27 May 2013

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

Dear Mr Pierce

Origin Energy Limited (Origin) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) Strategic Priorities Discussion Paper. The AEMC has appropriately idenfied some of the key issues that are likely to dominate the energy policy landscape over the next few years.

Our specific views on the three priority areas are set out below.

Consumers – important strides, but still work to be done

A number of recent market developments are likely to result in better outcomes for consumers. These include the introduction and progressive implementation of the National Energy Customer Framework, as well as the recent network reviews which should allow for more efficient network regulation with flow on effects for retail electricity prices.

Additionally, there has also been renewed focus on customer empowerment and education which supports more informed decisions around energy usage. Both governments and the private sector have a role to play in educating energy consumers. Origin's recently launched Knowledge is Power campaign is in keeping with this ethos and reinforces our commitment to customer education.

Despite the recent strides, however, there is still work to be done. Not all states have progressed to a deregulated framework for retail electricity prices. This means that the full benefits of deregulation such as greater innovation and competition have yet to be realised in all jurisdictions. We note that the AEMC's recently released Draft Report into the *Review of Competition in the Retail Electricity and Natural Gas Markets in NSW* has found that competition has been beneficial to NSW customers, and that price caps should be removed.

Another matter that needs to be addressed is the cross-subsidy issues created by the rapid uptake of solar PV. Whilst still benefitting from being connected to the grid, owners of solar PV do not pay their proportionate share of network tariffs as the current tariff structure is largely based on the volume of energy drawn from the grid. This results in those consumers that do not own solar PV paying higher network charges than they should.

Gas market – changing landscape, but the market continues to work well

The Discussion Paper makes mention of a new dynamic underway in the east coast gas market with exports of liquefied natural gas (LNG) scheduled to commence in 2014. This is expected to result in an approximate tripling of demand by 2017, and has led to an increased level of scrutiny of both market operations and current policy settings.

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Despite the changes underway, Origin does not consider that there are material problems with the functioning of the east coast gas market. As such, we are of the view that market development should focus on incremental improvements which will allow for efficient outcomes for all gas users. To this end we continue to work with various bodies such as AEMO, the Victorian Gas Task Force, and the AEMC. We see this as a natural extension of the work that began under the previous Gas Markets Leaders Group.

We remain mindful, however, of the potential for ill-conceived 'knee jerk' reactions to the new market paradigm, and in particular to any transitional issues that may arise.

Already there have been calls in some circles for the adoption of a domestic reservations policy – which could implicitly lock in prices below market equilibrium. Such a policy would only serve to distort the market and dissuade future gas exploration and production, to the detriment of gas users.

It is generally agreed that there is enough gas for both the LNG industry and domestic use. AEMO stated in its 2012 Gas Statement of Opportunities (GSOO) that current estimated recoverable reserves are sufficient to satisfy both the domestic and LNG markets over the 20 year outlook period[1]. The key to meeting future demand, therefore, is the development of these reserves in a timely manner. This will only occur if price signals are allowed to work.

Undoubtedly, the market is undergoing a period of transition. Historically, domestic gas prices have been well below those observed internationally. However in the short term, it is unlikely that these historical lows will be maintained. As conventional reserves dwindle supply is now largely dependent on less accessible and more costly unconventional resources. We would also expect some initial tightening in the market as demand ramps up, which could be reflected in prices.

Also as a consequence of LNG exports, for the first time there will be some linkage between the east coast and international markets. Often lost in these discussions is the symbiotic nature of this relationship. The relatively small size of the Australian market means that the large scale development of resources such as coal seam gas (CSG) would be uneconomic. Such development is only made possible by accessing the requisite volumes (and prices) available through international markets. This in turn makes gas available for the domestic market, which is crucial as conventional resources decline. CSG now accounts for 85 percent of all reserves on the east coast and provides 90 percent of Queensland's gas needs and powers 15 percent of its electricity generation.

The transitional period underway in the market is also manifested with some legacy supply contracts now coming to an end, and the negotiation of new contracts under a changing pricing landscaping likely to require some adjustment.

