

Australian Energy Market Commission
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Reliability Frameworks Review

The Australian Energy Council (the Energy Council) welcomes the opportunity to make a submission to the Reliability Frameworks Review Interim Report.

The Energy Council is the industry body representing 21 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses. The Energy Council has a number of members participating in the Review's Technical Working Group and many members will contribute their own submissions.

Introduction

The Energy Council supports the Assessment Framework as laid out in Appendix A. The Interim Report presents a thorough exercise into the key themes affecting reliability in an electricity market, investigates some contemporary proposals and presents useful international comparisons.

As discussed in the Report, the National Electricity Market (NEM) has produced successful reliability outcomes for the majority of its history, as presented in figure 3.1. The Energy Council is concerned regarding significant market design changes that may be pursued in hurried reaction to topical events. It is important that all proposals are carefully considered through the scrutiny of a framework such as that in Appendix A and in that regard the Commission's approach is welcome.

Furthermore, subsequent to the self-initiation of the Reliability Frameworks Review, the Energy Security Board (ESB) was tasked by COAG with designing a Reliability Guarantee. This will directly address the question of NEM reliability, and it would seem ill-timed to progress overlapping proposals ahead of that process. Nevertheless the Energy Council supports completion of the Reliability Frameworks Review, which we consider will provide a key input to the ESB process.

Context and Concepts

The Energy Council agrees with the general context of NEM reliability as described in the report, in particular:

- Adequate power system reliability best emerges through a market-based framework.
- That an economically based reliability standard should be promulgated by the Reliability Panel, supported by consistent market settings.

- That centralised information provision, such as demand forecasts, is a critical part of the market-based framework and the framework's success hinges upon its quality.
- That intervention is distortionary and implies a failure in the market-based framework.

The Energy Council agrees with the listed emerging challenges to reliability, but supports addressing them primarily within a market-based framework, fostering primary and secondary markets.

The Energy Council appreciates the Commission's efforts to define the concepts of dispatchability, flexibility and reserves in chapter 3. Only by achieving initial clarity can one grasp whether the existing market, or an enhanced design, adequately rewards each.

Forecasting and Information Provision

The Energy Council agrees that centralised information is a critical enabler of a well-functioning market and therefore reliability. The well documented over-forecasting of demand growth as presented in Figure 4.1 significantly contributed to over-investment and excess supply in the first half of the current decade, and current conditions reflect in part an over-correction of that period.

The Report correctly recognises short-term forecasts are also critical, as they assist reliable market operations. For example the 8 February 2017 load shedding may have been avoided through higher quality forecasts. The Energy Council understands the Directions paper will provide analysis on short-term forecasting performance, which is highly welcome.

As the NEM's central forecasts are prepared by a not-for-profit body, effective non-financial performance measures are necessary, such as clear, public benchmarking and board accountability.

The Energy Council considers that non-scheduled activities represent a growing challenge to NEM forecasting, and previous attempts to address this through Rule changes have been unsuccessful. This Review presents an opportunity to reconsider this important issue.

The Contract Market

The Energy Council supports the prominence that the Review has allocated to the success of secondary markets which is critical to underpinning the investment from which reliability will flow. The empirical information on the health of the current contract market is therefore valuable. The Review will need to consider, qualitatively, the impact that other reforms are likely to have upon it in the future; such as changes to settlement period and the National Energy Guarantee.

Wholesale Demand Response

The Energy Council considers that demand response has a beneficial role to play in supporting reliability when it participates in the market directly, and many of our members are highly active in facilitating exactly this with their customers. This supports the Commission's preliminary view that there are no regulatory barriers to market-based demand response and that additional mechanisms specifically targeting it are unnecessary and potentially distortionary.

Strategic Reserve

The Commission's cautious approach to this proposal is appropriate. The Reliability and Reserve Trader (RERT) mechanism remains controversial after twenty years of existence, and the Standing Reserve model is a substantial escalation of the concept.

Whilst the RERT represents an intervention and creates some distortions, its use is limited only to rare situations where the market has failed to deliver the economic reliability standard. In contrast, by design standing reserve continuously targets a higher level of reliability than the standard. This is problematic; whatever level of reliability that is deemed necessary for customers should also be reflected in the market

settings and incentives for market-facing investment. This means its costs are efficiently reflected in the spot price, where its risk can be managed by market participants.

The Commission notes that if community or political expectations have moved beyond the existing reliability standard, then it would be more appropriate to move the standard rather than introduce a non-market mechanism. Whilst not disagreeing, the Energy Council prefers that the standard should remain at an economic level as determined by the reliability panel, and that other expectations should be managed through education. The independence of our NEM institutions was intentionally created to enable them to confidently implement the National Electricity Objective, even when politically unpopular.

Day-ahead Markets

Whilst Day-Ahead Markets (DAM) have received much discussion during 2017, the Interim Report presents the first detailed institutional description of it, and is most welcome. There appears to be a wide range of designs used internationally, with entirely different implications. In particular the characteristic of being mandatory or voluntary implies major differences in objectives and regulatory burden. It is important that advocates of DAM clarify where their preferred model sits on this spectrum.

The Energy Council concurs with the Commission's desire to identify a specific problem that a DAM is attempting to address before progressing its design. With respect to:

- A voluntary DAM, there needs to be evidence that the industry could benefit from a short-term contracts trading platform, and is unable to create it autonomously.
- A mandatory DAM, evidence needs to be demonstrated of difficulties created in the existing pre-dispatch process by participants' freedom to regularly adjust their operations.

The Commission has correctly recognised that each international DAM example has evolved within a different context than the NEM, and cannot be readily imported. In particular mandatory DAMs are usually operated in the context of an explicit capacity mechanism, central unit-commitment, nodal pricing and financial transmission rights. Any shortcomings in the NEM's existing pre-dispatch processes could certainly not justify such fundamental reforms, so a mandatory DAM would need to be bespoke to the NEM arrangements.

Conclusion

In conclusion, the Energy Council believes that the review should concentrate on providing a market-based framework to ensure the reliability standard is met, and be considered in the context of the Energy Security Board's designs for the Reliability Guarantee. Furthermore the provision of appropriate information to AEMO and its use to prepare quality forecasts is critical to anticipating reliability issues before they arise. The Energy Council advocates analysis being conducted into forecasting accuracy and, if necessary, encouraging improvements in information provision and forecasting processes to support the reliability standard.

Any questions about our submission should be addressed to by email to ben.skinner@energycouncil.com.au or by telephone on (03) 9205 3116.

Yours sincerely,



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