



30 August 2010

Ref: EPR0017

Mr John Pierce
Chairperson
Australian Energy Market Commission
BY EMAIL

Dear Mr Pierce

FIRST DRAFT REPORT - REVIEW OF THE EFFECTIVENESS OF COMPETITION IN THE ELECTRICITY RETAIL MARKET IN THE ACT

Origin Energy Retail Limited (Origin) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC's) first draft report (the report) on the review of effectiveness of competition in the electricity market in the Australia Capital Territory (ACT).

Origin is an active energy retailer in four jurisdictions around Australia and is regularly assessing the competitiveness of retail energy markets and considering its retail presence and market strategy accordingly. As such, Origin acknowledges the role of the AEMC's competition reviews in the National Electricity Market as important milestones for retail markets and offer unique opportunities to enhance retail competition and consumer benefits into the future.

Origin agrees with the conclusion that the ACT retail electricity market is subject to barriers to entry and that, primarily, the regulated tariff is set at a low level that has the effect of eliminating sufficient margins for a new entrant to recover its entry costs over a reasonable period of time.

Origin has regularly participated in consultative processes undertaken by the AEMC and the various State and Territory based regulators and on several occasions has raised its concerns with the failure to remove the transitional regulated tariff in the ACT market, as recommended in 2006¹, as well as aspects of the regulated price methodology. As such, Origin observed that if the regulated retail price in the ACT does not reflect the marginal cost of customer acquisition, it will likely have a detrimental effect on competitiveness and consumer choice.

After the introduction of full retail contestability, the ACT market steadily developed to 2006 when the Independent Competition and Regulatory Commission (ICRC) declared the market was competitive and recommended the removal of price regulation. Since that

¹ ICRC, *Final Report - Retail prices for non-contestable electricity customers*, April 2006



time, a progressive decline in competition has been precipitated by the failure of the regulated price to mitigate the pricing risks of retailers in the wholesale market as well as not aligning with new entrant costs. The AEMC's report observes market behaviours such as limited rivalry, low switching rates and retailer market exits which support the draft findings of the AEMC.

Origin also accepts the draft finding of the AEMC regarding the transparent funding of social welfare and equity objectives. It is rational to conclude that the inclusion of considerations in Section 20(g) of the *Independent Competition and Regulatory Commission Act 1997* to establish the efficient price does allow social objectives to obscure the cost build-up process and consequently have the effect of holding the price level below competitive levels. Accordingly, social objectives strictly applied in a price setting scenario appear to be at the detriment of new entrants and impede the development of competition.

The evidence of firms entering the ACT retail market between 2005 and 2008 and taking up to 9 per cent of the small customer market shows several retailers saw the ACT market as an attractive proposition. Yet, no more than two years later in the 2009-10 period, it appears that there are no second-tier retailers actively promoting or seeking small market customers. This competitor behaviour suggests there are flaws in the current market mechanism.

Given retail price levels are below that expected in a competitive market and price adjustments are lower than neighbouring NSW small customer prices, there appears little cause for customers to be disgruntled. However, this is further evidence that short-term social objectives have been given too much weight in the price setting process to the detriment of long-term market outcomes.

Origin believes the apparent decline in competition in the ACT market is a disappointing outcome for energy markets and proves a retrograde step for the National Electricity Market. The obvious way forward is to promote the growth and development of competition through initiatives designed to remove existing barriers to entry, and this will form part of the stage two of the AEMC review process.

The competing interests of the current regulatory policy in the ACT between offering an efficient price and taking account of consumer impacts of price increases has distorted the regulated price. In this regard, the current price direction mandate and a competitive market in the ACT remain mutually exclusive concepts. Consequently, effective competition in the ACT may prove difficult while price regulation exists.

It is submitted the review process does not consider the unique situation where competition has failed in a retail energy market. For this reason, Origin believes² based on the decline of competition in the ACT market, the ACT review is one instance that price regulation should be phased out without the prerequisite declaration of effective competition. Whilst regulated prices remain artificially low the likely result for consumers in the future will be greater long-term price impacts to align with increasing retailer costs. However, regardless of future price levels a policy to continue with price regulation will not alleviate the regulatory uncertainty associated with price setting and may remain a sufficient deterrent for new entrants in the absence of more prevalent market activity.

² Noting this is not consistent with the form and procedure set out in the Australian Energy Market Agreement (AEMA), Retail Price Regulation (clause 14.10-14.14).



Origin notes that the structure of the ACT retail electricity market, with a single vertically integrated incumbent holding a dominant market share, is unique in Australia. The only other fully contestable jurisdiction with vertically integrated businesses, New South Wales, at least has three active incumbents, thereby providing a base-line for competitive activity. In this context the current ring-fencing arrangements in the ACT may require additional consideration in the context of facilitating effective competition.

Thank you for the opportunity to provide input into the consultative process undertaken by the AEMC. Origin is pleased to contribute to the ongoing development of competitive energy markets and accordingly, will continue to assist the AEMC with this review.

If you have any questions, please contact me on (07) 3028 5300.

Yours sincerely

A handwritten signature in blue ink that reads "Madonna Mead". The signature is written in a cursive, flowing style.

Madonna Mead
Regulatory Pricing and Policy Manager