Review of Regulated Retail Tariffs and Charges for Electricity 2007 to 2010

Response to Issues Paper

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Origin Energy

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1. Executive Summary

Origin Energy Limited (Origin) welcomes this opportunity to comment on IPART's (the Tribunal's) issues paper addressing matters associated with the review of regulated tariffs and charges for electricity.

Origin supports the objectives of the review as detailed in the Terms of Reference (page 30 of the Tribunal's issues paper), in particular the setting of regulated retail tariffs reflecting:

- mass market new entrant retail costs and margin;
- full recovery of distribution and transmission network use of system charges;
- the move to cost reflectivity of tariffs by 2010;
- the changes to energy procurement costs and forecasting activities associated with the removal of the Electricity Tariff Equalisation Fund (ETEF); and
- The need to take account of the impact of the Tribunal's decision on demand management.

As a new entrant in the NSW mass market, Origin has a strong interest in the outcome of the Tribunal's determination. The level of regulated retail prices established for the determination 2007-2010 will have a significant impact on the degree of electricity retail market competition over this period. The Tribunal has the opportunity to align regulated retail prices that reflect the costs and risks confronting new competitors in the NSW market and harmonise its determination with those jurisdictions that have experienced significant customer churn.

Origin's position on key elements of the issues paper are summarised in the table below:

Section	Issue	Origin's position
2.1	Phase out of ETEF	Cessation of ETEF assumed to take place from 1 July 2007.
2.2	Extent of competition with the NSW market	Determination should recognise that the level of competition historically has been significantly influenced by the level of regulated pricing applying to standard contracts.
2.3	Accommodation of advanced metering	Ensure that scope of regulated prices accommodate innovative pricing approaches. Moreover (but outside the scope of the current review) ensure that objectives and basis for rolling out meters is clear to all market participants.
3.1	Form of regulation, Weighted average price cap and "Opt out" tariff	Origin supports the retention of the N + R approach. The weighted average price cap (WAPC) should be applied only to the 'R' component of regulated retail tariffs. We note the Tribunal's deliberations regarding an opt out tariff and believe this is worthy of further consideration, particularly to address the issue of obsolete tariffs.
3.2	Limiting increases to customers' bills and to individual tariffs	We do not support the limitation of customer bills or increases in individual tariffs as this approach has not succeeded in achieving cost reflectivity over the current determination. Limiting increases for customers will detract from the objective of achieving cost reflectivity by 2010 as outlined in the Terms of Reference to the Tribunal's investigation.

Section	Issue	Origin's position
4.1	The LRMC of electricity generation	Origin believes that if augmented and compared with other available methodologies, the efficient LRMC of new generation is an appropriate mechanism to determine the energy component of regulated retail tariffs.
4.2	Hedging, risk management and transactions costs	The Tribunal needs to recognise hedge mismatch costs and load profile variation across incumbent retailers former franchise areas in determining efficient hedging approaches. Wholesale energy component of regulated retail tariffs should reflect the LRMC of efficient combinations of plant required to meet regulated customer profile shapes in each former franchise area.
4.3	Mass market new entrant retail operating costs	Origin supports the need to recognise new entrant acquisition costs, scale economies and additional marketing costs to encourage customers to consider negotiated contracts in a market characterised by low engagement.
4.4	Mass market new entrant retail margin	New entrant mass market retail margins needs to support the risks of operating in the NSW market. The approach taken in the previous determination to set retail margins for standard retailers has contributed to the limited level of competition in NSW to date.
4.5, 4.6, 4.7, 4.8, 4.9, 4.10	Pass through items and additional costs	Network charges should be passed through directly and included only in the 'N' component of regulated tariffs without the application of side constraints. Energy losses, the cost of greenhouse gas abatement schemes, market fees and the cost of new schemes need to be explicitly recognised in the cost build up of regulated tariffs.
5	Miscellaneous charges	The scope of allowed miscellaneous charges should be expanded to include changing consumer payment and transaction preferences. The Tribunal also needs to consider the materiality of late payment fees and the effectiveness of security deposits for standard supply arrangements.

The remainder of this response to the issues paper expands upon the above summary of our position on the matters raised by the Tribunal.

2. Policy changes that affect this review

2.1 NSW Government's decision to phase out ETEF

Origin supports the NSW Government's plan to phase out ETEF. As a new entrant retailer in the NSW market, Origin has been unable to access the protections of ETEF and believe that it has created inequality in the market in terms of competing with retailers that have had access to the scheme. ETEF has resulted in energy prices included in regulated retail tariffs that are below cost reflective levels, and has shielded incumbent retailers from the risks that face other retailers operating in the NEM.

The Tribunal has asked for comment on specific matters on page 6 of the Issues Paper, which we address in turn below.

For the purposes of establishing cost reflective tariff levels, should the Tribunal consider the phasing out of the ETEF over a period of time or assume that the ETEF immediately ceases?

Origin believes that for the purpose of setting retail tariffs, ETEF should be assumed to cease immediately. This view is formed primarily on the absence of ETEF support for new entrant retailers. Any consideration by the Tribunal of tariff settings needs to consider the costs and risks faced by all retailers in the market from the outset of the price determination period.

Further, an attempt to model the effects of the proposed ETEF phase out over the determination period would be problematic, as it would require a significant number of contentious assumptions regarding the effects of unwinding ETEF. We suggest the degree of uncertainty of this model renders a phase out approach unworkable for tariff purposes.

How will the phasing out of ETEF affect retailers' hedging risk management and transactions costs over the course of the determination? Are these costs different between a standard retailer and a mass market new entrant retailer?

It is likely that the phasing out of ETEF will increase the hedging and risk management costs of incumbent retailers, as they will have to contract and forecast in a less certain environment for mass market small customers, similar to the environment faced by other retailers in Victoria and South Australia. Further, each of the incumbent retailers will be hedging the load impacted by the phase out of ETEF at the same time with the resultant potential impact on price volatility and risk.

To the extent that incumbent retailers require improved trading systems and new personnel to manage the increased exposure in the absence of ETEF, they will be required to allocate more resources to the energy risk management function than they may had previously. Origin believes that the Tribunal should support competitive neutrality in this area. In particular, the Tribunal should assume that the board and management of the incumbent retailers (like those of the non-government sector) will place a high priority on managing exposure to wholesale market risks to protect the investment of shareholders, comply with statutory and corporate law obligations and manage risk in a manner consistent with the discipline imposed by financial markets.

