20 July 2012

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

Dear Mr Pierce

ERCO123: Draft Determination - POTENTIAL GENERATOR MARKET POWER IN THE NEM

Origin Energy Limited (Origin) appreciates the opportunity to comment on the Australian Energy Market Commission's (AEMC) Draft Determination to the Major Energy Users (MEU) Potential Generator Market Power Rule change proposal.

Origin welcomes the AEMC's decision to not make the proposed Rule given the absence of evidence of the exercise of substantial market in the National Electricity Market (NEM). It is our anticipation that the AEMC's findings under this extensive process will preclude the need for another such review in the immediate term, allowing for a more stable regulatory environment which is crucial for investment. Generally this submission focuses on two areas:

- Support for the draft decision; and
- Questions surrounding the rationale for any additional ongoing monitoring of spot pricing outcomes.

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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The Draft Determination

Origin welcomes the AEMC's decision to not make the proposed rule. The analysis undertaken by NERA and CEG clearly shows that there has been no trend of wholesale spot prices being above LRMC. This is consistent with the absence of substantial market power, which renders the rejection of the MEU's proposal the appropriate course of action. Regulatory intervention where there is no market failure is likely to impede rather than advance the achievement of the national electricity objective.

In our submission to the Directions Paper we cautioned against the over reliance on the results of any LRMC/spot price analysis as a means of justifying regulatory intervention, particularly given the intricacies of determining LRMC. NERA's approach in estimating the LRMC using two separate methodologies is prudent, and helps to allay some of these concerns. The use of two distinct approaches which both show that prices have not exceeded LRMC for any extended period of time gives greater credence to the overall conclusion that market power is not a cause for concern. Additionally, the estimation of a range of LRMC values under the approximation method lessens Origin's initial concern that the AEMC might have been seeking to achieve a level of precision that is not practical. Comparing pricing outcomes against a range of plausible LRMC values is reasonable and is less contentious than basing the analysis on a single LRMC figure.

Notwithstanding the above Origin cautions against any future use of this methodology that would seek to determine the likelihood of any exercise of market power in the future. Any such analysis would be based on a number of assumptions and would be highly imprecise (even more so than the backward looking analysis carried out under the current process) and thus the ensuing results could not be used as a means of justifying regulatory intervention.

Importantly, the Draft Determination highlights a number of key characteristics surrounding the functioning of the NEM. These are worth documenting and should serve as a useful filter if any similar concerns to those of the MEU's are raised in the future. These include that:

- Spot price variability/volatility is an inherent feature of the market due to marked fluctuations in the demand/supply balance. Given this, the observation of pricing outcomes at any particularly point in time is not necessarily indicative of the overall well being of the market – a longer term view is required;
- High prices are not necessarily reflective of market inefficiency and in fact play a critical role in signalling investment; and
- Generators must have the ability to recoup the full cost of producing energy over the life of their plant – i.e. they must be able to recover LRMC. Any initiative that constrains this ability, (such as the MEU's proposal) will act as a disincentive to invest and is likely to have a negative impact on reliability.

Ongoing monitoring

Origin notes that CEG has recommended that there should be ongoing monitoring of the South Australian (SA) region. The basis of CEG's argument seems to be that conditions in SA could give rise to barriers to entry. This, it considers, could allow for the exercise of substantial market power at some point in the future. However, whilst each region may have a particular set of circumstances surrounding new entry; these should not always be considered to be barriers to entry.

A precondition for the exercise of substantial market power is the existence of significant barriers to entry which would allow for the maintaining of prices above an efficient level for an extended period of time. Given that the AEMC's analysis reveals that there is no evidence of the exercise of substantial market power in NEM, (including SA), the logical conclusion is that there are also no significant barriers to entry.

It is important to note that the performance of the NEM and the bidding behaviour of market participants are already subject to regulatory scrutiny. The Australian Energy Regulator (AER) publishes a weekly report that outlines the performance of the market, including spot pricing outcomes. Additionally, the AER is also required to publish a report explaining the circumstances surrounding spot prices above $5000/MWh. The Australian Energy Market Operator too is required to publish market events reports. Given these, it is unclear as what form any additional monitoring would take, and if it is indeed required. It is important that any such monitoring is not intrusive and does not add to the regulatory burden of market participants.