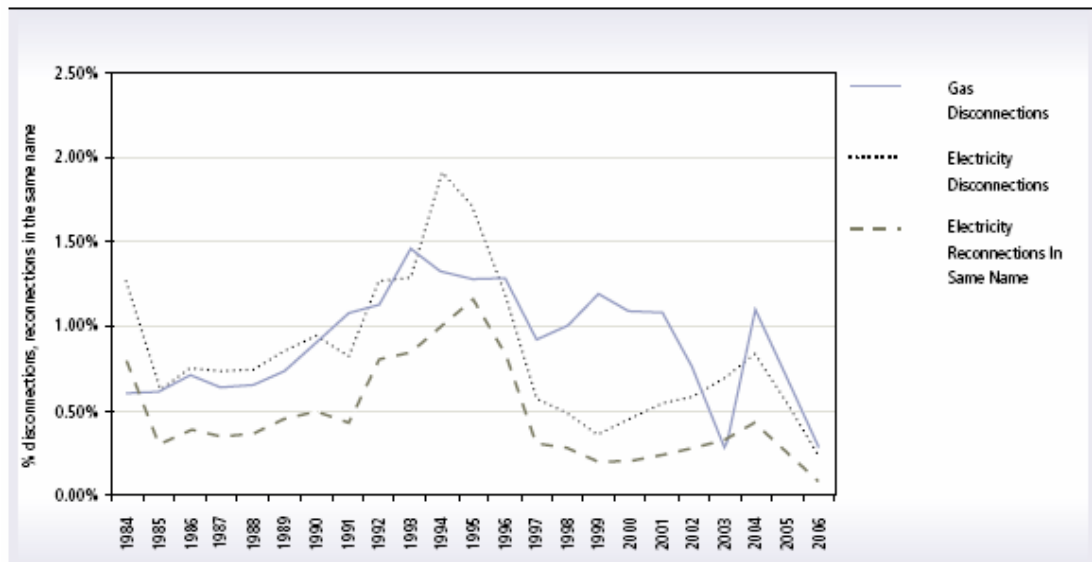
There is also no evidence that retail competition exacerbates customers' experiences of

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<sup>13</sup> Although it might be asked by how much retailers would increase their prices if they felt the customer could not pay anyway.

hardship. In fact, disconnection rates and assistance for customers in hardship has improved significantly since competitive reforms (and privatisation) were carried out in Victoria. As shown in Figure 1 below, disconnections in Victoria were at their peak a decade ago, and electricity disconnections since full retail competition commenced have been lower than they were under the former state monopoly.

Figure 1: Electricity and gas domestic disconnections 1984-2006 (domestic and business customers)



Source: ESC, *Energy Retail Businesses: Comparative Performance Report for the 2005-06 Financial Year*, November 2006.

This effect may be for a range of reasons, such as increased accountability and regulatory scrutiny, but also includes the fact that competitive forces have made the former public sector geographic monopolies far more attentive to brand, reputation and customer service.

It should also be noted that hardship policies created by retailers have often preceded any regulatory requirement. As outlined in our response to Question 14, Origin’s hardship programme has been operating for a few years, and pre-dated government requirements for specific hardship provisions in every jurisdiction.

Second, there is no evidence to support an argument that any customer group will be left out of the market based on socio-economic characteristics. As found in the competition reviews carried out by the regulators ESC in Victoria and ESCOSA in South Australia, customers of all types are being offered and are taking up market contracts. There are also no apparent data to support the argument that customers are being disadvantaged through inappropriate contractual terms and conditions.

Further, as discussed below, this group is essentially unable to be defined and targeted effectively in an objective, or systems focussed, way. This means retailers could not leave ‘vulnerable’ customers out of the market or seek to disadvantage them *even if they wanted to*.

Third, there should be greater focus on who ultimately has responsibility for customers in financial hardship in any event. The primary responsibilities lie with the customers themselves (to manage budgets and advise retailers if they need support) and government/social welfare agencies (to provide financial and other assistance).

While energy retailers can do what we can to make sure ongoing bills are affordable by:

- (a) helping customers understand usage and how to increase efficiency of use;
- (b) establishing affordable payment plans; and
- (c) co-ordinating other assistance where possible,

the fact is that the *ongoing long term management of customers who are in chronic financial hardship* across all areas of lifestyle *cannot* be the responsibility of energy retailers. As noted above, these people require more assistance than an energy retailer can provide.<sup>14</sup>

The fact remains that customers who the government wants to support can still be supported, as a matter of social policy delivered by government agencies. This has nothing to do with competition. If there are customers who need financial assistance outside of the extensions of time to pay or payment plans that can be provided by retailers, this is the responsibility of government.

In summary, once competition is established, retaining regulated price caps as a means of protecting vulnerable customers is a poorly focussed tool. There are far more effective and targeted ways to support those in financial hardship than price intervention. Government social programmes, community and industry initiatives have evolved considerably in recent years, and can be depended upon to provide the necessary support to those in hardship.

***Question 13a: What interpretation of the terms vulnerable and disadvantaged should be applied for the purposes of consumer policy?***

This issue gets to the heart of why the consumer policy regarding retail energy prices has developed to its current form: the terms 'vulnerable' and 'disadvantaged' (in retail energy these customers are referred to as those who are vulnerable to, or in, financial hardship) are close to impossible to define, which then renders certain targeted policy mechanisms unworkable. This is how we have ended up with over-coverage of policy approaches such as price controls.

To clarify the terms as they are used in our industry, the term 'hardship customer' is used frequently by those in the energy industry to denote those who are already within retailers' financial hardship processes or schemes (such as those in receipt of a Victorian Utility Relief Grant), or those who are mistakenly disconnected for reasons of non-payment.

However, this definition is inadequate if we recognise that some customers may not have been captured by retailers' hardship schemes or have been disconnected for non-payment, but still might require assistance. These people may be currently experiencing financial hardship but are not (yet) recognised by the retailer as requiring assistance or disconnection, or they may have managed the current level of payment but would not be able to afford any price increase.

Thus the argument needs to recognise the potential for 'hardship' cases to be increased through either making a previously invisible group visible through changed work practices,

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<sup>14</sup> In fact, the reality may well be that these measures can only assist a certain proportion of customers in hardship (that is, not 'most' of them). The remainder - a proportion not understood, and perhaps not able to be quantified in any ongoing sense - simply do *not have enough money*.<sup>14</sup> This may be a recent situation for some people but there is no evidence that it can be sustainably managed with *any* payment plan in a short term sense, or that it will resolve itself after once-off assistance from DHS or relief agencies. These people are in chronic hardship.

or through creating new hardship cases through price increases. It is this group of customers that has been generally understood as those who are 'vulnerable', meaning they are more vulnerable than the norm to having problems with the affordability of their bills.

