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1 May 2019

Ms Sarah Sheppard
Direct Energy Consumer and Affordability Branch
Department of Environment, Land, Water and Planning
PO Box 500
East Melbourne VIC 3000

Email: retailmarket.reform@delwp.vic.gov.au

Dear Ms Sheppard

**RE: VICTORIAN DEFAULT OFFER – DRAFT ORDERS**

Origin Energy appreciates the opportunity to provide a submission in response to draft Orders in Council to implement the Victorian Default Offer.

We retain our view that that the best method to address the Government's concerns relating to consumer engagement and standing offer prices is not through price regulation. Notwithstanding the risks associated with the re-introduction of price controls, we accept that this is the path the Government has chosen. What is now important is to limit the risks of this approach by ensuring that the regulatory framework adopts the principles of best practice regulation.

Minimising regulatory risk requires a framework that provides market participants and consumers with certainty and consistency regarding how decisions will be made and implemented. It also requires providing regulated entities with a reasonable opportunity to recover their efficient costs and being afforded reasonable timeframes with which to meet their regulatory obligations.

These principles are evident in the Federal and State Governments Australian Energy Market Agreement (AEMA) that states that the imposition of retail energy price controls should, to the extent possible, not hinder further development of competition and ensure that the benefits outweigh the costs. This principle that regulation should provide net benefits to consumers is also contained in the Essential Services Commission Act 2001[1] and the National Electricity Objective.

We believe the proposed Draft Orders do not adequately require the Essential Services Commission (ESC) to undertake a cost benefit assessment of the proposed price controls. Failure to perform this assessment may result in certain cohorts of customer benefiting at the expense of others. This is contrary to the long-term interests of all consumers, which is the objective of the ESC.[2]

We also believe that the Government needs to consider the impact of the timing of the VDO and the Order in Council with other regulatory obligations. The VDO and the Order in Council are yet to be finalised. While retailers can make system and billing upgrades these can only be finalised once a final decision is made. In addition, there are a number of separate obligations that come into effect on 1 July 2019 that require significant system upgrades, including the clear advice entitlement, bill change notice,

[1] See section 8A.
[2] See section 8 of the Essential Services Commission Act 2001.

best offer on bills, and GST inclusive billing. In addition, changes to the Energy Retail Code to support the Victorian energy fact sheets to come into effect on 1 July are yet to be finalised.

There are also national obligations that are not compatible with the Victorian reforms such as the Australian Energy Regulator's Default Market Offer (DMO) and reference price, which also commence on 1 July 2019.

We are concerned that the ability of retailers to implement these reforms has been considered independent of one another and not collectively.

The cumulative impact of these reforms is a significant, particularly given the short lead-in times provided. The short timeframes mean that retailers are forced to undertake expeditated processes to ensure they can go live on the specified dates. Without adequate time to undertake robust implementation and testing that we would normally adopt, there is a greater risk that there will be errors which means that the reforms may not operate on 1 July 2019 as intended. As a result, customers may not receive the experience they expect and deserve.

We believe the Government ought to apply a more flexible approach to how these reforms are delivered. This could include allowing a staggered approach to prioritise key reforms first with less critical reforms to follow. In this way all reforms could be completed by the time the ESC has powers to directly determine prices for the VDO in future periods.

Finally, given the potential risks to the competitiveness of the market and those most engaged consumers, we believe an assessment of the effectiveness of the VDO framework should take place no later than every two years.

Origin's responses to specific issues raised by the Department are set out below.

***Is the objective in clause 3 of the draft section 13 Order clear and appropriate?***

The Terms of Reference issued by the Government to the ESC for the purposes of calculating a VDO to apply from 1 July 2019, include the objective that the VDO should be calculated in a manner '…without impeding the consumer benefits experienced by those most active in the market'.

The objective included at clause 3 of the Draft Orders ignores this requirement. Furthermore, clause 11 of the Draft Orders remove the application of section 33(4) of the ESC Act applying to the ESC in the development of a VDO. This clause requires the ESC in making a determination to ensure that: a) the expected costs of the proposed regulation do not exceed the expected benefits; and b) the determination takes into account and clearly articulates any trade-offs between costs and service standards.

We believe that the Orders must reflect and be consistent with all the obligations set out in the ESC Act. To do otherwise will result in a fragmented regulatory framework and erode the fundamental principle of regulatory certainty and thereby create regulatory risk.

***Does Clause 6 of the draft section 13 Order adequately give effect to the VDO for the initial period from 1 July 2019 to 31 December 2019?***

The Terms of Reference issued to the ESC only applies to consumers on standing offers comprising flat tariffs (and flat tariff with controlled load) for the period 1 July 2019 to 31 December 2019. The Draft Order provides that standing offers comprising other types of tariffs will not be subject to price regulation for this period, however, customers will be able to opt-in to the VDO.

During the regulatory period on or after 1 January 2020, the standing offer tariffs must comply with any future VDO determination.

We are concerned that under these arrangements, a customer with an underlying flexible (i.e. TOU or demand) network tariff could seek access to a flat tariff VDO. Under these circumstances the financial risk of a mismatch in tariffs would reside with the retailer.

To avoid this risk, any underlying network tariff should mirror the regulated retail tariff.

***Does clause 9 of the draft 13 Order appropriately reflect the objectives of the VDO? What would be the implications of the alternative option – the VDO continuing to be a flat tariff (or flat tariff with controlled load tariff) only?***

Clause 9 of the Draft Orders allows the ESC to determine prices for a VDO or the manner in which the prices a retailer may charge are to be determined or calculated.

As a result, the Draft Orders provide an element of discretion regarding how a VDO could be derived.

