RELIABILITY FRAMEWORKS REVIEW

Issues paper - September 2017

Summary

Stanwell welcomes the opportunity to provide comment on the Australian Energy Market Commission's (AEMC's) Reliability Frameworks Review Issues Paper (issues paper).

We note the issues paper considers, at a high level, many different aspects of the current reliability frameworks. While Stanwell supports the stated principles and approach, we note that in considering the potential redesign of multiple elements of the market simultaneously, the commission has greatly increased the scope and complexity of its analysis relative to a more narrow review.

While more complex than examination of individual design elements, Stanwell welcomes the Commission's intent to provide holistic analysis. Determining which of the multiple approaches is most efficient will rely on specific consideration of the interaction between these design elements, not just the effects of a change in isolation.

Efficient investment in the NEM will be enhanced by careful management of related proposals, with multiple fundamental changes being considered concurrently, but independently. Changes to the settlement period, the potential creation of additional markets[1], and increasing obligations and liabilities[2] are some of the proposed regulatory reforms, each of which requires evaluation and implementation by participants, with associated cost to consumers.

It is also notable that external factors have the potential to override the value of whatever market reforms are proposed. *"Investment decisions for new generation require a degree of predictability about future market conditions. Yet stability and predictability in energy and climate change policy has been lacking over the past decade"*[3]. The latest example relating to Liddell power station may be the most egregious. Any investor in dispatchable power would be rethinking their strategy in the light of the immediate interventions so far by the Federal government.

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[1] Inertia, fast frequency response, non-scheduled demand response, day ahead and strategic reserve markets are all currently proposed.

[2] Including the proposed Generator reliability Obligation, Clean Energy Target, mandatory provision of primary frequency response.

[3] Grattan Institute

The Federal Government's nominated solution is also concerning as it appears to simply delay the issue to a timeframe which coincides with other potential closures of large incumbents. Stanwell understands that the Yallourn generating license and Gladstone offtake arrangements both expire in the late 2020s.

Physical markets and interventions

Stanwell supports the retention of market forces as the primary mechanism for driving investment in and operation of resources to ensure a reliable supply of electricity. Powers of intervention should be retained as a last resort measure only in order to provide comfort to participants and policy makers.

Accordingly, Stanwell supports the retention of the Reliability and Emergency Reserve Trader (RERT) with its short and medium notice periods and clause 4.8.9 Directions and Instructions. The combination of these intervention measures provides AEMO with the flexibility to access the greatest spectrum of last resort responses with minimum distortion to markets. Stanwell does consider that the compensation arrangements warrant review so as to align the impacts on similar resources with different registration status. It would be perverse if there was an incentive for resources to remain out of the market in RERT in order to obtain a better price compared with entering the market and receiving compensation through Directions.

Ensuring that such last resort interventions are executable by AEMO should be a higher priority than the detailed efficiency of such schemes (such as price discovery), as the schemes are intended not to be used. Consideration should also be given as to whether resources currently outside the market framework could be incorporated into the market thereby lowering costs for consumers.

Demand side participation

Stanwell also supports measures to incorporate demand side participation into market operation. The current system of non-scheduled, non-visible participation by entities with potentially conflicting objectives acts to inhibit AEMO's management of system reliability, resource maximisation and the behaviour creates market distortions.

Stanwell recognises the challenge facing the commission in achieving this aim, given recent decisions to reject both a non-scheduled Demand Response Mechanism[4] and the proposal for large demand-side resources to become scheduled[5].

Reliability obligations

Two reliability obligations are proposed in the Finkel review – the Generator Reliability Obligation which obliges non-dispatchable generation to provide some form of "firming", and an obligation on incumbents to notify the market of their proposed exit with sufficient lead time for investment to occur in response.

Stanwell encourages the commission to consider whether the closure notification proposal could be implemented through minor changes to the existing AEMO processes such as Medium Term Projected Assessment of System Adequacy (MT PASA). Extending the MT PASA process from two to three years, incorporating a "best estimate" type obligation on submissions and publishing more granular (station or unit level) results all appear worthy of investigation. Similarly, information submitted to the Energy Adequacy Assessment Projection (EAAP) and Electricity Statement of Opportunities (ESOO) could be utilised in relation to the proposed notification process.

Stanwell notes that no transparency mechanism will be sufficient to overcome external interventions, whether they be forced acceleration of closure or pressure to delay well telegraphed closure. The process must also be flexible enough to account for genuinely unforeseeable events such as major equipment failure, licensing interruptions or large changes in forecast energy consumption.

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[4] Stanwell supports this decision

[5] Stanwell does not support this decision

In relation to the Generator Reliability Obligation, Stanwell considers that it is important to incentivise investment in dispatchable resources prior to a shortfall occurring, not just when a reliability assessment indicates an additional need. It may be that investments occurring in a well supplied market lead to the retirement of incumbent generators, as occurred at Northern Power Station. Applying the obligation only to new entrants from this point, or retrospectively on recent entrants, is likely to distort investment incentives.

Reporting

Stanwell notes that the AEMC is considering whether Over the Counter (OTC) electricity derivatives should continue to be exempt from reporting under the G20 derivatives reforms[6]. While Stanwell considers that the rationale for this exemption remains valid, reporting of OTC electricity derivatives is not expected to significantly increase compliance costs for Stanwell, subject to an appropriate implementation timeframe.

We note that such an implementation timeframe should account for any competing requirements for system changes, including those resulting from current proposals such as the implementation of five minute settlement or a day ahead market.

Contract market

Stanwell agrees that "*The contract market has been an integral part of the NEM market design since its inception and makes a major contribution to reliability*"[7]. Husbanding a functioning and liquid financial market should be a key consideration in this review.

While some level of uncertainty is inherent in market-based investments, the threat of major changes and increasing interventionism reduce liquidity and shorten the tenor of contracts traded – a trend Stanwell has been observing for the past few years. The contract market needs both primary issuance ("natural hedging") and secondary trading (from banks, trading houses and changes to the forecasts or risk appetites of generators and retailers) in order to maintain liquidity.

If the market moves to an environment with greater levels of non-dispatchable and/or energy limited resources, primary issuance may require an increase in horizontal integration in order to accommodate technology and geographical diversity. Alternatively, these players may not form part of the contract market but may sell their entire output through long-term deals. Both of these scenarios will challenge the traditional views of regulators and policy makers. We encourage the commission to work with the Australian Energy Regulator in the development of its market monitoring processes[8].

[6] AEMC, Retail Energy Competition Review 2017, page 21

[7] Issues paper, executive summary, page i

[8] https://www.aer.gov.au/wholesale-markets/market-guidelines-reviews/wholesale-electricity-market-performance-monitoring-report-statement-of-approach


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