MINISTERIAL COUNCIL ON ENERGY

STANDING COMMITTEE OF OFFICIALS

NATIONAL ENERGY MARKET REFORM PACKAGE

- **STREAMLINING OF THE CODE CHANGE PROCESS**
- **AER-AEMC-ACCC MEMORANDUM OF UNDERSTANDING (MOU) FRAMEWORK**
- **APPLICATION OF THE INDUSTRY LEVY TO FUND THE AER AND AEMC**

SUBMISSION BY ORIGIN ENERGY

7th April 2004

Executive Summary

Origin Energy (Origin) would like to thank the Ministerial Council on Energy (MCE) for providing the opportunity for industry stakeholders to participate in the development of national energy market reforms. We hope that our views expressed in this paper influence the debate on the proposed reforms to the energy market. Origin has considerable experience both upstream and downstream in the energy industry, so we are well placed to provide comments on the practical aspects of the proposed reforms.

Origin supports the objectives of strengthening the national approach to regulation of the energy market whilst simultaneously dismantling the state regulatory authorities with the view to:

- regulating the energy markets using a consistent set of codes and rules regardless of the geographic location of business,
- harmonising regulatory approaches, and
- steering the national energy markets towards 'minimum necessary regulation' to achieve the objectives of effective and efficient outcomes for end users.[1]

While Origin is supportive of the objectives of the national reform agenda, we have a fundamental concern that the industry will end up with an additional layer of regulatory reform through the creation of the AER, without complete transfer of regulatory responsibilities and a reduction in funding to jurisdictions. Without effective rationalisation, financial accountability and governance, the new regulatory framework risks becoming more costly and complex; this would defeat the key objective of the reform package.

Streamlining the code change process

Origin supports the proposed changes, subject to resolving concerns around participants' exposure to Trade Practices Act (TPA) risk.

MoU Framework

Origin agrees with the content of the proposed MoU. In addition to the work presented so far, we encourage the development of a parallel set of MoUs with state regulatory authorities. We would prefer to see confirmed commitment, from jurisdictions at the outset, to reduce their respective regulatory oversight. Without this, there is no guarantee to industry or end consumers that the package of reforms will lower the overall costs of regulation. If this reform package results in an increase in the regulatory burden and complexity, it will defeat the point of the energy reform agenda.

Application of the levy to fund AER and AEMC

Origin recommends that the charge is:

- designed to recover that subset of the total costs of energy regulation that applies to the variable ongoing costs of regulating national gas and electricity markets arising from work undertaken by AER and AEMC,
- reviewed regularly and be developed in line with the Productivity Commission's guidelines on "Cost Recovery by Government Agencies",
- separated for gas and electricity, and based on a per unit volumetrics, and
- levied on distribution and/or transmission entities.

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[1] COAG (1997) Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard-Setting Bodies p.9

1 Introduction

Origin Energy (Origin) welcomes the opportunity to present our views on the national energy market reforms under consideration by the Ministerial Council on Energy (MCE) Standing Committee of Officials (SCO).

Origin is a leading Australian energy company that supplies natural gas, electricity and liquid petroleum gas (LPG) to more than 2 million business and residential customers in Australia, New Zealand and the Pacific. Listed on the Australian Stock Exchange in February 2000, Origin is a participant in most segments of the energy supply chain including natural gas and oil exploration and production, power generation, energy retailing and trading (natural gas, electricity and LPG), and asset management services. Origin employs almost 3,000 employees and has more than 140 years experience meeting the energy needs of Australians. Origin sold about 201PJe of energy to customers in 2002/03.

Origin is submitting one response paper to cover the three consultation papers on streamlining of the code change process, AER-AEMC-ACCC memorandum of understanding (MoU) framework and the application of the industry levy to fund the AER and AEMC. As many of our views apply to each of the three topics that the SCO is seeking comments on, it is appropriate for Origin Energy to address each of the consultation issues in a single submission.