On the one hand it could allow the ESC to adopt an AER DMO style approach where it sets an annual reference bill for the retailer to determine their own tariffs. On the other hand, it could apply a method similar to that adopted in the current VDO determination where the ESC determines a specified value.

It would be preferable for the ESC to maintain a consistent approach that adequately takes into account a retailer's costs, as provided for in section 33 of the ESC Act.

***Does the approach and methodology specified in clause 11 of the draft 13 Order appropriately reflect the objectives of the VDO? Are there any other matters the ESC should be required to consider in setting prices for the VDO?***

Origin considers that the objectives need to be expanded to capture the intent for the VDO not to impede the consumer benefits experienced by those most active in the market.

A key precondition to achieve this outcome is for the VDO to be set to provide a reasonably priced safeguard option but also at a level that still supports the development and maintenance of competition. The VDO needs to be set at a level that will allow efficient retailers to compete beneath the level of the VDO while still earning a normal return on capital. We believe this is best achieved through the inclusion of headroom and the selection of appropriate cost benchmarks.

Introducing a regulated price carries significant risks to the efficient operation of a market from regulatory error. If the VDO price is set too high, then we would expect more intense competition will compete away any excess margin over time. However, given the requirement to exclude headroom and only include modest customer acquisition and retention costs, this outcome is unlikely. On the other hand, if the VDO price is too low, then this will more likely to negatively impact competition.

In its advice to the COAG Energy Council on the customer and competition impacts of the DMO, the AEMC noted that retailers use market segmentation to compete. Where a regulated price is set below a retailer's standing offer, the retailer may seek to offset these losses by reducing the level of discount available on market offers. As a result, this creates a risk of convergence to the regulated price. The AEMC noted that when price regulation was re-introduced into the United Kingdom, there was a significant reduction in price dispersion.

Given the magnitude of the potential risks of regulatory error, we believe the ESC ought to conduct similar sensitivity analysis as part of a cost benefit assessment that ought to form part of the objectives set out in the Order in Council.

***Information on Customer bills***

Section 7 requires a retailer's electricity bill to include information about how the customer may access the VDO. This information must be in plain English and prominent on the electricity bill.

We also note that under the clear advice entitlement amendments to the Energy Retail Code, retailers are also required to provide customers with a deemed best offer message prominently displayed on the front page of their bill.

In addition, changes to the Energy Retail Code to support the Victorian energy fact sheets also come into effect on 1 July 2019.

Notwithstanding the pressure these cumulative reforms have on the ability of retailers to have systems and process completed and operational for 1 July 2019, we are concerned about the magnitude of information now being presented to customers in separate parts of their bill.

We believe the Government ought to consider allowing the retailers the flexibility to determine how best to present information regarding the VDO; whether this is incorporated in the same bill message box or separately, as long as the minimum requirements of the messaging are fulfilled.

This will alleviate some pressures on retailer system upgrades, but more importantly is likely to result in a better customer outcome as retailers are better placed to understand what messaging is likely to be more effective for their customers.

***Will the approach proposed in clauses 14 and 15 adequately meet the Government's intention to enable discounted offers to be easily compared? Is the proposed method for determining the estimated annual cost of offers in Schedule 3 simple and easy to use?***

We consider that it is necessary that any discount is expressed as the difference between the total cost of the VDO and the estimated total annual cost of the offer to which the discount or benefit is applied.

In this regard, we consider that it would be useful for the Order to provide more clarity regarding what is intended to be captured by the definition of benefit.

In addition, clause 14(2) requires that a retailer that offers or gives a discount or other benefit to a prescribed customer must disclose, prior to an offer being accepted or the commencement of the discount being given, any and We all terms and conditions that apply in respect of the discount or benefit including (but not limited to) the prices the customer will revert to if those terms and conditions are not satisfied.

This effectively duplicates the clear advice entitlement in section 70H of the Energy Retail Code, which commences 1 July. It is also unclear how 14(2)(c) impacts on explicit informed consent—the ESC has ensured that the clear advice entitlement does not negate EIC if it is not undertaken. As a matter of principle, there should not be two regulations trying to achieve the same thing as that conflict can create issues of compliance burden, conflict of laws etc.

***Is the proposed review period and approach appropriate?***

We believe the Orders should include a sunset clause and a mandatory annual review framework to regularly assess the effectiveness of the proposed price controls including whether it is delivering benefits or a market detriment. Given the risk of regulatory error to cause detriment to the market, especially those most engaged consumers, we believe this should occur no later than every second year.

*Closing*

Minimising regulatory risk requires a framework that provides market participants and consumers with certainty and consistency regarding how decisions will be made and implemented. A fundamental aspect of the Order in Council must to be to require the ESC to undertake the necessary cost benefit assessment of regulation to ensure it fulfils its legislative objectives and ensuring that the VDO achieves

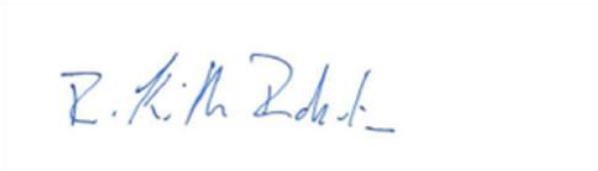
the balance between a regulatory safety net while at the same time not harming those most engaged in the market.

We also urge the Government to consider the number of reforms that the retailers are required to deliver by 1 July 2019 and the risks to delivering these. For these reasons we urge the Government to adopt a more flexible approach to timeliness by prioritising the implementation of key reforms and allowing flexibility with less critical reforms.

We look forward to working closely and cooperatively to support the Government finalising its Orders in Council.

If you have any questions regarding this submission, please contact Sean Greenup in the first instance on [redacted]

Yours sincerely



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