17 May 2011

Chairman
Australian Energy Market Commission
PO Box A2449
SOUTH SYDNEY NSW 1235

Dear Mr Pierce

Origin Energy Limited (Origin) welcomes the opportunity to help shape the Australian Energy Market Commission's (AEMC) strategic priorities work plan and applauds the AEMC for undertaking this important new initiative.

The National Electricity Market (NEM) has an exemplary record in meeting the energy requirements of consumers as evidenced by its performance against key parameters such as the reliability standard and the maintenance of network security. The continuity of this trend is largely dependent on:

- The ability of energy market frameworks to adapt over time in response to market dynamics; and equally important
- The avoidance of regulatory invention where the market has been found to be working well.

As the primary rule making body in the NEM the AEMC has a key role to play in ensuring that this balance is met, and it is our expectation that the initiation of this work stream will better facilitate this function. To maintain confidence in energy market frameworks this work stream should clearly set out the relationship between emerging challenges and strategic priorities and what constitutes the forward work plan to address these challenges.

Our detailed comments on the AEMC's discussion paper are outlined in the attached submission.

If you wish to discuss any of these issues further please do not hesitate to contact me on (02) 8345 5250 or Steve Reid on (02) 8345 5132.

Yours Sincerely,

Tim O'Grady
Head of Public Policy

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Market resilience and emerging challenges

The AEMC has outlined four emerging challenges facing the energy market, which it has used as the basis in identifying its strategic priorities. Whilst Origin broadly agrees with the challenges as set out in the Discussion Paper we consider that these could be refined to better reflect current market realities. Specifically, we recommend that 'increasing carbon constraints' should be made explicit as an emerging challenge and that 'market resilience' is recognised as the ongoing overarching market objective rather than as an emerging challenge.

Market resilience

The smooth and efficient functioning of the market i.e. market resilience has always been and should continue to be the overarching objective of policy makers, regulators, and market participants. Therefore, we consider it more appropriate that market resilience is recognised as the central principle that would guide all future works in this area, as opposed to being categorised as an emerging challenge.

The NEM's 'energy only' design has worked well and has facilitated sufficient generation investment to consistently meet customer demand. Notwithstanding the challenges highlighted in the AEMC's Discussion Paper, it is our view that the NEM will continue to deliver a high level of performance, particularly if a proactive approach is adopted in dealing with these challenges as they emerge. The market structure should be resilient to emerging commercial models and not pass judgement on the sustainability of such models. Any contemplation of alternative market structures can only be justified if there is clear evidence that the current market is broken beyond repair and that the benefits of adopting an alternative framework is outweighed by the costs of doing so.

Increasing carbon constraints

Notwithstanding the debate surrounding the carbon price, both sides of politics have agreed to a 5% emissions reduction on 2000 levels by 2020. This target effectively requires a 25% cut in business as usual emissions. In the longer term the Government has also committed to a 60% emissions reduction by 2050. Given these climate change objectives, and that approximately one third of Australia's emissions are as a result of electricity generation, it is reasonable to assume that climate change policy and the impetus toward a low carbon economy is an enduring trend that will continue to drive outcomes in energy markets.

Already, policies such as the renewable energy target (RET) and state based feed in tariffs have started to impact on the energy sector with the increasing market entry of renewable generation and the resultant implications for transmission investment and retail prices. High wind penetration in South Australia is impacting market price outcomes and may affect reliability and security of supply. The AEMC should, within its remit, proactively ensure that these policies do not undermine the integrity of energy markets.

Origin notes that the AEMC has already conducted a comprehensive review into the impacts of climate change policies on energy markets (Climate Change Review) which identified a number of areas where the current market framework could be strengthened. However, once Australia has decided on a primary mechanism to achieve its climate change objectives, i.e. a carbon price or direction action or both, the flow on

effects on energy markets will become more apparent and will need to be further assessed.

Strategic priorities

Origin is supportive of the strategic priorities identified by the AEMC, though we note that the AEMC's effectiveness in this space is dependent on the work packages that emerge from this consultation. The AEMC is already actively involved in a number of areas which are directly related to these priorities. We do not envisage that this work will be duplicated, but that this process will instead allow for the identification of any gaps that may exist.

