

4 April 2008

Mr Gary Henry
Director
Queensland Competition Authority
GPO Box 2257
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by email: gary.henry@qca.org.au

Dear Mr Henry

Draft Decision: Benchmark Retail Cost Index for Electricity: 2008-09

On 29 February 2008, Origin Energy (Origin) provided comment to the Queensland Competition Authority (QCA) on their *Draft Decision: Benchmark Retail Cost Index for Electricity: 2008-09*.

Subsequently, Origin greatly appreciated the opportunity to discuss the matters raised in its and other market participants' submissions in the Workshop held by the QCA on the 27 March 2008. Origin acknowledges that the workshop allowed for more extensive discussion on each of the main components of the Benchmark Retail Cost Index (BRCI).

The workshop also provided some useful insight around the methodology used by both the QCA and its consultant, Charles Rivers Associates (CRA) which hitherto had not been transparent to us. However, Origin would like raise several issues pursuant to the workshop, noting here that important new matters have come to light in recent weeks, affecting the calculation of the two key cost components of the BRCI, energy costs and network costs.

First, several items were raised within the workshop that Origin was of the understanding that the QCA would consider actioning prior to the release of its Final Decision in the interests of transparency for all affected parties. These were releasing:

- revised versions of the BRCI calculation tables (eg. Tables 3.1 and 6.2) from the Draft Decision that would take account of the revised Delegation provided by the Queensland Government in mid March 2008;
- further explanation by CRA of the energy purchase cost component of the energy cost modelling; and
- a summary that provided a clear understanding of the differing definitions of Queensland or state NEM Load used in the calculations and specific indications of which NEM Load figures were used in each component of the BRCI and where different interpretations apply, the basis for this difference.

Origin requests that the QCA provide this information as soon as possible.

Upon further consideration, and given that CRA only identified modelling errors in the Long Run Marginal Cost (LRMC) at the workshop itself, Origin believes it would greatly assist the transparency of the process if the revised tables could also include the impact

of the LRM C modelling corrections on the energy costs. Origin would appreciate this revised table being provided as soon as possible. We understand therefore that the new energy costs in the requested table may not incorporate revisions to the energy input costs in the LRM C calculations (ie would reflect only the corrections to the model). It would therefore need to be clearly marked as a corrigendum to the Draft Determination, not the Final Determination.

Secondly, Origin would like to record its understanding of other significant issues that came to light within the workshop and that the QCA and CRA agreed to address within the Final Decision.

- 1) That CRA will carefully review the input costs used within the LRM C modelling.

Origin notes the supplementary submission by AGL which includes analysis by ACIL Tasman on LRM C. Origin understands the March 2008 ACIL study updates the assumptions and consequential conclusions in the ACIL 2007 report. We also understand that the 2008 update was undertaken within the same analytical and conceptual framework as the 2007 ACIL study. Thus the concerns expressed by CRA with respect to comparison of the 2005 and 2007 ACIL study should not apply here. Moreover, we note that while the 2008 ACIL study is new, and has not therefore been widely circulated, the 2007 study (which is based on the same approach - see above) represents the industry benchmark in terms of the approach to assessing new generation costs.

Origin generally supports the 2008 analysis by ACIL particularly with respect to the changes in cost inputs and believes the range of cost increases in the report are consistent with both Origin's own industry experience and with the references cited by Origin in our response to the Draft Determination. Therefore Origin strongly urges the QCA and CRA to take the new ACIL analysis, and other references, into account in the Final Decision.

- 2) That the QCA and CRA acknowledge the higher volume/price risks arising from the energy purchase cost modelling approach and the higher cost of capital within the marketplace and that its impact is taken into account in an increase in the retail margin or, in the alternate, in the retail operating cost and cost of energy components of the BRC
- 3) That the QCA will review the figures used to incorporate the revenue impacts of ENERGEX's additional capital expenditure and consider amending them to remove the revenue over-recovery that was taken into account in the smoothing of the annual figures;
- 4) That the churn rates used by CRA in calculating the customer acquisition costs be further reviewed in the light of evidence from Victoria and South Australia, that churn rates do not decline over time (providing retail headroom remains relatively stable, consistent with the objectives of the process); and
- 5) That the QCA will come to a clear and transparent landing on the process for dealing with year on year changes. Methodological changes obviously require re-estimation of prior year figures in order for the BRCI to work as intended but Origin continues to be concerned with the re-estimate of previous elements of the BRCI were there is no significant change in method (eg. handling of TUOS and customer acquisition costs).

There are other matters that Origin raises in our previous submissions, such as the treatment of the Renewable Energy Costs given the confirmation of the expanded MRETS Scheme, and while we are not revisiting them in this letter, our views on these matters following the workshop largely stand.

Finally, Origin would take this opportunity to reiterate that the cost of energy should be weighted significantly more towards energy purchase cost than LRMC - that is, a 50 per cent weighting of energy purchase is a minimum. This was clear following the discussions within the workshop and the further clarification by CRA on the calculation of the energy purchase cost component of the BRCI. Origin now understands the high level of smoothing within this element as it is not only calculated over 24 months, it apparently mirrors a retailer hedging strategy with few significant events and minimal risks. Such a methodology produces an underestimate of a retailer's actual energy purchase cost so further smoothing with LRMC is not justifiable.

Origin does appreciate the efforts that the QCA has made last year and again this year to develop an acceptable BRCI methodology in line with the specific requirements of the *Electricity Act 2004*, the Electricity Regulations 2006 and the Ministerial Delegations. As a guiding rule in interpreting these requirements, Origin believes that the QCA's responsibility is to refer back to the fundamental policy objectives of the BRCI as set out by the Minister which, in summary, are to ensure that changes in the costs to supply energy are reflected in the energy price determination.

Specifically, one of the overall policy intents of the BRCI in the original, and repeated in the new Delegation, relates to retaining relatively stable retail headroom. This suggests that in addition to looking at each component in isolation, the QCA should consider the overall effect of all the BRCI. This matter was raised in the workshop and Origin believes it should form part of the QCA's considerations in the Final Determination.

Again, thank you for the opportunity to bring these matters to your attention. For any queries, please contact myself on (03) 9652 5702 or Patrick Wish-Wilson on (07) 3405 9424.

Yours sincerely

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Origin Energy Retail Ltd

(signed copy in mail)