

27 November 2017

The Commissioners
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Sent by: online lodgement

Dear Sirs

**National Electricity Amendment
(Declaration of Lack of Reserve Conditions) Rule 2017**

ERC 0226

Major Energy Users Inc (MEU) is pleased for the opportunity to provide its views on the AEMC Draft Decision on the rule change proposed by AEMO in regard to the declaration of Lack of Reserve conditions.

The MEU accepts that there is a need in the National Electricity Market (NEM) rules to ensure there is a reliable supply of electricity so that consumers are able to use electricity as and when they need it. Equally, electricity consumers in recent times face a more than a doubling of wholesale electricity prices from long term historic levels and this is a significant contributor to NEM electricity consumers now incurring considerably higher electricity costs than most other consumers in the developed world. This raises the fundamental concern that the very structure of the electricity market and its rules might be a contributor to the high prices being seen by consumers in the NEM.

The MEU has noted with extreme concern that the AEMC has been introducing changes to the NEM rules which are leading to:

-) Increases in costs to market participants,
-) A further reduction in competition between market participants that is fundamental to deliver the lowest cost outcomes for consumers,
-) Rules that allow market participants to use the low levels of competition exhibited to increase prices to consumers.

For example, the MEU has noted that:

-) A final rule change to move to 5 minute settlement has been made by the AEMC without due regard for the loss of competition that such a change will engender

- J The AEMC has driven increases in the Market Price Cap knowing that such increases lead to higher prices for consumers
- J The rule change on ramp rates allowed gaming by generators resulting in increased prices to consumers through an effective reduction in competition.
- J A lack of recognition that the market structure allows some generators in some regions to have, at times, market power to set prices and for this to be allowed to continue.

The ACCC in its recent preliminary report on retail electricity pricing highlighted that the electricity wholesale market is “highly concentrated” and that this has allowed market participants to use market power to set prices well above those that would occur under a competitive market.

With this mind, the MEU has reviewed the draft decision on the LOR and is concerned at the comment (page iii)

“The new framework is also likely to lead to a rise in the number of LORs declared. However, this does not automatically translate to more interventions. In fact, more accurate reporting of potential lack of reserve conditions increases the possibility of a market response to such lack of reserves (since these will be more accurately reported) and could minimise the risk of interventions.”

The discussion on page 29 expands on this, stating that the decision is likely increase the declarations of LOR1 and LOR2 conditions.

The MEU has noted that, generally, as a LOR is announced, prices in the spot market rise. This is understandable as the market is responding to an indication that there is a potential shortage of supply. However, with the very low levels of competition that already exist in the market, combined with the amounts of electricity already dispatched¹ when a LOR is declared, the MEU is very concerned that releasing more LORs advices will result in further increases in prices which are already excessively high compared to historical levels and those seen in overseas jurisdictions.

Against this, the draft decision posits that there will be less intervention in the market by AEMO and, presumably, less unserved energy through involuntary load shedding. However, the MEU points out that over the life of the NEM, the amount of unserved energy has consistently been less than the standard of 0.002% of unserved energy, indicating that the current process has served the market well, and that the proposed approach might lead to further reductions in the already very low levels of unserved energy. The MEU points out that the level of unserved energy of 0.002% has been determined as the efficient level and that there would be little appetite for further reductions in unserved energy at any cost increase to consumers.

The decision to declare a low reserve has three elements – viz the forecast of supply that will be available (relatively readily identified), the forecast of demand (not so readily available and based on various assumptions) and the forecast of likely load reduction as a response to the market prices (almost unknown). The proposed solution to combining

¹ Generators already dispatched cannot provide competition for the remaining demand

these three elements is to use a probabilistic approach – an approach the MEU supports. Where the MEU has a concern is that AEMO then determines whether to issue a LOR notice and at what level, and this decision will be made at AEMO discretion on actions it takes rather than the more prescriptive approach used now. Any of these actions by AEMO are likely to increase the cost of electricity for consumers. While the draft decision highlights that AEMO must enter into a consultation process to develop its guidelines, this does not mean that the guidelines will necessarily result in a transparent process for determining when and what degrees of LOR can be declared – consultation on guidelines does not result in transparent processes to be used!

While the draft decision examines the logistics of what the new approach to LOR development should be, it does not recognise that the new approach will result in a loss of transparency in the assessments and decisions that underpin the declaration of LOR. As the new rule will be a high level statement rather than being prescriptive, AEMO will be able to exercise much greater discretion in what it does and when, and its decision making will not be transparent against a trigger set in the rules.

With this in mind, the MEU considers that any new rule must provide clarity on what actions are available to AEMO for each of the various LOR conditions. The MEU, while accepting that AEMO will take all due care, recognises the cost outcomes of AEMO actions do not fall on AEMO but on consumers. With this in mind, the MEU considers that less discretion and more prescription in this rule is probably more appropriate in the interests of consumers.

The MEU is also very concerned that the draft decision does not include an assessment of the impacts of the draft decision on the levels of competition for supply into the NEM. The recent ACCC preliminary report on retail electricity pricing highlights that the NEM is highly concentrated where the theory behind the NEM is that it will be highly competitive in order to deliver the lowest prices to consumers.

It is well recognised that declarations of LOR deliver to generators a signal that the market is more uncompetitive than usual, and that higher prices can be obtained. While the MEU agrees that it is reliability of supply that the LOR signals, there must be an assessment of the cost increases that consumers might see as a result of the change.

The MEU is happy to discuss the issues further with you if needed or if you feel that any expansion on the above comments is necessary. If so, please contact the undersigned at davidheadberry@bigpond.com or (03) 5962 3225

Yours faithfully



David Headberry
Public Officer