3 March 2022

Charles Popple
Chairman and Commissioner
Australian Energy Market Commission

Dear Mr Popple

2022 Reliability Standard and Settings (RSS) Review (REL0082)

Hydro Tasmania welcomes the opportunity to respond to the Reliability Panel's *2022 RSS Review*.

As the National Electricity Market (NEM) undergoes a rapid transformation, it is critical that the market settings can deliver necessary investments in our future energy mix, capable of maintaining a secure, reliable and affordable electricity supply for all consumers. We consider that this review provides a timely opportunity to reassess the NEM's reliability framework holistically, and consider amendments to strengthen future reliability outcomes. In particular, the announced early closure of Eraring Power Station in 2025 presents a challenge to the market to replace capacity in a timely fashion, and provides an important backdrop for this review.

Hydro Tasmania believes that amendments to the RSS can provide the basis for maintaining a secure and reliable supply of energy in the NEM. We do not believe there is sufficient evidence at this time to move away from the NEM's energy-only market design.

Hydro Tasmania has provided some comments for the Panel's consideration in Attachment A. If you wish to discuss any aspect of this submission, please contact me on (03) 8612 6443 or at Colin.Wain@hydro.com.au.

Yours sincerely,

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Attachment A – Hydro Tasmania's comments on the RSS

1. Reliability Settings

Collectively, the NEM's Reliability Settings should be optimised to deliver strong and robust investment signals to meet the Reliability Standard at least-cost to consumers. The current Market Price Cap (MPC), Cumulative Price Threshold (CPT) and Administered Price Period (APP) forms a natural hedge for sellers of risk management derivatives. There could be a risk that these settings mute the investment signals for longer duration capacity in favour of shorter term capacity that will benefit from the protection offered by the artificially capped MPC, CPT and APP. Hydro Tasmania recommends further consideration of this issue and the implied investment signals against the resource mix needed for a reliable, secure and affordable low emissions system.

i. Market Price Cap (MPC)

Hydro Tasmania strongly supports the Reliability Panel's observation that *"It is not necessarily the case that a lower MPC will lead to lower average consumer costs. Similarly, a higher MPC may not necessarily lead to higher consumer costs."* If recalibrated accurately, Hydro Tasmania considers adjustments to the MPC (in conjunction with suitable amendments to other reliability settings) will deliver significant benefits.

The Australian Energy Regulator's analysis sets the Value of Customer Reliability (VCR) significantly higher than the current MPC. Noting the importance of reliability settings to provide investment signals to the market, we query whether it may be appropriate to reduce the divergence between the MPC and VCR, and carefully consider what behaviours/responses this may elicit from market participants. An increase in the MPC would sharpen signals to invest in new capacity by creating a greater demand for financial derivatives in order to manage price risk, and importantly, will allow the MPC to more accurately reflect the real value of reliability in the energy-only market. If the MPC and CPT are adjusted appropriately, alongside the introduction of new markets for Essential System Services, we believe the current market frameworks can successfully incentivise the appropriate mix of assets required to achieve reliability objectives under a high-renewables future.

The rationale for changes to the MPC must be accompanied with clear and unambiguous messaging. This will be critical to dispel any misconceptions that might arise from proposed adjustments to the level of the MPC (particularly any proposed increases). We note the Panel's view that *"…while the MPC may move either up or down over time, these movements should be gradual"*. However, it's important that these adjustments should not be so gradual that they fail to adequately incentivise the investments necessary to support optimal reliability outcomes in future energy scenarios. This is a delicate balance to manage, particularly in the context of our rapidly evolving market, and we look forward to engaging with the Panel as this review progresses.

ii. Cumulative Price Threshold (CPT)

The Issues Paper observes that *"…a higher CPT increases the effectiveness of price signals as an effective investment cue…"* and that *"The level of the CPT will also affect the investment decisions regarding the duration of storage for battery storage plant…"* Hydro Tasmania strongly agrees with these observations. If adjusted correctly, we believe amendments to the CPT could prove highly effective in incentivising investments in much needed 'deep storage' assets such as Pumped Storage Hydro.

As currently set, the CPT limits the duration at which high prices can persist, before entering into the Administered Price Period. Historically, this has been a logical measure to protect consumers from prolonged periods of scarcity pricing when major non-credible contingencies occur. However, as our energy supply becomes increasingly reliant upon weather-dependent energy resources, careful calibration of the CPT is required to ensure an adequate mix of resources are incentivised to manage extended periods of low wind and solar outputs. On this basis, we support the Reliability Panel's intent to examine whether the current form and level of the CPT sends the right price signals to invest in an appropriate mix of short, medium and long-duration energy storages.

iii. Administered Price Cap

For consistency with the approach to index the CPT and MPC, we recommend the Panel to also consider indexing the APC. While we recognise the important role of the APC in protecting customers from financial stress due to sustained high prices, we also consider that indexation of the APC is required to maintain effective market signals for investment and operation of flexible generation and storage. In the long term, we expect that greater entry and use of these technologies will improve reliability in the NEM as it transitions away from thermal generation towards higher uptake of VRE.

We also agree with the option suggested in the Issues Paper to allow the APC to gradually decline from the high level during an administered price period, rather than the current approach of falling to some defined level (currently at $300/MWh) immediately. Under the current approach, the APC is most likely to affect long duration storage technologies which are most able to supply during sustained periods of high prices compared to short duration storage technologies. This may reduce the incentive for investment and operation of longer duration storage when most needed – potentially reducing reliability in the NEM.

We consider that allowing a gradual decline of the APC during administered price periods appropriately balances the need to protect consumers from high prices in the short term with the need to improve signals for investment in the required assets to support the NEM's transition in the long term.

2. The Reliability Standard

We support the Panel's intent to investigate the ongoing suitability of Unserved Energy (USE) as the key metric to inform forecasting practices in the NEM. As noted in the Issues Paper:

> *"A single metric has historically provided sufficient information to signal reliability risk. However, this may not be the case in the future when reliability is significantly influenced by energy constrained resources, rather than capacity limited thermal generation."*

We strongly agree with this statement, as it highlights the importance of ensuring that any amendment to the RSS drive investments in the appropriate mix of new generation and storage assets to meet future reliability objectives. While we do not hold a specific preference for any alternate or supplementary metric at this stage, we consider it a practical consideration as part of this review.

We also note that there appears to be a significant divergence in views between the current reliability standard, government expectations and customers as to the appropriate level of reliability and the value placed on this by stakeholders. This is demonstrated by the current reliability standard (0.002% unserved energy (USE)), the interim reliability standard (0.0006% USE), and other market interventions enacted by governments. If an alternative metric to define reliability is proposed, it must have the confidence of Federal, State and Territory energy ministers, ensuring that interventions that may act

to distort investment signals for reliability are only undertaken where there is a market failure. Hydro Tasmania believes that this review process should prioritise establishing a shared view amongst governments, policy makers, industry participants and consumers. This will provide a stronger foundation on which to pursue an effective NEM market design and settings.