Mr Neville Henderson
Chairman of the Reliability Panel
Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney NSW 2000

Lodged online via www.aemc.gov.au

Wednesday 20/12/2017

Dear Mr Henderson,

RE: Reliability Standard and Settings Review 2018 draft report REL0064

ENGIE appreciates the opportunity to provide feedback on the Reliability Standards and Settings Review 2018 draft report.

ENGIE is a global energy operator in the businesses of electricity, natural gas and energy services. In Australia, ENGIE has interests in generation, renewable energy development, and energy services. ENGIE also owns Simply Energy which provides electricity and gas to more than 630,000 retail customer accounts across Victoria, South Australia, New South Wales and Queensland.

Effectiveness of the existing reliability settings

The Reliability Panel concludes that no changes to the reliability standard and settings are required because:

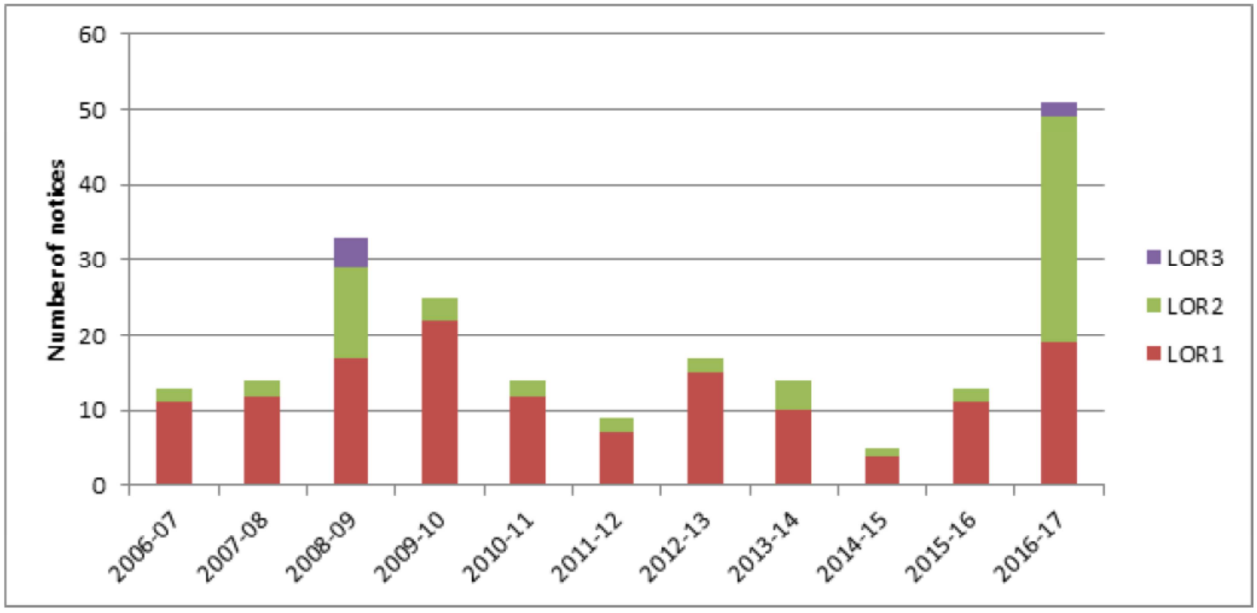
- current settings are achieving their purpose and likely to continue to do so out to 2023/24;
- Market Price Cap (MPC) and Cumulative Price Threshold (CPT) parameters are sufficiently high to allow investment to occur; and
- provision of regulatory certainty by not changing parameters will benefit consumers.

These recommendations do not appear to fully account for the developments in the National Energy Market (NEM) where there is ongoing policy uncertainty, several market interventions and technology uncertainty. A reliability settings review may need to consider these over a longer timeframe then out to 2023/24.

Recently, the Australian Energy Market Operator (AEMO) used the reliability and emergency reserve trader (RERT) in a less than transparent matter. Both demand and supply side responses were acquired in advance of the summer period.

Australia
Level 33, Rialto South Tower,
525 Collins Street Melbourne, Victoria 3000, Australia
Tel. +61 (0)3 9617 8400 Fax +61 (0)3 9617 8401 engie.com.au

According to the Energy Security Board “The Health of the National Electricity Market” 2017 annual report, the number of the number of low reserve notices is at an all-time high as illustrated by the following chart.



Source: AEMO and AEMC

This perhaps suggests the current reliability settings are not working effectively.

Additional measures are being implemented in South Australia to bolster system security and reliability at a cost of $550 million to consumers and taxpayers. Broadly speaking, the introduction of additional generation is distortionary to the NEM and further undermines investor certainty.

The draft report fails to acknowledge the gravity of the market interventions and distortions, and fails to explicitly consider the impact of these interventions on existing assets and the investment environment in the medium to longer term. Arguably, the reliability settings should consider these developments and strive to prevent the need for market interventions.

