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Reliability Panel
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By electronic submission: www.aemc.gov.au

Reliability standard and settings review 2014 – issues paper

EnergyAustralia welcomes the opportunity to comment on the AEMC Reliability Panel's reliability standard and settings review issues paper (the issues paper).

EnergyAustralia is one of Australia's largest energy companies providing gas and electricity to over 2.7 million household customers. We own and operate an integrated portfolio of energy generation and storage facilities across Australia. The efficient and reliable supply of electricity is essential for our customers. The reliability standard and settings play a key role in balancing the cost, risk and reliability objectives of customers and other participants in the National Electricity Market (NEM).

We broadly support the approach outlined in the issues paper and the key factors that the reliability panel will consider in recommending the reliability settings to apply from July 2016. In particular the analysis should consider the impact on forward contract prices and contract liquidity, and participant's ability to efficiently manage market risk, in addition to spot prices and reliability.

The reliability standard (0.002% Unserved Energy (USE)) has largely been met across the NEM for the last ten years. However, consideration of the reliability settings is necessarily forward looking and there are significant factors impacting the NEM that may make past performance a poor indicator of future reliability, including:

- **Increasing penetration of intermittent generation** responding to renewable energy subsidies, distorting the ability of the energy only market to signal efficient investment;
- **Reduced average demand and prices** (ex-carbon), reducing the economic viability of existing base load generation;
- **Increasing periods of negative pricing**, in large part due to the volume of subsidised and unscheduled energy being forced into the energy market;
- **Proposed increased regulation of electricity derivatives** that would impose new restrictions and costs on participants' ability to manage market risk and underwrite investment; and
- **The proposed wholesale market demand response mechanism (DRM)** that would introduce a counterfactual baseline demand into the spot market, altering contract market dynamics and investment signals.

The market price cap (MPC) and cumulative price threshold (CPT) have been largely informed by the viability of the marginal new entrant peaking plant and the need provide a financial risk management tool without hindering investment. There has been an implicit assumption that existing reliable base load generation will always be available to provide auxiliary services and meet a significant proportion of maximum load. In the current market and regulatory circumstances, it is not clear that this assumption remains valid.

We encourage the reliability panel to actively engage with market participants in the development of its analytical approach and modelling assumptions, rather than simply present the results for consultation in the draft report. Analysing the impact of potential changes to reliability settings on spot prices, forward contract prices and liquidity, and investment in the NEM, is necessarily complex and somewhat subjective. It is therefore imperative to seek market participant input prior to embarking on the modelling task.

Form and level of the reliability standard and value of customer reliability

The form of the reliability standard as an output based measure expressed in terms of the maximum permissible unserved energy is appropriate. The level of the reliability standard (0.002% USE) should be informed by the need to balance the value of reliability to consumers, the expected cost of meeting the standard and the ability of market participants to efficiently manage risks within the NEM design.

It is not practical to have different reliability standards for generation and bulk transmission capacity within and between NEM regions. Therefore the value of customer reliability needs to reflect an average across the NEM.

Market Price Cap / Cumulative Price Threshold / Market Floor Price

We cannot provide definitive comment on the appropriate levels for the reliability settings until the analysis and modelling has been completed. The issues paper appropriately identifies the tradeoffs between cost, reliability and risk.

As noted above, market and regulatory circumstances have changed since the current reliability settings were established. Actual demand has fallen and projected demand growth has been significantly reduced. In the period to 2020, the retirement of scheduled capacity may be a significant a factor affecting reliability across the NEM. The relationship between the market price cap, spot prices and contract prices is likely to be affected by this change in market fundamentals. Proposed changes to the regulation of electricity derivatives resulting from Australia's G20 OTC derivative commitments may reduce options for participants to efficiently manage their exposure to market risk¹. The implementation of the proposed wholesale DRM would provide a free, but valuable option for some customers to arbitrage between their retail contract and the spot market, altering the dynamics of the contract market and introducing a counterfactual baseline into the spot market settlement². This mechanism is intended to alter investment signals from the energy only market and to the extent investment is deferred; a real and predictable scheduled response will become essential to meeting the reliability standard.

¹ See <http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Over-the-counter-derivatives-commitments-consultation-paper>

² See <http://www.aemc.gov.au/Media/docs/Energy-Supply-Association-of-Australia---Attachment-A---Economic-implications-of-the-proposed-Demand-Response-Mechanism-727d9edc-6713-4297-9930-b252ad2d5cb5-0.pdf>

The negative market floor price is not directly related to investment or achievement of the reliability standard. The negative floor price recognises the short term technical inflexibility of thermal generators, who generally have a minimum stable generation load and are exposed to significant start up costs if they cease generating for any period. However the external subsidy provided by the renewable energy target is driving an increased penetration of generators who are subsidised to generate at negative prices to produce renewable energy certificates rather than for any technical constraint. This undermines the efficiency of the energy only price signal and the commercial viability of all generators not eligible for the subsidy.

The panel review should consider the appropriateness of the market price floor in this context and whether generation and market interconnectors should only be able to bid negatively where they have demonstrable technical constraints.

We thank the AEMC for this opportunity to respond to the issues paper. For any questions regarding this submission, please contact me on (03) 86281034.

Yours sincerely

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