

17 May 2007

Mr Ian Woodward
Chairman
Reliability Panel
Australian Energy Market Commission

By email: panel@aemc.gov.au



Dear Mr Woodward,

Comprehensive Reliability Review – Interim Report

The Energy Retailers Association of Australia (ERAA) is pleased to have the opportunity to comment on the Reliability Panel's interim report for the Comprehensive Reliability Review (CRR).

ERAA members have a range of views on the detailed aspects of the review, and we would expect many of them to put these to the Panel directly. However, the ERAA has identified a number of higher level themes of agreement that we believe are worth commenting on to the Panel. These are outlined below.

The reliability standard

The ERAA agrees that the current standard of 0.002% USE is appropriate, and supports the interim recommendation that this be maintained.

However we have concerns with the Panel's suggestion that consideration should be given to allowing separate jurisdictionally based standards rather than adopting a NEM wide standard. The ERAA believes that the introduction of such a scheme would be inconsistent with the objective of creating an integrated NEM, and should therefore be avoided.

We do not see any particular need for further consideration of a Hybrid standard

A notable exception to this position is Energy Australia, which does support hybrid standards, and separate jurisdictional standards.

The level of VoLL

Modelling performed by the Panel's consultants appears to indicate that the current 0.002% standard can be met by an energy only market (in the absence of external policy intervention) with the current level of VoLL based on the price cap being escalated at the inflation rate.

There is no consensus among the ERAA about what an appropriate level of escalation should be applied to VoLL. Energy Australia and Country Energy do not support any increase to the current price cap, and Origin supports indexing only at the inflation rate. Other members, however, would accept a rise to \$12,500 followed by indexation. TRUenergy considers that the change to \$12,500 only compensates for the lack of previous indexation and that VoLL should be raised significantly, perhaps with some notice to allow adjustment by participants¹.

Implementation of an inflation escalator would appear to be consistent with the Panel's modelling, which shows that maintaining VoLL at current levels in real terms (ie. with escalation) is capable of delivering outcomes consistent with the reliability standard. If a CPI escalator is to be implemented, it would need to be incorporated into the Rules rather than requiring a specific Rule change each year, to avoid an annual disruptive debate about the level of VoLL via the Rule change process.

Cumulative price threshold

On a related matter, the ERAA notes that the Panel has not proposed any changes to the Cumulative Price Threshold (CPT) mechanism. This is a disappointing development, given that the ERAA put significant effort into preparing our submission on this matter for the 2006 reliability review. In particular the CPT mechanism creates exposures that cannot be hedged by retailers and which should be addressed to ensure that the CPT does not become a mechanism which merely moves financial default from the generator participant class to the retailer class. This would do little to protect customer reliability. The ERAA urges the Panel to reconsider its position on this matter, and we refer the Panel to our earlier submission for suggestions on what amendments could be usefully implemented with regard to this mechanism².

Reliability mechanisms

From our reading of the interim report, the Reliability Panel is concerned that the main threat to the ability of the current energy only market to deliver the targeted reliability levels is in fact ongoing external policy intervention. To address this risk, a wide number of possible modifications to the market design are proposed for consideration.

While views amongst the ERAA membership vary as to the ability of the current market arrangements to operate satisfactorily into the future, it would be fair to say that there is a broad agreement that the Panel has yet to adequately demonstrate the need for the types of major structural changes to the NEM foreshadowed by these options. This is particularly the case given the Panel's assessment of the current market arrangements as having been successful to date in delivering reliability outcomes in the NEM.

¹ The three years notice currently in the Rule would allow participants to engage in risk management practices to ameliorate the increased risk.

² We note that Energy Australia does not support an increase to the level of the CPT.

If the need for a major structural change to the market design was demonstrated by the Panel, then of the options under consideration by the Panel, the ERAA does have a preference for the Standing Reserve mechanism. However, the following conditions would need to be met:

- The costs of the scheme are able to be passed through regulated retail price caps;
- That under no circumstances should the reserve capacity contracted under such an approach be operated on grounds other than to ensure system security (it specifically should not be operated on economic grounds); and
- The existing reserve trader scheme is discontinued.

Previously the ERAA has advocated removal of the current reserve trader arrangements. The key reasons for this were concerns over its ability to enhance reliability and the unpredictability of the costs associated with the scheme. A more stable long term arrangement should make cost recovery less of an issue for retailers.

While the Standing Reserve option would provide much greater stability with respect to the costs of the scheme, one key concern the ERAA has with this approach is that the presence of Standing Reserve plant would be used to intervene in the market for other than reliability purposes. This would severely undermine investment certainty in the NEM and thereby further exacerbate any market reliability problems, encouraging further intervention in the market by the Jurisdictions. It is not clear to the ERAA that a sufficiently robust set of protections could be developed to ensure that such an outcome did not occur under a Standing Reserve scheme. We therefore urge the Panel to give careful consideration to this issue before recommending such a scheme.

Finally, there would appear to be no justification in continuing with the existing reserve trader mechanism while at the same time implementing a new Standing Reserve scheme. The Panel should therefore make it clear to participants in the market that in the event the Standing Reserve mechanism is implemented that the existing reserve trader scheme will be removed.

Should you require any further information in relation to this matter please feel free to contact me on (02) 9437 6180.

Yours sincerely

[Transmitted Electronically]

Cameron O'Reilly
Executive Director
Energy Retailers Association of Australia