Ideally the strategic priorities work programme would allow for:

- The timely identification of any shortcomings in the current energy market framework brought on by the emerging challenges;
- The development of proposed solutions to any problems identified;
- The determination of what challenges are likely to be enduring as opposed to transitory. For example a disincentive to invest due to uncertainty surrounding the carbon price is likely to be temporary; and
- The development of efficient energy market policy. Though the AEMC is not directly responsible for setting policy, the early identification of any potential problems associated with proposed policy solutions can help shape the appropriate design of these policies, allowing for better market outcomes. This could also be applied to the AEMC's assessment of existing policies. For example, the price impacts and overall clumsiness of various state-based climate change policies indicates the need for rationalisation and the adoption of a cohesive national approach.

Predictable regulatory and market environment for rewarding economically efficient investment

Regulatory uncertainty is a major impediment to investment and efficient market outcomes. One area of particular concern is the continued regulation of retail prices in States other than Victoria. This issue takes on greater significance in light of climate change policies such as the RET and the proposed carbon price.

Notwithstanding jurisdictional agreement under the Amended Australian Energy Market Agreement which allows for the full pass through of costs associated with the carbon price and RET; the costs of complying with the small scale renewable energy scheme (SRES) have not been fully passed through into regulated retail tariffs in all jurisdictions.

Most markedly is the situation in Queensland. In its recent *Draft Decision for the Benchmark Retail Cost Index for Electricity: 2011-12,* the Queensland Competition Authority has made clear that it does not consider that the regulatory framework permits the inclusion of costs associated with the first six months of the SRES.[1] This means that retailers are required to absorb the costs that are incurred with compliance of the SRES from 1 January 2011 through to 30 June 2012. This clearly has a significant financial impact on all affected retailers.

[1] http://www.qca.org.au/files/ER-NEP1011-QCA-IntConsulNote-1009.pdf

The experience of retailers in recovering the costs of the SRES in regulated tariffs makes it clear that the removal of retail price regulation is necessary to ensure the successful implementation of any further climate change initiatives, including a carbon price. In order for Australia to make a successful transition to a low carbon economy, the energy sector must be financially robust, and sufficiently confident in its ability to pass through the costs associated with climate change policies.

Though a final decision on the removal of retail price regulation is outside the AEMC's remit, we envisage that by identifying the pitfalls of continued regulation, the strategic priorities work stream will help inform policy makers on the importance of progressing to a deregulated framework.

Building the capability and capturing the value of flexible demand

In light of rising retail prices and peak demand, effective demand side response is important in helping to mitigate ensuing negative effects for consumers.

Smart metering has been identified as a means of monitoring and controlling energy consumption. Where possible, Origin considers that smart meters and associated infrastructure should be deployed on a contestable basis rather than through a monopoly distributor as was mandated under the Victorian derogation. Contestable deployment would allow for competitive tension between suppliers resulting in better services and lower prices for consumers. This would also help to ensure that selected communication technologies meet market needs and preferences. In examining this issue under Stage 3 of its Demand Side Participation Review (DSP Review), we would expect that the AEMC would seek to determine the suitability of the Victorian roll out model for the rest of the NEM.

Distributed generation (DG) such as cogeneration can also allow for more efficient demand management, which over time is likely to reduce expenditure on transmission and distribution network infrastructure, resulting in lower costs to electricity customers. For this benefit to be fully realised, however, there are a number of barriers to the further uptake of DG that will need to be addressed. These include, the inconsistency in the application of technical standards for DG (which increases the compliance burden) and deficiencies in the connection process which does not allow for the revelation of the full costs of a connection upfront, resulting in 'hidden costs' along the way. Origin expects that these issues will also be dealt with under the DSP Review.

Ensuring the transmission framework delivers efficient and timely investment

Given the long lead time required to undertake transmission build, a more strategic approach to transmission planning and investment is needed to support generation entry. One are of concern for generators is the deficiencies in the current network connections framework which does not always allow for efficient and expeditious connections. There are a number of ambiguities in the current Rules that allow for this to occur. Origin will be making a detailed submission on this as part of the AEMC's Transmission Framework Review (TFR).

Additionally, the emergence of generation clusters as a result of the RET has presented a number of challenges in the building of efficiently sized connection assets. We note that whilst this issue is being dealt with under the Scaled Efficient Network Extension Consultation, given the connectivity of this work with the TFR wider transmission review, it might be best to amalgamate the two processes.