The market price cap setting in light of uncertainties

In our previous submission, ENGIE developed a case that the MPC needs to be effectively calibrated to incentivise generator and demand side response to deliver a ‘two sided’ electricity market. The ‘two-sided’ market is critical in moving away from a default value of customer reliability to a real value as set by customer choice. A two sided market would also serve to allay concerns over situational market power as the price could be set by supply or demand.

Should the MPC be set too low, supply or demand side response will be discouraged since some of the inherent risk in the market would be mitigated ‘for free’ by the regulated price cap. This will in turn lead to reduced incentive to forward contract, and hence impede liquidity in the contract market and eliminate some of the medium/longer term market signals that are essential to support investment.

The MPC needs to be set at a sufficiently high level to underpin an active demand response sector and to encourage unsophisticated commercial players to contract and not 'ride spot' on the back of oversupplied intermittent generation.

A fundamental principle in setting the MPC should be to ensure that the cap is 'out of the way' in all plausible scenarios considered. In this way both sides of the market (supply and demand) can respond below it. Such a response would also decrease the risk of market intervention by AEMO or on state basis, and serve to increase policy certainty (less cause for politically motivated responses to arising concerns).

In ENGIE's view it can be argued that investment in the NEM has been seriously compromised by policy interventions and therefore risk (and hence WACC) has increased at the same time as payback periods have been severely shortened across all technology types. This doesn't impact just new entrants but any investments related to existing plant, especially when considering refurbishment of plant.

ENGIE welcomes the inclusion of a number of these key uncertainties, especially the gas price sensitivities, increased WACC and shorter asset life, in the E&Y modelling.

E&Y modelling results show that in Victoria a setting of >$24,000/MWh is required to maintain the 0.002% USE reliability standard. When a higher level of WACC is used or a shorter asset life is modelled, the MPC setting needs to be in excess of $50,000/MWh.

Unfortunately the draft report proceeds to dismiss these higher settings on the basis that these scenarios are unlikely and would serve to increase cost to consumers.

As previously outlined, if the MPC/CPT settings are too low, there is increased probability of market interventions which entail their own costs to taxpayers and consumers. To make a meaningful comparison between alternative settings, the Reliability Panel needs to assess the impact of interventions on the market, investments (existing and prospective) and prices to customers. Cost of interventions and/or load shedding is quite material. According to the Energy Security Board 12/17 report, interventions are costing tens of millions of dollars due to compensation and inefficient dispatch.

It is important to minimise the need for on-going invention in the market instead of using interventions to manage the "top end" issues in the market and facilitate investment.

The Victorian Renewable Energy Target and associated auction arrangements have been established by the Victorian Government to satisfy policy goals in that state. There is a risk this mechanism will stress the system and present challenges to existing plant under the current reliability settings. In that context, it could be suggested that the MPC should be increased to make it consistent with the reliability standard under most scenarios considered.

5 minute settlement impacts on reliability settings

The study and report don't appear to consider the potential impacts of the 5 minute settlement dynamics on the reliability settings.

Peaking plant (i.e. CCGT) will not be able to rely on the 30 minute averaging to achieve revenue adequacy and its short term revenue will become more uncertain. Open cycle gas turbine plant takes 10-20 minutes to start-up. Such

plant must have a reasonable prospect of recovering its start-up costs as well as the short run marginal costs (fuel cost, incremental maintenance cost and possibly environmental policy cost impost) in order to self-commit.

Following a decision to start a CCGT, the 5 minute prices can reduce to below the price needed to achieve revenue adequacy for the whole start-up cycle. This may lead to generators delaying their start to ensure prices post unit synchronisation, as well as their expected operating time, will achieve revenue adequacy. Such a response is likely to lead to greater price volatility and its impact on reliability also needs to be considered.

In the context of a “cap defender”, the efficiency of price capture will be lower, and will also need to be priced into the contract market. This can be reasonably expected to increase cap prices as a consequence and/or reduce the amount of caps in the market.

The reliability settings are being developed for the period that also includes the introduction of the 5 minute settlement and the Reliability Panel needs to assess the impact of this arrangement on the reliability settings and USE levels.

National Energy Guarantee considerations

There is a lack of detail in relation to the National Energy Guarantee (NEG); however, it is considered important to consider the design principles from a reliability perspective.

The design of the NEG will by definition impact the reliability setting in the NEM and will potentially make the settings out to 2023/24 inappropriate.

The Reliability Panel needs to consider how it should respond in order to facilitate a review of the settings consistent with the final NEG design. This may also require a rule change to enable the Reliability Panel to consider the changes.

The Reliability Panel should recommend a process to be followed in case of such an eventuality.

ENGIE trusts this submission will assist. Should you wish to discuss our submission further, please contact David Hoch (Regulatory Strategy and Planning Manager) on 04 1734 3537.

Yours sincerely,

David Hoch
Regulatory Strategy and Planning Manager