origin

24 February 2009

Mike Buckley
General Manager - Network Regulation North
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Dear Mr Buckley

NEW SOUTH WALES - DRAFT DISTRIBUTION DETERMINATION 2009-10 TO 2013-14

Origin Energy Retail Limited (Origin) is a second-tier electricity retailer in New South Wales and has been an active participant in the small customer market for the past two years. As an active retailer in New South Wales, Origin believes it is important for the Australian Energy Regulator to contemplate prospective views of other New South Wales energy market participants, particularly with regard to contemporary issues facing retailers and consumers.

Origin has formulated this response for the purpose of encouraging competition in services which are moving towards contestability and with a view to ensuring the distribution charges are efficient and cost reflective and avoid adverse impacts on retail pricing for small customers. Retailers are directly impacted where there is a disparity between the distribution charges and the regulated bundled retail tariff. Additionally, a retailer is the intermediary between the customer and distributor which empowers a retailer with information regarding customer perspectives. In this regard, Origin has a vested interest in ensuring the customer's points of view are properly acknowledged.

Origin, like many consumers and governments, actively promotes green energy initiatives to encourage a more environmentally conscience approach to energy consumption. This sentiment should apply equally to all energy market participants including consumers, retailers and distributors. Origin takes the view that the introduction of the carbon pollution reduction scheme (CPRS), state based energy efficiency schemes and other environmental initiatives will impact network businesses and is an important consideration for future network determinations.

For these reasons, Origin has raised some issues not canvassed in the draft decision as well as making general observations regarding the key outcome of ensuring the distributors are in a position to provide a safe and secure, efficient, cost effective distribution system for consumers.

As a general point, Origin's is concerned by the significant increases in proposed spending by Distribution Network Service Providers (DNSPs) in the next regulatory period and questions the need and ability of the DNSPs to undertake the proposed work program cost-effectively. Although Origin has not specifically referred to the decisions for Transgrid and ActewAGL, our general comments will apply equally to these decisions.

Origin Energy Retail Ltd ABN 22 078 868 425 • Levels 10, 119 Charlotte St Brisbane QLD 4000
GPO Box 484, Brisbane QLD 4011 • Telephone (07) 3405 9275 • Facsimile (07) 3405 9390 • www.originenergy.com.au

In this context, Origin Energy appreciates the opportunity to respond to the draft distribution determination 2009-10 to 2013-14 for New South Wales released by the Australian Energy Regulator on 21 November 2008 including the recently submitted Revised Regulatory Proposals from each DNSP. Our comments are set out and explained below.

Classification of Services

Origin submits meter services should be unbundled from standard NUOS charges. Such a change to the classification of services for NSW DNSPs will bring NSW in line with the current practice in Victoria and that determined by the AER in the Framework and Approach Paper for ETSA Utilities 2010-15 in November 2008.

It is noted the deemed classification of standard control services within the Transitional Rules (National Electricity Rules (NER)) does not unbundle metering charges from network use of system (NUOS) charges. However, whilst metering costs remain smeared within NUOS charges, it creates a significant barrier to the alternative provision of metering services. Accordingly, Origin believes that in order to promote contestability of small customer metering services, metering service charges need to be explicitly separated from NUOS[1].

There is an increased use of advanced metering infrastructure in the mass market, due to the improved service, increased information provision and other benefits the new technology can provide customers and the retail market. It is therefore important that retailers and customers have the option of accessing alternative metering services where there are commercial and competitive incentives to do so. Previously, Origin has used the example of the Adelaide Solar Cities project. As part of this project, 5000 small customers are receiving type 4 meters. Origin faces challenges with the installation of these meters. With regard to meter charges, Origin was in a position where payment to its vendors for meter provision and meter data services was necessary but was also liable for the smeared cost of basic meter provision and meter data services within the bundled NUOS charge, despite the DNSP owned meter and data services being replaced. Effectively, each customer has to pay metering provision and data service charges twice.

Origin takes the view that network businesses have a vested interest in encouraging innovative products and trials, such as that demonstrated by the PowerSmart program undertaken by Energy Australia. Additionally, the energy industry will benefit from small customers utilising metering technology as a means of managing energy consumption. If the NSW DNSPs were to unbundle these charges, small customers are more likely to voluntarily install a smart meter to better manage individual electricity consumption without the risk of incurring duplicate metering and data service provision charges.

[1] Origin understands that the MCE has provided a policy direction to the effect that distributors will be granted a monopoly for the purposes of a mandated advanced meter roll-out. However, (a) the NSW Minister has not made such a proposal at this time, and (b) the MCE has also indicated the need for flexibility in provision of metering services beyond the mandated roll-out period. Notwithstanding this, the separation of metering capital and operating costs from the costs associated with the provision of the network services generally, promotes transparency in the lead up to a mandated roll out period, and provides a mechanism to promote the long-term MCE objectives.

origin

Mass market rollout of interval meters

Origin supports the use of interval meters where it is cost effective to do so and there are net benefits to consumers, network businesses, retailers and the broader market associated with their use.

