



6 August 2009

Review of the Regulatory Burden on Business
Productivity Commission
PO Box 80
Belconnen ACT 2616

By email: regulatoryburdens@pc.gov.au

Dear Sir/Madam,

ORIGIN SUBMISSION TO PRODUCTIVITY COMMISSION PAPER

Origin welcomes the opportunity to comment on the Productivity Commission's *Review of the Regulatory Burden Economic and Social Infrastructure Services Draft Paper*.

Origin is Australia's largest integrated energy company and has some three million electricity, natural gas and LPG customer accounts across Australia and the Pacific region. Origin also has a 51 percent stake in Contact Energy, one of New Zealand's largest integrated energy companies.

Origin has been at the forefront of delivering sustainable energy solutions to the market for many years, and currently has over 500,000 customers signed to green energy products, holding more than 35 per cent market share of accredited GreenPower™ accounts.

Origin also supplies a range of other products nationally. These include solar panels, solar hot water systems, water tanks and carbon offsets as well as home appliances through our extended network of retail stores.

The Council of Australian Governments' (COAG) principles of best practice regulation include proportionality, transparency and effectiveness.¹ The Australian Energy Regulator's (AER) recent *Statement of Approach to Regulation and Compliance*² reflects this, with its focus on regulation that is consistent, non-discriminatory, cost-effective and transparent. The regulatory burden should be considered in light of these principles.

In Origin's view, regulation covering retail energy should avoid costly duplication; support an open and competitive retail market; provide transparency in decision making; and provide an appropriate framework for protection for more vulnerable customers.

In relation to the Commissions' *Draft Report*, Origin's interest relate in particular to:

¹ Council of Australian Governments, *Best Practice Regulation: A Guide for Ministerial Councils and National Standard Setting Bodies*, October 2007.

² Australian Energy Regulator, *Compliance and Enforcement Statement of Approach*, June 2009, accessed at AER website, July 14.



- Retail price deregulation;
- The National Energy Customer Framework (NECF), and
- The multiplicity of climate change related programmes.

The goals of removing price regulation and establishing a national energy customer framework have long been agreed by COAG and supported by the Ministerial Council of Energy (MCE).

The two goals are neither new nor controversial. Yet in both cases obstacles remain to full implementation, because momentum has been lost or earlier commitments appear to have been overwhelmed by more immediate pressures. As a result, from Origin's perspective, commitments made in the COAG and MCE processes have for some time not been matched by practical outcomes at the jurisdictional level.

With benefits so close at hand it is vital that a renewed commitment be made to these goals and the reforms implemented in full. The resources required to drive reforms such as these are considerable. If the reforms are not implemented in full these cost cannot be recouped.

In reviewing the regulatory burden the cost implications of incomplete reform must be considered. Without corresponding gains in efficiency these costs represent a significant and unacceptable burden on governments, businesses and consumers.

1. Retail price regulation

Origin supports the Commission's finding that price regulation is distorting consumption and investment decisions and should be abolished by state and territory governments as soon as effective competition has been demonstrated.

Origin has made numerous representations on the question of retail energy price deregulation in a range of forums. This includes an extensive submission to the Productivity Commission's *Review of Australia's Consumer Policy Framework* in 2006. On the specific question of retail price regulation and climate change policies Origin made a detailed submission to the Australian Energy Market Commission's (AEMC) *Review of market frameworks in light of climate change policies* first interim report. Origin will make its second submission to the AEMC review in parallel to this submission. The input provided below should be read in conjunction with Origin's other submissions on related topics.

Retail price regulation imposes a considerable regulatory burden on retailers and governments, with no demonstrable countervailing benefit for consumers. The process required to set retail prices is costly and replete with risk: consumers have no way of knowing that costs projections will be accurate or cost-reflective. Retailers face ongoing financial risk and uncertainty in the face of a diverse set of objectives and approaches to price regulation. Efficient retail pricing is achieved through competitive markets. In a monopoly environment, regulation of revenues is unavoidable; where competition is effective the associated cost and risk cannot be justified.

Price regulation is seen by some as the primary means to protect vulnerable customers. This view persists, notwithstanding commitments in the AEMA that favour a direct approach to customer protection ahead of any approach that distorts prices for the wider community. The impact of price rises on vulnerable customers can be more effectively



addressed through policies that are better targeted - without large scale, costly intervention in the retail market and retail prices. Origin has considerable experience promoting access to essential services for vulnerable customers and has long maintained that alternative policies would serve to *improve* protections for vulnerable customers compared with the status quo under regulated prices.

Under regulated prices, indirect and opaque cross-subsidies flow between customers in an inefficient and inequitable manner. Large scale interventions limit innovation and can dampen incentives for expanding supply. This generally implies increases in prices at the margin over time. If regulated prices are set too low this will inflate demand, sending inaccurate signals to some customers about the cost of their use and forestalling greater increases in prices in the future.

