Energy Retailers Association of Australia Limited

23 February 2010

Mr Neville Henderson
Chairman, Reliability Panel
The Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Re: REL0034 Reliability Standard and Settings Review Draft Report

Dear Mr Henderson

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide comments on the AEMC Reliability Panel's Reliability Standard and Settings Review Draft Report.

The ERAA is an independent association representing retailers of electricity and gas across Australia. This includes both incumbent retailers and second-tier providers, who collectively provide electricity to over 98% of customers in the NEM and are the first point of contact for end-use customers for both gas and electricity.

This submission identifies some key implications for retail competition that may arise following an increase to the market price cap (MPC) and cumulative price threshold (CPT). The ERAA sets out these retailer impacts for the Panel's consideration.

Market Price Cap

There are a number of retailer related implications, which need to be considered before increasing the MPC. In particular, the current approach to considering the MPC may oversimplify the investment process.

An increased MPC may lead to increased market volatility and higher spot prices. Consequently, AEMO is likely to increase prudential requirements for retailers participating in the NEM, requiring greater levels of bank guarantees. At the same time, contract market liquidity may reduce if generators offer fewer contracts to retailers. These higher costs can place retailers in financial stress, meaning smaller retailers may become less viable in the market. This could lead to market exit (including retail failure) and raise barriers to entry for new retailers. The overall level of competition may therefore decrease.

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The drivers for investment are complex and they need to be carefully considered in the broader context of market arrangements. ERAA believes the MPC is an important price signal for investment but not the only one that impacts on the reliability standard. The contract market is seen as the main driver of new investment. There needs to be a more conscious investigation into the link between the spot market and the contract market when considering the incentives for new generation investment. It is also important to consider the impact of other drivers on reliability improvement including network and interconnector investment.

The ERAA notes the concept that if the MPC is set too low, this may limit investment. However, an MPC that is set too high may be counter-productive as it may unnecessarily increase market volatility and complexity with no benefit to reliability. A more comprehensive consideration of these impacts is required to ensure an optimum balance between cost and reliability is achieved.

Cumulative Price Threshold

The ERAA sees the CPT as a key component of the market framework. However, over time, its purpose has lost clarity. A clear re-statement of the role of the CPT by the Panel is required. The ERAA holds the view that the CPT should limit the possibility of cascading financial collapse of the industry if extreme events outside the market design envelope were to occur.

ROAM's consideration of the CPT is unclear and potentially insufficient. Its Report does not adequately set out any CPT analysis. Also absent is a clear rationale for maintaining a fixed ratio of MPC to CPT. The ERAA would like to see a CPT recommended that is based on the clearly articulated purpose of the CPT and supported by solid rationale and robust analysis.

Retail Pricing Implications

The ERAA believes that any increase in the MPC would need to be reflected by increases in regulated retail tariffs in order to ensure the benefits of competition are not suppressed. As discussed above, an increase in the MPC is likely to increase retailer costs.

Retention of retail price caps in the face of rising energy costs associated with any increases to the MPC must be reflected in the regulated tariffs on a timely basis, and in a manner which ensures that retailer's value remains whole. Any time delays, or lost value, are likely to impact on the financial viability of retailers in an un-predictable way[1], which in the first instance is likely to distort competition, and potentially lead to retail exit, which may trigger RoLR events.

From a reliability perspective, regulated tariffs set below costs can be detrimental. Retailers are unlikely to contract with generators at rates above what they can recover from their customers. Arguably, such an outcome could breach their

[1] Retailers have no capacity to hedge value at risk driven by regulatory decisions.

fiduciary duties to shareholders. For this reason, any increase in MPC that was not passed through into regulated price caps would be unlikely to have any positive impact on the generator investment environment. It would be useful for the Panel to advise government stakeholders of this perverse impact of regulated price caps and encourage them to advance reform efforts aimed at removing them.

Yours sincerely

Cameron O'Reilly
Executive Director
Energy Retailers Association of Australia