It is understood some of the NSW DNSPs are progressively installing interval meters to residential customers. As an example, Energy Australia has been installing interval meters for residential customers since 2006 on a new and replacement basis, approximately 50,000 customers each year[2]. Origin notes for instance that in addition to the interval meters already installed (some 260,000); Energy Australia intends to spend some $100m on "smart meters" by the end of the current regulatory period in June 2009[3]. As the capital costs and service standards associated with this are not transparent to the market, it is difficult to assess whether such investment meets standards of prudent and efficient investment within the current regulatory period framework, and whether the benefits and costs of this capital (and associated operating) expenditure are captured symmetrically in the next regulatory period.

Irrespective of whether the rollout of interval meters to all small customers will meet a cost benefit test, Origin supports a more transparent process for metering services and greater accountability for metering costs that exceed the prevailing minimum regulatory requirements for small customers.

Given the distributor provides metering services to small customers on an exclusive basis, it is reasonable to expect the metering charges are properly scrutinised and hence more easily comparable to metering services already available on a competitive basis. In addition, such transparent data will then assist the AER in assessing the DNSP reasonable costs associated with a mandated AMI roll-out.

Origin seeks to understand the recovery of costs associated with the progressive installation of interval meters. At present there is no transparency around metering charges or the cost recovery for interval meters. If the metering costs are smeared across all customers it is assumed that all small customers are paying for the interval meters regardless of access or utilisation.

Economic Outlook

The potential impact of the global financial crisis in Australia has only recently become apparent and the scale of the expected downturn was not clear during the AER's deliberations of the draft determinations. The outlook has not improved subsequent to the release of the draft decision. Given the current economic outlook, the AER is responsible to ensure price increases flowing to customers are fully substantiated. Origin submits the AER take further account of the economic downtown, in relation to capital programs, operating expenditures and demand forecasts with a view to ensuring expenditure for the next regulatory period remains at efficient levels.

---

[2] "Interval Meter Technology Trials and Pricing Experiments" at p19-20, accessed at http://www.isf.uts.edu.au/publications/riedy2006intervalmeters.pdf

[3] "Smart meter jolt", 18 July 2006 accessed at http://www.australianit.news.com.au/story/0,24897,19822428-15306,00.html

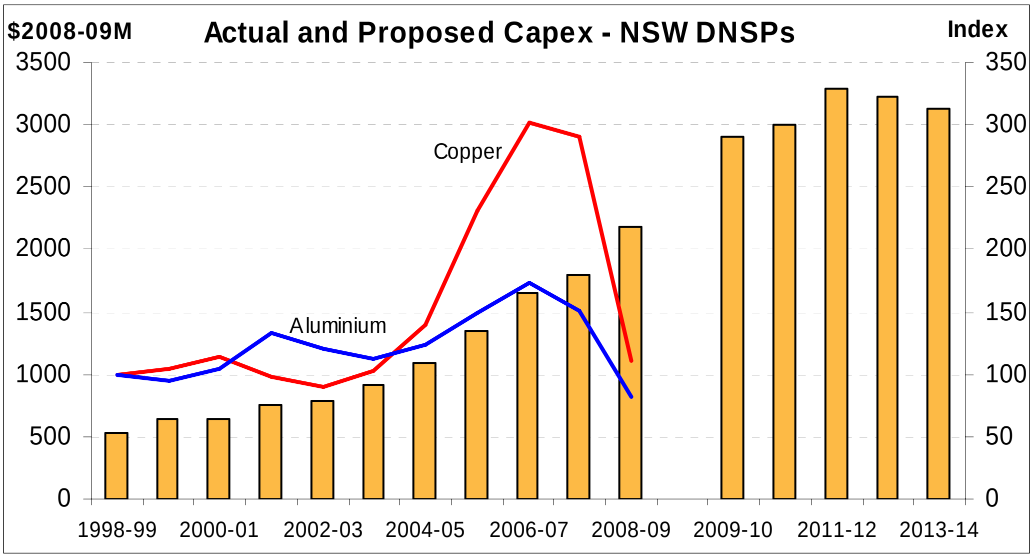
While Origin understands the issues raised by the DNSPs in terms of the difficulty businesses have in general in obtaining capital for investment, and more specifically, the spread between reserve bank interest rates and market interest rates; nevertheless market rates have declined in real terms since the Draft Determination, and we would expect this to be reflected to some degree in the Final Determination given that DNSP's have a regulated return on capital, unlike many other business entities.