However, as noted above, defining this group in any operational sense is problematic.

In 2004 the Senate Inquiry into Poverty and Financial Hardship<sup>15</sup> provided estimates for numbers of people in poverty in Australia as reported to the Inquiry as shown in Figure 2 below.<sup>16</sup>

**Figure 2: Poverty in Australia - Selected Estimates**

	Year	Numbers in poverty
Henderson poverty line <sup>a</sup>	1999	3.7 - 4.1 million (20.5 - 22.6% of population)
St Vincent de Paul Society <sup>b</sup>	-	3 million
Australian Council of Social Service <sup>c</sup>	2000	2.5 - 3.5 million (13.5 - 19% of population)
The Smith Family <sup>d</sup>	2000	2.4 million (13 % of population)
Brotherhood of St Laurence <sup>e</sup>	2000	1.5 million
The Australia Institute <sup>f</sup>	-	5 - 10% of population
Centre for Independent Studies <sup>g</sup>	-	5% of population in 'chronic poverty'

Sources (as cited in Senate Community Affairs References Committee (2004) *A hand up not a hand out: Renewing the fight against poverty, Report on poverty and financial hardship*, Commonwealth of Australia, March):

<sup>a</sup> Cited in Harding A & Szukalska A, *Financial Disadvantage in Australia - 1999*, The Smith Family, 2000, p.38.

<sup>b</sup> Submission 44, p.44 (SVDP National Council).

<sup>c</sup> Submission 163, p.9 (ACOSS).

<sup>d</sup> Harding A, Lloyd R & Greenwell H, *Financial Disadvantage in Australia - 1990 to 2000*, The Smith Family, 2001, pp.5, 22-23.

<sup>e</sup> Submission 98, p.3 (BSL).

<sup>f</sup> *Committee Hansard* 19.6.03, p.648 (The Australia Institute).

<sup>g</sup> Submission 45, p.10 (CIS).

As we can see, the leading community organisations do not have a common understanding of how to define or quantify who is in poverty or financial hardship. This is also clear in the energy industry, with the 2005 Victorian Inquiry into Financial Hardship of Energy Consumers,<sup>17</sup> as well as many consumer advocates, also suggesting there is no common definition of this consumer population.

Origin's own observation on the matter supports this; that is, that there are no specific proxies for financial pressure or hardship that retailers might use to better identify and target this customer group as a whole.<sup>18</sup> Targeting approaches or locating indicators involves unpicking a range of complicated issues that affect people's lives, such as:

<sup>15</sup> Senate Community Affairs References Committee (2004) *A hand up not a hand out: Renewing the fight against poverty, Report on poverty and financial hardship*, Commonwealth of Australia, March.

<sup>16</sup> Where poverty is defined in a range of ways, but generally captures the concept of people not being able to afford basic necessities.

<sup>17</sup> See <http://www.dpi.vic.gov.au/dpi/dpinenergy.nsf/childdocs/-844E6406280EB3D5CA25729D00101732-1AC2510A81322843CA2572B10014F827?open>.

<sup>18</sup> We have found this through our own direct experience, as well as through specific work undertaken for us by Kildonan Child and Family Services, who carry out visits to the premises of selected Origin (Victorian) customers in long term financial hardship as part of our *Power On* policy.

- differentiating long-term problems with bill affordability (e.g. high medical appliance bills and sole reliance on a disability pension for income) from short- to medium-term hardship (e.g. sudden loss of unemployment when there are multiple bills due); and
- differentiating those who are having difficulty paying for preventable reasons (e.g. poor prioritising in budgeting, or use of energy inefficient appliances) and assisting them through financial counselling or energy efficiency advice, from customers whose difficulty paying is more chronic and pervasive, and whose issues are less able to be resolved.

These combined issues mean that the only reliable method of detecting and assisting customers who are having difficulty paying their energy bills is to provide the environment where customers feel confident and comfortable enough to *self-identify* through communicating their current inability to pay. This environment must ensure each customer maintains self-respect, and as such, it should be empathetic and sensitive to customer issues.

To be completely clear, what this means is that systems cannot be configured to somehow flag customers who *might be* in hardship or *may be in danger of falling into hardship*.<sup>19</sup> While we would be keen to develop such an approach to be more responsive to customer needs, automation in this area is not possible as it would be meaningless in the face of likely major over or under-inclusion which would result.

For example, of the information retailers collect about customers, information regarding delays in bill payment, significant increases in consumption, or the basic concessions status would be the obvious leads for energy companies in this area. However, for the reasons below, even this information would not assist in objectively identifying customers who might be in hardship:

- **Where payment has been delayed:** Given that up to half of all customers require a reminder notice to pay their bill, and that many customers pay on the disconnection notice, this would not act as a meaningful indicator of hardship or potential hardship. We can assume that a significant number of these people will have had reasons other than financial hardship for not paying their bill sooner.
- **Where there has been a major change (increase) in consumption:** Major bill changes can occur for a variety of reasons, such as: purchase of new appliances; additional people in the house; and seasonal differences in consumption patterns. Thus it would not be reasonable or practicable to have systems set to detect major changes in consumption and presume hardship will result.

In any event (and as we know) it is not just bills that change, but *life changes* that are often the issue. This means that a bill that was manageable before may not be manageable the next time if other lifestyle or employment issues arise.

- **Where the customer is on a concession:** 30% - 50% of customers in some areas are on concessions, which would indicate that concessions status would not be a useful proxy for customers who may fall into hardship.

Even if only Health Care cardholders (half of all concession holders) were considered to be in danger of hardship, as Health Care cards are managed by the federal government and can change on a three monthly basis (one electricity billing cycle and one and a half gas

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<sup>19</sup> Where if we assume the retailer has access to information on these indicators - which in many cases it wouldn't - we assume the next step would be for the retailer to contact the customer directly by telephone to offer assistance.



billing cycles) this still would mean (a) significant over-coverage of customer contact and (b) administrative difficulty in keeping meaningful records on this issue and staying in contact with customers as required. Health Care card ownership would also leave out the increasing population of the 'working poor'.

