



6 February 2018

John Pierce
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted online: www.aemc.gov.au

Dear Mr Pierce,

RELIABILITY FRAMEWORKS REVIEW – INTERIM REPORT

Origin Energy appreciates the opportunity to comment on the Australian Energy Market Commission's (AEMC's) Reliability Frameworks Review Interim Report. We welcome the Interim Report as a thorough and well-researched document that discusses several key themes affecting reliability in the National Electricity Market (NEM).

The NEM has had historically high levels of reliability and as shown in the Interim Report, only a small fraction (0.24%) of supply interruptions from 2007-08 to 2015-16 were related to reliability.¹ The NEM is now undergoing a transformation driven by changing consumer preferences and constantly evolving technologies. Compounding this are the sudden closure of the Hazelwood and Northern power stations and investment uncertainty as a result of ongoing policy uncertainty, namely around emission reductions targets. Already this summer the Australian Energy Market Operator (AEMO) has deployed emergency reserves by activating the Reliability and Emergency Reserve Trader (RERT). It is clear that the NEM is being challenged and questions are being raised about the continued suitability and effectiveness of the current reliability arrangements.

It will be important for this review to clearly define the nature of any reliability issues that may be facing the NEM. A first step would be to distinguish between any temporary issues that may have arisen (for example due to the sudden closure of generation plant and the current policy stalemate) and any enduring structural concerns that may negatively impact the adequacy of investment and ultimately reliability. Such an approach will help to inform the suitability of the measures currently being contemplated, including the specifics around the design of the reliability limb of the National Energy Guarantee (NEG).

Where reliability concerns have surfaced due to policy uncertainty, this should be identified and addressed directly – changes to the market design should not be viewed as a substitute for this. In our view, the case for implementing some of the enhancements to the NEM now being considered is contingent on clarity around an inability of the market to deliver the requisite level of reliability within the required timeframe. The design of these mechanisms should be such that they enable the market to remain the primary tool by which reliability is met; but in the event the market does not deliver, these enhancements would serve as a valuable safety net. However, where the market does deliver, there must be an ability to scale back these mechanisms so that costs to consumers are minimised.

¹ AEMC, Reliability Frameworks Review Interim Report, 19 December 2017, p. 43.

We note the Energy Security Board (ESB) is concurrently developing the design of the proposed NEG. Given the likely interactions of the NEG with arrangements considered under the AEMC's Reliability Frameworks Review, we suggest further considerations as part of this review must be coordinated with the development of the NEG. This should include an evaluation of the varying objectives of, and incentives under, each of the different mechanisms and how these interrelate and are intended to complement each other.

1. Forecasting and information provision

Accurate forecasting is an integral component of efficient NEM functioning and underpins the reliability frameworks. The AEMC's analysis does not definitively support the view that inaccurate forecasts are contributing to reliability issues in the NEM. We share the AEMC and AEMO's concern that despite this, the increasing penetration of distributed energy responses, variable renewable generation and demand response complicate the ongoing ability for AEMO to forecast accurately. Origin supports exploring potential enhancements to current forecasting practices and processes before consideration is given to significant market redesigns such as a day-ahead market. We support the AEMC investigating potential improvements to forecasting including whether it is practical and beneficial for the provision of greater levels of information from semi-scheduled generation and demand-side load.

2. The contract market

A robust contract market underpins reliability by informing both investment and operational decisions. Like the AEMC, we agree to the Australian Financial Markets Association (AFMA) restarting its survey of the turnover of over the counter (OTC) contracts. Coupled with observations about exchange-traded contracts through the ASX, this should provide greater visibility and accuracy about the state of contracting in the NEM, which in turn will promote confidence in the contract market.

The Interim Report correctly describes swaps and caps as the two most common types of contracts currently traded on the ASX and bilaterally. Origin agrees with this but we wish to highlight that as the NEM evolves so too does the contract market. In addition to exchange-traded contracts and OTC contracts, other instruments are emerging that retailers can use to manage risk. Examples of these include long-term power purchase agreements (PPAs), which the AEMC identifies in the Interim Report, and insurance products. This contract market evolution is an entirely reasonable response to changing market conditions in the NEM as market participants seek diversity in how they manage risk. Options are also available and represent a reasonable amount of the volume that is traded.

3. Wholesale demand response

Wholesale demand response supports reliability as it promotes efficient consumption of electricity in the NEM, particularly in tight conditions where an increase in the amount of wholesale demand response can prevent or at least reduce the amount of emergency response required. Origin supports the AEMC's view that there are no regulatory barriers to wholesale demand response. Demand response can and is happening in the NEM through different products offered by retailers and the ability of customers to register as market customers so they can purchase electricity directly from the wholesale market.