Capital and Operating Expenditure

Origin supports economically efficient, cost reflective distribution charges to support a safe, secure network system. In this respect, Origin has reviewed the forecast expenditures for NSW distributors in the next regulatory period.

Origin notes that the proposed forecast capital expenditure for all NSW DNSPs in the next regulatory period, if accepted, will represent an increase of nearly double the current regulatory period. Additionally, the forecast operating expenditures are approximately 40 per cent over that spent in the current regulatory period.

Origin has concerns with the significant increases proposed and the resultant impact upon network charges. The significance of the increased capital expenditure and the impact upon distribution charges is demonstrated in the chart below which highlights the actual capital expenditure by NSW DNSPs over the last 10 years and the proposals for the next regulatory period. Origin has included price indexes for copper and aluminium, two major components of power supply assets, for comparison.



Source: ABARE 2008

It appears to Origin that the DNSPs have based their future capital expenditure and operating expenditure on the performance of the networks in the final years of the current regulatory period. This practice is not of itself unusual, however there are some doubts surrounding the expediency of capital expenditure in 2008-09 due to the nature of the roll forward methodology provisions (transitional chapter 6 rules, National Electricity

Rules) for the closing asset base. Specifically, the opening regulatory asset base for the next regulatory period is increased by the amount of capital expenditure incurred previously, not by the capex allowance. The substantial increase to capital expenditure in the final regulatory year exhibits a renewed vigour, on the part of the DNSPs, to improve the network assets.

It is therefore arguable that the expenditure in 2008-09 is not indicative of prudent spending and given the present economic outlook, is not an appropriate starting point for forecasting over the new regulatory period. Further doubt as to the suitability of this expenditure is raised by the capital expenditure trend over previous regulatory periods. The chart above shows a consistent progressive increase in expenditure, despite the high increase in costs over recent years and offers no explanation for why there is expected to be a sharp increase in 2009-10.

The consultant reports for the AER recognised the proposed capital and operating expenditure for all DNSPs for the next regulatory period are substantially above the levels projected for the current regulatory period. The increases have largely been attributed to real escalation in labour and materials and an increased scope of work to be performed. Whilst Origin Energy is not in a position to comment specifically on the increased scope of work, it is concerned with the predicted increases in labour and material costs based on earlier periods which suggests the data relied upon regarding labour and material cost growth is ceasing to reflect actual changes. Clearly all economic data is pointing to stable labour and reduced material costs (see copper and aluminium indices above) in 2009-10 compared with the 2006-07 and 2007-08 financial years.

The DNSP's have recently highlighted the impact of current economic conditions on capital raising and associated costs. To the extent this is taken into account (and given our qualifications above), then the impact of these same conditions should be considered in terms of the forward capital investment program.

A further issue relates to asset renewal, the draft determination identifies that a significant proportion of capital expenditure is attributable to asset renewals. It is not clear from data available in the decision whether the renewals have occurred before the end of the life of the assets. If this is the case, Origin queries whether the residual asset values have been removed from the asset base or how the residual value for the remaining life of the asset has been accounted for.

Origin requests the AER take account of these matters in respect of capital and operating expenditure with a view to ensuring the expenditures are economically efficient and based on achievable levels and consistent with economic growth generally.

Demand Forecast

Origin supports the draft decision to recalculate the proposed demand forecasts for the next regulatory period based on more recent actual sales revenue, however there are additional factors that must be considered to achieve realistic demand forecasts.

There has been greater recognition in recent years of the impact of energy consumption on the environment. Key policy decisions to combat environmental impacts of energy consumption were made in 2008 which has been largely driven by environmental advocates and growing public concerns. As a result, initiatives such as the carbon pollution reduction scheme (CPRS), energy efficiency schemes, appliance efficiency improvements, individual consumer awareness and conservation measures and DNSP demand management initiatives have emerged. All these measures are targeted at reducing traditional energy consumption.

Origin believes that these measures may significantly impact future electricity demand and indeed, the CPRS White Paper, released in December, indicates a reduction in energy consumption. As such, these measures may override previous growth trends in energy consumption and demand growth.

It is recognised the exact impact of these measures is uncertain. The uncertainty will also extend to the consumer response to retail prices and the impact of improved information flows achieved through more accessible smart metering technology. However, it is noted the proposed annual growth forecasts for each DNSP appears largely unaffected from previous years. Origin requests the AER ensure its review of the forecasts submitted by the DNSPs take these matters into account.

Thank you for considering our response. If you would like to discuss the issues raised please telephone myself or Madonna Mead on (07) 3867 0617.

Yours sincerely

B J Hughson

Bev Hughson
National Regulatory Manager- Retail
(03) 9652 5702 - Bev.Hughson@Originenergy.com.au