origin

Cost Pass Through Application to the Independent Pricing and Regulatory Tribunal for customers on Integral Energy Standard Retail Contracts

March 2012

Contents

Summary

This cost pass through application relates to the incremental costs incurred during the period 1 July 2011 to 30 June 2012.

On 24 February 2012, the 2012 Small-scale Technology Percentage (STP) was prescribed by regulation. The Government set the binding STP for 2012 at 23.96 per cent. The STP establishes the rate of SRES liability attributable to liable entities which is equivalent to a target of 44.8 million Small-scale Technology Certificates (STCs) for 2012.

As a result, Origin Energy (Origin) will incur a materially higher cost for the Small-scale renewal energy scheme (SRES) than that provided for in the *Final Report for Changes in regulated electricity retail prices from 1 July 2011* for its customers supplied on a Integral Energy Standard Retail Contract.

Accordingly, Origin seeks the Independent Pricing and Regulatory Tribunal's (IPART) approval for a positive pass through to recover the incremental costs associated with the purchase of STCs to satisfy the SRES liability directly related to the Integral Energy regulated supply.

At the time IPART made its final report for the 2011 Annual Review, the non-binding estimate for 2012 was 16.75 per cent. This was based on an estimated 24.7 million STCs to be created in 2012 and an estimated 6.4 million excess STCs to be carried forward from 2011.

The 2012 binding STP increased significantly predominately because of 22.5 million surplus STCs created in 2011. The excess certificates carried forward have resulted in higher SRES compliance costs for liable entities.

Origin's application for a Positive Pass Through is based on:

- a Pass Through Event occurring on 24 February 2012. The prescription of the STP for 2012 by regulation is a decision of an Authority and/or a change to Applicable Law within the definitions in Schedule 4, IPART 2010 Final Determination;
- the incremental costs of complying with the SRES liability for 2012 qualifies as a Pass through Event for 2011-12 year as the increased STC target substantially varies the risk placed upon a Standard Retailer to meet its SRES liability for its regulated load;
- the event meets the materiality threshold and therefore is a Positive Pass Through Amount which should be passed onto customers from 1 July 2012; and
- the efficient and incremental cost equates to $7.1 million and requires a pass through amount of $2.30/MWh in Integral Energy's 2012-13 retail electricity prices.

1. Background

1.1 Small-scale Renewable Energy Scheme

The Office of Renewable Energy Regulator (ORER) is a statutory authority established to oversee the implementation of both the Large-scale Renewable Energy Target (LRET) and Small-scale Renewal Energy Scheme (SRES) schemes.

The Renewable Energy Regulator is appointed by the Minister for Climate Change and Energy Efficiency to administer the schemes implemented by the *Renewable Energy (Electricity) Act 2000* (Act) and accompanying *Renewable Energy (Electricity) Regulations 2001* (Regulations). The Renewable Energy Regulator is assisted in his duties by ORER.

The purpose of the SRES is to encourage the purchase of solar water heaters, heat pumps, and small-scale solar panels by offering a financial benefit to owners through the assignment and sale of small-scale technology certificates (STCs).

Liable entities have a legal requirement to buy STCs and surrender them on a quarterly basis. There is no target on the number of STCs to be generated for a given year. The number of STCs to be purchased is calculated using the Small-scale Technology Percentage (STP) set annually in the Regulations. The obligation to set the STP in a given year falls upon the Minister pursuant to Section 40A of the Act.

Under section 40B of the Act, the Regulator must publish a non-binding estimate of the STP for the next two years before 31 March of each year. The estimate does not bind the Regulator, the Commonwealth or any other person.

The binding STP must be prescribed prior to 31 March of the year in which it applies (or the default STP will apply). The basis of the value of the STP is calculated on the estimated number of small-scale technology certificates that will be created for the year and the amount of electricity that will be acquired by liable entities for the year. As the value is an estimate, there is potential for variation in forecasting the number of certificates created in a given year. In the event of a variation, the scheme provides for certificates to be carried forward to the next period to enable all certificate holders to claim its value.

Prior to setting the STP for the current year, the Minister must take into account certain information, in particular, the amount by which the previous year’s estimate was exceeded by the creation of STCs in that year.

Once the STP is prescribed by regulation it cannot be changed. If the prescribed STP does not exactly match the STCs created in that year, ORER will recommend the Government adjust a later year to take the overall STC creation into account. In practice, this means that the additional certificates created in a prior year can be carried forward to the next year increasing the SRES liability.

1.2 IPART Allowance for SRES in 2011-12

The 2011 Annual Review undertaken by IPART determined the cost allowance for SRES liability in the first two quarters of 2012 based on the estimated STP published by ORER in March 2011. When IPART finalised the 2011-12 regulated prices, the 2012 estimate was 16.75 per cent. The final STP is 23.96 per cent.