Origin is fully supportive of the objectives of the MCE energy market reforms, including the objectives that are most relevant for this consultation:

- strengthening national governance of the energy markets,
- streamlining and improve the quality of economic regulation across energy markets,
- lowering the cost and complexity of regulation,
- enhancing regulatory certainty,
- lowering barriers to competition, and
- promoting further introduction of retail competition.

Origin believes that the most efficient method of achieving a more competitive energy market, which is capable of delivering improved outcomes for consumers, is through the creation of a level playing field, without bias towards fuel sources and with fewer barriers to entry and where the unfettered interaction of demand and supply can allocate scarce resources through market forces to ensure maximum benefits to consumers.

As the energy markets mature over time, the need for regulation will diminish. Reduced regulatory involvement increases certainty in markets and investors are more likely to undertake the high-cost, long-term capital infrastructure investment that will ensure a secure supply of energy to meet future demand. There will be a point in time when national energy markets are sufficiently mature for regulation to be reduced to the most appropriate level. Regulation in itself is not the end goal.

In parallel with the establishment of new regulatory bodies, the industry needs to consider how future energy markets will function, what they will look like, what will be the indicators of a mature energy market that is ready for less regulation and how the existing regulatory bodies will transition to a narrower role. Any new regulatory bodies need to be structured with the aim of minimising regulation in the long term, especially in competitive sectors of the industry.

Unfortunately, the trend in Australia is for a rising volume of regulation at the Commonwealth level through legislation, an increase in the average length of legislation, as well as an increase in the number of subordinate instruments including statutory rules.

Similarly the volume of State/Territory and local government regulation has increased.[2] Over the last decade, "governments have tended to focus on the benefits of regulation to particular groups without giving enough consideration to the costs."[3] Origin expects that the MCE will proceed with care and diligence to develop a regulatory framework that reduces the incidence of regulatory costs imposed on the energy industry.

The proposed national regulatory approach should be designed to improve the operation of the national energy market. The national approach should aim to deliver efficiency savings to the benefit of energy consumers and deliver disperse benefits nation-wide, improving Australia's competitive position in the world economy. Origin hopes that a national regulatory framework will encourage the development and implementation of a more coherent national energy policy than the collection of individual jurisdictional approaches that industry participants now operate under.

The differences in regulatory rules across the states, as well as the different stages of market reform across the states, results in a complex web of rules that relies upon the varied success of a "ripple effect" of reactions across the states to implement reforms. Therefore the implementation of reforms has progressed slowly, intermittently and under a process of gradual adjustment, which has meant that potential benefits from a more structured national approach have been lost.

We would like to see the MCE reforms deliver:

- a reduction in the number of regulatory authorities in the states and territories
- harmonisation of the disparate regulatory rules and codes administered by the various regulatory authorities
- efficiency savings in regulatory costs across governments
- an increase in transparency/visibility in the regulatory environment
- improved accountability in the regulatory environment
- the appropriate application of cost recovery principles
- a simple funding arrangement for national energy regulation.

We have strong concerns that there is a risk that the Australian Energy Regulator (AER) and Australian Energy Market Commission (AEMC) will become new layers of regulation at the cost of end users because the jurisdictions will not transfer their regulatory responsibilities promptly and will not reduce the existing charges and fees levied on end users and industry. We are also concerned that there is no mechanism for financial restraint to stop a burgeoning of the new entities' budgets, especially given that industry and consumers are paying for them. Our concerns can be grouped under the themes of rationalisation, financial accountability and governance.

Rationalisation - We are concerned that the proposed changes for AER and AEMC will add to the regulatory burden in the industry, increasing regulatory costs. There appears to be no explicit and binding commitment between the AER–AEMC-ACCC and the state regulatory authorities that formalises the MCE agreement to transfer responsibilities from the ACCC and the states to the AER-AEMC. Since the levy will be charged to industry participants, Origin would like to see the structural framework include an instrument for obtaining the agreement of the state regulatory authorities to the reforms prior to the establishment of AEMC and AER. This could take the form of a parallel Memorandum of Understanding between AER, AEMC, ACCC and state regulatory authorities. Such an instrument would increase transparency in regulation of the energy market, improve regulatory consistency, provide a mechanism for harmonisation and help to steer the way towards achieving the goal of most appropriate level of regulation.