However, given the existing capacity of standard retailers in NSW and their understanding of the mass market load profile, it is possible that the costs of managing mass market load risk are lower for these participants than new entrant retailers. While this may be the case, it should not lead the Tribunal to focus on incumbent retailer costs in the determination of regulated retail prices, as this will not reflect sufficient cost recovery for mass market new entrant retailers, who face greater volatility and lower profile diversity than incumbent peers.

How should IPART recognise the forecasting risks that retailers face in the absence of the ETEF and are these risks different between a standard retailer and a mass market new entrant retailer?

In the absence of ETEF, all retailers will face a degree of forecasting risk. However, Origin would urge the Tribunal to recognise that standard retailers have significant existing load diversity and experience in understanding the behaviour of the consumption patterns of the NSW market.

Therefore we believe that the Tribunal should focus on the risks confronting new entrant retailers in forecasting and managing the risk of a less predictable mass market load profile. As we discuss above, we also believe that ETEF should be assumed to cease immediately for the purpose of setting tariffs. Setting any benchmark view of energy costs based on forecasting risks of incumbent retailers is not likely to sufficiently recognise the energy procurement costs of new entrant retailers.

2.2 COAG endorsement of MCE's agenda to phase out retail price regulation

What is the extent of competition within the NSW electricity market?

Retail electricity competition in NSW has not been as active as the markets in Victoria and South Australia. However, this should not be seen as a failure of the market; rather, it is the result of the unique structural and regulatory features of the NSW electricity supply industry. In fact, the relatively low levels of churn are due in substantial part to the level and structure of regulated retail tariffs in NSW. The lack of cost-reflectivity in the current price controls has been problematic, and particularly so where there have been obsolete tariffs in place that significantly under-recover costs.

It is also important to look carefully at the nature of the churn to date in NSW. As Origin perceives the market, to the extent that there has been customer churn, this has been largely within the incumbent retailer population, and is characterised by limited discounts and longer-term lock in contracts.

There has, in our view, therefore been a distinct lack of depth in terms of new entrant retailers participating in the NSW market and associated with this, limited product diversification. In comparison, for instance, the competitive markets in other Australian jurisdictions feature not only the incumbents but also both large and small new entrants with different strategies and market targets thus offering a much wider diversity of products and prices to mass market consumers.

In any event, we suggest that it is worth re-assessing the question of what is expected to be found when observing competition and market outcomes. Origin has recently addressed this issue in detail in its submission to the

MCE SCO's Consultation Paper *Phase out of Retail Price Regulation for Electricity and Natural Gas – Draft Effective Competition Criteria.*[1]

We suggest that rather than looking for positive evidence of the outcomes of competition, the primary aim should be to identify any significant impediments to competition, where these may be linked to misuse of market power to make monopoly profits in some way (misuse of this type of market power is the market failure which should prompt regulatory intervention, and already has legal precedent through the *Trade Practices Act 1974* and legal interpretation of the Competition Principles). It would then be logical to allow the market to work by removing the impediments to competition, rather than intervening in the market to impose prices.

In NSW the issue is not so much failure of the market, but that regulatory intervention has constrained competition. The policy and regulatory framework that enabled ETEF and unsustainable tariffs is the major cause of the slow development of competition and emergence of evidence supporting its existence.

The removal of ETEF and creation of cost-reflective tariffs are necessary to create a truly competitive market structure. Importantly, this includes a more aggressive regulatory approach to removal of obsolete tariffs (or pricing them on a par with new tariffs).

What is the appropriate form of regulation given Governments' aim to phase out energy retail price regulation?

Origin supports the Government's aim to phase out energy retail price regulation. Origin agrees that as the market develops, retail price setting 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. The major action the government can take to encourage the development of a competitive and sustainable market is to minimise the barriers to entry and ensure that the national competition principles of ring-fencing and competitive neutrality guide regulatory decision making processes.

We are pleased to that the NSW Government has signed on to the recent amendments to the Australian Energy Market Agreement (AEMA). The amended agreement clearly supports the 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 promises the optimal achievement of both objectives. See Appendix 1 for a detailed discussion of how customers in hardship are supported.

With respect to the form of regulation during the regulatory period 2007 to 2010, Origin believes there are several overarching principles that need to be applied to decisions about price regulation, as shown in Figure 1 below. 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.

[1] See http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=67740037-D441-E066-015DCFD71BCCA661

Figure 1: Principles for effective 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.

2. **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 costs of administration] + Retailer [costs + reasonable margin]

3. **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.

4. **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).

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.

The importance of setting out consistent pricing principles in a regulated energy industry has been well documented with respect to distribution and transmission pricing. The recent agreement by the Federal Government to including pricing principles in the amendment to Part IIIA of the *Trade Practices Act (1974)* is an example of the widespread acceptance of the importance of such principles in effective regulation. In the short term, Origin sees no reason why regulated retail prices should not be similarly determined within a set of relevant, nationally agreed pricing principles.

The above principles are neither new nor radical, and in fact the first two principles have already been explicitly built into the Tribunal's current retail price review. The principles described above reflect those that have been espoused in one form or another in multiple reviews of the energy industry over the last ten years of energy market reform and 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.

A detailed discussion of the forms of price regulation is provided below in Origin's response to Section 3 of the Issues Paper.

2.3 COAG's agreement to roll out time-of-use meters

Origin supports a coordinated, national approach to the roll-out of interval meters (IMs). In saying this we recognise that in a competitive market, (characterised by, inter alia, financial and operational separation of networks and retailing), the roll out of time-of-use meters to mass market customers on bundled retail prices provides a particular challenge to regulators and retailers alike. As such, however, a co-ordinated and transparent approach is even more important. It provides a means to ensure the costs and benefits are captured appropriately both between and within jurisdictions and it greatly simplifies the development of a national regulation and competition model.

More specifically, from a network perspective, time-of-use meters provide the opportunity to:

- Signal to network customers, via network pricing structures, the impact of electricity usage patterns on network costs, particularly the capital and O&M cost of the reinforcement/expansion of transmission and distribution capacity.
- Actively manage electricity demand in times of peak network capacity.