The discrepancy between the March estimate for 2012 and the binding value is predominately due to the high uptake of solar and a greater surplus of STCs created in 2011 than expected. The STP for 2012 increased as a consequence of 22.5 million certificates being carried forward, thereby doubling the 22.3 million projected installations in 2012. This imposed a much larger cost on retailers than anticipated.

1.3 Basis of Cost Pass Through Application

IPART's Final Determination[1] sets out the requirements for the Cost pass through mechanism in Schedule 4.

By definition, a *pass through event* means a *Regulatory Change Event* or a *Tax Change Event*. The functions and obligations within the Renewable Energy Legislation fall within the ambit of a Regulatory Change. It is defined within Schedule 6 of the Final Determination as:

> ***Regulatory Change Event*** *means:*
>
> (a) *a decision made by any Authority;*
>
> (b) *the coming into operation of an Applicable Law; or*
>
> (c) *the coming into operation of an amendment to or revocation of an Applicable Law,*
>
> *on or after 18 March 2010 that has the effect of substantially varying:*
>
> (d) *the nature, scope, standard or risk of the Pass Through Services; or*
>
> (e) *the manner in which a Standard Retail Supplier is required to undertake any activity in order to provide the Pass Through Services, including obligations:*
> *(1) under any Customer Hardship Program (subject to paragraph (j));*
> *(2) arising as a consequence of any Last Resort Supply Event; or*
> *(3) under any Green Energy Scheme,*
>
> *but does not include:*
>
> (f) *the making of this determination;*
>
> (g) *a Tax Change Event;*
>
> (h) *any decision, determination or ruling in relation to Energy Loss Factors;*
>
> (i) *the phasing out of the Electricity Tariff Equalisation Fund (as defined in the ESA); or*
>
> (j) *the coming into operation or amendment of any Customer Hardship Program to the extent the Standard Retail Supplier's costs of compliance with obligations imposed under that program are funded by a government or third party.*

The prescription of the STP through Regulation qualifies as a *regulatory change event* as it:

- is a decision made by an Authority, or an amendment to an Applicable Law; and
- has the effect of substantially varying the nature of the Pass Through Services.

1.4 Materiality

For an event to be a *positive pass through event* it must result in an increase in the costs of a Standard Retail Supplier that exceed a threshold of 0.25 per cent of the total revenue arising from the regulated retail load.

This pass through event meets the materially threshold test as defined in the Final Determination.

[1] Review of regulated retail tariffs and charges for electricity 2010 -2013, March 2010

2. Cost Pass Through Application

Origin is seeking a positive pass through for the increased compliance costs for SRES as allowed for under Schedule 4, Section 3.1 of the Final Determination[2]. In seeking this cost pass through, Origin is required to provide notice to IPART specifying:

(1) details of the Positive Pass Through Event;

(2) the date the Positive Pass Through Event occurred;

(3) the increase in costs as a result of the Positive Pass Through Event;

(4) the total amount the Standard Retailer Supplier proposes to pass through to Customers;

(5) the amount the Standard Retailer Supplier proposes to pass through to Customers in each Year; and

(6) the proposed date of commencement of the pass through if the Standard Retailer Supplier proposes to commence pass through on a date other than 1 July of the following Year.

These items are addressed below.

2.1 Details of Positive Pass Through Event

On 24 February 2012, the Government released the binding STP for the 2012 calendar year of 23.96 per cent. The STP establishes the rate of SRES liability attributable to liable entities. Individual annual STP liabilities can be determined by multiplying the relevant acquisition (in this case, the retailer's regulated load) by the STP.

The IPART Annual Review for 2011 considered SRES costs (as part of the green cost allowances) as a component of total energy costs for 2011-12 electricity prices. The binding STP is significantly higher than the non-binding target of 16.75 per cent used by IPART in the setting of retail prices for 2011-12.

The 2012 target comprises:

- An estimate for 2012 installations of 22.3 million STCs; plus
- the carry forward of surplus STCs from 2011 of 22.5 million.

Table 1 sets out the binding and non-binding STP values for 2011 and 2012 as at February 2012 that are relevant to this cost pass through application.

