LUMO ENERGY

4 September 2014

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted electronically

Dear Sir/Madam,

Re: Optional Firm Access Design and Testing: Publication of First Interim Report

Introduction
Lumo Energy welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) publication of its First Interim Report on the Design and Testing of Optional Firm Access (OFA).

We are 100% owned by Infratil Limited, a company listed on the New Zealand and Australian Stock exchanges. We sell gas and electricity in Victoria and New South Wales and electricity in South Australia and Queensland. We are one of the largest second tier retailers.

The Lumo Energy generation portfolio consists of 163.4MW of diesel peaking generation. Of this total 135.4MW is located in South Australia with the remaining 28.8MW based in New South Wales. Our major generation sites are classified as "non scheduled" meaning that Lumo Energy does not bid the units into the market. Therefore, our comments regarding OFA are made as an energy retailer.

As part of the ongoing development of OFA, the COAG Energy Council has directed the AEMC to develop OFA in more detail to undertake an assessment of the impact of implementing it. In response to this, the AEMC has released its First Interim Report on the design and testing of OFA. The report provides the market with an update of the AEMC's progress in developing the core elements of the design of OFA.

The analysis presented in the First Interim Report highlights the quality and work completed by the AEMC to date in progressing the COAG Energy Council's reform agenda. Lumo Energy is pleased to have the opportunity to participate in this market reform, and appreciate the amount of effort made by the AEMC in progressing a reform of this magnitude.

In this submission to the AEMC, Lumo Energy does not take a position on supporting or objecting to OFA. We take this position as we have only begun to assess the OFA model in some detail and do not consider it appropriate to comment on the merit of the proposal. Both the AEMC and the other market participants that have worked on developing OFA over the course of the Transmission Frameworks Review (TFR) would be better qualified to comment on the merits of OFA. As such, in this submission we comment on some of the key elements of OFA from the perspective of an energy retailer.

Firmer Access Standard Supported
Lumo Energy supports the introduction of a revised firmer inter regional access product developed by the AEMC in its First Interim Report.

The revised firm access product provides the market with a more reliable inter-regional hedge compared with the previous product developed by the AEMC in its Transmission Frameworks Review (TFR).

In the TFR, the AEMC developed a product with a firm access standard that would be applied in a defined set of conditions – normal operating conditions. The normal operating conditions would include system normal (where all transmission elements are in service) and planned outages (where the TNSPs plan for some transmission elements to be out of service). The firm access standard developed would require TNSPs to provide the agreed access amount specified in each access agreement under normal operating conditions only.

The revised firm access standard developed by the AEMC would apply at all times. It would incorporate both normal and abnormal operating conditions. It would not rely on the specifications of normal and abnormal operating conditions. And, it could be applied over a wider range of conditions, improving the certainty of the firm access standard that would be available to the market.

Short term and long term inter-regional firm access standard supported
Lumo Energy supports both the short term and long term firm inter-regional access products developed by the AEMC.

Both generators and retailers could procure firm inter-regional access rights that would entitle them to the price difference between two NEM regions. The firm access standard product would be firmer than the Settlement Residue Auction (SRA) units that are currently available for purchase, since the units are not dependent on interconnector flows. On the whole, this reform would give the market greater confidence to trade across regions.

Additionally, Lumo Energy considers the issuance arrangements being proposed for both of these firm inter-regional access products to be satisfactory. More specifically, Lumo Energy is comfortable with short term firm access service being offered in quarterly blocks and are supportive of long term firm access service being offered on an annual basis.

Secondary trading of short term and long term inter regional firm access supported
Lumo Energy supports the secondary trading of firm inter-regional access (whether short term or long term) products as proposed by the AEMC.

Efficient trading mechanisms of firm access products would encourage secondary trading of firm access. This progression and development of deeper liquid markets for these products would be benefit the NEM.

The AEMC considers that it would be appropriate for secondary trades to be issued through some public auction system. Whilst we have no policy position on this issue, we support arrangements that will facilitate the efficient trading of secondary markets for firm access.

Clarification on the treatment of SRAs
Lumo Energy seeks clarification of the treatment of the current Settlement Residue Auctions (SRA) products if they are replaced by the firmer inter-regional hedge product under OFA.

Market participants currently manage inter-regional risk by purchasing SRAs. The SRAs available in the market are auctioned over four quarters. Currently, these products are purchased by market participants providing an inter-regional hedge for up to three years.

An important consideration for any retail business will be to determine how our existing portfolio of SRAs will be treated under OFA.

It will be important for the AEMC to provide the market with additional information on how they plan to deal with this issue if OFA is introduced.

Long Run Incremental Cost (LRIC) pricing
The LRIC cost recover method in OFA appears sensible.LRIC involves payment from a market participant that seeks firm access to pay for the incremental cost (both capex & opex) of bringing forward a reliability augmentation on the network.

The LRIC methodology compares favorably to alternatives that require access seekers to pay for the entire cost of an augmentation (deep connection). The LRIC model ensures that a market participant only pays for its share of the costs of bringing forward an augmentation compared to paying for the augmentation in full.

Perhaps the AEMC should provide greater clarity on how the cost of Firm Access Service (FAS) would be priced under the LRIC model. To date, the AEMC has presented the LRIC pricing model in a stylised format without any detailed practical examples of LRIC pricing.

A key issue that Lumo Energy would like the AEMC to explore in detail is to understand whether a market participant that seeks firm access would be required to pay for the costs (capex and opex) costs of bringing forward an augmentation that was justified under the RIT-T on the interconnector or whether we would we have the option of requesting we pay for the costs of bringing forward a cheaper augmentation. It could be that some of the answers to these questions will be clearer after the AEMC releases its pricing model prototype.

TNSP Sales revenue
Lumo Energy considers that revenue recovered by TNSPs from offering short term firm access products should be kept to a minimum.

Ultimately, TNSPs are monopolies regulated under CPI-X incentive regulation. Therefore, the starting point for determining the level of revenue that a TNSP should be entitled to should not exceed its regulated revenues.

There appears to be two ways that a TNSP could potentially over recover their regulated revenues under OFA:

1. A TNSP could issue more short term FAS. Given that short term FAS will come from the current transmission capacity that has already been funded by consumers, this will give them the opportunity to “double–dip” and over recover their regulated revenue;

2. TNSPs may have an incentive to over build the transmission system under OFA to avoid compensating a generator for being constrained off.

The question of whether TNSPs should be entitled keep revenues they earn in excess of their regulated revenues are a complex question that we are probably not best placed to answer as a retailer. Nevertheless, our starting position would be that there is a strong principle applied that says that TNSPs should only recover their regulated revenues. A deviation from this principle would need to be justified on a sound basis.

Conclusion
Lumo Energy would welcome the opportunity to discuss our submission with the AEMC. We thank the AEMC for the opportunity to make a submission in response to the First Interim Report.

For any enquiries regarding this submission, please contact Con Noutso, Wholesale Regulatory Manager at Lumo Energy on 03 9976 5701.

Yours sincerely,

Justin Mulder
General Manager Wholesale
Lumo Energy Australia Pty Ltd