



21 November 2022

Anna Collyer
Chair
Australian Energy Market Commission

Submitted online: www.aemc.gov.au

Dear Ms Collyer

Operational Security Mechanism – Draft rule

Origin Energy Limited (Origin) welcomes the opportunity to provide comments on the Australian Energy Market Commission's (AEMC) Operational Security Mechanism (OSM) draft rule.

The efficient valuation and provision of essential system services (ESS) is critical in minimising reliance on market interventions such as directions. To this end, we generally support the intent of the OSM, which is largely to facilitate the scheduling of services procured through contracts (e.g. system strength) and provide a mechanism through which additional service volumes can be procured in operational timeframes to support system security if required. However, we have identified a number of aspects of the draft rule that require further consideration to ensure the OSM can facilitate efficient provision of system services, as discussed further below.

1. Transparency

Origin is strongly supportive of ensuring the OSM is underpinned by robust transparency and governance arrangements, noting the provision of timely, clear and relevant information on system services will be critical to the success of the mechanism. The draft rule includes a number of supporting measures in this respect. However, additional information relating to service pricing (on a forward-looking basis) will ultimately be required to enable generators / market customers to optimise their operations across energy, FCAS and the OSM markets and / or efficiently manage their exposure to any OSM costs.

For the energy and FCAS markets, pre-dispatch currently provides price / volume information on a forward-looking basis in operational timeframes. Under the draft rule, the OSM provisional and final schedules published in the lead up to real time will contain the volume of services enabled (or provisionally enabled), but reporting of prices will ultimately be ex-post, which represents a significant gap in the proposed framework. While we appreciate there may be commercial sensitivities associated with publishing bids prior to OSM gate closure, the AEMC should consider what other indicative pricing information could be provided to help participants determine their OSM exposures (e.g. publication of a range forecast OSM prices).

Over planning timeframes, it would be useful if additional forward-looking information was published on the volumes of OSM services expected to be required (with reference to any relevant standards) and forecast changes (entry / exits) to the fleet of OSM providers. This information could be provided as part of the annual AEMO OSM reporting proposed in the draft rule.

The draft rule also requires the Security Services Guideline and the OSM Procedures to be developed and updated in accordance with the Rules Consultation Procedures. We support these formal consultation requirements.

2. Impact on other markets

The draft determination states the OSM's objective function would seek to maximise the value of trade to coordinate the dispatch of security services alongside the existing markets of energy and FCAS, and that addressing security issues can reduce overall costs of dispatch.¹

Origin considers the OSM should be limited to only procuring services for which a spot market does not exist, and with a view to meeting the minimum service level required to maintain system security within defined standards. The resources enabled through the OSM should also be those that can effectively meet system security requirements at the lowest cost. Anything beyond this could result in OSM enablement interfering with, or diminishing efficient price signals in the energy and FCAS markets, which could undermine investment signals in those markets.

3. Settlement 'make-whole' payments

The settlement arrangements in the draft rule establish make-whole payments that 'zero-out' energy market revenue derived from energy produced as by-product of a unit providing a security service. We understand that make-whole payments would only apply to the portion of energy associated with the unit's provision of security services – which would usually be its minimum generation level.

We support insulating service providers from negative energy market prices, so as not to penalise them for providing a critical system service. However, a potential adverse consequence of the make-whole arrangements proposed is that if energy prices unexpectedly spiked post-OSM gate closure, an OSM enabled generator that has sold contracts for energy would be unable to defend those contracts with its full capacity. This is because the make-whole payments 'zero-out' any revenue derived from energy produced as by-product of a unit providing a security service. In such a case, the generator would be exposed to high energy market costs, which could deter participation in the OSM, or lead to a premium being applied to OSM bids to account for the identified risk.

To address this issue, we recommend the settlement arrangements are amended such that, the make-whole payment does not require adjustment of a generator's energy market revenue when the energy price exceeds the OSM bid.

4. Gate closure timing

The AEMC states that it would be concerned if the OSM gate closure (to be defined by AEMO) is earlier than one or two hours before the final run of the OSM.² We agree an earlier gate closure could have a significant impact on a participant's ability to make efficient operational and commercial decisions. This is because participants would be less able to respond to market conditions if units are OSM enabled far ahead of real-time. This risk is magnified by the fact the enablement of large OSM volumes will likely coincide with periods of high variable renewable energy generation (with the associated potential for highly volatile generation and pricing outcomes). Given this risk, the AEMC should establish strong governance arrangements to guide AEMO's determination of the OSM gate closure period.

¹ AEMC, Draft Determination – Operational Security Mechanism, p. v.

² Based on the AEMC's discussions with AEMO. Ibid p. 55.

5. Market power

The draft rule establishes an ongoing role for the AER to assess and identify market power in the OSM and recommend mitigation measures, which could include the application of a price cap. In such an event, it would be critical to ensure the price cap is set at a level that provides market customers with adequate protection to extreme OSM prices and costs, while also incentivising new and existing service providers to participate in the OSM.

If you wish to discuss any aspect of this submission further, please contact Thomas Lozanov at thomas.lozanov@originenergy.com.au.

Yours Sincerely,

A handwritten signature in black ink that reads "S Cole". The signature is written in a cursive, slightly slanted style.

Shaun Cole
Group Manager, Regulatory Policy