



21 July 2010

Mr John Pierce  
Australian Energy Market Commission  
Level 5  
201 Elizabeth Street  
Sydney NSW 2000

Dear Mr Pierce

#### **EPR0016 - DRAFT DECISION - Compensation Claim from Synergen Power Pty. Ltd**

Origin Energy Limited (Origin) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC's) Draft Decision on the Administered Price Period (APP) compensation claim from Synergen Power (Synergen).

Origin provides views on the following two issues in this submission: (1) the compensation mechanism; and (2) the challenges with the existing recovery process for the awarded compensation amount. We discuss these below.

#### **The compensation mechanism**

Origin does not have specific view regarding the total amount or individual components of the direct compensation being awarded to Synergen. We support the market design that enables the recovery of such costs during administered price periods, like that experienced in South Australia in between 29 January and 7 February 2009. This mechanism provides a risk management and investment incentive mechanism for generators operating in market stress periods.

#### **Challenges with the existing compensation recovery processes**

Origin considers, however, that there are some substantive challenges with the existing process for recovering compensation amounts from Market Customers.

First, the National Electricity Rules (NER), the relevant AEMC Compensation Guidelines<sup>1</sup> and Australian Energy Market Operator (AEMO) procedures provide retailers and other Market Customers with little or no clarity or guidance around the classification of the compensation recovery amounts. While these documents set out the methodology for determining recovery amounts and the timing under which AEMO must pay and recover the compensation, they do not state explicitly the nature of the cost or fee that AEMO charges the relevant Market Customers. At this stage, retailers know they may face a new cost, but the arrangements are not clear as to whether or not retailers can pass these costs on to customers.

The potential risk exposure could be significant. First, retailers are unable to forecast, hedge or directly influence administered price events. Putting an effective risk management strategy in place is thus challenging when the exposure to generator

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<sup>1</sup> "The Determination of Compensation Following the Application of the Administered Price Cap, Market Price Cap, Market Floor Price or Administered Floor Price Guidelines" (Compensation Guidelines).



compensation is unknown. Second, there is no cap on the level of compensation that the AEMC could award. This leaves retailers exposed to funding an unknown amount of compensation over which they have no control or an explicit cost recovery mechanism.

Origin considers that to promote market efficiency, the NER needs to provide retailers with sufficient mechanisms to manage wholesale market risks, including infrequent events like the application of the administered price cap. The cumulative price threshold and related administered price cap and floor price provide customers with a risk management instrument to protect against extreme and prolonged market price events. Compensation is a complementary risk instrument for generators over the same period. However, the absence of an explicit cost recovery mechanism for any associated generator compensation introduces a lesser, but potentially no less material, exposure for retailers.

When determining the level of compensation, the AEMC needs to consider explicitly the direct impact on Market Customers. In highly competitive energy markets margins are already slim so a large compensation amount could erase several months of normal margin. At an extreme, a substantive compensation award could place a smaller retailer into financial stress, potentially resulting in market exit months or years after the original administered price event. This would not promote efficient market outcomes.

#### Issues to consider in the AEMC's Final Decision report

In light of these concerns, Origin requests that the AEMC consider and respond to the following issues in its Final Decision:

- Clarify the existing arrangements for cost recovery, including the explicit classification of charge that the AEMO will levy on Market Customers to recover the compensation amount;
- Identify, assess and have regard to the effect the amount of compensation payable by Market Customers has on those participants when making the final decision on the level of compensation; and
- Identify any necessary changes to the Compensation Guidelines, NER or AEMO procedures to address the above, including the process for progressing any changes.

Should you have any questions or would like to discuss this submission please call me on (02) 8345 5250 or Hannah Cole on (02) 8345 5500.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Tim O'Grady".

Tim O'Grady  
Head of Public Policy  
Corporate Affairs