To summarise, we argue that there are no objective characteristics of hardship, and thus no robust 'definitions' or indicators. This then affects all policy mechanisms that seek to target vulnerable customers through objective indicators, such as price controls.

Retailers can only identify customers in hardship by talking to these customers and understanding their individual circumstances, where the way to differentiate those who 'won't pay' from those who 'can't pay', is to *view those who identify themselves as unable to pay, or requiring more assistance, as requiring assistance*. This is a good faith matter, but we have found that our approach also makes good business sense. In our experience customers who won't pay do not tend to make contact (or respond to contact) *at all*, let alone identify themselves as being in financial hardship and go through the processes to ascertain their capacity to pay.

It is not particularly helpful to try to define hardship beyond this.<sup>20</sup> The challenge for utility businesses - and, we suggest, also for Governments, regulators and consumer agencies - is thus to make customers aware of our willingness to assist, and to encourage them to access our services, while also communicating the *need* to pay or make contact to discuss an alternative without driving away well intentioned customers.

The best consumer policy is thus about education at the broadest level, then more targeted support for people who identify as requiring it.

***Question 13b: Are the needs of vulnerable and disadvantaged consumers best met through generic approaches that provide scope for discretion in application, or through more targeted mechanisms?***

Leading from the above, we suggest that the needs of vulnerable and disadvantaged consumers are best met through a combination of generic and targeted mechanisms. The degree of targeting is highly dependent on the actual policy mechanism.

The generic approaches need to be light-handed and focussed on information provision and swift and efficient funnelling of customers who require support into the appropriate support mechanisms. They also need to address generic issues only, and not interfere in market prices.

Then the more targeted approach is the support mechanism itself, such as a specific hardship programme that assists the individual reach a manageable payment solution. We provide more information about how this works for energy in our response to Question 14.

#### ***4.1.1 The problem with a hardship tariff***

The worst of all worlds occurs where governments use consumer protections to cover a whole customer population when only a fraction of the population might require them, and these people cannot be identified through objective processes. Retail price regulation in energy is a key example. This has occurred because policymakers continue to believe that

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<sup>20</sup> Note that while we have found that the 'won't pay' generally do not make contact or respond to contact, we do not assume all customers who don't get in contact fall into this category. We recognise that some people who are in financial hardship may not be comfortable making a call to discuss their problem, or they may be in denial about their circumstance.

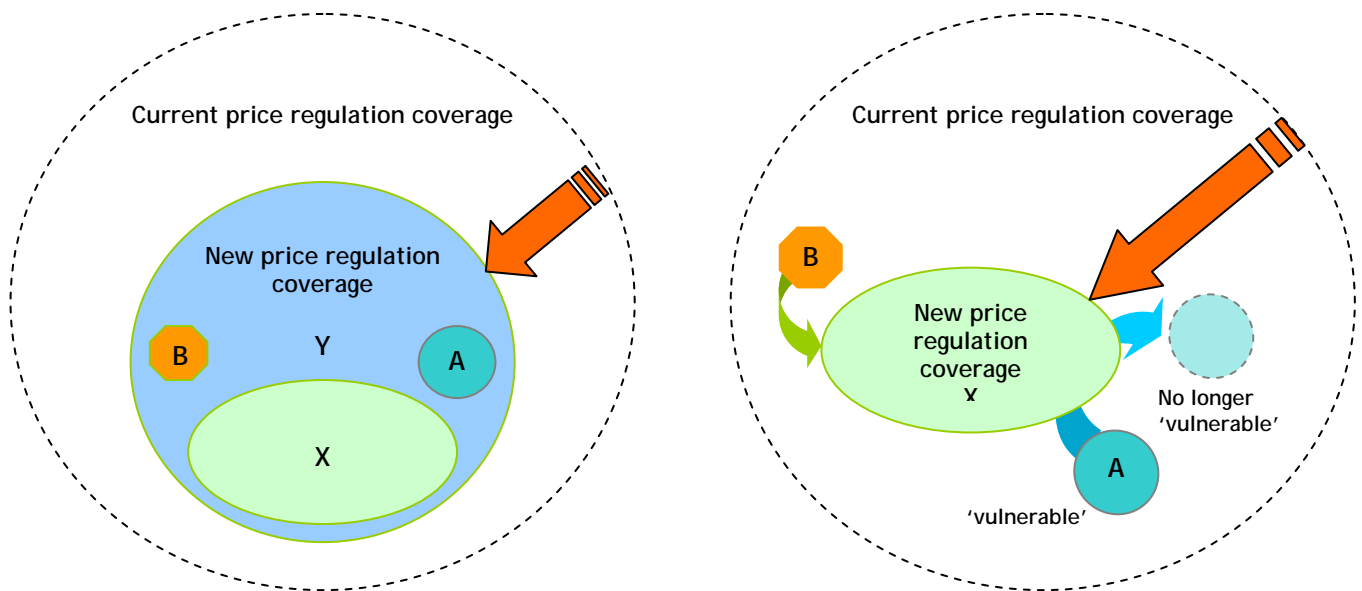
price regulation is required across the whole market because they cannot appropriately identify those customers who *might* find their energy bills unaffordable.

However, targeted price controls *have* been considered by some. Policymakers and some industry commentators continue to raise the prospect of a hardship tariff for retail energy; that is, a regulated contract price that applies only to those believed to be vulnerable to financial hardship. The problem is, however, that the benefits of such a targeted regulatory approach - assumed to be more efficient from a market perspective - are outweighed if the transaction or co-ordination costs of identifying and managing a customer sub-population are significant. In retail energy, this can be expected to be the case.

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

This issue of needing to trade off various costs and benefits is represented in Figure 3 below. This shows two 'pure' models of regulated offer coverage. In each model, Type X customers are those covered by default; customer Type A represents customers who need to be captured by the regulated offer in a temporary capacity (they should be shifted out when appropriate); and customer Type B represents the (inevitable) group of customers who are not captured within the default group (they may possess exceptional characteristics that warrant protection) but should be covered in an ongoing sense.

**Figure 3: Two 'pure' models of price regulation coverage**



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

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

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

However, the Model I approach is flawed for the purposes of determining price controls, for the economic efficiency reasons described earlier, which can be summarised as *an effective market in a good or service cannot have a politically determined end price*. In fact, neither Model I nor Model II is an effective means to manage the provision of, and affordability of, contracts to small consumers. We propose, and have proposed to policymakers across various Australian jurisdictions, that issues related to protection of vulnerable customers can be managed in an entirely different way.