We anticipate that NECA will be abolished.

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[2] Banks, G (March 2003) "Reducing the Business Costs of Regulation: Address to the Small Business Coalition" Productivity Commission Canberra p2

[3] Ibid. p4

Accountability – There will need to be robust audit control processes in place for applying restraint in budgeting, evaluation of cost control mechanisms and assessment of cost effectiveness of programs. Because the charge is levied on different industry participants, there is no opportunity for the funders to directly influence the spending plans of the AER and AEMC. The kind of Parliamentary scrutiny that normally would be imposed when funding comes from consolidated revenue, such as through budget committees or funding grant reviews, are absent in this model. Similarly, the activities of the AER and AEMC are not subject to the private sector rigour of competition in the market place.

There are three areas of budget concern. Firstly, the AER, AEMC and ACCC budgets should be, in total, lower than the sum of the regulatory authorities they are replacing due to efficiency savings from a national approach. This may be a one-off initial saving. Secondly, developments in the market to review the need for regulation may reveal a reduced need for regulation as the energy markets mature and move towards full price competition. This should be accounted for through an annual reduction in the levy function. Thirdly if the metric is based on per unit of energy consumption and energy consumption increases over time, then the levy will raise an increasing amount of funding over time, which is not required for regulation. This should be accounted for through a reduction factor in the levy unit function that is linked to annual demand forecasts.

Governance – There is a separation of the source of funding from the reporting structures for the AER-AEMC. Therefore, if the activities of the AER-AEMC bodies expand beyond the COAG principles of 'minimum necessary regulation'[4], or management of the risk framework is insufficient, or the costs become out of proportion to the perceived needs for regulation, there may be issues regarding the ability to impose disciplinary measures or financial restraint. Since industry participants will pay for the costs of regulation, they will want meaningful opportunities for consultation. A consultative committee could be established with stakeholder representation to monitor the agency against performance measures, having access to adequate information on agency processes and costs. The national regulatory framework will need to incorporate an independent evaluation of the appropriateness of continued regulation in the energy sector over time as well as opportunity to consider whether regulation is the most effective and efficient approach to resolving a problem.

Origin anticipates that a robust national regulatory framework will be developed that will resolve the concerns raised above and that will achieve the main objectives of rationalising regulation to lower the costs and complexity of regulation, with the goal of achieving the most appropriate level of regulation in energy markets.

2 Streamlining of the Code Change Process

Origin supports the Ministerial Council on Energy's intention to streamline the Code Change Process, with qualified support for the proposals put forward. Origin is also supportive of the proposed model for achieving this. Origin notes that, while the proposed model appears to be capable of addressing market participants' main concerns with the current process, its success in this regard is heavily dependent on the role played by the ACCC in practice, and the implication of the proposals for the relationship between the Code ad the TPA.

There is general agreement that the current process is severely hampered by inappropriate involvement by the ACCC at the end of the process. A key strength of the proposed model appears to be that the ACCC's expertise would be integrated into the process at the beginning and in a less formal manner, with a quick review and sign off on competition issues rather than extensive supplementary submission process as occurs now. This coupled with a high degree of consistency between the "Prescribed Criteria" for assessing code change proposals and the Trade Practices Act should substantially minimise the likelihood of a final determination by the AEMC contravening the competition aspects of the Act.

[4] COAG (1997) Op. Cit. p.9

In theory these factors would obviate the need, in the vast majority of cases, for authorisation of code changes by the ACCC. However if this does not occur in practice, the proposed reforms need to be revisited.

There is a concern that the proposed code changes may expose participants to Trade Practices Act (TPA) risk. Other participants would be well within their rights to commence proceedings and seek remedy if they consider themselves to be affected adversely by any unauthorised code provision. Origin considers that the code change discussion paper has given too little attention to the extent to which this may expose participants to TPA risk.

3 Memorandum of Understanding Framework AER-AEMC-ACCC

Origin considers the establishment of an effective memorandum of understanding (MoU) between regulatory authorities essential to the overall effectiveness of national energy market reform. The potential benefits of reform, in terms of administrative savings and investment certainty, will be dampened if coordination, cooperation and consultation among rule makers, rule enforcers and market participants are not made as efficient as possible.

