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Mr John Pierce

Chairman

Australian Energy Market Commission

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Submitted online: www.aemc.gov.au

30 January 2015

Project Number: EPR0039

Dear Mr Pierce,

AEMC Optional Firm Access, Design and Testing – Request for comment

AGL thanks the Australian Energy Market Commission (**AEMC**) for the opportunity to respond to the *Optional Firm Access, Design and Testing: Acknowledgement and request for comment* which seeks stakeholder views on the need (or otherwise) – now or in the future – for the proposed Optional Firm Access (**OFA**) regime.

AGL is one of Australia's leading integrated energy companies and largest ASX listed owner, operator and developer of renewable energy generation in the country. AGL has a diverse power generation portfolio including base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources including hydro, wind, landfill gas, solar and biomass. Accordingly, AGL has a strong interest in the regulatory and market frameworks applying to access to transmission services and, thereby, the wholesale market.

The AEMC has requested comment on the need for an OFA regime in the following terms:

> ***Why do stakeholders consider that the major problems that OFA is attempting to address are no longer relevant?***
>
> ***If the problems are no longer relevant, are there circumstances in which stakeholders could envision any or all of these problems becoming relevant at some time in the future? If not, why not?***
>
> ***If the problems are still relevant, what alternatives to OFA might address them, recognising that it would likely take a number of years to develop and implement any alternatives?***

The OFA regime fell out of the Transmission Frameworks Review, which was initiated almost 5 years ago. Expectations about likely growth in demand for electricity in the National Electricity Market (**NEM**) and the need for new generation capacity were markedly different then. Forecasts have since been substantially revised down from a scenario of ongoing growth to one of depressed demand, with no new generation capacity forecast by AEMO or industry analysts to be required for at least 10 years.

This shift in the NEM's demand profile is due not only to closures in manufacturing and large industrials and to general efficiency gains, but also to residential responses to electricity price rises, the proliferation of rooftop solar systems and an increase in on-site 'embedded' generation by commercial users. We are also starting to witness the exploration of storage technologies at both the household, commercial and utility scale.

Given the unprecedented change now being witnessed in the market, today's long-dated forecasts of supply and demand conditions may well in time also prove inaccurate. It is not clear that if / when new generation is required that it will take the same form and behave in the same way from a network flows perspective as it has to date. With such an uncertain outlook it seems imprudent to design and implement a high-complexity model which attempts to resolve issues which may have been perceived as (potentially) material under conditions existing a number of years ago but which conditions may not exist again.

For example, under current conditions, new generation plant seems unlikely to be built except in response to mandated renewable energy targets and similar government schemes. Fuel availability is generally the most important factor in any generator locational decision, but is arguably even more important to renewable plant (like wind farms). In the case of thermal generating plant, there is at least the possibility of transporting the fuel to an alternative location. Fuel availability will then join other factors – such as water and labour availability, access to transmission infrastructure, local network constraints and applicable loss factors – in a project proponent determining whether to proceed in a particular location.

Accordingly, while theoretically useful from an efficiency perspective, in practice the locational signal generated by an OFA regime may only be applied to a limited number of new projects in coming years and often be 'drowned out' by fuel availability and other factors – but with the new entrant nevertheless facing a higher project capital cost than it would otherwise. Given it would be infeasible for existing capital intensive generation plant with a long operational life to relocate on the basis of a new firm access signal, then there are unresolved questions about the purpose and effect of imposing new access pricing on these generators and even sculpting their access back over time.

Similarly, while the network continues to experience congestion to some degree, in practice it has generally been transient, affecting one or other part of the network from time to time, rather than presenting as a systemic network access issue. The RIT-T framework appears to be doing a reasonable job since its 2010 implementation at ensuring transmission investment keeps pace with generation developments where this maximises net economic (consumer and producer) benefit. As is generally acknowledged, some degree of network congestion is in fact efficient. To the extent that under the RIT-T framework there is sometimes a lag in the provision of new transmission investment, this may yet be less detrimental than a model (like OFA) which requires AEMO and TNSPs to accurately predict the future direction of these developments in order to develop an efficient access price.

Thus, although it would be an overstatement to suggest that the issues which OFA attempts to address are no longer relevant to any degree, current market conditions render them more distant and less pressing than they might have appeared to be some years ago. This being the case, the response in the form of OFA is a disproportionately fundamental and complex, and therefore risky, change to the market.

As the Design and Testing work has progressed, more and more issues are emerging – and they are of such a range and complexity that is it not clear how they would all be resolved or whether there are yet further issues waiting to be uncovered. Further, in many cases, the OFA looks likely to exacerbate issues that it seeks to moderate. For example:

- Rather than cultivating 'market led' transmission investment, the model (by relying so heavily on AEMO and TNSP forecasts of the likely volume and location of generation growth on different parts of the network) appears to further embed centralised transmission planning and the inherent risks of forecast errors.
- Multiple challenges in developing accurate and genuinely cost reflective access pricing utilising the LRIC methodology (many of which were brought to light in the AEMC's recent consultation on the 'Supplementary Report on Pricing') may impact on the efficiency of the locational signal that is generated under the OFA regime.
- The OFA may require TNSPs to inefficiently over-build the network where the reliability standard and firm access standard are treated 'additionally', rather than as complementary and overlapping standards, under the OFA regime.
- Rather than removing incentives for generators to offer electricity in a non-cost reflective manner in the presence of congestion (so-called 'disorderly bidding'), the OFA may introduce incentives for other forms of non-cost reflective bidding both by generators without firm access to avoid a constraint binding (so-called

'headroom bidding') or the reverse by generators with firm access (so called 'bidding to bind').

- Whereas the existing derivative and contract markets show a healthy depth and liquidity, by fracturing the RRP-index into a complex nodal pricing system (with overlapping paths to market via various meshed flow-gates) the OFA seems likely to make contracting and hedging considerably more complicated than it is today. The range of potential impacts are not yet well understood, but seem likely to include a reduction in liquidity and an increase in participant risk.

We would expect a framework change of the magnitude represented by the OFA to be reserved for the resolution of a very material market failure. This threshold test does not appear to have been met in any analysis or quantification of the costs imposed on the market by the issues that the OFA is designed to address. Nor is it yet clear that the OFA would actually address these issues without introducing a suite of new and costly challenges of its own. In fact, the full range of flow-on impacts and issues associated with the introduction of OFA have not yet been methodically documented and assessed and consequently do not appear to be at all well understood.

We note also that there are a suite of other proposed market reforms currently under active consideration – such as the demand response mechanism, market bidding reforms, changes to generator ramp rate requirements, and potential changes to the governance and implementation of reliability setting and standards. It is, as ever, important that such reforms are coordinated and their interdependencies properly considered. Regulatory uncertainty – particularly when the market reforms under consideration represent a significant change to market operation and structure – naturally heightens the risks of market participation.

In summary, AGL does not consider the OFA to be a justified or appropriate reform under current market conditions. We are unable to predict whether the issues that the OFA is designed to address will re-emerge or become more material at some time in the future. However, considering the prevailing uncertainty about the direction that electricity production and consumption will take in coming years, and the impact this will have on network utilisation, stability and reliability, it would seem highly imprudent to proceed with the OFA at this time.

Should you have any questions in relation to this submission, please contact Eleanor McCracken-Hewson, Wholesale Market Advisor, on (03) 8633 7252 or EHewson@agl.com.au.

Yours sincerely,

Duncan MacKinnon

Manager, Wholesale Markets Regulation