#### 4.1.2 Origin's proposed approach to enhancing access

Origin has suggested to policymakers across various Australian jurisdictions that a number of their concerns about how vulnerable customers are dealt with by retailers could be addressed through an enhanced access approach.<sup>21</sup> This is a generic policy (in the sense that it addresses the whole domestic energy sector) but it does not interfere with market prices. This would essentially replace price regulation, but also depends heavily on competition in the market being effective (thus keeping prices efficient) and effective hardship policies from both government and industry (thus keeping bills affordable and sustainable).

Origin's proposal supports a shift from the notion of only the incumbent retailers being obliged to provide access to retail contracts (called standing offer or standard contracts) to customers, to all retailers within a region having this obligation,<sup>22</sup> with the offers extended to all residential customers. This may be modified slightly if governments have concerns about smaller retailers' capacity to carry out this requirement.<sup>23</sup> Each retailer could choose the extent to which they disaggregated this offer (for example having different basic offers for different distribution regions, or only one for a state).

Currently Origin will provide an offer to anyone who requests it, regardless of whether Origin is the designated provider of the basic standing offer contract. We would be comfortable to continue doing this, and to even guarantee this, if we had more comfort about the nature of the offer itself, and the means by which prices would be set, as above.

The contract would have all the basic options, such as a range of payment methods. We would also publish prices for this offer, and would commit to publishing by set periods, so that prices across all retailers for the standing offer contract can be accessed easily and transparently via an external reporting mechanism.

As per the approach used in the UK, this type of published basic offer will ensure customer

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<sup>21</sup> This is detailed in our submission to recent Ministerial Council on Energy consultation processes about national rules for the retail and distribution of energy. See <http://www.mce.gov.au/index.cfm?event=object.showSubmissionList&objectID=79BFB95D-C62B-0857-F6609BE926327F67>.

<sup>22</sup> Note that we are not suggesting this in the separate context of deemed contracts. We support deemed contracts as reverting to the retailer financially responsible for the site.

<sup>23</sup> Although most retailers across the jurisdictions *do* have this capacity. A potential model for this is the existing obligation on all gas and electricity retailers in SA to publish a set of default terms and conditions and prices (available to all move-in customers and the like). Both large and small retailers incur this obligation and although SA is a simpler market than some other states with multiple distributors, nevertheless it demonstrates the capability of all retailers to support this type of approach and its relatively low cost.

access to supply, at terms and conditions which are unlikely to be able to lead to any disadvantage. If it is also offered by all retailers, each residential customer will then have a 'right' to a range of published basic offers, which is an enhancement to the current regime.

This approach is the only way Origin can see price regulation being *able* to be removed in the current environment: where there is a clearly demonstrated range of retailer options for *every* domestic customer.

*Question 14: What are the examples of policies that are very effective in targeting vulnerable and disadvantaged consumers? Are there instances where a desire to protect these groups has imposed significant net costs on the wider community?*

We will address the first element of this question only, as the second element has been discussed above in some detail.

An example of a policy in the energy sector that has been very effective in targeting vulnerable and disadvantaged customers is the hardship policy approach of Origin, which in turn was based on the approach taken by businesses in the Victorian water sector. Origin's approach has been confirmed and validated by subsequent work carried out by expert panels into hardship in both Victoria and New South Wales, and the recent hardship policy approach regulated by the Victorian ESC<sup>24</sup> was also largely consistent with what Origin has been doing for the past couple of years.

The philosophy behind Origin's approach is about providing the most conducive environment for customers to self-identify. We have moved away from the more historic approach of trying to determine if customers 'genuinely' have difficulty, and the usual debates which used to arise about differentiating those who *will not* pay from those who *cannot* pay. Engaging in these discussions only ever led to retailers setting themselves up to achieve the impossible; as already discussed, we have no way of knowing what customers' *genuine* circumstances are. We instead decided to take what our customers say on face value, and provide support from there. We suggest this is the best way to conceptualise how *any* energy retailer can assist a customer in hardship.

This approach involves retailers:

- Providing sufficient information to customers not only about their payment obligations, but also about the approachability of the company and flexibility of payment options.
- Developing a responsible and sensitive approach to responding to customer calls - retailers need to be able to engage the customer in a conversation in which they feel comfortable and where a realistic and manageable outcome can be agreed.
- Being able to deliver services oriented specifically to customers in hardship in a way which continues to be responsive to their needs after the initial contact, and is flexible enough to be modified upon changing circumstances.

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<sup>24</sup> See Essential Services Commission (2007), *Final Decision: Energy Retailers' Financial Hardship Policies*, April. This work arose from recommendations made by the Committee of Inquiry into the Financial Hardship of Energy Consumers, from 2005. In response to the Committee's recommendation, the Victorian Government enacted the *Energy Legislation (Hardship, Metering and Other Matters) Act 2006*. This required that energy retailers have hardship policies that contain certain criteria.

#### 4.1.3 *Origin's general customer management approach*

Origin's customer management incorporates the principles above into business practice which is:

- empathetic and respectful;
- fair and reasonable to customers;
- promotes an ongoing ability for customers to manage debt in an affordable way;
- commercially sustainable;
- compliant with both the spirit and letter of the relevant legislation and regulatory obligations; and
- able to evolve to meet the changing needs of the business and its customer base.

Our approach has been informed by the practices of the Victorian water sector (specifically Yarra Valley Water) and has received ongoing input and assistance from Kildonan Child and Family Services, a leading community service organisation.

The Kildonan staff has provided input to our call centre and credit staff on dealing with customers who may be in financial difficulty, and has also provided advice on scripting for calls. This advice has focussed on positive language and styles of communication that encourage customers to feel comfortable and able to engage with the Origin staff member on what we know to be a sensitive issue.

Over the past couple of years we have also increased resources available to handle telephone calls, and worked on targeting our internal definitions of when customers need to be offered different forms of assistance.

Where customers are unable to manage payment plans as set up by our Customer Call Centre or Credit areas (based on payment of arrears and future use over a 12 or 18 month period), or indicate other signs of payment difficulty, they are transferred to our Community Liaison Team for further assistance through the Origin *Power On* programme. The Community Liaison Team has greater discretion in provision of payment options, and is specifically trained to work toward a solution by listening and understanding the issues.

