NATIONAL GENERATORS FORUM

2 May 2011

Mr John Pierce
Mr Neville Henderson
Dr Brian Spalding
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Commissioners,

ERC0115: National Electricity Amendment (Reliability Settings from 1 July 2012) Draft rule determination 24 March 2012

A: Introduction

The National Generators Forum (NGF) welcomes the opportunity to provide a response to this Draft Rule Determination.

The NGF supports the draft rule determination on the basis it calls for the Reliability Panel to index the Market Price Cap (MPC) and the Cumulative Price Threshold (CPT) annually. Give the significance of these parameters in the energy only market, the improved price certainty will encourage more investment to help achieve the reliability standard.

The NGF believes that it is important to maintain the real value of the reliability settings regardless of what one believes that the absolute value of these parameters should be. Whilst there is considerable debate about whether the financial risks from increasing the reliability settings would be acceptable to all NEM generators, we all agree that the real value of the reliability settings should be maintained annually.

The NGF submits its key thoughts in relation to the following key areas of this rule change in the rest of this submission.

- The maintenance of the MPC & CPT in real terms
- The 4 yearly review of the Reliability Standard, the reliability settings and the appropriateness of the indexation
- The ratcheting of the index in striking the right balanced between certainty for investors and cost reflectivity
- The CPI as the appropriate index to use

B: Key issues

1 The maintenance of the MPC & CPT in real terms

The NGF considers that the indexation of the MPC and the CPT will be beneficial in achieving the reliability standard in the long run. As indicated in our original submission, the NGF believes that investment in generation to deliver the reliability standard is driven by a number of factors, included but not limited to: forecast demand growth, forecast contract prices, cost and availability of project finance. In this regard, the MPC is not the prime driver for investment by either existing participants or new merchant players.

Having argued this, given we operate in an energy only market, the NGF believes that the indexation of the MPC & CPT will benefit the market to help ensure that the reliability standard is met. In short, the indexation of the MPC & CPT will improve investor certainty, sustain the time value of money, and capture yearly movements in generation costs. In addition, market participants will get additional certainty from the increased predictability of movements in the MPC and CPT.

2 The four yearly review of the Reliability Standard, the reliability settings and the appropriateness of the indexation

The NGF supports a four yearly review of the Reliability Standard, the reliability settings and the appropriateness of indexation. We agree that a four yearly review represents the right balance between the certainty provided by indexation and the need to periodically check that the reliability standard, the value of the reliability settings and the indexation of these settings continue to be appropriate.

The NGF considers that the removal of the obligation to review the reliability standard every two years will benefit the market. Therefore, as part of our original submission to this rule change, we supported revised arrangements that would:

- abolish the biennial review of the Reliability Standards & Settings
- assume that the newly indexed values of the MPC & CPT were appropriate, with each subsequent yearly review to test whether the indexation is appropriate or not
- allow the AEMC or a market participant to initiate a major review of the Reliability Standards & Settings if the indexed value of the MPC or CPT had deviated significantly enough to threaten the reliability standard being achieved

The NGF anticipates that the four yearly review of the reliability standard and settings will not deviate significantly from the process applied in the current biennial review. The four yearly review would consider the appropriate values of the MPC & CPT that would be required in order to achieve the reliability standard. In the last biennial review, ROAM Consulting determined this based on whether new entry open cycle turbines (OCGTs) would be sufficiently profitable at a given level of reliability standard and MPC. As we understand it, the expected level of profitability of the OCGTs would be based on Monte Carlo spot market simulations.

3. The ratcheting of the index in striking the right balanced between certainty for investors and cost reflectivity

The NGF considers the effective ratcheting of the index strikes the right balance between certainty for investors and cost reflectivity.

We regard the revised arrangements in the draft rule as appropriate for the following reasons:

- They adjust the nominal values of the MPC &CPT annually accounting for real prices increases under an appropriate index
- They allow the Reliability Panel to adjust the MPC & CPT where significant changes occurred to the economics for delivering the Reliability Standard
- The amended values of the MPC & CPT would never be lower than the previous year's values

Overall, the revised arrangements together send the appropriate investment signals to the market. However, we reiterate, our support for these comments is subject to the condition that the arrangements that restrict the value of the MPC & CPT from falling below the previous years values are sustained. Importantly, we would withdraw our support for the current revised arrangements if this feature was removed.

4: The CPI as the appropriate index to use

The NGF is satisfied that the CPI represents an acceptable index to use in the indexation process. However, we consider the Producer Price Index (PPI) is the most appropriate index to use.

We agree with the Reliability Panel that the PPI provides a sensible reflection of the costs associated with meeting reliability and avoids being too general like the CPI, or too specific , as with a commodity specific index. As such, we support the use of the PPI.

In addition, the MPC reflects the value of lost load to customers. Thus, we believe it makes sense to adjust these reliability settings based on an index that best reflects the costs of the industry. This way, when load is lost during a high price event, the MPC should reflect the actual cost to the consumer more closely.

C: Conclusion

The NGF appreciates the opportunity to provide a submission to this Rule change.

We continue to support all the key components of the Panel's Rule change request subject to some minor qualifications.

In short, we support:

- the changes proposed that seek to firstly, fix the MPC & CPT at the 1 July 2010 levels and maintain the real values over time through indexation
- the implementation of the four yearly review

We believe these revised arrangements will add regulatory certainty & predictability to these key reliability settings facilitating stronger investment to ensure the reliability settings are met.

If you have any enquiries regarding this submission, please feel free to contact Mr. Con Noutso - Regulatory Manager at TRUenergy on Tel: 03 8628 1240.

Yours sincerely,

M. Roberts

Malcolm Roberts
<u>Executive Director</u>