



7 February 2017

The Chair  
Australian Energy Markets Commission  
PO Box A2449  
Sydney South NSW 1235

Lodged online

Dear Mr Pierce

**MEU Comments on System Security Market Frameworks Review**

**Interim Report**

**AEMC reference: EPR0053, ERC0208, ERC0211, ERC0214**

The MEU welcomes the opportunity to provide its views on the AEMC Interim Report for its System Security Market Frameworks Review. The MEU has been actively involved with the issues of supply reliability in the NEM, with particular reference to the SA region. A continuing concern of the MEU and its members has been the high costs involved in providing electricity services to consumers, particularly in light of more recent events.

While the Interim Report provides a sound and detailed description of the issues and problems being faced in the electricity market (particularly in SA) the MEU considers that the solutions provided by the AEMC are too focused on “within region” solutions. As a result, the MEU is concerned that the costs of implementing the AEMC proposed solutions might incur greater costs for consumers than necessary.

What is also clear, is that the AEMC, in identifying its proposed solutions, has not examined sufficiently how similar concerns are addressed in overseas jurisdictions.

For example, the MEU is aware that other jurisdictions have recognised that a capacity style market provides electricity markets with fewer stability and security problems than are exhibited in an energy-only market like the NEM. While the MEU is not necessarily promoting a move to a capacity market, it does recognise that in a market where synchronous generation is losing the ability to cover its fixed costs due to declining market share, the effects of such a loss are more keenly felt in an energy only market. The MEU considers that the AEMC should address this option as part of its further analysis.

The MEU notes that in its examination of options to address the increasing lack of stability due to the loss of synchronous generation, the AEMC does not contemplate at all whether

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increased interconnection between regions might deliver a lower cost solution to the problem. Instead it focuses on “market based” solutions on the premise that:

“Competition and market signals generally lead to better outcomes than prescriptive rules or centralised planning since they are more flexible to changing conditions and give businesses the ability to meet consumers’ needs as efficiently as possible.” (page xii)

While the MEU recognises that such market based solutions might deliver efficient outcomes **if there is sufficient competition**, the MEU notes the Interim Report also highlights that competition amongst generators (especially synchronous generation) is falling and likely to continue to fall as the amount of non-synchronous generation continues to increase. This increase will further reduce the amount of synchronous generation available to provide the “market based” services proposed in the report. This means that relying on market based solutions is fraught with the risks of those remaining synchronous generators being able to exercise their market power with their pricing for the new services contemplated.

For example, in the SA region there are only three base and intermediate load generators which are able to provide significant inertia – all owned by “gentailers” – and one of these has already made a decision to limit its involvement in the electricity market by selling its gas entitlements into the gas export market and reducing its electricity output. One of the three generators is larger in capacity than the other two combined, providing a perfect opportunity for the dominant synchronous generator to exercise market power.

With this in mind, the MEU considers that relying on market based solutions and signals could well lead to even more increases in electricity prices than are already extant in the market – increases which are identified as unacceptable by governments.

The Interim Report also notes that certainty of getting a return on an investment is also critical. This means that any market based solution that requires a provider to invest in assets or technology will expect that it will recover all of that investment. To provide that certainty will only be an outcome if consumers effectively underwrite the investment, either directly as seen in network regulation or indirectly through a third party such as a retailer. If certainty is critical (and the MEU agrees that it is) then providing that certainty will lock consumers into a significant risk exposure and future long term cost. With this in mind, the MEU questions whether it would be a better option to provide this certainty and be able to control the risks through a regulatory process rather than a market based one. This aspect is not discussed in sufficient detail in the Interim Report when it is considered that there will be a distinct lack of competition in the provision of the services.

The MEU notes that certainty of achieving the required outcome for both inertia and fast response could well be provided through regulated services including increased interconnection between adjacent regions which is a feature of how some overseas jurisdictions have addressed the problems identified in the report. What is concerning is that the potential of increased interconnection to address the problems has not been discussed at all in the report. The MEU considers this to be a major shortcoming.

For example, if the current review by ElectraNet identifies that a new large interconnector with another region delivers a net benefit then the introduction of this new interconnector will result in a significant and positive change to the SA market stability. While the cost of such an interconnector might be significant, it will provide a number of other benefits<sup>1</sup> as well as increased inertia and fast responses. That this option is not considered as a potential solution to the problems identified in the report is a significant oversight.

The report does consider an option of transmission networks providing services as part of resolving inertia and fast responses, but the MEU points out that such an option might be a regulated service or a market based service. This then creates challenges as to how these services will be paid for in order to provide the certainty of a return.

For example, it has been discussed elsewhere that transmission networks might provide network sized batteries in order to address problems such as fast response times for the market. What is not addressed is the mechanisms that would have to be developed to address the payment (regulated or market) for the asset and how the arbitrage between buying and selling electricity will be managed by a regulated entity.

While the MEU recognises that the Interim report is to provide options for addressing the issues, it should also recognise that there are other potential solutions which have not been countenanced such as a change in the market structure or increased interconnection between regions. Further, the report should also highlight key drawbacks of the various options provided, at least at a high level, to explain what needs to be carried out as the options are developed in more detail.

While generally supportive of the report, the MEU is concerned about what the Interim Report does not identify as options for addressing the problems identified well by the report. By focusing on identifying regional approaches to resolving the problems, the report fails to look at the bigger picture and options which might also provide other benefits

The MEU would be pleased to expand on its response and if this would assist, please contact the undersigned on 03 5962 3225 or at [davidheadberry@bigpond.com](mailto:davidheadberry@bigpond.com)

Yours sincerely



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<sup>1</sup> Such other benefits include the value of fuel costs, increased reliability, lower costs for consumers, etc