



**Cost pass through application to
the Independent Pricing and
Regulatory Tribunal
for Origin's Customers in the
Essential and Endeavour Network
Areas supplied under Standard
Retail Contracts**

March 2013

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Summary

This cost pass through application relates to the incremental costs incurred during the period 1 July 2012 to 30 June 2013.

On 15 March 2013, the 2013 Small-scale Technology Percentage (STP) was prescribed by regulation. The Government set the binding STP for 2013 at 19.70 per cent. The STP establishes the rate of SRES liability attributable to liable entities which is equivalent to a target of 35.7 million Small-scale Technology Certificates (STCs) for 2013.

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* for 1 July 2012 for its customers supplied on a Standard Retail Contract in the Essential and Endeavour network areas.

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 customers Origin supplies on a Standard Retail Contract in the Essential and Endeavour network areas.

At the time IPART made its final report for the 2012 Annual Review, the non-binding estimate for 2013 was 7.94 per cent.

Origin is seeking IPART's approval for a Positive Pass Through event that will allow Origin to recover the following efficient and incremental costs:

- \$7.09 million and requiring a pass through amount of \$4.01 /MWh in 2013-14 the retail electricity prices that apply in Endeavour Energy's network area and;
- \$12.65 million requiring a pass through amount of \$3.67/MWh to the 2013-14 retail electricity prices that apply in Essential Energy's Network Area and;

Origin therefore requests that IPART include an allowance for the following pass through amounts in the determination for 2013-14 retail electricity prices:

- \$4.01/MWh in Endeavour Energy's network area
- \$3.67/MWh in Essential Energy's Network Area

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 Renewable 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 their 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 STC 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 2012-13

The 2012 Annual Review undertaken by IPART determined the cost allowance for SRES liability in the first two quarters of 2013 based on the estimated STP published by ORER in March 2012. When IPART finalised the 2012-13 regulated prices, the 2013 estimate was 7.94 per cent. The final STP is 19.70 per cent.

1.3 Basis of Cost Pass Through Application

IPART's Final Determination 2010-2013¹ 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 materiality 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 Determination². 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 15 March 2013, the Government released the binding STP for the 2013 calendar year of 19.70 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 2012 considered SRES costs (as part of the green cost allowances) as a component of total energy costs for 2012-13 electricity prices. The binding STP is significantly higher than the non-binding target of 7.94 per cent used by IPART in the setting of retail prices for 2012-13.

Table 1 sets out the binding and non-binding STP values for 2012 and 2013 as at March 2013 that are relevant to this cost pass through application.

Table 1: Small-scale Technology Percentages

| Calendar Year | IPART Annual Review (2012) | Binding STP (March 2013) |
|---------------|----------------------------|--------------------------|
| 2012 | 23.96% | 23.96% |
| 2013 | 7.94% | 19.70% |

IPART has previously acknowledged in its letter of 12 December 2012 that if IPART approves the cost pass through application that the cost pass through mechanism for FY14 may account for these changes. Origin supports this position and believes the additional cost, above the non-binding estimate used by IPART, should be passed through to customers in 2013-14 regulated prices.

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

The prescribed STP for 2013 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 2012 estimate published by ORER and used in IPART's 2012-13 pricing decision; and
 - the impact of this decision materially increases SRES liability for 2013 compared to the estimate.

2.2 Date of Positive Pass Through Event

The pass through event occurred on the 15 March 2013 . On this date, the STP for 2013 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 Obligated 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 six months of 2013 is based on:

- 35 per cent x 2012 regulated load x 2013 STP x STC price (Q1)
- 25 per cent x 2012 regulated load x 2013 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.³

The total efficient costs incurred for the SRES obligation are calculated based on the binding STP liability for the first six months of 2013 calendar year. The incremental cost will be the total efficient costs less the allowances provided for by IPART in the 2012 Final report⁴.

³ Page 41, "Changes in the regulated electricity retail prices for 1 July 2012" IPART, June 2012

⁴ Ibid 4.