In principle, time-of-use meters also provide the opportunity to signal to energy users the real time costs of generation and, in particular, the cost of building peak generation capability.

When retailers provide unbundled products to large customers, the retailer can reflect these costs appropriately in the retail price package, for example, by a direct pass-through of the network charges (distribution and transmission) and by varying the energy price in terms of time of day, day of week and season of year (as appropriate).

Similarly, when mass market customers are on basic meters, the situation is somewhat simplified from a retailer's perspective as network service providers can only charge on a relatively simple volumetric basis (with controlled load "add-ons"), and the energy costs of each customer are based on the "smeared" aggregated net system load profile (NSLP) rather than their specific energy consumption patterns.

However, when mass market customers are moved to a time-of-use meter, the situation may change significantly with respect to the retailer's **costs of supply.** The network provider may now charge based on time of day, peak demand tariff etc, while the wholesale energy costs will reflect the actual demand profile of the customer (as the customer is moved out of the NSLP)

The situation is further complicated when there is a lack of consistency between jurisdictions in terms of the regulatory approach to any IM roll-out and to cost/benefit recovery in the respective regulatory determinations. Even within jurisdictions we see the emergence of different strategies by the various distribution businesses.

In Victoria, for instance, the IM programme is conducted within a formal regulatory framework that attempts to quantify costs and benefits and to reflect these in the regulatory network pricing determinations. Nevertheless, individual distribution businesses have significant latitude in

the operational management of the roll-out programme, in the structure of their demand management tariffs etc.

What problems have arisen during the current determination as a result of network roll out of time-of-use meters?

In NSW, in contrast, the IM roll-out appears to be occurring outside the regulatory pricing determination framework and the methodology for cost recovery and benefit capture is not transparent. In addition, Origin is concerned with the very different approaches, technologies, pricing strategies and roll-out timetable that appear to be emerging from the distributors themselves.

As a new entrant retailer in the NSW mass market, Origin believes that the piecemeal approach to the roll out of interval meters creates a significant barrier to entry by adding directly and indirectly to the costs of participation in the NSW market and on the ability to service customers in the most appropriate and efficient manner. As an example, in the EnergyAustralia network & retail area, if an existing domestic customer receives an IM as part of the EnergyAustralia network IM roll-out program, but stay on a standard contract price, EnergyAustralia networks will not charge its IM network tariff (i.e. not charge *LVEnergy40ToU*) to the retailer.

However, if the customer moves to a negotiated contract, EnergyAustralia networks will commence charging on the basis of the *LVEnergy40ToU*[2]. In this situation, the new retailer will have to either offer a TOU type retail tariff in competition with a flat rate standard retail tariff, or bear the risk of a time-of-use tariff.

In our view therefore, the development of a consistent and overarching regulatory approach to IM is essential to maximising the benefits associated with interval metering and ensuring competitive neutrality in its implementation.

Though not included in the terms of reference to this review, Origin would urge the Tribunal to consider the need to ensure that the basis of network tariffs associated with interval meters are sound and that the proliferation of network tariffs linked to such meters be avoided to the extent possible.

How the can the new determination be used to facilitate the transition to time-of-use tariffs?

How should the Tribunal consider the impact of its determination on demand management?

In addition to providing the overarching regulatory framework for the roll-out of IM, the Tribunal can assist the transition to time-of-use retail tariffs directly within the current pricing determination by adopting the following approaches (some of which are discussed again in later sections of this response):

[2] This analysis is based on Energy Australia's Network Price List, Note 1 to description of the *LV Energy40 Time of Use* tariff (page 4).

- Provide for an N+R regulatory approach that explicitly allows full pass through of network tariffs in the regulated retail price.
- Associated with this, ensuring that the form of any price controls are sufficiently flexible to permit retail price restructuring to reflect both network price signals and wholesale market price signals. As noted by the standard retailers, the Tribunal's current approach limits the ability of standard retailers to pass through both the overall quantum and the structure of the network tariffs;
- Support the compulsory assignment of customers to TOU retail tariffs when IM are installed as part of any approved IM roll-out by the network operators.

We note here the analysis undertaken by Energy Australia as set out in the "*EnergyAustralia Network Annual Prices Report*", May 2006. In their analysis EA demonstrates that only 8% of customers would see an increase in their network cost component of more than 10% if they were moved to a network TOU tariff. (Appendix 3, page 20).

An approach such as that recommended by Origin may result in limited price shock for some customers as noted in the EA study. However, the benefits are considerable. Such an approach, for instance, will not only place the NSW market on a more competitively neutral footing, but will also enhance the rate of adoption of TOU tariffs and ensure that the benefits of IM are maximised – noting that there is an intrinsic link between the extent to which retail tariffs incorporate time dependent pricing and the realisation of any net community benefits of IM[3].

Importantly, our recommended approach addresses the vexed issue of "self-selection". While customers who have IM can choose to stay on, or revert to, a standard retail flat tariff that does not incorporate time-of-use components, then those customers with the worst load profiles will "hide behind" this protection, thus defeating the very purposes of the IM investment of (i) signalling costs to customers and (ii) changing behaviour and/or truly allocating costs to those that most incur the costs.

However, if the Tribunal were to adopt Origin's recommendation, careful thought would need to be given to the impact of this progressive peel-off of IM meters on the remaining NSLP shape (and therefore costs) for customers with basic meters on standard retail tariffs. Again, a structured approach to the roll-out of IM is required to appropriately account for the cost impact of this transitional issue,

[3] For instance, if distributors or generation investors are not confident in the forecast of the uptake of time-of-use retail tariffs because they are "voluntary", then they cannot rely on these as the basis of any reductions in capital expenditure to meet peak demand periods.

3. Form of regulation and price constraints

3.1 Broad options for the form of regulation

The Tribunal seeks comment from stakeholders on the regulatory approach that best meets the objectives for the review, the pros and cons of the options, and whether there are additional broad options of variation within the options that the Tribunal should consider.