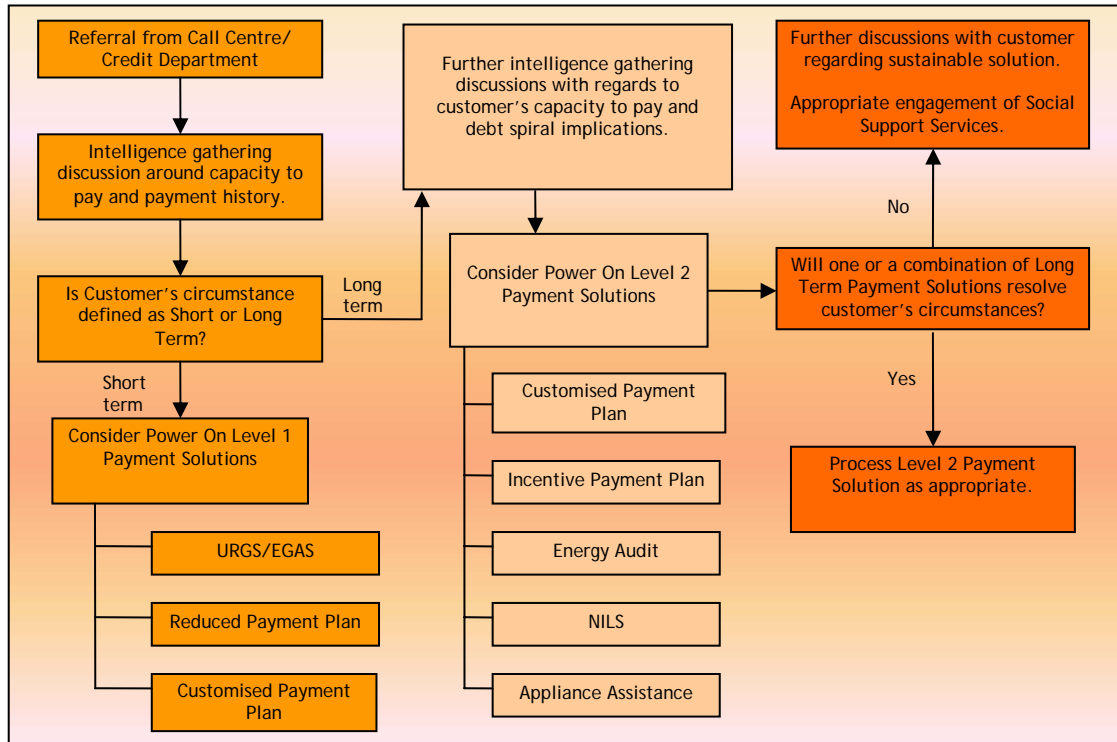
#### 4.1.4 *Our targeted approach: the Power On programme*

Origin's *Power On* programme is designed to assist our customers through difficult times. *Power On* can help customers better understand their energy use, which can lead to households using less energy and having more affordable bills.

Where one of our contact centre or credit staff becomes aware of a customer who may require further assistance beyond the usual instalment plans, they transfer the customer to the Community Liaison Team.

A training programme facilitated by Kildonan Child and Family Services extends across our Contact Centres, Credit Departments and Customer Advocacy Teams. The *Power On* process flow is shown in Figure 4 on the following page.

Figure 4: *Power On* process flow



As shown above, *Power On* involves a suite of assistance measures, including a range of payment plans. In particular, Origin seeks to break the debt cycle by motivating customers to pay their bills through matched payments by the company (the incentive payment plan).

We have found this to be a sustainable business approach, where customers actually choose to pay more if payments are matched, and are less likely to fall into further debt.

In Victoria, *Power On* brochures are distributed to financial counsellors, and distributed with every Utility Relief Grant (URG, a Government support programme that provides emergency relief) application. The offer of payment assistance is also included on all bills, overdue notices and follow-up letters. The *Power On* policy is also visible on the Company website.

Kildonan Child and Family Services also provides further services to Origin, where financial counsellors from Kildonan have been contracted by Origin to visit customers' premises in person. They have also been trained to undertake a comprehensive energy usage audit while in the customer's home. We have found that most customers have been able to reduce their consumption - and thus their bills - after these visits.

We also accept what financial counsellors say in good faith, and have found this to be a viable and reasonable approach. We have found that most people do want to pay and are keen to make some arrangement with the company to pay debt.

## 4.2 Generic versus specific regulation

**Question 15: How effective are the generic provisions in the TPA and Fair Trading Acts in meeting their intended objectives? What, if any, changes are required to deliver better outcomes?**

Overall we believe that the generic provisions of the TPA and Fair Trading Acts are effective in meeting their intended objectives. There has been no evidence to suggest otherwise.

However, we have not had much opportunity to test this given that most of the relevant clauses have been replicated in industry specific regulation for the retail energy sector. For example, we have comprehensive market rules in place that tend to revisit the generic market conduct rules. For example, page 1 of the seventeen page *Code of Conduct for Marketing Retail Energy in Victoria*<sup>25</sup> explicitly states:

The *Code* reinforces key provisions of the Victorian *Fair Trading Act 1999* and the *Trade Practice (sic) Act 1974*, specifically those provisions covering misleading and deceptive behaviour and unconscionable conduct. Further, it supplements these legislative requirements by addressing such matters as training and auditing.

Market conduct rules such as this were set up by the various jurisdictions before competition commenced, and in each case, were therefore developed to manage market issues 'just in case' poor market behaviour eventuated. Consumer advocates and policymakers were particularly attentive to bad market practices from other industries at the time. While the rules have been revised on occasion, the premise for their ongoing existence was not apparently questioned, even in the absence of a direct consumer need to go beyond the existing TPA and Fair Trading Acts.

While the current national reform programme is addressing this issue of overlap, outcomes are not yet clear.

**Question 16: What principles should guide the choice between generic and industry-specific regulation? How well does current mix of regulation accord with these principles?**

We will respond to this question as if the choice was to depend on *existing* generic regulation, or create *new* industry-specific regulation, which are the only options energy policymakers have tended to have. Origin suggests that the principles that should guide the choice between generic and industry-specific regulation are as follows:

- Is there a genuine problem that needs to be regulated across the industry, or are there other options? From our experience, much regulation occurs before any market failure has been identified.
- Is the problem that requires regulation a systemic issue, or have the reasonable likelihood of becoming a systemic issue? If not, perhaps further regulation is not required and greater use can be made of existing regulation (whether industry-specific or not).
- Is there already generic regulation in place that addresses the issues presented? For example, are there relevant provisions in either the Trade Practices Act or jurisdictional Fair Trading Acts that could address the problem?