Origin is supportive of the proposed MoU with the exception of two critical omissions. Firstly, the nature of proposed governance reforms necessitates a transitioning from current, jurisdiction-based arrangements, to nationally-based arrangements. This means there is a key role for jurisdiction-based regulators, initially, in establishing the proposed framework. Origin strongly recommends the inclusion of jurisdiction-based regulators in the MoU and that these aspects of the MoU are accompanied by appropriate sun-set clauses.

Secondly, it is not clear in the MoU that the priorities of AEMC should override the priorities of the ACCC when it comes to any exchange of staff and resources between the two organisations. The ability of the AEMC to undertake its on-going work and meet its responsibilities should not be diminished by any transfer of resources to the ACCC. Since industry will be funding AEMC and the ACCC obtains its funding from the Commonwealth government, an exchange in resources should not result in a net transfer of funding away from the AEMC.

In Origin's view, the effective and timely transition from current governance arrangements to new governance arrangements is critical in terms of investor certainty. Regulatory uncertainty to date has stemmed from the fragmented, often inconsistent, regulatory approaches adopted by jurisdictional governments and their regulators. Ensuring energy supply reliability and security is largely dependent on providing investors with as much long term certainty is possible.

4 Application of the Industry Levy to Fund the AER and AEMC

4.1 General discussion

In December 2003, the MCE agreed to fund the AER and AEMC through an industry levy. The discussion paper does not seek industry comment on the advantages and disadvantages of an industry levy nor does it seek comment on alternatives to an industry levy. Therefore, although Origin has views on these matters, we will focus our consultation response on the issues raised for consideration by the discussion paper.

Having said that, we wish to note that there is an argument that national energy regulation should be funded from general taxation, such as currently occurs for the ACCC, rather than through a levy. The Productivity Commission recommends that the basic information product set of agencies should be funded from general taxation revenue rather than from

cost recovery. The basic information product set should be defined by reference to public good characteristics, significant positive spill-overs and other government policy reasons.[5] The public good nature of regulation in energy markets and the positive spill-overs for the economy are sufficiently high to argue that the day to day operations of the AER and AEMC should be funded through taxation revenue.

However, we accept the argument that regulatory costs should be recovered from industry to the extent that industry is a driver of costs and that the consumers of energy, rather than taxpayers, see the benefits of regulation. We agree with the objectives of the funding mechanism as outlined in the discussion paper. Origin particularly supports a funding solution that promotes:

- economic efficiency
- competition within and between each energy sector
- transparency for the stakeholders who financially support the funding mechanism
- financial responsibility
- the development of responsible behaviour by market participants, without excessive resource to appeals mechanisms.

We also believe that the levy and any other financial arrangements for the AER and AEMC should not be costly to administer.

Origin anticipates that the framework of all cost recovery mechanisms, including the levy, that will generate funding for use by the AER and AEMC will follow the cost recovery guidelines recommended by the Productivity Commission's *Inquiry Report into Cost Recovery by Government Agencies* (2001).

As a discussion paper, we recognise that the document contains preliminary concepts for debate and that substantial work still needs to be undertaken to address all the relevant issues.

We found that some crucial matters were not raised in the discussion paper. Of most concern is the omission to identify the locations of existing funds for energy regulation in the state and Commonwealth regulatory authorities' budgets. To ensure that the existing regulatory authorities relinquish responsibilities in energy regulation to the AEMC and AER, the funding allocated in state and Commonwealth budgets for energy regulation, as well as relevant funds raised through cost recovery mechanisms, will need to be removed, including that part of the NEMMCO levy that funds NECA and National Electricity Tribunal processes. There is also a substantial pool of finance generated from application and licence fees across the states that is currently used to fund regulatory activities. The introduction of a new levy should lead to a reduction in the licence fees that are currently charged to industry to reflect the transfer of regulatory responsibilities from jurisdictions to the AER and AEMC.