Table 1: Small-scale Technology Percentages

Calendar Year	IPART Annual Review (2011)	Non-binding (Dec 2011)	Binding STP (Feb 2012)
2011	14.80%	-	-
2012	16.75%	23.95%	23.96%

IPART has previously acknowledged if the prescribed STP for 2012 was materially different to the obligation assumed in its 2011 Annual Review[3], the cost pass through mechanism may account for these changes. Origin supports this position and believes the additional cost,

[2] Review of regulated retail tariffs and charges for electricity 2010 -2013, Electricity – Final Determination, March 2010

[3] Page 45, IPART Annual Review of the total energy cost allowance, "Changes in the regulated prices for 1 July 2011"

above the non-binding estimate used by IPART, should be passed through to customers in 2012-13 regulated prices.

The prescribed STP for 2012 is a positive pass through event as it meets the definition of a regulatory change event for the following reasons:

- setting the STP in terms of Section 40A of the Act is both a decision of the Minister for Climate Change and Energy Efficiency and a change to Applicable Law within the scope of a Regulatory Change Event; and
- the event has the effect of substantially varying the nature, scope, standard or risk placed upon a Standard Retailer, in providing Pass Through Services as;
  - the prescribed STP is significantly higher than the March 2011 estimate published by ORER and used in IPART's 2011-12 pricing decision; and
  - the impact of this decision materially increases SRES liability for 2012 compared to the estimate.

2.2 Date of Positive Pass Through Event

The pass through event occurred on the 24 February 2012. On this date, the STP for 2012 was prescribed by regulation, pursuant to section 40A of the Act and 23A of the Regulations.

2.3 Increase in Costs due to Pass Through Event

The compliance obligations for an Obliged Retailer are based on calendar year quarters. A retailer is obliged to surrender 60 per cent of the calendar year obligation in the first two quarters of the calendar year. This means 35 per cent of the total liability for the year must be surrendered in the first quarter of the year and a further 25 per cent surrendered in the second quarter.

Accordingly, the calculation for the first 6 months of 2012 is based on:

- 35 per cent x 2012 regulated load x 2012 STP x STC price (Q1)
- 25 per cent x 2012 regulated load x 2012 STP x STC price (Q2)

This pass through application has based the cost calculations on the half yearly SRES cost rather than quarterly based calculations. These calculations also use an estimated regulated load for the financial year rather than the regulated load in the calendar year.

The appropriate cost for the STC is the cost exchanged through the STC Clearing House fixed at $40. The basis for using the fixed price was clearly articulated by IPART in its Final Report.[4]

The total efficient costs incurred for the SRES obligation is calculated based on the binding STP liability for the first six months of 2012 calendar year. The incremental cost will be the total efficient costs less the allowances provided for by IPART in the 2011 Final report[5].

As shown in Table 2, Origin as the retailer responsible for the Integral Energy regulated load is obliged to surrender STCs equivalent to $20.8m for the first 6 months of 2012. IPART provided an allowance of $14.6m for SRES compliance costs over the same period resulting in an incremental SRES liability in 2011-12 of $6.3m.

[4] Page 43, IPART, "Changes in the regulated prices for 1 July 2011"
[5] Ibid 4.

Table 2: SRES Calculation for 2011-12 Prices

Period	Surrender obligation	IPART Decision		Actual	
		STP	Allowance ($m)	STP	Cost ($m)
Jul 11-Dec 11	40%	14.80%	$8.6	14.80%	$8.6
Jan 12-Jun 12	60%	16.75%	$14.6	23.96%	$20.8
2011-12			**$23.1**		**$29.4**

2.4 Total Amount to Pass Through

IPART determined that a retail margin of 5.4 per cent be applied to total costs as provided for in the Final Determination. The increased SRES liability is an additional cost imposed on Standard Retailers hence the incremental costs must be adjusted by the retail margin.

Additionally, the incremental costs for Q1 and Q2 of 2011-12 need to be adjusted to account for the Standard Retailers' holding cost. Retailers are required to surrender certificates for the SRES obligations throughout the course of a calendar year. As a result, retailers incur incremental costs during the regulatory period but those costs will not be recovered until 2012-13. IPART previously calculated the 2011 pass through amounts based on the Standard Retailer's holding cost using IPART's nominated weighted average cost of capital (WACC) of 9.1 per cent and assuming a holding period of 9 months.

Table 3: Total Amount to Pass Through

	($m)
Incremental Cost of SRES	$6.3
Time Value of Money	$0.5
Margin Adjustment	$0.3
Total Amount	**$7.1**

This total pass through amount must be divided by the forecast regulated load for 2012-13 in order to calculate a $/MWh amount by which regulated tariffs will be escalated. Based on a forecast regulated load for 2012-13, Origin proposes that the pass through amount be recovered by including an additional $2.30/MWh in the Integral Energy regulated retail prices for 2012-13.

2.5 Period to apply the Pass Through Amount

Origin proposes that the total pass through amount is passed through in the annual 2012-13 retail prices from the 1 July 2012.