



24 January 2013

Mr John Pierce  
Chairman  
Australian Energy Markets Commission  
PO Box A2449  
Sydney South NSW 1235

Submitted online: [www.aemc.gov.au](http://www.aemc.gov.au)

Dear Mr Pierce

**EPR0026 - Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Price Floor**

Origin Energy (Origin) welcomes the opportunity to comment on the Australian Energy Market Commission (AEMC) Draft Report (Report) on the Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price. Origin considers the AEMC has accurately identified the limitations:

- under the current compensation framework through the eligibility criteria in the wholesale market; and
- it has in establishing cost recovery provisions in retail markets.

Origin agrees that the objective of this compensation framework (under NER clause 3.14.6) is to ensure sufficient incentives for generators to continue to supply energy during an Administered Price Period (APP). We also agree that the erosion of investment signals is an important secondary objective to ensure the ongoing reliability of supply while an Administrative Price Cap (APC) is in place. The compensation framework plays a key role in promoting reliable supply by ensuring generators are not disadvantaged financially by committing supply through an APP.

The AEMC's proposed methodology improves generator certainty around recovering efficient costs - both direct and opportunity costs - during an APP. A compensation framework based on cost recovery can provide greater certainty to generators compared to the current, more prescriptive approach, based on bid offers and the spot price. This is particularly relevant for generators with high and variable fuel costs, like liquid fuel and hydro power plant.<sup>1</sup>

Origin remains concerned, however, that on-going retail price regulation could restrict the ability of retailers to pass the cost of compensation through to customers on a regulated tariff. We consider the current items that could be included in a jurisdictional price determination may not include the cost of this type of compensation, potentially preventing retailers from being able to recover these costs.

*Wholesale market perspective*

The AEMC is correct in stating the current eligibility criteria for compensating generators "contain a number of ambiguities which reduce their effectiveness...centr[ing] around the

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<sup>1</sup> Origin has a vested interest in ensuring a clear and robust cost recovery process as its generation portfolio includes Mt Stuart liquid fuel plant in Queensland and the Shoalhaven hydro pump storage plant in New South Wales.

fact that the current criteria are based on the differences between spot prices and dispatch offers.”<sup>2</sup> Generator bids or rebids are not necessarily reflective of direct costs in all circumstances, but rather reflect a range of factors including physical plant characteristics and broader business portfolio considerations; some of these have been accurately identified by the AEMC<sup>3</sup>. Therefore, basing the eligibility or calculation of compensation on a bid offer or spot price is not appropriate.

Origin supports the AEMC’s position that “the eligibility criteria should refer explicitly to participants who have incurred net losses in direct or opportunity costs following the application of the APC”<sup>4</sup> after factoring total revenue received from the spot market. We also agree it is appropriate to keep a generator’s direct operational and maintenance costs confidential. As the cost of compensation is being passed through to Market Customers, however, it is not unreasonable to consult publicly on the methodologies and quantum of compensation for any opportunity cost claims. Opportunity costs are subject to greater interpretation and variation whereas direct costs are more likely to be transparent.

Origin agrees with the AEMC’s recommendations and considers the proposal could increase the certainty and timeliness for a generator to recover direct or opportunity costs incurred during an APP. Simplifying the eligibility criteria and process for cost recovery helps ensure the compensation objective is met efficiently and can strengthen investor confidence in the operation of the National Electricity Market.

#### *Retail market perspective*

In a deregulated energy retail market, retailers and customers have the opportunity to negotiate contracts, which can include terms around cost pass through events. This is an efficient outcome. In regulated markets, however, a retailer’s ability to recover compensation following an administered price event is determined by the jurisdictional price regulator; they set out the terms and conditions for cost recovery and pass through events through their pricing determinations. In that environment, retailers have uncertainty around efficient cost recovery.

Origin agrees with the AEMC that retailers should not be constrained from passing the cost of this type of compensation through to customers<sup>5</sup>. We consider, however, that current regulated retail tariff determinations may not allow for the efficient recovery of these costs from regulated customers; determinations for current regulatory periods may not be reopened or the cost of compensation may not be included in future jurisdictional price determinations.

We note the AEMC’s position that section 34 of the National Electricity Law (NEL) - relating to the rule making functions and powers of the AEMC - may not include matters related to retail pricing in the NER.<sup>6</sup> We appreciate, therefore, that it currently appears beyond the AEMC’s ability to require jurisdictional regulators to allow for explicit cost recovery provisions for to compensation amounts following an APP.

Origin considers that this restriction does not preclude the AEMC from offering its opinion on whether or not jurisdictional regulated pricing frameworks should allow for the efficient cost recovery of compensation following an administered pricing event. A

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<sup>2</sup> AEMC 2012, *Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price*, Draft Report, 29 November 2012, Sydney. p. 24.

<sup>3</sup> Ibid, p. 31.

<sup>4</sup> Ibid, p. 25

<sup>5</sup> Ibid, p. 48.

<sup>6</sup> Ibid.

positive statement of this nature would be consistent with the AEMC's position that retailers should not be constrained from passing on these types of compensation to customers. This is different from the AEMC stating that there are no specific mechanisms preventing the inclusion of compensation in regulated retail price determinations<sup>7</sup>.

Origin agrees with the AEMC that market-based retail contracts could allow for cost pass through provisions for compensation. Without full retail deregulation, however, there is uncertainty around the ability for retailers to recover the cost of compensation from all customers in jurisdictions where regulated retail tariffs remain; potentially resulting in cross-subsidisation among different classes of customers. To this extent, the surest method of ensuring the recovery of approved generator compensation is through retail price deregulation, which provides both retailers and customers with the flexibility to determine the most efficient way to fund those compensation amounts.

### *Conclusion*

Origin commends the AEMC's approach to improve the current compensation framework and arrangements. Linking the eligibility criteria for recovering a net loss through an APP to a compensation objective, which provides incentives to supply energy during an APP, is both logical and practical. These recommendations can increase the certainty around timely and efficient direct and opportunity cost recovery. Clarification of the cost recovery mechanism improves upon the current framework in the NER.

While we recognise that Section 34 of the NEL limits the AEMC in prescribing cost recovery in the NER, jurisdictional retail price regulation continues to act as a potential barrier to efficient cost recovery from regulated customers. While there are contractual options available in jurisdictions with retail price deregulation, similar flexibility is restricted in jurisdictions where retail regulation prevails. We consider it important for the AEMC to recognise this limitation in the current framework, even though it is beyond its ability to implement a solution itself.

Should you have any questions or wish to discuss this information further, please contact Hannah Heath (Manager, Wholesale Regulatory Policy) on (02) 9503 5500 or [hannah.heath@originenergy.com.au](mailto:hannah.heath@originenergy.com.au).

Yours sincerely,



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<sup>7</sup> Ibid, p. 57.