These recent developments, described above, have placed the operation of the market firmly in the spotlight, with the AEMC's Scoping Study the latest gas market review to be initiated. Specifically, a number of areas have come under scrutiny, including:

[1] AEMO 2012: Gas Statement of Opportunities, Exec Summary, pg iii

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Trading arrangements

Traditionally gas market development has been underpinned by long term bi-lateral contracting. The capital intensive nature of gas production means that this is unlikely to change as the securing of long term contracts is crucial to attaining the necessary financing for gas projects to go ahead. Over the past few years, the avenues for gas trading have increased with the emergence of the east coast short term trading markets. This is a positive development as it allows market participants to better manage their long term contracting positions.

Most recently the development of a supply hub at Wallumbilla has been seen as an important step in increasing market flexibility. The Wallumbilla gas supply hub has the potential to deliver value to the gas market. However, there should be a realistic assessment of what it is likely to achieve – at least initially. There has been some talk of replicating the Henry Hub, but this is likely to be premature and unrealistic. Wallumbilla has some operational challenges associated with its existing infrastructure that means it is unlikely to have the pipeline interconnectivity to allow for a trading platform along the lines of the Henry Hub. Another limitation is the disconnect between the exchange transaction itself and the physical delivery of gas. The physically settled trades on the exchange are dependent upon actual deliveries which mean that they are not "firm". This is likely to hamper efforts in developing a viable futures market.

Industry is considering the above issues in order to identify solutions, and explore how they can be implemented in an efficient and effective way. It is unlikely that this process will be completed prior to the anticipated start of the market in early 2014. However, continued development and evolution of the hub post market-start will enhance its value and encourage greater participation and liquidity.

Transparency

There has been much talk of the need to increase transparency in the market. Over the past few years there has been some improvement in this area with the introduction of the Bulletin Board and AEMO's publication of the GSOO. Improving the functionality of these existing instruments where practicable is an important first step when looking to enhance transparency. For example, Origin is in discussions with industry regarding a proposal to develop a webpage that would list the contact details of counterparties that are interested in trading transmission pipeline capacity on the east coast. For those seeking transport services, this can provide greater visibility. As demand for these service increases, industry can then identify options for streamlining trade.

Going forward, it is important to bear in mind that transparency is not an end in itself. Policy makers therefore need to be clear on how greater transparency will create value/net benefits, particularly when taking into consideration the cost of gathering and providing the required information.

Market Priority – impacts of slowing demand is exacerbated by the RET

Since the AEMC last looked at this priority, a significant change in the electricity market has become evident – i.e. the unprecedented slowdown in energy consumption. It is still not clear if this is an enduring trend or in fact a temporary aberration. What is certain, however, is that a number of factors have contributed to softer demand. These include: declining competitiveness of energy intensive industries such as aluminium smelting;

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increased uptake of solar PV; energy efficiency; and more frugal energy usage due to higher retail prices.

Unsurprisingly, the decline in demand has been accompanied by a reduction in wholesale electricity prices. As highlighted in the Discussion Paper, real prices over the past two years have been the lowest since the start of the NEM.

Generally our view on these matters is that the market is self-correcting and should be left to do its work whereby extreme pricing outcomes (whether low or high) will send the appropriate signal that will allow for the realignment of supply and demand over time. The problem, however, in this instance is that the lower demand and resulting oversupply in the market is being exacerbated by the artificial injection of even more energy in the market through the renewable energy target (RET). This is likely to have a destabilising effect on the market and could discourage investment in thermal plant which is still needed for the provision of a secure and reliable supply. Paradoxically, the RET continues to put downward pressure on wholesale electricity prices whilst adding to retail prices.

Origin has argued for a realignment of the RET to reflect the new demand conditions. This is of course an issue for the Commonwealth Government; however, it would be useful if the AEMC periodically reports on the impacts on the market, of various climate change policies. Going forward this could help inform the formulation of more effective and efficient policy.

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