Origin supports the eventual removal of price regulation in energy markets across Australia, and where this is not possible, regulatory arrangements that transition toward this objective (refer to the discussion above in Section 2.2). Noting that the terms of reference support an approach that is intended to allow cost reflectivity of tariffs by 2010, it is Origin's view that the form of regulation needs to allow sufficient flexibility for new entrant retailers to compete effectively.

In particular, Origin agrees with the proposition that the basis of energy purchasing costs has not reflected outcomes in other jurisdictions or the commercial realities of procuring energy in the NSW wholesale energy market. Furthermore, the retail margin applied by the Tribunal in 2004 does not allow for returns that accommodate the risks that face new entrant retailers.

Origin supports the retention of the N+R approach,[4] but does not believe that a forensic build-up of costs (based on either incumbent or new entrant retailer costs) to determine the R component will result in regulated tariff levels that will enhance the level of competition, consumer choice, demand management or the efficient operation of the market more broadly. There is no template of a model new entrant retailer that would allow the establishment of an R component that would adequately reflect the costs of all new entrant retailers in the NSW market.

For these reasons, Origin considers that **only the R component** should be subject to a weighted average price cap (WAPC). This view is consistent with the principle that the network component of regulated retail prices should be considered as a pure pass through to:

- preserve network price signals; and
- to enhance the transparency around the foundation of competition among retailers, that is, retailers compete on the basis of efficient operating and energy procurement costs only.[5]

Numerous regulatory decisions regarding retail costs over recent years have shown that arriving at unambiguous cost estimates is unlikely. Therefore, we suggest that rather than expending further effort on this matter to build up retail costs from scratch, the R component can be developed with reference to recent benchmarks used in other jurisdictions, supported with actual cost data only where this is both readily available and reflective of true stand-alone retail costs.

[4] Although we note that the approach to this point has not truly been N+R, as side constraints on the final tariff have limited the pass-through of legitimate network cost increases.
[5] Network costs reflect the provision of a monopoly service. Such costs should be irrelevant to an individual customer considering alternate retail market offers from retailers.

Furthermore, Origin believes that the N+R approach should apply without additional side constraints, particularly constraints that apply to individual customers.

This provides retailers with flexibility more likely to achieve the objectives of the review as detailed in the terms of reference. However, we are prepared to accept side constraints on the R component if they apply only at the tariff group level (for example domestic general tariffs) and not to individual customers or tariffs.

We reiterate our belief that side constraints should not apply to the pass-through of the N component of the N+R approach. To date, these constraints have been proven to be a significant barrier to tariff reform, strictly limiting the ability of the standard retailer to recover network costs let alone include appropriate adjustments for retail costs.

To continue with any side-constraints that impact on the full pass through of the N component is clearly inconsistent with the Tribunal's new objectives of cost reflective tariffs and demand management

The recommended approach will, in contrast, furnish the Tribunal with the flexibility necessary to encourage further competition in NSW and allow new entrant mass market retailers to develop innovative products that accommodate other policy objectives of the government including demand management.

As a final point, Origin notes that the Tribunal states on page 12 of the Issues Paper that:

> …a weighted average price cap alone may not provide sufficient protection for customers whose needs cannot be met through the competitive market.

We question why the Tribunal has included this consideration in its assessment of applying a WAPC. The terms of reference to the review do not make mention of affordability as a factor in determining regulated retail prices for the forthcoming determination.

Moreover, we do not understand the very basis of this concern. Approaches similar to the weighted average price caps were adopted as the primary regulatory control mechanism in both Victoria and SA (in SA applying to the R component only), accompanied by some broad side-constraints, and retailers have not used this to discriminate between customers despite significant price increases overall in the initial year(s) of price adjustments.

It is the status of the competitive market in general, not individual customers that will drive retailers to set each tariff at a cost-reflective level (whether this is achieved by increases or decreases in particular tariffs). In the process, some customers will be impacted positively and some negatively, and some more than others; this is inevitable as cross-subsidies are unwound.

Origin believes that excluding the consideration of a WAPC on this basis will not provide the scope to eliminate obsolete tariffs and will reduce the capacity for retailers to achieve cost reflectivity by the end of the review period. The very real issue of transitional customer impacts are not effectively addressed by regulators limiting pricing reform and retaining cross-subsidies between classes of customers. The social impacts of tariff reform are much better addressed by transparent CSO's.

Opt-in regulated tariffs:

We note the suggested option of establishing a limited number of basic opt-in regulated tariffs, with all current tariffs becoming unregulated from the outset of the determination period.

Assuming that the new "opt-in" basic tariffs are genuinely cost reflective, from Origin's perspective, the appeal of this approach is that it provides a relatively effective and efficient way of moving customers off the multitude of "obsolete" retail tariffs many of which are well below costs and have inefficient costs structures despite six years of pricing reform under the N+R approach[6]. These tariffs:

- represent an effective cross-subsidy between new customers in NSW who largely pay cost-reflective prices (albeit based on a very restrictive understanding of retail costs) and the customers remaining on the obsolete tariffs; and
- serve as a very significant operational and financial impediment to competitive activity.

As the Tribunal has identified, the "opt-in" proposal would be a new approach and one that has significant implications for customers. Nevertheless, the NSW market is unique to the extent to which its efficient operation and the ability to apply new demand management pricing principles is hindered by the existence of these obsolete tariffs. In comparison, while both Victoria and SA have obsolete tariffs, the impact of these are diminished because they are both less numerous and the initial pricing adjustments allowed at the start of the respective price path regimes allowed for very significant restructuring of these prices.

As such, the "opt-in" proposal in NSW represents an important approach to addressing one of the major fundamental difficulties in the NSW market. In our view it should be seriously considered as an option to achieving the Minister's objectives, albeit one that is accompanied by clear steps to mitigate negative impacts. These mitigating steps could include, for instance:

- A one-year "transition" period which nevertheless includes significant price adjustments and tariff rationalisation with the Tribunal taking a leading role, as the independent regulator, in educating customers on the proposal;
- An obligation on standard retailers to advise all standard contract customers in writing some one to two months in advance of:
    - any proposal to change/withdraw the existing tariff; and
    - the new standard tariffs.

To encourage standard retailers to adjust the existing obsolete tariffs to cost reflective levels/structures under any "opt-in" scenarios, the Tribunal would need to ensure that the new standard tariffs are set on a stand-alone cost reflective basis such as to limit any ongoing cross-subsidies between the new tariffs and the non-cost reflective tariffs (with consequent anti-competitive effects).