<sup>25</sup> See [http://www.esc.vic.gov.au/NR/rdonlyres/132AD8B7-C484-4716-9533-0E93E4A08C17/0/MCC\\_FinalOct04.pdf](http://www.esc.vic.gov.au/NR/rdonlyres/132AD8B7-C484-4716-9533-0E93E4A08C17/0/MCC_FinalOct04.pdf).

- How have other industries addressed similar issues? Perhaps there are some lessons to be learned, or even existing mechanisms that can be accessed.

*Question 17: Is industry-specific regulation particularly well suited to some areas? Are there examples where specific regulation has been helpful in putting a particular sector on notice? To what extent has the growth in specific regulation reflected inadequacies in generic regulation or its enforcement?*

*Question 18: Are there significant areas of industry-specific regulation that do not provide a net benefit to the community? To what extent does this reflect the pursuit of redundant objectives or objectives that could be adequately addressed using the available generic regulatory instruments? Are there any substantial inconsistencies between industry-specific regulation and the generic regime and, if so, with what consequences?*

Origin recognises that there are specific issues that arise within competitive energy markets that may be outside the scope or coverage of national and jurisdictional consumer protection laws. Energy services are seen as essential services, and this may require the existence of additional terms to protect customers in addition to general Fair Trading provisions.

However, we note that jurisdictional regulators have developed a number of guidelines under energy market specific retail Codes that have significantly extended the protection framework and the regulatory burden on retailers (particularly in Victoria) within the context of a rapidly maturing and highly competitive market. At present for example, additional guidelines exist in Victoria around the application of early termination fees, specific to the retail gas and electricity market. Origin notes that the current energy-specific regulatory regime has supported a proliferation of regulation, which has been introduced without regard to its net benefits or assessed in a rigorous manner.

*Question 19: Are there ways that the costs of industry-specific regulation could be reduced without reducing its effectiveness? For example, would more emphasis on principles-based regulation be helpful?*

Origin believes that the costs of industry-specific regulation could be reduced, and this could occur through more principles-based regulation. However, we also recognise that regulation through principles can be difficult.

Our own experience of the industry is that the uncertainty of the environment has tended toward the ever increasing need to specify intent through more detailed regulation or contract. This is driven by retailers (who sometimes require clarity to ensure compliance), the Ombudsman (who also requires clarity to assess industry compliance) and other industry stakeholders who have a keen interest in retailer conduct and the outcomes of the market. So, to some degree, increased detail and/or prescription in regulation in an essential service might be unavoidable.

However, there should be stronger criteria around how rules and regulation are written, and how they are managed over time. For example, in Victoria 'guidelines' are black letter law, not guidance. Non-compliance with a guideline has the same effect as non-compliance with any other regulatory instrument. The rules and guidelines are also not subject to assessments of effectiveness, or public benefits tests. The regulation has been allowed to proliferate as new issues continue to be identified as not being 'clear enough' to some



parties, and this has occurred since before the markets even opened. Other ways of managing problems are generally not addressed, such as self- or co-regulatory options, and obscure or ineffective regulation is rarely, if ever, stripped from the regime.

#### 4.3 Enforcement and redress issues

*Question 20: Are there significant enforcement gaps in the current framework? If so, do they mainly reflect the level of resourcing for those entities responsible for enforcement or are there other factors at work? To what extent has more regulation been substituted for better or more timely enforcement?*

We believe that there are enforcement gaps in the current energy retail policy framework. As noted above, we have sometimes seen a reticence from jurisdictional regulators to enforce to the full extent of the law, instead preferring the creation of new regulation. This is less likely to be a resourcing issue and more likely to be a cultural issue. We believe that creation of new regulation has commonly been a substitute for better or more timely enforcement.

*Question 21: Are current redress and penalty provisions appropriate and effective? Would changes to these provisions in the TPA, Fair Trading Acts and other generic regulation reduce the incentive to employ specific regulation?*

*Question 22: Are the current dispute resolution mechanisms and arbitration processes, including consumer tribunals, readily accessible and effective?*

Origin believes that current redress and penalty provisions are appropriate and effective in the retail energy industry. In addition to regulatory provisions, consumers have access to energy industry Ombudsman schemes in the contestable markets, and each Ombudsman is keenly involved in consumer energy issues.

#### 4.4 Self and non-regulatory approaches

*Question 23: What principles and considerations should guide the use of self-regulatory, coregulatory and non-regulatory options in the consumer policy framework? What are the best examples of effective self-regulation, co-regulation and non-regulatory approaches and why have they worked well in these cases? Is enough use currently made of such measures? If not, where are the main opportunities for further uptake?*

In retail energy, there has been much progress in recent years in forming alliances between government, consumer and industry stakeholders to further inform policy and industry practise.

For example, the alliance Origin has formed with Kildonan Child and Family Services has provided a cross-fertilisation of ideas across industry and consumer advocacy sectors, and greatly enhanced our compliance with both the spirit and the letter of consumer policy regarding management of customers in financial hardship.

A further example of interaction between stakeholder groups was the work undertaken by the Victorian Utility Debt Spiral Project, through the Committee for Melbourne. The result of the two stage project was a guideline for energy and water retail businesses on how to better assist customers presenting with a need for support in managing debt and ongoing

consumption costs for their use of energy and water.

The guideline was developed by a range of specialists in the energy, water and social welfare sectors, specifically representatives from energy and water retailers, social advocacy organisations, the Essential Services Commission and the Energy and Water Ombudsman (Victoria). As such, it reflects the insight and experience of a wide range of organisations, policymakers and practitioners. Many of the principles are already used by Victorian energy and water businesses. It has been broadly supported by key energy and water businesses.

*Question 24: Would there be benefits from government support for a consumer advocacy body and would they outweigh the funding and other costs involved? Should such a body's role be limited to advocacy, or should it also be responsible for bringing forward consumer complaints? Do consumer advocacy bodies adequately represent the interests of all consumers? If not, what other means could be used to elicit the views of consumers? Is there a need for greater research into consumer and market behaviour to inform policy development? If so, who should be responsible for carrying out and resourcing such work?*

In Origin's experience, a 'one stop shop' consumer advocacy body is unlikely to garner much support; there are a range of voices in consumer advocacy, and there can be significant differences in approach within the consumer sector.<sup>26</sup> However, this is an issue we will leave to consumer stakeholders to comment further upon.

