



28 September 2007

The Reliability Panel  
Australian Energy Market Commission  
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AUSTRALIA SQUARE NSW 1215  
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## Comprehensive Reliability Review Second Interim Report

Origin Energy appreciates the opportunity to provide this short submission in response to the Reliability Panel's Second Interim Report of the Comprehensive reliability review.

While we support all issues addressed in the Energy Retail Association of Australia (ERAA) submission, members were unable to form agreement on whether (Value of Lost Load) VOLL needed to be increased. The purpose of this submission is to comment specifically on this matter.

Origin is of the view that at this stage VOLL should remain at \$10,000/MWh. We consider that any increase in VOLL would have little impact on investment returns as there are few instances where the spot price has risen to \$10,000. However it would increase risk to participants: encouraging retailers to seek additional contracts and generators to seek less, which would add a significant risk premium to the forward contract price.

Origin also notes that the Panel was uncertain about whether such changes in risk positions would increase or decrease contracting levels in the NEM. We consider that increasing VOLL may result in generators offering fewer contracts because of the increased cost associated with not being able to meet the contract obligations in the event that the generator fails or is constrained off the system. Generators may find it less risky to offer their capacity on the spot market and to the extent an increase in VOLL lowers contract liquidity, this may also deter investment.

In its First Interim Report the Panel itself noted that increases of \$2,500/MWh to VOLL would change the 0.002 per cent reliability standard by only 0.0003 per cent at a time. Given the significant increase in contracting risk this is a very marginal improvement in reliability. A material improvement in reliability would therefore appear to require very substantial increases in VOLL and the Panel has performed little analysis at this stage which provides any insight into how a further substantial increase



in VOLL is likely to affect risk, and perceptions thereof, in the market. Any reliability improvements must be weighed against increased market risk, and more importantly, how this may subsequently be managed.

We remain to be persuaded that the reliability benefits of a material increase in VOLL will outweigh increased costs associated with contract, system and operational changes required to manage higher risk exposures for participants.

Furthermore, it is not clear that the Panel's analysis underpinning an increase in VOLL fully captures the strategic ability of generators to set market prices well above SRMC in many circumstances (which is normal and appropriate commercial behaviour in oligopoly type markets). It is Origin's view that average market prices over time determine the level of investment in the NEM, which in turn is determined by market structure and the level of competition rather than VOLL *per se*, provided VOLL is set at a level above the cost of the most expensive units in the NEM.

In this regard there is no evidence that the current level of VOLL is set at a level which precludes the ability of generators to make meaningful profits, which appears to be demonstrated by the substantial level of generation that has entered the NEM to date. Nor has evidence been presented by the Panel to suggest that the current level of VOLL will not continue to attract sufficient investment into the NEM. As Origin sees it an increase in VOLL will only increase retailer risk.

Given these market uncertainties, we are not supportive of any change to VOLL at the present time.

Please call me on the number below if you wish to discuss any of these issues further.

Regards,

*[Transmitted Electronically]*

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