Thus, while Origin's preference is for a weighted average price cap on the R component, accompanied by high level side constraints, we believe that the "opt-in" proposal does address some very important issues. At the very least, it supports the requirement for a price path approach that

[6] A clear example of this is the Country Energy tariffs in areas such as southern NSW which are fully variable with no transparent pass through of fixed costs.

encourages a very rapid move to the removal and rationalisation of many obsolete tariffs, and the adoption of cost-reflective pricing across all segments of new and existing customers. The cross-subsidies between new customers and market customers on the one hand, and those on obsolete "under the water" tariffs on the other, should not be allowed to continue.

3.2 Price constraints

The Tribunal seeks views on whether and at what level it should set price limits, how price limits interact with the form of regulation, and whether it is appropriate to remove price limits on obsolete tariffs.

Limiting increases to customer's bills

The Tribunal seeks comment on:

- *Whether it should impose limits on increases to customers' bills.*
- *Whether there are alternative approaches that the Tribunal should consider.*
- *Experiences with the customer bull price limit in the current determination.*
- *Whether different limits should be applied to different customer classes, and why.*

Limiting increases to individual tariffs

The Tribunal seeks comment on:

- *Whether it should impose limits on increases to individual tariffs.*
- *Whether there are alternative forms of price limits it should consider.*
- *Whether different limits should be applied to different tariffs or tranches of tariffs, and why.*

Origin's views on limiting increases, whether at the customer level or at the individual level, have been set out in detail in Section 3.1.

In brief, we are strongly opposed to any price-path approach that limits increases on individual customer's bills. This methodology has been tried over the last six years and has not achieved the aim of cost-reflective pricing or the removal/rationalisation of the multiple standard tariffs on offer.

To take an example from Country Energy regulated tariffs, it is simply not possible to reform many of the regional tariffs which are based on either a minimum bill concept and/or a variable charge only with no supply charge, without impacting some customers in a significant way. Yet without the introduction of a fixed supply charge in the retail tariff, the network charge cannot be appropriately "passed through"[7] nor can the retailer appropriately recover their fixed retail costs.

Similarly, if there is a constraint based on individual customer impacts, then it is difficult to see how time-of-use standard tariffs could be effectively introduced.

Clearly the very aim of these new demand management tariffs is to ensure that those people who place relatively high costs on the system are priced

[7] The network charges include a fixed "network access charge" based on $/day rate.

accordingly, and for some, this may result in a significant increase on their current flat rate bill. That is the nature of cost-reflective pricing and the objectives of any demand management program itself will be undermined if customers are "protected" from being exposed to these costs.

Side constraints at the tariff level do provide greater flexibility for tariff reform. Nevertheless, in the particular circumstances of NSW pricing, it is likely that side-constraints at the tariff level will still inhibit the achievement of cost-reflective pricing and effective demand management pricing by 2010. The Tribunal should only introduce such side constraints if it can be clearly demonstrated that effective tariff rationalisation can be achieved, and it does not inhibit introduction of new demand management tariffs and the full pass through of network price changes.

3.3 Assessing the options

The Tribunal seeks comment on the most appropriate form of regulation, having regard to the terms of reference.

In Origin's view, the approach adopted by the Tribunal for setting standing contract prices in the past has not achieved its limited objectives of cost reflectivity, perhaps due to the weight given to other objectives of customer protection. In any case, it is certainly not consistent with the attainment of the new objectives set out by the Minister, objectives that in turn reflect NSW's commitment to the national energy market reform agenda.

As noted in previous sections, Origin's preferred form of regulation, and the one which we believe is most likely to lead to the attainment of the objectives set by the Minister, is the N+R approach where this involves:

- Full pass through of network charges, with no constraints applied to the pass through of N.
- A calculation of R based on reasonable assessment of stand-alone new entrant retailer costs.
- Calculation of a price path for R by applying a weighted average price cap.
- Removal of all side-constraints that apply to individual customer level.
- Use of side-constraints at the tariff level only if it can be clearly demonstrated that it will not inhibit cost-reflective pricing, tariff rationalisation and introduction of new DM tariffs.
- Side-constraints at the tariff-bundle level are however, acceptable, providing they apply only to the R component.
- Incentives to remove and/or rationalise obsolete retail tariffs.
- Consideration of compulsory assignment of customers who are on IM to relevant time-of-use retail tariffs, noting that this could only be done within an overarching policy and operational framework.
- Address any significant customer impact issues by appropriate and transparent CSO's, recognising that the energy price should not be the primary the mechanism for addressing general social welfare and equity issues.

4. Costs to be recovered

4.1 Long run marginal cost of electricity generation

The Tribunal seeks views on:

- *The appropriate level of LRMC to be included in regulated retail tariffs.*
- *How and whether the Tribunal should recognise projected future changes in net system load profiles and what these profiles are likely to look like in 2010.*

Origin notes that there are a number of different approaches to determining an appropriate allowance for electricity purchase costs within retail tariff structures. In broad terms, Origin supports the approach adopted by the Tribunal and developed by IES in the 2004 price determination. The IES approach determines the annualised least cost combination of new entrant generation (base load, intermediate and peak) that would be required to meet an increase in demand over an extended period of time (30 years). Demand in this case is adjusted to reflect the NSW franchise load shape for each retailer. [8]

This approach would appear to be consistent with determining the level of cost recovery needed to sustain an efficient level of generation investment in the NEM. However, it does suffer one limitation which is that it does not bear a close relationship to short-term contract prices, which are more subject to medium-long term weather forecasts, perceived supply and transmission constraints, generator availability and so on. In other words, it may not reflect the actual costs faced by retailers with regard to their short term purchasing arrangements in the NEM. Origin therefore considers it important that this approach is cross referenced against appropriate alternative methods, such as the "prudent retailer" approach to ensure the overall allowance is set at realistic levels[9].

If an LRMC approach is adopted it will be important to include an appropriate component for generation required to meet NEMMCO reliability standards. NEM wide reliability standards require additional generation to be available over and above that required to meet extreme levels of demand in each state (a 1 in 10 probability of exceedence demand). Franchise customers benefit from such insurance as much as contestable customers and should therefore be required to make a contribution to its costs. Reserve generation costs should be allocated to franchise load based on the latter's share of overall NSW demand[10].