#### 4.5 Jurisdictional responsibilities

*Question 25: What are the main areas of duplication, overlap and inconsistency in consumer regulation across jurisdictions (and with New Zealand)? How significant are the costs of this inconsistency, overlap and duplication relative to any benefits provided?*

We have already alluded to a degree of duplication, overlap and inconsistency in consumer energy regulation across jurisdictions. With the variety of state mechanisms that seek to cover the same issues, but slightly differently, this leads to an onerous compliance regime for national retailers such as Origin. Origin recognises the difficulties in achieving a truly national framework, not the least because the various jurisdictions have different ownership arrangements of their energy utilities and are in different stages of competition. However, these issues are being addressed by the work of the Ministerial Council on Energy (MCE) as part of the national reform agenda.

Under the Australian Energy Market Agreement (AEMA) there is provision for divergence from the national approach, commonly called Jurisdictional Directions.<sup>27</sup> Stakeholder consultation on the nature and content of Jurisdictional Directions was anticipated for earlier this year, but has been delayed. We understand the delay has occurred because disagreements between the jurisdictions and the Commonwealth. As such, we are not certain of the degree to which jurisdictions will be able to assert control over the national rule making processes.

<sup>26</sup> For example, see the consultation carried out by the Victorian Department of Treasury and Finance in 2001 regarding the shift to the Essential Services Commission from its previous incarnation as Office of the Regulator-General, and the establishment of a 'one stop shop' consumer advocacy body.

<sup>27</sup> Although this is not a term used in the AEMA.

We strongly believe that the process of providing for Jurisdictional Directions needs to be managed carefully. While the approach proposed to date is preferable to the previous derogation process, we would still seek greater discipline placed on the jurisdictions and their use of Jurisdictional Directions.

Where jurisdictions seek variations from the national approach, these should be transparent, limited in time (wherever possible), and justified clearly and publicly against policy objectives. This would include an assessment of the impact of the Jurisdictional Direction on national consistency, the national market objective and competitive neutrality.

Origin suggests that there should also be a stated objective of removing the Jurisdictional Directions process within a set period of time, say five years.

In addition, the Australian Energy Regulator (AER) should report on the Jurisdictional Directions required by each jurisdiction, and any amendments during the year (in addition to the proposed publication in the respective Government Gazettes), so that the actions of the jurisdictions are more transparent and jurisdictional comparisons are facilitated. This could be reported for instance, in the AER Annual Report.

*Question 26: Are there areas of regulatory responsibility that could readily be consolidated within one level of government? Are there areas which could be harmonised across jurisdictions? What particular considerations arise in relation to facilitating greater integration with New Zealand and international trade more generally?*

See our response to Questions 6 and 7.

#### 4.6 Gatekeeping and review arrangements

*Question 27: How effective are the current regulation making and review processes (at both the Commonwealth and State and Territory level) in facilitating the development of best practice consumer regulation? Are there ways to ameliorate some of the difficulties in measuring the benefits and costs of consumer regulation without compromising the integrity of the assessment process?*

Given the current shift of regulation and rule-making processes for the energy sector, we cannot comment here. However we would ask that the Commission and any non-energy specific bodies maintain a close interest in what happens in the sector, as we would seek messages about consistency in consumer policy approaches to be communicated to the MCE and its sub-groups (as described in our response to Questions 6 and 7).

*Question 28: Beyond procedural inertia, and/or delays in modifying regulations to take account of changed market circumstances, are there institutional factors that have helped to sustain regulation that does not provide a net benefit to the community? How could these be addressed? What other improvements could be made to current gatekeeping and review arrangements?*

The institutional factors in energy retail that have helped sustain regulation that does not provide a net benefit to the community have largely been due to:

- (c) the variations in energy regulatory frameworks across the states and territories; and
- (d) the political decision-making that has occurred at a jurisdictional level about such matters as retail price controls.

These issues are being addressed by the current national reform programme. Our only concern, as noted above, is the allowance for jurisdictions to keep some politically sensitive issues under their discretion. This is likely to leave key decisions to purely political criteria, with no reference to due process, market objectives, or actual consumer need. For example, statements made by key officials in the media and in private consultation would indicate that removing price controls in some jurisdictions will be particularly difficult, regardless of whether competition is effective or not.

#### 4.7 Regulatory and oversighting bodies

*Question 29: Do consumer regulators have the appropriate structure, resources, skills and powers? Is there scope to consolidate industry regulators, or to subsume their functions within generic bodies? Are there tensions or problems where regulators are involved in both policy making and enforcement, and/or in enforcement and advocacy, and how might these be addressed? Should consumer policy be administered separately from competition policy or should institutional arrangements reflect the synergies between the two?*

*Question 30: Are the Ministerial Council arrangements working well? If not, what changes are required? Would changes to other policy oversighting arrangements help to deliver better outcomes for consumers?*

*Question 31: Is there a need for improved policy and enforcement arrangements between Australia and New Zealand?*

See our response to questions above. In energy there is currently a shift from jurisdictional economic regulatory bodies to the AEMC (policy) and AER (enforcement). As yet, this split between policy and enforcement is untested. We have some concerns about resourcing in the AEMC, but recognise that we are in early days.

## Appendix A: Comments on the AEMA

Origin would like to comment on two issues within the AEMA:

- jurisdictional powers and rationale for retention of price controls: this will affect jurisdictions' interpretation of the AEMA; and
- principles of remaining price regulation that Origin recommends should also be added to the AEMA.

### Jurisdictional powers

Origin notes that under section 14.4 of the AEMA, jurisdictions have agreed that phase out of the exercise of retail price regulation:

*(b) may involve a period of price monitoring and/or price agreements with retailers under appropriate oversight arrangements; and  
(c) does not prevent the exercise of a reserve price regulation power by the State or Territory where effective competition for categories of users ceases, provided that the power is only exercised in accordance with a regulatory methodology promulgated by the AEMC, and is subject to review by the AEMC of the effectiveness of competition.*

While Origin understands the likely rationale for the inclusion of these provisions in the AEMA, we have (unsuccessfully) sought clarification about how these clauses might be used in practice.

In particular, we have asked policymakers to be prepared to critically assess any arguments that might be made for the retention of price regulation to protect certain customer groups. The MCE has already highlighted the requirement for AEMC to evaluate customer experience by customer class.