Origin sees distortions in supply and demand driven by government regulation as entirely inimical to the interests of consumers. Distortions affecting structural supply and demand can also take considerable time to reverse. Interventions such as these should be considered when they are the only effective means of addressing a public policy goal. This is not the case in retail energy. Where competition is effective, direct subsidies to particular customers would be a far more targeted means to aid vulnerable customers. This approach would reflect the socialised cost of supplying these customers more accurately and transparently, with only limited impacts on market dynamics.

Moreover, all jurisdictions are confronting the impact of increased peak demand on network infrastructure and generation costs. In response to this networks are looking to recalibrate network pricing, so prices reflect the cost of peak demand. These price signals can only be conveyed to customers through their final retail price as customers do not see network tariffs. To date, retail price regulation frameworks and associated regulatory constraints have hindered this process and frustrated attempts to manage demand, because retail prices have not been flexible enough to articulate network price signals. Constraining prices in an attempt to protect customers (both vulnerable and otherwise) from cost-reflective pricing creates an unnecessary impediment to reform: vulnerable customers could be better protected through direct means.

In light of the above, the removal of retail price regulation in jurisdictions where competition has been found to be effective is an immediate priority.

The benefits of competition in retail energy have long been recognised by Commonwealth, state and territory governments, most notably in the Australian Energy Markets Agreement (AEMA, 2006). The AEMA has the full endorsement of all state and territory governments. Thus it is vital that jurisdictional governments be empowered with firmer commitments to the removal of price regulation, given that deregulation may be politically contentious in the first instance.

To this end, Origin supports the Commission's finding that the AEMA should be amended to ensure stronger commitments to competition reviews by the AEMC. Origin also proposes additional amendments to the AEMA, to strengthen processes associated with price deregulation. These amendments should reflect the joint commitment of Commonwealth, state and territory governments to competition and should include the following:

- That where jurisdictions decide to maintain retail price regulation, this is done with a clear and explicit commitment to the objectives of supporting retail competition in the regulatory period, with the goal of achieving retail price deregulation at the end of the period. (Origin notes, for instance, that the two

most recent jurisdictional terms of reference for the next regulatory period - while establishing objectives of cost reflectivity and encouraging competition - do not mention the final objective of price deregulation, even though this is explicit in the AEMA.)

- Jurisdictions that do not move to end retail price regulation following a finding by the AEMC that competition is effective must provide:
 - A transparent rationale for their decision, using evidence to identify where competition is inadequate;
 - Proposed steps to be taken by the jurisdictional government to address remaining limitations in the competitive environment;
 - A date within the next twelve months by which to report on progress in addressing limitations in the competitive environment as identified, with new measures proposed, if required; and
 - A date within the next twelve months by which time a new decision on removing price regulation will have been taken.
- Provision should be made for a portion of Federal funds to participating states to be dependent on the achievement of the goal of removing retail price regulation where competition has been proven to be effective.

Price regulation and the Carbon Pollution Reduction Scheme (CPRS)

Origin supports the Commission's finding that for as long as retail price regulation remains, it should be revised to allow pass through to consumers of energy cost increases associated with the Carbon Pollution Reduction Scheme (CPRS).

As noted above, Origin has made an extensive submission to the AEMC on the importance of allowing cost pass-through in relation to the CPRS. In essence, retailers will face unacceptable risk in the wholesale market if regulated prices do not reflect fluctuations resulting from the CPRS.

Regulated retail price regimes are insufficiently flexible to ensure the fundamental objective of efficient retail pricing is consistently achieved. Under the CPRS and expanded RET the situation is likely to become even more problematic.

Neither regulators nor businesses can accurately project the impact of the CPRS months in advance, because there is no experience of the interplay between an emission permit market and the National Electricity Market and the behaviour of generators in response to the dynamics of emissions trading.

In this way, the CPRS may challenge the robustness of retailer risk management arrangements, by increasing the likelihood of unexpected activity in the market. The risk of defaults by emissions intensive generators will increase, and strategies of bidding and investment will alter in unpredictable ways.³ At the inception of the competitive energy market there was a period of dynamic market activity, then as the market matured, a merit order and pricing structure were established. Volatility and risk will also attend the introduction of a price on carbon. Unlike a stable cost impost, such as a tax, the price of

³ Report for the Energy Retailers Association of Australia by consultants Farrier Swier, *Managing CPRS transition: implications for electricity retail price regulation*, June 2009.



carbon under the CPRS may be very volatile so establishing market equilibrium will take longer, implying increased volatility and risk for an extended period.⁴

Retailers will have difficulty obtaining appropriate levels of hedge cover or optimising their hedge costs where no reliable forward prices are available. If pass through is not permitted, retailers may be required to buy energy on the wholesale market with no option to recoup the associated shortfall from regulated customers. This position will not be sustainable.

