6 February 2018

Peter Adams
General Manager, Wholesale Markets
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Submitted via email: wholesaleperformance@aer.gov.au

Dear Mr Adams

Wholesale Electricity Market Performance Monitoring – Draft Statement of Approach and Draft 2018 Focus

Origin Energy Limited (Origin) welcomes the opportunity to provide comments on the Australian Energy Regulator's (AER) Wholesale Electricity Market Performance Monitoring Draft Statement of Approach and Draft 2018 Focus.

Analysing the effectiveness of competition and the efficiency of wholesale electricity markets is a complex task. Appropriately defining the overarching assessment framework will therefore be critical to ensuring the findings of the AER's performance monitoring are meaningful in the context of the National Electricity Market (NEM). Consistent with this, Origin believes it is important the following key factors are taken into consideration by the AER.

- *Defining market power*: The definition of market power should distinguish between any transient market power and the exercise of any substantial or enduring market power.
- *Assessment timeframe*: Observed pricing outcomes at a particular point in time are not necessarily indicative of the overall well-being of the market. A longer-term view that is consistent with timeframes for developing new generation is required to adequately understand the cyclical nature of pricing and investment.
- *Assessing market concentration and structure*: There is no one metric that can be relied upon to determine whether the market is effectively competitive or efficient. Metrics such as the Herfindahl-Hirschman Index (HHI) and Residual Supply Index (RSI) should therefore be carefully interpreted and only form part of the AER's overall assessment framework. Caution should be exercised in comparing outcomes in the NEM with other industries or markets which may be fundamentally different.
- *Vertical integration and derivative market liquidity*: There is significant mismatch between the location and profile of the generation and retail loads of each vertically integrated retailer. Vertically integrated firms therefore have strong incentive to be active participants in the hedge market. The AER's assessment should therefore also examine the extent to which vertically integrated firms support market liquidity and competition more broadly. Any such analysis should also take into account risk management options in the NEM more broadly, given an assessment of the derivatives market liquidity alone does not provide an adequate basis on which to determine if a lack of options is creating a barrier to entry.

- *Prices*: Analysis of levelised cost of energy (LCOE) and/or long run marginal cost (LRMC) will be heavily dependent on the underlying assumptions and methodology. Given it is unlikely any one approach or set of assumptions will be universally agreed upon, Origin believes the AER should: consider a range of approaches; be transparent in its methodology; and not solely rely on the output of this analysis.

In addition to the above, Origin is supportive of the AER relying on publicly available information to carry out its monitoring functions. This will assist with reducing the reporting burden on businesses and also avoid unnecessary duplication of effort, given the range of information and data that is already transparently reported and assessed by various bodies, including the AER.

More detailed feedback on the AER's proposed approach is provided in Attachment 1. 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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Wholesale market performance monitoring framework

Framework element	Origin views
Overarching definitions	
1. Market power	Appropriately defining market power is crucial in framing the AER's assessment of wholesale market performance. Economic theory points to the existence of some degree of market power in all market structures except for a perfectly competitive market, which does not exist in reality. This is particularly relevant in the context of the energy only markets, where periods of price volatility in response to tightening supply/demand conditions enable generators to recover fixed costs. Consistent with this, in considering market power the AER should distinguish between any transient market power and the substantial or enduring market power.
2. Relevant products	The principal product traded in the NEM is physical electricity, therefore this should form the key area of focus for the AER's wholesale monitoring function. The AER also notes it intends on assessing the performance of Frequency Control Ancillary Services (FCAS) markets and spot markets separately. Given the NEM dispatch engine co-optimises energy and FCAS requirements, Origin believes any assessment of FCAS market structure/performance must recognise that outcomes observed are not independent of those in the energy market. As identified through AER's monitoring of high FCAS price events, plant availability and operational limitations can also impact the performance of these markets.
3. Relevant timeframe for assessment	Spot price volatility is an inherent feature of the NEM and participants do not enter or exit the market on the basis of prices in a particular 30 minute trading interval. Rather, market participants make business and investment decisions based on their ability to earn a commercial return over the life of their investments. Both transmission and generation investments also require significant lead times, not just for the construction of the project, but also to complete planning and approval processes. Observed pricing outcomes at a particular point in time are therefore not necessarily indicative of the overall well-being of the market. A longer-term view that is consistent with timeframes for developing new generation is required to adequately understand the cyclical nature of pricing and investment.
Assessing market structure and performance	
4. Market concentration metrics	Analysis aimed at determining the level, and impact, of market concentration are likely to have limitations. Metrics such as the HHI and RSI should therefore be carefully interpreted and only form part of the AER's overall assessment framework. Where these tests are employed, the results should not be automatically viewed as being reflective of a particular level of market competitiveness or efficiency. Additionally, caution should be exercised in comparing outcomes in the NEM with other industries or markets which may be fundamentally different.

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5. Vertical integration	In looking at vertical integration, the AER should note that: ▪ The extent of effective integration cannot be determined by simply observing an integrated entity's generation and load. There is significant mismatch between the location and profile of the generation and retail loads of each vertically integrated retailer. As a result, integrated firms are still active participants in hedge markets. ▪ Vertically integrated retailers have a strong incentive to supply hedge contracts, even in preference to using generation to back their retail load if hedge prices diverge from expected spot prices. Given the above, the AER should examine/discuss the extent to which vertically integrated firms are likely to support liquidity in the contracts market. The AER should also broaden its analysis to include a discussion on how vertical integration may support effective competition.
6. Liquidity of derivatives markets	In considering the liquidity of derivative markets, we suggest the AER should: ▪ Look to define liquidity. In our view a liquid market is one where participants can trade without significantly impacting the price. ▪ Note that while liquid markets tend to have high trading volumes, lower volumes are not necessarily indicative of declining liquidity. Market participants are likely to increase trading activity at times of high and volatile prices, with less incentive to do so when prices are lower or more stable. ▪ Acknowledge that vertically integrated firms can support liquidity given they still have incentive to trade in the market. ▪ Bear in mind that while liquidity is an indicator of the extent to which participants are utilising derivative products to manage risk, participants also employ other risk management tools. Given the range of strategies available to manage risk, assessing the liquidity of derivatives markets does not provide an adequate basis on which to conclude there are barriers to entry. Any such analysis should therefore be coupled with a broader assessment of risk management options available to market participants. It is also important to ensure derivate market liquidity is assessed in a meaningful way. Simply observing the volume of ASX and OTC contracts traded in the market may provide misleading results, given trading volumes vary along with market participants' appetite to hedge pricing risk.
7. Prices	The outcomes of any LCOE and/or LRMC analysis will be dependent on the underlying assumptions and methodology. Given it is unlikely any one approach or set of assumptions will be universally agreed upon, Origin believes the AER should: consider a range of approaches; be transparent in its methodology; and not solely rely on the output of this analysis.
8. Market efficiency	In assessing the efficiency of the market, the AER intends on highlighting issues that compromise productive, allocative or dynamic efficiency. As part of this assessment, an overarching question the AER must reconcile is 'what is the optimal market outcome against which to measure inefficiencies?'. In reality, spot market outcomes reflect a range of different inputs, including: the contracting levels of market participants; system reliability requirements; and state/commonwealth renewable energy targets. Market intervention and

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	ongoing policy uncertainty can also impede market efficiency by distorting signals for investment. It is important these factors are taken into consideration when determining whether sub-optimal outcomes are being observed in the NEM.

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