

31 March 2006

John Tamblyn, Chairman
Australian Energy Market Commission
Level 16, 1 Margaret Street
Sydney NSW 2000

By email: submissions@aemc.gov.au

Dear John,

SNOWY HYDRO AND MACQUARIE GENERATION PROPOSALS FOR REGIONAL CHANGE IN SNOWY REGION

Origin appreciates this opportunity to provide some comments on the proposed rule changes put forward by Macquarie Generation (MacGen) and Snowy Hydro (Snowy) with regard to amending the regional boundaries of the Snowy region. Given these proposals are alternative ways for addressing the same issue we thought it expedient and efficient to consider them together.

Both proposals seek to address a serious constraint between Murray and Tumut in the Snowy region. The Snowy proposal seeks to merge the Snowy region into Victoria and NSW so that the boundary between the two cuts across the constraint between Murray and Tumut. Murray generation would subsequently observe the Victorian regional reference price and Tumut generation the NSW regional reference price.

The MacGen proposal is seeking to replace the Snowy region with two new regions; a northern Victorian region and southwest NSW region, with Murray generation being allocated to the former and Tumut generation to the latter. Two new regional reference nodes would be created.

Origin prefers the Snowy proposal. Removing the Snowy region has the effect of placing a substantial additional increment of generation into both Victoria and NSW; which, as we argued in our submission to the LYMMCO consultation, would enhance the liquidity of trade and competition around the regional reference nodes in each of those states. This may be considered to arise for the following reasons.

First, more generation observes the same price signal which enhances competitive neutrality and reduces distortions in bidding; second, each generator has less ability to influence the price they receive for their output; and third, prices tend to be less volatile in larger regions, partly because of the first two points and partly because there is simply more trade around prices that reflect higher concentrations of generation and load. Finally, a fewer number of regions also means that fewer transmission paths need to be hedged by retailers, reducing basis risk and thereby encouraging interregional trade.

The MacGen proposal would have the opposite effects. Dividing NSW and Victoria into four new regions with two new regional reference prices will add to volatility and risk in the energy market and reduce competition. Significant new system and transaction costs will be imposed on retailers since they have to incorporate two new regional reference nodes into their contracts and mass market supply arrangements. This will also introduce

substantial complexity for retailers in ensuring customer prices in each state remain uniform in line with requirements by state governments. Further, a requirement by retailers to hedge more volatile prices in each of the four new regions will increase contract risk premiums with inevitable flow on impacts into consumer prices.

The removal of the snowy region would have no such impacts.

Origin also notes that the MacGen proposal seeks to address constraints more broadly in NSW and Victoria, hence the requirement for two new regions. However, addressing these other constraints with regional change appears to reverse the approach to congestion envisaged by the MCE. The MCE proposes a sequential process which begins with the introduction of CSP/CSC type arrangements to improve the price signals around constraints; followed by transmission investment if improved price signals do not reduce congestion; and only subsequent to this is boundary change considered on the basis of a rigorous cost benefit analysis.

The MacGen proposal should therefore await outcomes of the current regional boundary review consultation for guidance on the appropriate sequencing of measures for addressing congestion in respect of these other constraints.

This issue does not apply to the Snowy proposal, as it seeks to address a constraint which is already subject to a CSP/CSC arrangement and for which transmission investment has already been determined to be impractical. Regional boundary change therefore represents the only remaining option for dealing with this particular constraint; and is thus a far less contentious proposal in this regard.

Nonetheless, the underlying economic criteria for analysing the costs and benefits of regional change proposals have also not been settled upon and form the basis of another consultation running concurrently with this one: the Congestion Management Review. Origin acknowledges that the details underpinning the cost-benefit analysis of regional change need to be finalised before the Snowy proposal can be further progressed.

Once the Congestion Management Review concludes Origin urges the AEMC to quickly fast-track assessment of the Snowy boundary proposal. Given the likely net-benefits of this proposal identified above we consider the prospects for its implementation to be extremely high.

If you wish to discuss any of these matters further please do not hesitate to call Con van Kemenade on 02 8345 5278

Yours Sincerely,

Michael Hayes
Manager, Portfolio Strategy & Regulation