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John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
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Submitted online: www.aemc.gov.au

Dear Mr Pierce

Enhancement to the Reliability and Emergency Reserve Trader – Options Paper

Origin Energy Limited (Origin) welcomes the opportunity to provide comments on the Australian Energy Market Commission's (AEMC) Enhancement to the Reliability and Emergency Reserve Trader (RERT) Options Paper.

Origin does not believe a significant change in the RERT procurement trigger is necessary at this time to account for a potentially "peakier" supply/demand balance, or that is appropriate to delink RERT procurement from the reliability standard. Such an approach would undermine existing reliability settings and compromise the ability of the wholesale market to deliver appropriate amounts of the right type investment.

Origin is therefore broadly supportive of Option 1, which would retain the existing framework but introduce a more explicit link to the reliability standard (i.e. RERT procurement volumes would be capped at the level required to meet the standard). However, this option should also be supported by additional transparency around the nature of forecast USE events. This will enable market participants to better understand the circumstances that are giving rise to USE and the extent to which those risks can be mitigated through a market response. It will also allow for a more thorough assessment of the appropriateness of AEMO's approach to RERT procurement in the future.

1. Adequacy of the current RERT procurement trigger

It is not clear that a fundamental change to the RERT procurement trigger is needed at this time to better account for a potentially "peakier" supply/demand balance. In operationalising the reliability standard over medium and long notice RERT timeframes, AEMO carries out a significant number of power system simulations for 10 per cent and 50 per cent probability of exceedance (POE) demand scenarios and weights them by 0.3 per cent and 0.7 per cent respectively. As noted by the Reliability Panel, an increasingly peaky supply/demand balance would be captured by these simulations and reflected in any resultant USE forecasts. The USE forecasts may also be conservative given:

- the simulation process does not consider 90 POE demand scenarios to balance out the use of 10 POE demand scenarios (i.e. the forecasts are naturally weighted toward accounting for low probability events); and

- forecasts of maximum demand growth are generally uncertain and may be overstated in some regions (e.g. despite recent observed reductions in maximum demand, the Electricity Statement

of Opportunities has forecast an increase in maximum demand in the order of 2 GW over the period to 2030 in New South Wales).

The current RERT framework also allows AEMO to procure RERT in operational timeframes when more up to date information relating to weather forecasts, demand projections and generator availability becomes available. Coupled with AEMO's ability to issue market directions and instructions, this provides AEMO with flexibility to manage the risk of less certain USE events should they arise.

2. Impact of delinking RERT procurement from the reliability standard

The reliability standard is foundational to the reliability settings of the NEM, which includes the market price cap (MPC), cumulative price threshold (CPT), administered price cap (APC) and market price floor (MPF). Collectively, these parameters protect the long-term integrity of the market by limiting price exposure, while also ensuring prices can reach a level that is sufficient to incentivise investment in generation capacity to meet the reliability standard. Delinking the RERT procurement trigger from the reliability standard would undermine this framework, which may ultimately distort wholesale market price signals and expose consumers to unnecessary costs.

As discussed in our response to the AEMC's earlier Consultation Paper, emergency reserve mechanisms such as the RERT can have a significant distortionary impact on energy-only markets. Within an operational timeframe, the need to activate a reserve well ahead of an anticipated shortfall represents a market intervention that can distort pricing outcomes that may otherwise have occurred. Over the longer term, this dynamic can lead to inefficient wholesale market dispatch outcomes, as more cost-effective plant may be held outside the primary market.

Emergency response mechanisms are also an inherently expensive means of ensuring reliability. Total RERT costs (including weekly availability payments) for the 2017-18 summer period alone were estimated to be to around $51 million. This equates to approximately $79,000/MWh, or around 5.5 times the value of the current MPC in the NEM.

The above issues are likely to be particularly acute under Option 2, given the proposed framework would establish a separate market for RERT procurement that targets a level of reliability beyond what the reliability standard and associated market settings are intended to deliver. The risk of over-procurement is also heightened by the use of conditional tail expectation analysis, given this approach places even greater reliance on accurate forecasting of what are fundamentally, highly uncertain, low probability type events. To the extent retailers are potentially exposed to such costs under the Procurer of Last Resort Function of the Reliability Obligation, this may result in retailers contracting to inefficiently high levels to minimise risk, creating further costs for consumers.

Option 2 also relies primarily on estimates of the Value of Customer Reliability (VCR) to guide procurement decisions. As VCR is generally mch higher than the MPC, this will reduce incentives for reserve providers to participate in the primary wholesale market. The level of the distortion will be heavily dependent on the accuracy of VCR estimates, which are indicative only and were not intended to be explicitly used for price setting and procurement decisions in the NEM.

Origin therefore does not believe it is appropriate to delink RERT procurement from the reliability standard. To the extent there is a view that current market settings are not delivering adequate levels of reliability, a more cost-effective solution that maintains the integrity of the energy-only market framework may be to increase the MPC.

3. Improving the existing framework

Given the above, Origin is broadly supportive of Option 1, which would retain the existing framework but provide a more explicit link to the reliability standard. However, given this approach still provides AEMO

with some discretion as to how it operationalises the reliability standard, it is important the level of transparency around the modelling of USE events is made available to market participants. This includes information around the supply/demand mix when USE is forecast to occurs, as well as the size, duration and timing of events.

This information will enable market participants to better understand the circumstances that are giving rise to USE, and therefore the extent to which they can mitigate the potential for such events occurring through a market response. It will also allow for a more thorough assessment of the appropriateness of AEMO's approach to RERT procurement in the future.

Origin is also supportive of the AEMC's approach to considering the appropriateness of the reliability standard, noting it will be subject to further stakeholder consultation ahead of the Draft Determination. A key question that should be canvassed in this context is whether or not it would be cost effective to design the standard to protect against low probability events such as those being targeted under Option 2. As noted in EY's recent analysis of forecast USE over the period to 2021 in Victoria, an additional 1,000 MW of capacity would be required to avoid any unserved energy under that scenario, which would increase wholesale energy costs by nearly seven per cent ($200 million per annum) in that region.

If you wish to discuss any aspect of this submission further, please contact Shaun Cole at shaun.cole@originenergy.com.au or on 03 8665 7366.

Yours Sincerely,

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