A further issue to be addressed in setting a wholesale energy allowance is the extent to which the load shape may vary over the determination period. The new entrant LRMC reflects the mix of new generation required to meet an increment in demand on the basis of a particular franchise load shape. The forecast is generally based on a previous year plus some

[8] We understand, however, that the 2004-07 ETEF price was based on overall NSW load shape and did not reflect differences in the 3 retail areas, an issue that is of concern from a competitive neutrality perspective – new entrant retailers will have to face energy costs based on the NSLP of each individual supply area.

[9] Though it should be recognised the latter also has significant limitations, such as the lack of quality independent data, lack of liquidity for the type of contracts generally entered into by retailers, and the requirement for difficult judgements to be made regarding the appropriate timing of purchases.

[10] ESIPC, *Estimates of the long run marginal cost of supplying electricity to small customers in 2005*, Information paper prepared for the Essential Services Commission of SA, 31 August 2004

escalation factor to reflect demand growth etc. However, if the load profile turns out to be peakier than expected this means the wholesale costs to the standard retailer will have been underestimated, since the retailer will have been required to obtain additional expensive hedge cover at short notice, or purchase from the pool, for those periods in which it was under hedged.

This illustrates the broader issue of hedge mismatch risk. That is, in the absence of a perfect load following hedge such as that provided by ETEF retailers are likely to be either under or over hedged at various times due to the essential unpredictability of weather driven demand. Retailers will consequently be subject to unforeseen pool purchases or swap payments over and above their energy purchase allowance. This hedge mismatch risk is particularly relevant to franchise load as it tends to be the peakiest element of a retailers portfolio load profile. The peakiness and subsequent riskiness of franchise load is increasing over time due to increasing rates of churn, and increasing penetration of interval meters and refrigerative air conditioning loads.

A component for hedge mismatch risk should therefore be incorporated in the energy purchase allowance. Retailers use sophisticated methodologies for assessing hedge mismatch risk and then include this as a premium in their retail prices[11]; though at a general level because the risks are asymmetric (with the financial costs of under hedging being greater than over hedging) retailers tend to be conservative in their contracting behaviour for mass market load. For instance by obtaining cap contracts for meeting a 1 in 10 year demand to meet their general peak load requirements.

It is important therefore, when making the pricing determination, that IPART takes into account the risk management policies that would be adopted by the board/management of a new entrant retailer to protect its shareholder funds and exposure to the commercial discipline of the financial markets.

4.2 Hedging, risk management and transactions costs

The Tribunal seeks comments on:

- *The appropriate level of hedging, risk management and transaction costs for inclusion in the regulated retail tariffs.*
- *Whether the concepts of LRMC and hedging are compatible and how any relationships should be considered.*
- *Whether the Tribunal should consider hedging costs against the pool price or only allow costs for hedging above the LRMC estimate.*
- *Retailers' experience in hedging load for customers less than 160MWh per annum in NSW and hedging in other relevant markets*
- *What impact the phasing out of the ETEF is likely to have on hedging risk management costs over the determination period.*

An appropriate portfolio approach to LRMC reflects the least cost combination of base load, intermediate and peaking generation required to meet the franchise load profiles. This in turn should approximate an efficient mixture of flat, peak and cap contracts. In principle therefore, providing that an appropriate component for reliability capacity costs and hedge mismatch risk is added the wholesale energy allowance (as discussed

[11] Origin is happy to discuss its approach with the Commission.

previously), no further hedging costs need be included. Note, however, we strongly support the use of a different LRMC for each retail area (unlike the current methodology)

Another key issue will be the effect of phasing out of ETEF in a staged manner on energy allowance costs over time. ETEF represents a lower cost approach to managing the risks retailers face than is available in the market more generally (as it effectively operates as a fully sculpted internal hedge). To the extent therefore that ETEF is peeled off while franchise retail tariffs remain in place, the relevant market based wholesale cost that replaces it will be necessity be of a higher value (due to hedge mismatch risk essentially). Failure to account for this factor will result in assessment of costs that do not reflect the full portfolio costs of the incumbent retailers for supplying the franchise load (because of the changing mix of ETEF cover and market cover). More importantly, it will significantly underestimate the costs facing the new entrant retailer who has no access to ETEF.

It therefore may be appropriate and administratively simpler to assume immediate cessation of ETEF upon commencement of the next regulatory term. The wholesale cost allowance determined in this review with respect to franchise tariffs should commence immediately the next regulatory term begins. This would ensure incumbent retailers will face a consistent wholesale exposure throughout the determination period for their regulated customers.

To the extent that this means franchise retail tariffs may be above the level consistent with ETEF in the initial phases of the regulatory term this should not be an issue, as a greater level of headroom will enhance the scope for new retailers to enter the market and compete. This in fact should facilitate the withdrawal of ETEF over time and, importantly, is consistent with the basic premise of deregulation that markets are preferred to regulation for price discovery and determining efficient prices.

4.3 Mass market new entrant retail operating costs

The Tribunal seeks comment on:

- *The appropriate level of mass market new entrant retail operating costs for inclusion in regulated retail tariffs.*
- *The experience of mass market new entrant retailers, both in NSW and other relevant markets.*

Mass market new entrant operating costs need to include all of the costs incurred in entering a new market. Given the relatively low levels of customer switching to new entrants to date, the scale economies in NSW are necessarily lower than in jurisdictions where a higher level of switching has occurred through customers selecting negotiated contracts (or their equivalent).

Origin supports the components of retail operating costs established by KPMG and referred to in EnergyAustralia's submission to the issues paper.[12] Importantly, the retail operating costs now include the explicit recovery of trading and risk management operational costs. These activities which are an essential part of a competitive market must be supported by highly skilled management and analyst teams with robust systems to forecast

[12] EnergyAustralia (2006), page 42

demand, acquire contracts supply and monitor exposures on an hourly basis. These costs must be included in retail operating costs.

In addition, explicit recognition of customer acquisition and related costs is also required if new entrant operating costs are to be reflected in the forthcoming determination.