In this context, Origin would note the recent interim finding the Australian Energy Market Commission (AEMC), in its Review of Energy Market Frameworks in light of Climate Change Policies.⁵ The AEMC found that the “extent to which the CPRS drives up electricity wholesale purchase costs will be uncertain and will be hard to forecast.”⁶ The AEMC found that magnitude of likely cost changes and the potentially limited capacity for hedging costs will make CPRS costs “substantially different from other forms of cost volatility that pricing regulators address in setting tariffs.”⁷

Analysis quoted by the AEMC indicates increases in retailer costs in the range of 10 to 30 per cent.⁸ This is a broad range. If a regulator underestimated this increase even by a small increment, this could eclipse a retailer’s margin.

In response to the risks outlined above, the AEMC has proposed an adjustment mechanism whereby regulated retail prices could be changed as frequently as every six months. Origin welcomes this recommendation. Yet it is important to note that even allowing for a mechanism like this, increases in regulated prices will still be informed by economic models and institutional processes adopted by regulators. If these models and processes are not sensitive to changes in key parameters relevant to the CPRS, it may be difficult for retailers to substantiate the case for prices changes. In other words, limitations in the institutional framework associated with price regulation may impede price changes even where the need for these is both evident and urgent.

Origin therefore welcomes the COAG agreement that the AEMA be amended to specify that energy cost increases associated with the CPRS will be passed through to end-use consumers in all circumstances.

However, we remain concerned that while there is agreement among jurisdictions to the principle of CPRS cost recovery, the analysis of these CPRS related costs may not be sufficiently accurate or consistent across jurisdictions. It remains to be seen, for instance, if the two jurisdictions currently setting three year price paths (covering the period in which the CPRS will be introduced) do in fact put in place methodologies that adequately capture a retailer’s costs, given the complex issues associated with assessing the direct and indirect impacts of CPRS on the energy market.⁹

⁴ Farrier Swier, op cit.

⁵ Australian Energy Market Commission, *Review of Market Frameworks in light of Climate Change Policies, 2nd Interim Report*, 30 June 2009.

⁶ op cit., p.51.

⁷ op cit., p.52.

⁸ op cit., p.51.

⁹ For instance, if the regulatory frameworks rely on calculation of long run marginal cost (LRMC), then a range of additional parameters must be considered, beyond the cost of carbon (even if the carbon cost could be known with confidence). These include matters such as the impact of CPRS on replacement of generators, merit order, transmission systems and transmission interconnectors, all of which will in turn impact on the LRMC of providing energy to small consumers.



2. National Energy Customer Framework

Origin recognises that, as the NECF is a prospective reform and still the subject of consultation, the Productivity Commission has not examined the regulatory burden associated with the transition to the NECF in detail - or the burden of the jurisdictional regimes it will replace.

Nonetheless, Origin notes the Commission's finding that based on current settings, significant jurisdictional variations will remain even after the NECF has been implemented in each participating jurisdiction. Origin agrees with the Commission's view that unless the NECF is implemented consistently, the result will be "a hybrid, rather than a truly national regime."¹⁰

Origin (like many other retailers) operates on a national basis and the NECF provisions fundamentally affect the manner in which we manage and service customers. To the extent that jurisdictional variations remain and retailers are required to manage different systems in each state, the NECF will have failed to achieve its core objective - a national regime.

As the development of the National Energy Regulatory Framework (NECF) commenced in 2005 and has undergone many rounds of review. Origin now believes that the Standing Committee of Officials (SCO) should focus its attention on the implementation of this vital piece of work.

Origin is of the view that the implementation of the NECF should not simply remain at the discretion of each jurisdiction. This would undermine the very benefits that the framework seeks to capture and its potential contribution in the broader process of national competition reform.

Without a planned implementation rollout the NECF becomes just another set of compliance obligations, in addition to the jurisdiction's own rules. This will increase the regulatory burden, rather than reducing it.

Jurisdictions must ensure that the proposed NECF is implemented as quickly as possible, with jurisdictional variations kept to a minimum. The process of review has been so extensive it is inconceivable that the balance of interests reflected in the NECF should require further detailed scrutiny and input. In light of this painstaking balancing of interests that has occurred over many years, jurisdictions looking to vary this framework must be explicit about their objectives.

To this end, timelines should be established for jurisdictions to achieve full implementation. In the interim, jurisdictions should keep transparent records of outstanding exceptions to the national regime; the justification for these; and steps proposed to eliminate these exceptions.

3. Multiplicity of climate change related programmes

Origin notes that in November 2008 COAG endorsed a set of principles and a process for jurisdictions to review and streamline their existing climate change mitigation measures, with the aim of achieving a coherent and streamlined set of climate change measures in 2009.

¹⁰ Productivity Commission, cited in Draft Report on p.172



Origin notes the Commission's finding that notwithstanding COAG's commitments, new climate change related measures are being introduced, or existing measures expanded, that do not appear to be consistent with the agreed framework.

Origin endorses the Commission's finding that states should review all climate change related programmes, and that measures additional to the CPRS should only be maintained where they generate additional net benefits for the community.

If you have any queries about this submission please contact Steven Macmillan in the first instance on (03) 8665 7155.

Yours sincerely

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