Without this reduction in the states and Commonwealth regulatory authority funds, a timely transfer of responsibilities is less likely to be achieved, resulting in an increase in the duplication of rules and codes and increasing the costs of regulatory in Australia. This would be the antithesis of the purpose behind the establishment of AER-AEMC and would represent a significant step backwards along the path for increasing competition in the energy markets. Origin is strongly opposed to the creation of additional regulation because it increases in the complexity of the market and increases costs to consumers and taxpayers as well as increases the regulatory burden to industry.

The second omission in the discussion paper is comment on the total size of funds required to be raised through the levy. Both streamlining code change processes and transferring

[5] Productivity Commission (2001) "Cost Recovery by Government Agencies: Recommendations and Findings" Recommendations 7.5 and 7.6 pages 4-5

regulatory responsibilities to the national bodies, will deliver efficiencies. The discussion paper does not raise the issue of efficiency savings. Streamlining the code change process will deliver immediate cost savings, such as from the ACCC budget. The transfer of responsibilities from the jurisdictions to the AEMC may occur more gradually, making estimation of the budget and therefore the size of the levy more problematic. There is also a timing issue of the collection of the levy occurring at the same time as the regulatory activities occur which hampers the estimation of how much funding is required and therefore what size the levy should be. Therefore the calculation of size of the levy should be estimated using data from the budgets of all existing regulatory authorities that are likely to transfer responsibilities, less the substantial savings from reduction in state regulatory responsibilities.

The third omission in relation to the funding levy is the temporal issue of reduced need for regulation over time as the energy sector matures. Rather than seeing the concept of a long-term levy enshrined in statutory legislation, Origin favours a funding approach that allows for flexibility to reduce in size over time and actively incorporates a cost reduction function that will impose increased cost restraint over time to achieve real reductions in costs.

4.2 Identifying the cost pools

We do not believe that the total costs of regulation incurred by the AER and AEMC should be recouped through the industry levy. The Productivity Commission recommends that “cost recovery arrangements should apply to specific activities or products, and not to the agency as a whole”.[6]

Costs to be recouped by non-levy cost recovery mechanisms

At the highest level, funding can be separated into fixed establishment costs and on-going variable operating costs. Establishment costs ought to be funded by governments to gain their commitment to a national approach instead of state-led regulatory framework.

Within operating costs, the discussion paper identifies regulatory service activities that will be attributable to a specific entity such as consulting advice, presentations or dispute resolution services. Such costs should fall outside the industry levy. Instead, the costs of these activities can be directly recouped by billing the entity for a fee including the direct and indirect efficient costs involved in undertaking the activity such as staff hours and administrative overheads.

Other costs that can be classified as extraordinary expenses from an accounting perspective ought to be funded by governments. This category includes defending an appeal. The costs of legal appeals are highly variable across years and cannot be reliably forecast. An industry levy is not the appropriate mechanism to fund this cost as it can lead to the temptation to overcharge to grow a pool for a legal challenge, which is an inappropriate and inefficient use of the levy.

Incremental revenue, such as revenue generated from publications and hosting industry conferences, should be offset against the costs of these activities guided by the principle of not-for-profit to focus the attention of the regulatory bodies on their core function of regulating the industry.

There is an argument that it would be useful for the AEMC to know the plans of prospective entrants into and existing participants in the energy markets and that a licence/registration system is the most straight forward way of gathering that information. If a licensing system is to be considered in addition to a levy, then the size of the levy should be reduced to compensate for funding generated through a licence. We are strongly opposed to the introduction of *additional* licences. We advocate the removal of local, state and territory

[6] Ibid. recommendation 7.2 page 4

licence systems to be replaced by national licence fees, with a commensurate reduction in the levy.

Application fees for code changes should not be considered. In the interests of promoting a regulatory environment that is open for all stakeholders to participate effectively, and the removal of barriers to entry, application fees should be abolished.

Operating costs to be recovered by an industry levy

Origin supports the concept of a levy used to generate funds to cover the costs of day to day regulation of the gas and electricity markets. Such day to day activities include code development and the upcoming Victorian Essential Services Commission electricity distribution price review.