Table 2: SRES Calculation for 2012-13 Prices, Endeavour Energy Network Area

| Period | Surrender obligation | Sales Load (TWh) [1] | Loss Factor | Purchase Load (TWh) | IPART Decision | | Actual | |
|---------------|----------------------|----------------------|-------------|---------------------|----------------|-----------------|--------|------------|
| | | | | | STP | Allowance (\$m) | STP | Cost (\$m) |
| Jul 12-Dec 12 | 40% | 1.24 | 7.97% | 1.35 | 23.96% | \$12.92 | 23.96% | \$12.92 |
| Jan 13-Jun 13 | 60% | 1.24 | 7.97% | 1.35 | 7.94% | \$4.28 | 19.70% | \$10.63 |
| 2012-13 | | 2.48 | | | | \$17.21 | | \$23.55 |

As shown in Table 2, Origin as the retailer responsible for the regulated load in Endeavour's network area Origin is obliged to surrender STCs equivalent to \$10.63m for the first 6 months of 2013. IPART provided an allowance of \$4.28m for SRES compliance costs over the same period resulting in an incremental SRES liability in 2011-12 of \$6.34m.

Table 3: SRES Calculation for 2012-13 Prices, Essential Energy Network Area

| Period | Surrender obligation | Sales Load (TWh) [1] | Loss Factor | Purchase Load (TWh) | IPART Decision | | Actual | |
|---------------|----------------------|----------------------|-------------|---------------------|----------------|-----------------|--------|------------|
| | | | | | STP | Allowance (\$m) | STP | Cost (\$m) |
| Jul 12-Dec 12 | 40% | 2.19 | 9.23% | 2.41 | 23.96% | \$23.07 | 23.96% | \$23.07 |
| Jan 13-Jun 13 | 60% | 2.19 | 9.23% | 2.41 | 7.94% | \$7.65 | 19.70% | \$18.97 |
| 2012-13 | | 4.37 | | 4.82 | | \$30.72 | | \$42.05 |

As shown in Table 3, Origin as the retailer responsible for the regulated load in Essential Energy's network area is obliged to surrender STCs equivalent to \$18.97m for the first 6 months of 2013. IPART provided an allowance of \$7.65m for SRES compliance costs over the same period resulting in an incremental SRES liability in 2011-12 of \$11.33m.

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 2012-13 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 2013-14. IPART previously calculated the 2012 pass through amounts based on the Standard Retailer's holding cost using IPART's nominated weighted average cost of capital (WACC) of 8.0 per cent and assuming a holding period of 9 months. IPART is yet to determine the WACC that will apply in FY14 and is completing a review of the methodology for calculating WACC. Origin has provided submissions to IPART on this method and has

applied a WACC of 10.4 per cent for this application, consistent with Origin's submission on the approach to determining WACC.

Table 4: Total Amount to Pass Through, Endeavour Energy Network Area

| (\$m) | |
|--------------------------|---------------|
| Incremental Cost of SRES | \$6.34 |
| Margin Adjustment | \$0.34 |
| Time Value of Money | \$0.52 |
| Total Amount | \$7.21 |

This total pass through amount must be divided by the forecast regulated load for 2013-14 in order to calculate a \$/MWh amount by which regulated tariffs will be escalated.

Based on a forecast regulated load for 2013-14 of 1.8 TWh, Origin proposes that the pass through amount be recovered by including an additional \$4.01/MWh in the regulated electricity retail prices for Endeavour Energy for 2013-14. Origin expects to be able to provide a revised estimate of both FY13 and FY14 volumes closer to the Final Determination date.

Table 5: Total Amount to Pass Through, Essential Energy Network Area

| (\$m) | |
|--------------------------|----------------|
| Incremental Cost of SRES | \$11.33 |
| Margin Adjustment | \$0.61 |
| Time Value of Money | \$0.93 |
| Total Amount | \$12.87 |

Based on a forecast regulated load for 2013-14 of 3.5 TWh, Origin proposes that the pass through amount be recovered by including an additional \$3.67/MWh in the regulated electricity retail prices for Essential Energy for 2013-14. Origin expects to be able to provide a revised estimate of both FY13 and FY14 volumes closer to the Final Determination date.

2.5 Period to apply the Pass Through Amount

Origin proposes that the total pass through amount is passed through in the annual 2013-14 retail prices from 1 July 2013.