

04 September 2014

Mr John Pierce
Chair
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By email: aemc@aemc.gov.au

Dear Mr Pierce

Re: First Interim Report: Overview Report, Optional Firm Access, Design and Testing (Reference: EPR0039)

The Consumer Utilities Advocacy Centre Ltd (CUAC) is a specialist consumer organisation established in 2002 to represent Victorian energy and water consumers in policy and regulatory processes. We have been following the Optional Firm Access (OFA) framework development through our seat on the AEMC's OFA Advisory Panel and participation in the public forum on 14 August, 2014, in Sydney, as well as discussions with other consumer groups.

CUAC welcomes the OFA framework's goal to increase the National Energy Market's (NEM's) resilience and sustainability, to better coordinate investment in transmission networks and generation, and to decrease the downside risks for consumers. We support consumers facing less risk of inefficient transmission investment decisions, and generators facing less volume and price uncertainty.

The risk and uncertainties faced by the NEM, and the likely changing patterns of demand and generation as technologies change and Australia undertakes the necessary process of energy decarbonisation, mean robustness and adaptability are very important policy considerations. The OFA framework offers great potential benefits in this regard.

For the reasons given above, CUAC supports the aims of the OFA framework. However, we have concerns around several issues, including transitional arrangements as well as interaction with reliability standards and demand side mechanisms.

Transitional arrangements

We acknowledge that the implementation of the OFA framework would represent a material change in operation conditions for market participants, and that some form of transitional arrangements would be appropriate to lessen any shocks related to its introduction. Temporary provision of free OFA rights could well provide such an arrangement.

However, we have seen no compelling reason why the target level of free OFA rights should not be zero, nor why the 'sculpting' – the decrease in the number of free rights – should not occur as quickly as possible.

Further, we strongly oppose any transitional process that provides advantages to incumbent market participants over potential new entrants. At the time the NEM was developed, one of its objectives was that, "A person wishing to enter the market should not be treated more favourably or less favourably than if that person were already participating in the market." Rephrased, this principle states that no party should receive an advantage simply because it has entered the market earlier than another party.

As it applies to sculpting, this principle means that any new entrant should receive the same treatment as if it had been in the market when the transitional arrangements started. No party wishing to enter the market should be treated less favourably than one already participating in the market.

Given that a major goal of implementing an OFA framework would be to increase the NEM's ability to change, it would be a perverse outcome if the transition to this framework entrenched advantages for incumbent participants or the current generation structure. Favourable treatment of incumbent generators – the majority of which are powered by fossil fuels – could interact negatively with future policies aimed at transforming the energy sector, in particular policies that try to achieve decarbonisation.

For example, under a future carbon price, free OFA permits for incumbent generators could skew the effect of the carbon price on the electricity sector relative to other economic sectors. This would not be in the long term interests of energy consumers.

'Grandfathering' rights distorts the market and create opportunities for windfall profits for incumbents. It is a wealth transfer from the public to incumbent generators, and will create a barrier to entry for new participants. In our view, this is clearly not in consumers' interests; nor, indeed, would any other 'gaming' of transitional arrangements be in consumers' interests.

We support the consideration of alternative transitional arrangements as proposed by the Centre for Energy and Environmental Markets in their Optional Firm Access working paper and submission.¹

Interaction with reliability standards and demand side mechanisms

Under the proposed OFA framework, there would be two standards for transmission businesses to meet: the standard demanded by generators through their purchase of OFA rights, and the AEMC's reliability standards. The higher of the two is decisive for the level of network investment, and it is unclear to us how the potential benefits of the OFA framework can be realised in situations where the reliability standards exceed the firm access standards.

We are pleased to see that the first interim report recognises this issue, as it deserves further exploration.

It is also important to note that the OFA framework would not be a change occurring in isolation. Policies that target demand, whether at a distributed level or at the level of individual high volume users, increasingly have the potential to materially reduce network congestion. While demand side policies don't address as many areas as an OFA framework might, their implementation may reduce a key potential benefit of the OFA scheme.

For example, if a transmission business could meet its relevant standards by reducing demand during times of congestion, there wouldn't necessarily be as much incentive for generators to secure firm access.

We are interested to see how demand side policies might interact with the OFA framework – or, in the absence of demand side policies, how consumers themselves create a new demand-side scenario.

Other considerations

We support the suggestion of the Victorian Department of State Development, Business, and Innovation that the AEMC consider the effects of OFA on wholesale and retail competition in their market review, to ensure that the direct competition benefits of OFA flow through to consumers.²

We also agree that the AEMC should not give disproportionate weight to transaction cost measurements versus longer term efficiency and competition benefits simply because the former are easier to measure. As suggested by the South Australian Department of State Development, a sensible course of action may be to use quantitative modelling to inform a qualitative assessment.³ However, this should not imply a less rigorous assessment: we

¹ Riesz, Gilmore, and MacGill (2014) Working Paper on the proposed Optional Firm Access model for the Australian National Electricity Market; and Riesz, Gilmore, and MacGill (2014) Second Working Paper on the proposed Optional Firm Access Model for the Australian National Electricity Market

² DSDBI, presentation to the AEMC public forum on OFA, 14 August 2014

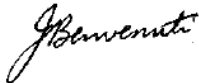
³ SA DSD, presentation to the AEMC public forum on OFA, 14 August 2014

encourage modelling where possible, such as in case studies of generation currently planned for constrained parts of the network and how OFA might function there. Modelling should involve working with the incumbent generators.

As is appropriate for a framework designed to deal with changing patterns of demand and generation, we consider it is important that the OFA framework be evaluated across a broad range of future scenarios. Relatedly, we are interested in how easily the OFA framework itself would be adaptable if the problem it is addressing changes; what preconditions underpin its successful operation in the proposed form, and how could it react to the absence of those preconditions to still deliver value?

CUAC looks forward to working together with the AEMC and other stakeholders on this issue. Questions or feedback should be directed at Martin Jones, martin.jones@cuac.org.au or 03 9639 7600.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jo Benvenuti', written in a cursive style.

Jo Benvenuti
Executive Officer