By their nature, new entrant retailers have to acquire their customer base through market initiated activity. In order to encourage new entrant activity these costs need to be acknowledged and recovered in establishing retail tariffs. An allowance for the amortisation of customer acquisition and related costs needs to be included in the cost base to ensure that retail tariffs adequately compensate new entrant retailers. The appropriate amortisation period for customer acquisition costs can be calculated on the estimated life cycle of a customer in a competitive market and can be referenced from other markets. Origin would be pleased to discuss our experience in other markets with the Tribunal on a confidential basis.

4.4 Mass market new entrant retail margin

The Tribunal seeks views on the appropriate mass market new entrant retail margin to be included in regulated retail tariffs

Origin concurs with the Tribunal's assertion that retail margin must adequately reward investors for the risk associated with investing in an energy retail business. We also note that the existing net margin established in NSW under the current determination of approximately 2% has not encouraged competition nor attracted significant new entrant investment. Indeed, as noted previously, much of the existing churn in NSW is among incumbent retailers and the NSW market has not attracted the same interest from independent small retailers as we have seen in other jurisdictions.

When considering an appropriate mass market new entrant retail margin we believe that the Tribunal should make reference to other benchmarks such as retail margins in other jurisdictions where competition has been more robust. While there is no definitive statement of a sustainable new entrant retail margin we believe that the allowable retail margins in Victoria and South Australia, in particular, provide a useful reference point for the Tribunal's consideration.

When considering these benchmarks we urge that the Tribunal clearly establish whether the retail margin relates to the bundled retail tariff (i.e. N+R) or is calculated solely on the R component of the tariff. We note in particular that where the margin is calculated on the basis of the R component, there must be explicit recognition of the working capital costs associated with the time difference between payment for network services and energy costs to the NEM and the receipt of income from the customers. ESCOSA's determination of the electricity standing price in SA for the period 2004 – 2007 provides a useful analysis of these costs which formed part of the decision to allow a net retail margin of 10% on the R component.

Moreover, as noted in section 5 of this paper, the working capital costs will be directly affected by the policy decisions of the NSW Government and the Tribunal with respect to such matters as late payment fees and security deposits. The lower these charges are, the greater will be the working capital requirements of the business to fund delays in customer payments.

4.5 Network charges

The Tribunal seeks views on how best to ensure that network charges are fully recovered by retailers.

Origin believes that the Tribunal needs to recognise that all network charges need to be fully passed through to customers. The transparent application of the N+R form of regulation will ensure the distinction between retail and network costs. Therefore, in assessing regulated tariff levels the Tribunal should examine the level of network tariffs and explicitly allow for their pass through to consumers.

We also reiterate our view that if any side constraints are to be included in the tariff determination that these constraints should only apply to the R component. Any constraints on a bundled retail tariff (i.e. N+R) will undermine the Tribunal's objective of cost reflectivity as well as impeding network price signals to consumers.

4.6 Cost of compliance with green energy obligations

The Tribunal seeks comment from stakeholders on the appropriate allowance for such costs and how they might change during the course of the determination.

Regulated retail tariffs should include an allowance for the costs of complying with greenhouse policy measures, including the Mandatory Renewable Energy Target (MRET) and the Greenhouse Gas Abatement Scheme (GGAS). Retail prices that do not reflect the additional costs of sourcing electricity from less-greenhouse intensive energy sources would not provide an adequate signal to consumers to alter their behaviour. It is therefore important that retailers are able to fully pass-through the costs of meeting their obligations under MRET and GGAS.

Over the longer term, the costs of complying with MRET and GGAS will be determined by the long run marginal cost of producing certificates under the schemes (RECs and NGACs respectively). Therefore, Origin proposes an allowance linked to the projected long run marginal cost of new plant eligible to produce RECs and NGACs, consistent with the approach for wholesale electricity outlined in Section 4.1. This approach bypasses the uncertainty and volatility of short term AFMA contract prices and is more consistent with long term purchase contracts entered into by most retailers.

4.7 Retailer NEM fees

The Tribunal seeks comment from stakeholders on the appropriate allowance for retailer NEM fees, and on whether these fees are expected to change significantly from their current levels.

Origin does not see any significant change to the scope of NEM fees; however, it would ask that the Tribunal index current NEM fees over the period of the determination.

4.8 Energy losses

The Tribunal seeks comment on the appropriate allowances to account for energy losses in supplying electricity.

Energy loss data is published by NEMMCO and distributors. Origin believes that losses should be explicitly included in the determination of regulated retail prices and the determination compensate for the potential of these losses to change over time. Further, to the extent that other costs are affected by the level of energy losses (for example NEM market fees) that this also is reflected in the regulated retail prices established.

4.9 Optional Green Power component to all new (or moving) residential tariffs

The Tribunal seeks views on the most appropriate way to account for the requirement of energy retailers to offer a 10 per cent Green Power component to all new (or moving) residential tariffs.

Origin believes that the unregulated approach to any green power component should continue for the forthcoming determination period. Origin considers that attempting to prescribe any green power premium for regulated retail tariffs will not allow standard retailers the flexibility or incentive to purchase lowest cost renewable generation. Again, if standard retailers attempt to over recover against the (unregulated) green power component, they will face increased competition from new entrant retailers, if the underlying retail tariffs are cost reflective.

4.10 Mechanism to capture costs of new schemes

Tribunal seeks views on:

- *The appropriate form of the mechanism that should be included.*
- *Whether 'material' should be defined in terms of a particular threshold.*

Origin agrees with the Tribunal requires a mechanism that allows the inclusion of the costs of new schemes (such as a National Emissions Trading Scheme) in determining regulated retail tariffs. The development of an appropriate competitive benchmark that would reflect the costs of complying with the scheme given the characteristics of the regulated customer base may be considered as an incremental ($/KWh) cost to the WAPC applying to the R component.

Origin further considers that any new scheme introduced by a government or regulator is likely to be material in nature. As such, it does not agree that a threshold be considered.

5. Miscellaneous charges

Origin's position on miscellaneous charges is that retailers should have the right to recover these costs in full from the market. Our strong preference is that it is allowable to recover these costs directly from the customer. Failure to do so only increases the retail cost to serve and ultimately forces the recovery of these costs from the entire customer base.

