30 March 2012

Nathan Petrus
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Dear Nathan

Re: 2012 AGL Application for Special Circumstances Review

Origin Energy (Origin) appreciates the opportunity to comment on AGL's *Application for a variation to the 2011-2014 Electricity Standing Contract Price Determination due to "special circumstances"* as submitted to the Essential Service Commission of South Australia (ESCOSA).

Origin is particularly interested in the outcome of this review given it is the largest energy retailer in Australia and an active retailer in South Australia.

Despite price deregulation being delayed in South Australia, ESCOSA's Relative Price Movement (RPM) methodology has been progressive in allowing competitive forces to derive future retail electricity prices. It has been unfortunate that unexpected network cost increases have complicated the initial workings of the RPM but to date, Origin is supportive of ESCOSA's handling of the necessary variations to its Price Determination.

As such, Origin supports further adjustment to the RPM cap to account for the impact of carbon costs and the additional increases in ETSA's distribution network charges in South Australia.

Origin has reviewed AGL's application and is generally supportive of its adopted methodology for estimating the impact of carbon. Origin believes the use of the average carbon intensity of the National Electricity Market (NEM) is the correct approach as:

- the NEM is a national market with strong interconnection between states and incorporates a financial sub-market;
- it is not possible to specifically identify where the electricity supplied to customers in South Australia is generated. State-based generation intensities reflect the carbon intensity of electricity generated in a state but do not reflect the electricity consumed in that state (eg. South Australia relies on electricity generated in Victoria, which has higher carbon intensity, in periods of peak demand and also when wind generation is not possible); and
- the carbon costs of individual retailers will vary depending on their physical supply portfolios as well as use of the financial market.

Origin would highlight that AGL's use of AEMO generation data to calculate the average carbon intensity results underestimates the actual carbon intensity because it is measured at the generator gate rather than the Regional Reference Node consistent with all other wholesale energy costs. While AGL has appropriately included the cost impact of transmitting energy from the Regional Reference Node to the customer via the application of distribution network losses the cost of getting the energy from the generator gate to the Regional Reference Node has not been included. Origin supports the average carbon intensity being calculated at the Regional Reference Node via the application of Marginal Loss Factors to AEMO's generation and emission intensity data.

Given this adjustment, Origin believes AGL's approach is reasonable, especially when it is recognised that:

- this approach is being used to adjust the upper bound for the RPM methodology rather than attempting to set retail prices;
- market retail prices will be determined competitively and will generally sit below this level depending on retailer's individual cost changes (including carbon); and
- the RPM methodology will fail to provide competitive outcomes if the change in the upper bound is not sufficient to meet the change in the cost of supplying electricity for individual retailers.

As mentioned by AGL in its application, there will be many other additional costs faced by retailers due to the introduction of the carbon price including, but not limited to:

- Upstream Supply Chain Emissions. The major carbon cost for generators is attributable to the emissions directly released at the electricity generator. However, electricity generators are also exposed to increased fuel costs from the introduction of a carbon scheme and will look to pass on these costs;
- Specific capital and operational costs of retailers' implementing and then complying with the intricacies of the carbon pricing scheme;
- the increase in working capital costs associated with servicing the additional carbon price revenue, including borrowing costs associated with the lag in cash flows; and
- the general impact on retailers' operational costs due to higher energy charges resulting in higher charges for goods and services in the economy.

Origin recognises that these cost impacts are difficult to quantify but they are significant and will need to be considered by retailers in the setting of competitive retail electricity prices. However, it is not imperative to include these additional cost impacts if ESCOSA uses the average NEM carbon intensity at the Regional Reference Node to adjust the upper bound of its RPM methodology. In this instance, the resultant increase in cap should be sufficient to provide for competitive retail pricing.

If you have any questions regarding this submission, please call Patrick Whish-Wilson on (07) 3867 0620.

Yours sincerely

Brendan Manzie
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