The AEMC intends exploring ways in which third parties, such as aggregators, could more easily capture the value associated with wholesale demand response, particularly from small customers, under the current framework. It is important that this assessment is premised on the principle of avoiding market distortions, considers the breadth of potential flow-on effects and assesses the potential benefit of any proposed change against the associated cost. This should also include an evaluation of the extent to which wholesale demand response is currently being underutilised to ensure a balanced way forward if appropriate.

4. Strategic reserves

The existing RERT and the strategic reserve discussed in the Finkel Review are intended as safety net measures in the event the market has failed to deliver reliability. Origin supports the AEMC's preliminary view that some sort of safety net is appropriate. We agree the first step should be to identify any weaknesses in the existing RERT framework to see if any enhancements are required or whether the implementation of a strategic reserve is warranted. This should also consider the potential distortionary impacts of a safety net measure.

Regardless of whether the RERT is maintained in its current form or if a strategic reserve is adopted some key aspects in the application of any safety net will need to be clarified. These include:

- Greater clarity and transparency around how much reserves AEMO procures and how this relates to the reliability standard.
- A discussion on whether a distinction is needed between the reliability standard and an operational standard that AEMO could use to guide the deployment of reserves. If the development of such an operational standard is deemed appropriate, its relationship with the reliability standard will need to be carefully considered.
- Greater transparency of the costs associated with the RERT and how they will be recovered.

It has been suggested that the lead times for procuring reserves for the RERT are too short at only up to ten weeks. This is the result of the removal of the ability to procure long-notice RERT that came into effect from 1 November 2017 following the AEMC's rule change on the extension of the RERT.² This decision was based on the view that shortening the lead time for procuring reserve would allow greater opportunity for a market response to address a projected shortfall and hence would minimise market distortions. In evaluating the appropriate lead time for procuring reserves, the AEMC should consider whether there is an issue with procurement now as compared to when it considered this earlier rule change. It may be useful to get a greater understanding of the makeup of RERT available for this summer and how this could change for next summer, for example what amount is long-notice RERT that would not be available next summer or would need to be contracted in a different, and potentially more costly, way.

It has also been suggested that the lack of availability payments has been a barrier to RERT participation. An availability payment adds a potentially significant cost to the procurement of safety net reserves. This cost is potentially amplified the longer the lead time for procuring reserves. The first step in evaluating the need for availability payments should be to investigate the extent to which this has inhibited participation in the RERT to date. If an availability payment is considered appropriate, its structure should be carefully assessed to ensure it provides the correct incentives to participants and does not lead to considerable cost that would ultimately be recovered from consumers.

As the electricity market undergoes its current transition, the need to call on a safety net measure may become more necessary as we have already seen with the first ever activation of the RERT on 30 November 2017 and again on 19 January 2018. However, following this transition period and with the implementation of other NEM design enhancements, a safety net measure may not be needed to support ongoing reliability. For example, many of the current reliability concerns relate to the sudden closure of Hazelwood and Northern power stations. There are recommendations from the Finkel Review, such as the generator closure notice period, that are looking to address this issue. As such, the RERT or a strategic reserve does not necessarily need to be a permanent feature of the market and so a periodic review mechanism and sunset period should be considered.

Origin appreciates there may be some pressure to finalise arrangements around a safety net measure in time for next for summer period. We urge the AEMC to explore this urgency with AEMO. An

² AEMC, Extension of the Reliability and Emergency Reserve Trader Final Determination, 23 June 2016.

urgency to implement a reserves mechanism should not be at the expense of a well-developed design supported by a thorough consultation process.

5. Day-ahead markets

A day-ahead market is a common feature of a number of international markets. Origin appreciates the Interim Report's discussion of these different international examples and the comparisons between the NEM and day-ahead markets. It is clear that day-ahead markets around the world have developed for different reasons, have different objectives, and are applied in a different context to the NEM's energy only gross pool design.

We agree that while the NEM does not have a formalised day-ahead market, it has many features that play a similar role. We also agree with the AEMC's preliminary view that it is not clear what issues a day-ahead market would solve in the NEM. As a result, further considerations of a day-ahead market should first clearly define what the issues are with the current NEM design, explore the materiality of those issues and assess whether the implementation of a day-ahead market is a balanced response.

6. Further information

Should you wish to discuss the contents of this submission further, please contact Lillian Patterson on (02) 9503 5375 in the first instance.

Yours sincerely



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