The consultation paper on streamlining code changes proposes a code change framework that involves the ACCC early in the process of code change. Regular supply of information from the AEMC to the ACCC is integral to success of the reforms to the code change process and the MoU will establish the protocols for information exchange. Although the principles of user pays cost recovery would dictate that the ACCC should pay for the information and advice it receives from AEMC, Origin does not recommend that cost recovery mechanisms should be required between AEMC and ACCC. The main reason is that a requirement for charging could jeopardise the smooth and timely flow of information between the two agencies, which is not in the interests of the industry in general. However, equally, we do not want to see the industry-funded resources of the AER and AEMC financially drained by the ACCC for the purposes of compliance with its statutory obligations. There may need to be some annual budget balancing arrangement to net-off exchanges in resources.

In the interests of transparency, the calculation of the levy should be simple. The costs of gas and electricity regulation should be a clearly separated to avoid cross subsidies and to keep the levy aligned with user pays principles.

Where it is appropriate that a new function or activity is assumed by the regulatory bodies, such as extending the regulatory environment to natural gas industry participants, or extending the framework to include Northern Territory and Western Australia, then the levy ought to be adjusted upwards. Industry participants should be consulted before the levy is adjusted upwards.

In relation to common costs, we would like to bring to your attention the risk of cross subsidy between gas and electricity. Retail issues apply in common to gas and electricity so the retail costs could be apportioned equally between the sectors, whereas code issues will need to be attributed to either electricity or gas as appropriate. There may be a case for reducing the levy for gas one year if the regulatory focus in that year is on electricity issues and vice versa. Consideration will need to be given to the trade-off between increasing complexity in the levies versus the materiality of the costs to be apportioned.

4.5 Practical application of the levy and review arrangements

Where the levy has generated surplus funds, there should be arrangements for carryover across years to prevent end of year splurges that have happened in the past when funding was withdrawn if it was not used. The budgets for the following 5 years should be smoothed downwards to compensate for previous years' overestimations. Where the levy has generated insufficient funds the regulatory body must have recourse to borrowings from the Commonwealth government. Borrowings can be repaid by adjusting the levy upwards, in a symmetrical way with cost reductions. Industry participants should be consulted before the levy is adjusted upwards.

Origin would prefer that the recommendations of the Productivity Commission in relation to review of the cost recovery mechanisms were followed. In particular we consider it important that:

- the cost recovery arrangements should be subject to periodic review against the Guidelines every 5 years.
- The AER and AEMC should publish a Cost Recovery Impact Statement (CRIS), which is summarised in the Annual Reports and made available to Parliament.
- An independent review body should be appointed to assess whether CRIS adequately address the cost recovery Guidelines.

4.6 Which metric to use as a basis for collection of the levy

The Productivity Commission recommends that where it is not possible to charge a fee-for-service reflecting efficient costs, then levies may be appropriate but only where the basis of collection is closely linked to the costs involved.[7] We believe that the costs of regulation can be closely linked to the collection metric.

Origin considers that the most practical metrics to use for collection of the levy are volumetric (per unit charges) separated between gas and electricity. This split between the electricity and gas markets is consistent with aligning the costs of regulation with the markets in which regulatory activity is focussed. It may be the case that in one year, regulatory activity is concentrated on the gas markets and the following year electricity is under review. The use of one metric for each industry allows for two separate levies to be charged to industry participants and for the levy to reflect the costs incurred- at least through an ex-poste wash-up/carryover mechanism as described above.

Another advantage of volumetric measures is that they are relatively simple administratively. Since customers already pay according to the volume consumer, the levy could be added to the price, as a separate line item. We would expect that the charge per household will be relatively small, therefore the levy would not create any distortionary effects, especially since demand for gas and electricity is relatively inelastic.

Smoothing the budget of the AER and AEMC across years is also a useful mechanism for taking into account changes in energy consumption. Demand in energy consumption is forecast to increase. Between 2000/2001 and 2019/20 final energy consumption is forecast by ABARE to grow by an average of 2.3% per year.[8] Without any adjustment to the levy, this kind of growth in demand will result in an increasing pool of funds over time that is generated by a levy that uses a metric of per unit consumed. The levy function will need to contain a reduction factor linked to either actual ex post demand or forecast demand (with a balancing or wash-up mechanism) to keep costs below real growth.