Origin recognises however that the Tribunal's review is limited to those miscellaneous charges identified in the *Electricity Supply Act* (1995). However, we also note the potential correlation between the approach to consumer regulation in general and the costs that need to be recovered by these fees or within the regulated price cap, a correlation that needs to be considered by IPART in setting appropriate levels for these charges.

For instance, regulatory policy on disconnection will impact on the extent and nature of security deposits and/or the direct cost to serve. If the regulator wishes to reduce disconnections as a matter of public policy, then the costs to the retailer of unpaid bills will rise, a cost that can be addressed either by increasing the reach and level of security deposits or providing greater allowance for bad debt within the retail operating cost or retail margin.

Similarly, late payment fees provide a mechanism to encourage timely payment of bills, and thus reduce the retailer's working capital requirements. If late payment fees are prohibited, or set below realistic levels, then greater allowance needs to be made in the working capital costs component of the retail operating costs or retail margin.

With respect to these particular charges we comment as follows:

5.1 Security deposits

The Tribunal invites views on the appropriate level for security deposits, and on the circumstance in which a security deposit may be collected and refunded.

Origin notes that the current arrangements for collection and refunding of security deposits relate to standard retailers only.

5.2 Late payment fees

The Tribunal invites views on the appropriate level for the late payment fee and information on the costs incurred by retailers where a customer does not pay a bill by the due date.

Origin would support increased flexibility in the setting of late payment fees for the forthcoming determination period. The current level of late payment fees limit the effectiveness of competition by reducing the scope of alternate arrangements that might be offered via negotiated contracts. Origin suggests that the Tribunal's oversight be limited to assessing the fair and reasonable nature of late payment fees, rather than setting an arbitrary fee. The current level of late payment fees in NSW is relatively low, and does not reflect the costs incurred by retailers or is likely to deliver sufficient incentive to customers to alter their payment behaviour.

5.3 Dishonoured bank cheque fees

The Tribunal invites views on the level of the dishonoured bank cheque fee.

As noted above, regulated retail prices need to reflect the costs that are borne currently by retailers. While endorsing the continuation of dishonoured bank cheque fees we note that customer payment channels have altered significantly. To this end we believe that such a fee be expanded to cover the growing and increasingly popular methods of payment that may result in the retailer incurring a fee from a financial institution (for example direct debit arrangements). Origin recognises that the Tribunal does not have the capacity to alter the legislation, but would support an amendment that catered for alternative payment options that may result in retailers incurring additional miscellaneous costs.

Appendix 1

Supporting Customers in Hardship

The customers that governments (and regulators) primarily seek to protect through ongoing state price regulation 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.[13] 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.[14] 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.

In general, 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. 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 consumer 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. This 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.[15] 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.

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[13] The term 'hardship customer' is used frequently by those in the 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.

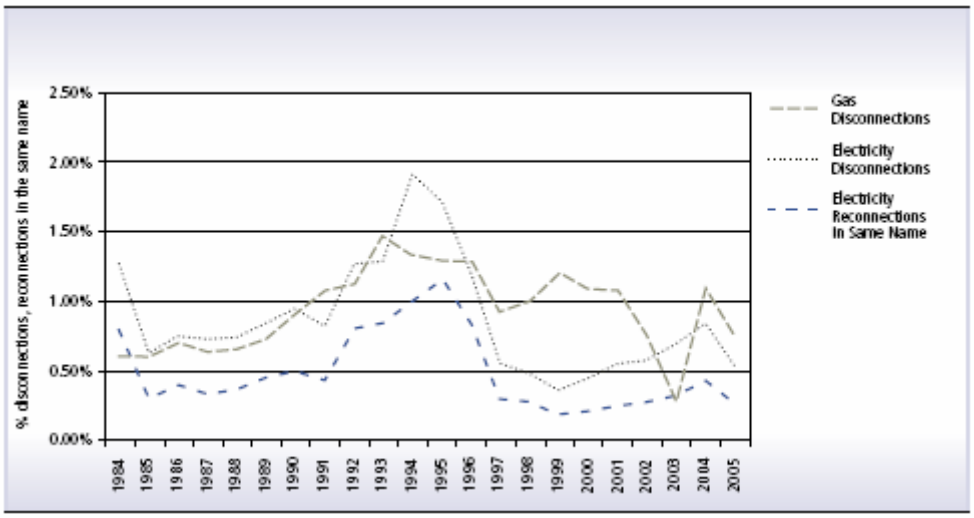
Thus the argument needs to recognise the *potential* for 'hardship' cases to be increased through either making a previously invisible group visible through changed work practices, or through creating new hardship cases through price increases. It is this group of customers that has been generally understood as those who are 'vulnerable', meaning they are more vulnerable than the norm to having problems with the affordability of their bills. However, as discussed, defining this group in any operational sense is problematic.

[14] See Bildstien, C. (2006) 'Scrapping price caps 'silliness'', *Adelaide Advertiser*, Business Journal, 22nd August, page 38.

[15] Although it might be asked by how much retailers would increase their prices if they felt the customer could not pay anyway.

There is also no evidence that retail competition exacerbates customers' experiences of 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 2 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 2: Electricity and gas domestic disconnections 1984-2005 (domestic and business customers)



Source: ESC, *Energy Retail Businesses Comparative Performance Report for the 2004-05 Financial Year*, December 2005.

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 former public sector geographic monopolies far more attentive to brand, reputation and customer service.

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 by 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, 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.*[16]

[16] Targeting approaches or locating indicators involves unpicking a range of complicated issues that affect people's lives, such as:

- 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. Following from this, we have found that the only way 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).

The industry as a whole has worked hard to develop and deliver a collections and hardship management approach which is responsive to customer needs as well as fulfilling both the spirit and letter of retail compliance obligations. Energy retailers provide assistance 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.

However, any ongoing long term management of customers who are in chronic financial hardship across all areas of lifestyle *cannot* be the responsibility of energy retailers. Chronic difficulties with paying energy bills are generally symptomatic of more wide-spread social/economic issues, and people experiencing these difficulties require more assistance than an energy retailer can provide.

Government bears the key social responsibility of ensuring customers have access to those services seen as 'essential', through the provision of targeted programmes delivered by government departments and agencies. 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 any private sector 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.

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.

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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*.