The customer group that assessors of competition are often specifically asked to look at is those people who have difficulty paying their energy bills (for a range of reasons, but generally linked to low income). These are the 'hardship' or 'vulnerable' customers.<sup>28</sup> The political perception of the circumstances of this group, and what might happen if price regulation is removed, is generally behind the political decisions to retain price regulation. We note recent Ministerial media statements that support this view.<sup>29</sup>

Origin does not disagree with a potential need for a specific assessment of the effect of the market on customers who may be subject to financial hardship. Further, if there is found to be market failure according to the criteria outlined in this submission, ongoing regulation may well be warranted. However, it needs to be clear: the market as 'effective' for this group is unrelated to whether market prices available to them are *affordable*. Efficient prices from effective markets do not guarantee affordability for all people irrespective of their financial outlook. This is where government and community support are important as a supplementary measure to the market. Government social programmes, community and industry initiatives have evolved considerably in recent years, and can be depended upon to provide the necessary support to those in hardship.

While Origin welcomes AEMA Clause 14.11 (b) which states 'social welfare and equity objectives will be met through clearly specified and transparently funded State or Territory community service obligations that do not materially impede competition', we hope that

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<sup>28</sup> This term is addressed in detail in the body of this submission. See also Origin's submission to the Victorian Inquiry into Financial Hardship of Energy Consumers for a further discussion, at <http://www.dpi.vic.gov.au/dpi/dpinenergy.nsf/childdocs/-844E6406280EB3D5CA25729D00101732-1AC2510A81322843CA2572B10014F827?open>.

<sup>29</sup> See Bildstien, C. (2006) 'Scrapping price caps 'silliness'', *Adelaide Advertiser*, Business Journal, 22<sup>nd</sup> August, page 38.

the issue of support mechanisms for those in financial hardship (where the market is effective) is fully captured by this clause and does not become entangled in the methodology for competition assessments.

### Principles underpinning remaining price regulation

It is expected that an interim process will be required for the jurisdictions where full retail competition is not yet established (such as Queensland). It would also be used in the unlikely event that ongoing price controls are required in the states with retail markets that are generally held to be effective (such as Victoria).

We suggest that the regulatory approach to any remaining retail price regulation should also be based upon clear and agreed national pricing principles, similar in concept (if not in detail) to the pricing principles currently in Part IIIA of the TPA,<sup>30</sup> or in line with high level principles set out in the proposed amendments to Part IIIA, the Competition Principles Agreement (CPA) and the National Gas Law.

The importance of setting out consistent pricing principles in a regulated energy industry has been well documented with respect to distribution and transmission pricing. Origin sees no reason why regulated retail prices should not be similarly determined within a set of relevant, nationally agreed pricing principles.

The proposed principles that need to be applied to decisions about price regulation are shown in Figure 5 on the following page.

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<sup>30</sup> Part IIIA allows recovery of efficient costs and return on investment 'commensurate with the regulatory and commercial risks involved'.

**Figure 5: Principles for effective retail price regulation**

1. **Competition** is the preferred overall means of regulating the retail energy market. Any price regulation deemed necessary must support longer term evolution of the market toward cost-reflective tariffs, and perhaps provide retail margin to facilitate competition and innovation.  
  
We suggest that the state should bear the burden of proof to demonstrate how its decisions to continue with price regulation will promote the process of competition - regulators are already required under competition law to produce Regulatory Impact Statements that address the impact of their regulation on competition.
2. **Consistency** in approach across jurisdictions is vital. There should be a presumption of a national approach, with exceptions only to be managed by jurisdictions. Approaches should also be aligned with the rest of energy industry, such as appeals mechanisms and cost allocation (see principles 6 and 7).
3. **Cost recovery** must be provided for in tariffs, both across customer segments and within customer segments, thus eliminating cross-subsidies. Prices should also allow for a reasonable commercial margin to the retailer. For example, in a triangular relationship:  
  
*Final Price = Network [tariff pass through + retailer's cost of administration] + Retailer [costs + reasonable margin]*
4. **Competitive neutrality** principles must be upheld. The objective of competitive neutrality is to ensure government business activities do not have competitive advantages or disadvantages relative to their privately owned competitors simply as a result of their government ownership.
5. Regulation must be '**light-handed**' in the sense of not representing high regulatory or compliance costs.
6. **Accounting separation** should be monitored and enforced so retail businesses cannot be subsidised by their distribution arms (where these are present).
7. **Appeals processes** should be in place, where this is relevant.

These principles are neither new nor radical. They reflect principles that have been espoused in one form or another in multiple reviews of the energy industry over the last ten years of National Competition Policy. In Origin's view, they are essential if retail pricing (which drives customer behaviour) is to be aligned with the national reform agenda.

Regulatory approaches that follow these principles will enhance investment and innovation in the relevant market, as they will reduce market participants' perceptions of sovereign or regulatory risk. The forms of price regulation chosen are less of a concern while these principles are upheld.

Any necessary CSO agreements would then be negotiated between jurisdictions and energy businesses on a commercial basis.

## Appendix B: Outline of the structure of the energy industry

The two competitive functions in the energy supply industry are generation and retailing.

Electricity generation operates on a national level, where generation output is electricity traded in a National Electricity Market (NEM) which involves a 'spot market' in electricity traded in half-hourly intervals. The spot price is determined by the balance between electrical load (or demand) and available generating capacity for each half-hour.

Retailing involves electricity retailers competing against each other to supply consumers. Competition works through allowing consumers to have a choice of retailers licensed in the relevant jurisdiction, where these generally comprise at least one incumbent retailer and further independent retailers. Retailers are expected to be innovative and offer a range of service offers to meet various consumers' needs, such as different billing cycles, tailored or discounted price structures and other services.

Choosing a retailer involves the consumer entering into a contract with that retailer and going through certain procedures to ensure they have provided their informed consent. However, consumers do not have to actively choose a retailer, they can passively stay with the retailer that was serving them at the time competition commenced.

The transport of electricity through the transmission network and the distribution networks (the 'poles and wires') remain regulated monopoly activities, where all retailers licensed to sell electricity have equal right of access to them.

The gas industry is similar to the electricity industry, except that rather than being generated, gas is located through exploration activity. The gas is then transported via transmission and distribution networks to customers, as with electricity. The logistics of retailing gas to consumers via contracts and the competitive market is essentially the same as for electricity.