

26 March 2003

Mr Sebastian Roberts
A/g General Manager
Regulatory Affairs-Electricity
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2606

Attention: Sebastian Roberts

Dear Mr Roberts

REVIEW OF THE REGULATORY TEST- DISCUSSION PAPER

Origin Energy Limited (Origin) thanks the Australian Competition and Consumer Commission (ACCC) for the opportunity to provide an additional letter to this review.

First, however, Origin notes that the Essential Services Commission of South Australia (ESCOSA) has provided a submission on this issue effectively arguing for the removal of the regulatory test, leaving the decision on interconnects to governments. While Origin is sympathetic to ESCOSA's views on the complexity and difficulty associated with modelling the costs and benefits of investments in transmission, Origin strongly disagrees with replacing an economic basis for determining such investments with a non-economic politically driven one. Origin is concerned that customers will be required to pay via TUOS for inefficient costly investment without the ability to avoid such costs.

Origin is also concerned about the adverse market impact of non-economic transmission investment. Transmission investments may have significant and irreversible commercial impacts on market participants since transmission is often in direct competition with generation and therefore the allocation of resources to this investment are much too important to be left to a non-economic process. Any lack of rigour and bias inherent in a non-economic process also compromises principles of 'efficient' network investment that require the network be expanded only where there is a clear net market benefit of doing so, and the benefits exceed the alternatives such as generation or demand side management.

Removal of the regulatory test would significantly increase the potential for inadequate assessments of regulated investments, leading to excessive costs in the regulatory asset base, which are ultimately paid for by electricity customers. It could also significantly disadvantage innovative new 'non-regulated' developments in generation alternatives such as greenhouse friendly embedded generation and wind turbines. Origin has, and is hoping to continue to, invest significantly in these areas. However, an inadequate process for evaluating competing investment alternatives that is possibly open to jurisdictional influence and bias may generate considerable regulatory risk for market participants and will deter the investment and participation in the NEM.

Origin therefore urges the ACCC to strongly resist any calls for the removal of the regulatory test because the regulatory test at least imposes some commercial rigour on transmission projects that will be in direct competition to investments currently exposed to market risks.

This is not to say that the current Regulatory test could not benefit from considered review. Indeed, while Origin agrees with many of the proposals put forward by the ACCC for improving the test; nonetheless, a number of issues remain.

In the first instance, Origin does not consider that the Network and Distributed Resources (NDR) package meets the stated ACCC objective of "consistent application of the regulatory test across the NEM". Origin remains unconvinced that devolving the responsibility of applying the regulatory test to the various Transmission Network Service Providers (TNSPs) is appropriate, given they naturally have divergent and regionally focused transmission objectives. To the extent the test is interpreted differently by TNSPs it opens the way for it to be applied in an inconsistent and arbitrary fashion.

Further, and as Origin pointed out in an earlier submission, it is inappropriate that TNSPs who own the networks, and therefore have considerable stake in their expansion, are also placed in the invidious position of evaluating the investment alternatives to their own proposals. This leaves the process open to possible gaming and bias. Origin considers that such powers and responsibilities are best vested within a central, nationally integrated, transmission entity that would have no ownership rights over the network.

Therefore Origin is of the view that the NDR package is not the appropriate way forward for transmission planning in the NEM.

Origin also notes that in the discussion paper the ACCC provides little indication of its views on the value of a "market failure" test. Origin believes the application of the regulatory test should only occur as a last resort and therefore considers it imperative that sufficient time be allowed for market-based alternatives to come forward. The current minimum 6-month timeline is insufficient and needs to be extended to at least a 12-month period.

Origin also supports the notion that once this specified period has expired market solutions should not compete with regulatory options, as the current regulatory test allows. An appropriate sequencing is important; firstly, to prevent gaming in respect of attempts by market participants to delay regulatory developments by proposing non-committed market alternatives; secondly, it also raises moral hazard issues in respect of the lack of sufficient incentive for market providers to come forward in the initial period (they know they have two bites at the cherry).

Origin's final, and perhaps key, area of concern relates to a proposal to introduce a competition benefits test. Origin is of the view, despite the measurement options presented, that such benefits remain in fact impossible to reliably and accurately measure. Firstly, it would require forecasting the future bidding behaviours of generators over some specified period of time. It would also require predictions of how consumers would respond to lower pool prices. Both are highly subjective and therefore would leave the regulatory test open to considerable dispute and regulatory delay.

Moreover, given the low elasticity of demand of electricity it is likely that any estimates of lower pool prices will reflect distributional transfers from generators to consumers

rather than changes in net market benefits *per se*. It is Origin's view that it will be difficult, if not impossible, to disentangle net market benefits from distributional benefits on an *ex ante* basis and also determine the appropriate future time period over which such benefits should be assessed.

To conclude, Origin notes that one of the key rationales for Australia heading down the de-regulation path, following the Hilmer Report, was the inefficient use of capital by utility companies. Therefore proposals to exclude transmission investment, whether this be at an intra or inter-region level, from appropriate economic assessment risks seriously undermining the competitive basis on which the NEM was first initiated.

If you wish to discuss any of these issues further please do not hesitate to contact Con van Kemenade on 02 9220 6278

Yours sincerely

Tony
General
Public & Government Affairs

Wood
Manager