The AER and AEMC will need to internally account for their direct activities on the basis of which sector, either gas or electricity, their work is principally undertaken in. There may be some work that can be attributed to both sectors.

Using the volumetric measures is an efficient approach because larger energy users will make a larger contribution to the overall costs of regulation, whilst they are likely to be the main recipients of the benefits of regulatory reform.

4.7 Where to levy the charges in the supply chain

Origin's considered view is that the most effective place to levy the charge to fund AER and AEMC is on transmitters and distributors. There are some compelling economic arguments for this.

Firstly, as noted by the MCE "economic efficiency should be promoted by attributable rule making and regulatory costs being borne by those industry participants who give rise to the costs."[9] One of the main justifications for regulation in the energy market is to ensure that

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[7] Ibid. recommendation 7.10 page 5
[8] ABARE Economics (2003) "Australian Energy National and State Projections to 2019-20" p.26
[9] MCE (March 2004) "Application of the Industry Levy to fund the AER and AEMC: Discussion Paper" p.5

natural monopoly entities do not take advantage of their monopoly position by engaging in non-competitive practices. Since transmission and distribution companies have natural monopoly characteristics, they are one of the main reasons for regulatory activity and therefore should be charged.

Secondly, Origin contends that the costs of retail regulation should become a smaller and smaller part of the overall costs of regulation because jurisdictions will be periodically reviewing the need for price caps, and they may ultimately find that retail price regulation is no longer required to deliver efficient and competitive outcomes. Therefore we expect that the burden of regulatory effort in the future will focus on distribution and transmission companies because of their natural monopoly characteristics. In the absence of price cap regulation, the portion of retail regulatory costs from total costs will be very small, so it would be inefficient to levy the charge on retailers. Instead it is efficient to levy the charges on the distribution and/or transmission entities, which are as close as possible to the source of the costs.

A third reason for charging the distributors and/or transmitters is that these organisations will each have opportunities to argue for cost pass through with the regulator. If they are not permitted by the regulator to pass through the costs in total, then each of the beneficiaries of regulation along the supply chain could be required to absorb some of the costs.

A forth reason, is that a charge on distributors and/or transmitters would be administratively simple. The levy could be rolled into the use of services (DUoS) charge and/or the transmission use of service (TUoS) charge. Regulatory authorities generally accept the principle that the DUoS and TUoS may be passed through to end users, through retailers, as a network component.

If the MCE is inclined to recommend that the industry levy is charged to retailers, Origin Energy can only support charges levied on retailers if mechanisms are in place to allow costs to be passed through to consumers. An explicit mechanism is needed that contains jurisdictional agreement to the transfer of regulatory responsibilities to the national bodies and that includes a strategy for re-allocation of regulation funding.

The mechanisms that would be acceptable to Origin are a complete removal of price regulations by jurisdictions or, within the current framework of price regulation, jurisdictional commitment that charges can be passed through.

Given that the energy market is heavily regulated, especially in retail prices, we are not confident that regulators will allow for the levy to be passed through to consumers. The discussion paper contends that retailers have skills in billing and recovering costs from end users. Whilst that may very well be true, Origin's ability to exercise these skills is severely limited by regulators in all jurisdictions through retail price caps. Our experience to date is that state governments and regulatory authorities have been reluctant to permit cost flow through to end users.

There is a substantial risk here for Origin that the retailers (possibly in combination with energy consumers) will bear the burden of regulation for the whole industry. We are strongly opposed to retailers absorbing the full costs of regulation. The benefits of regulation flow to all companies in the supply chain as well as to consumers so all participants should contribute to the costs of regulation.

Further work is needed to consider how to introduce regulatory charges to capture other interests in the market. Levying the charges by volumes on distribution and/or transmission companies will not capture all industry participants. Interests of self contracting users of energy and large wholesalers are omitted from the levy.