NATIONAL GENERATORS FORUM

7 June 2013

Mr John Pierce
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SYDNEY SOUTH NSW 1235
By email: submissions@aemc.gov.au

Re: AEMC Strategic Priorities for Energy Market Development 2013

Thank you for the opportunity to comment on the Australian Energy Market Commission's (the Commission) Discussion Paper - *Strategic Priorities for Energy Market Development*. As an industry body representing major generators, the National Generators Forum (NGF) has a keen interest in ensuring the direction of policy and regulatory change is focused on the key challenges facing the sectors. We note the three areas outlined by the Commission as priority issues for the next twelve months include: Strengthening consumer participation; Promoting the development of efficient gas markets; and Market arrangements that encourage efficient investment and flexibility. Given the challenges facing the sector, the NGF considers this is an appropriate set of priorities, however, we have a number of points to raise regarding the Commission's proposed direction and approach to each of these issues. We also encourage the Commission to include a fourth priority relating to the emerging issue of distributed generation and the associated network management and costs allocation issues, particularly in respect of the possibility that customers may choose to be disconnected from the distribution network during the lifetime of the assets we are building today.

The NGF acknowledges the importance of continuing to monitor that the policy settings, supporting the sector, are effective in promoting efficient economic outcomes. The sector has, however, undergone considerable change (e.g. introduction of carbon pricing and changing load patterns, increased levels of vertical integration, ownership changes, the rise of the gas industry and LNG exports and other regulatory reforms). The future policy environment also remains uncertain and the industry is likely to face further transformation.

To allow industry to position itself for these challenges, it is important we enter a period of stability where the out workings of policy and regulatory change can be observed without additional interference. The NGF considers that over the coming period, regulatory change should be minimised with regards to the wholesale market.

Strengthening consumer participation while continuing to promote competitive retail markets

We note the Commission has undertaken a significant amount of work in this area including the Power of Choice Review and the Review into Electric Vehicles as well as conducting reviews into retail competition in various jurisdictions (currently New South Wales). While recognising the need to improve customer responsiveness to market signals, the NGF's preferred option to boost customer participation is improving competition in the retail markets and removing retail price regulation. This will encourage greater product diversification and innovation in customer pricing options and will target the entire customer base.

While the Power of Choice Review makes a number of helpful recommendations, including improved customer information and protection provisions, we are concerned that the Demand Response Mechanism (DRM) proposal presents a number of issues that will limit its effectiveness in delivering the desired level of customer participation. Putting aside questions about market efficiency and cost, at a practical level, the complexity and risk (i.e. information and analytical requirements and lack of risk management options) associated with participating in the proposed DRM scheme is likely to result in limited direct uptake by customers (even at the commercial and industrial level). Based on general market feedback and observations, retailers are in the best position to offer specifically tailored products to meet customer requirements (including load reduction options).

While the development of the DRM scheme has progressed and the Australian Energy Market Operator (AEMO) is considering its implementation, moving forward we would strongly encourage the Commission to refocus its efforts and concentrate on options to remove regulatory barriers to the development of efficient retail pricing in the electricity sector and encourage greater competition. In parallel to the announced schedule of jurisdictional reviews of retail competition, the Commission could consider working with jurisdictional regulators to assist in reviewing regulatory approaches (and implementation) particularly in the area of energy purchasing costs and the setting of retail margins and headroom.

Promoting the development of efficient gas markets

Generally, the NGF considers the rate of gas market development is advancing (although there are specific issues facing individual jurisdictions). The Short-term Trading Market for gas (STTM) has been useful in improving price transparency and allowing participants to balance their positions. The proposed gas hub at Wallumbilla should also improve market liquidity. While these developments are positive, the industry is still transforming and there are a number of related policy and/or regulatory initiatives that could improve market efficiency and the level of integration between gas and electricity markets including: Developing the financial markets; Facilitating further investment in pipelines and Promoting gas storage. Each of these points is discussed below.

Developing the financial markets

In considering the rate of market development, it is important to be aware of the current development of the financial markets to underpin the STTM. A number of NGF members are promoting the development of derivative products, which as the market grows, will provide participants with more options to manage risk.
As is the case in other derivative markets, the development of standardised deal/contract terms and documentation will deliver improved market liquidity and price transparency. The process will also be streamlined for participants (if they choose to utilise these arrangements) and reduce transaction costs. While this issue does not relate directly to the National Gas Rules (NGR) it is still important, in the context of broader market efficiency, that the Commission recognises the issue and works with related bodies to promote the development of efficient gas hedge markets.

Pipeline development

The NGF supports encouraging further investment in gas pipelines which have open access to promote the efficient swapping and trading of gas and increase the level of regional interconnection. Importantly, the major benefits of more increased physical trade via the STTM or the new supply hub at Wallumbilla will not be realised unless additional pipeline access can be secured by gas users. We note the National Gas Law and NGR contain incentives to promote gas pipeline investment including:

- Greenfield incentives that exempt qualifying pipelines from regulation for 15 years;
- Light (non-price) regulation for qualifying pipelines; and
- New capital investment criteria to facilitate the recovery of efficient costs in expanding existing pipelines.

While these arrangements were reviewed prior to the introduction of the National Gas Law (NGL) and NGR, it is time to review whether these incentives are effective in delivering the required level of new investment given the onset of the LNG export market.

With regards to incremental increases in pipeline capacity, as a start, pipeline owners could provide details (including likely costs) of expansions/capacity increase options. The Annual Gas Statement of Opportunities (or other mechanisms available under the regulatory framework) could be used as a basis for advising the market. Gas users would then be informed about the likely cost impacts and timing of options. Publication of this information would also highlight whether a group of customers have a joint interest in possibly funding an expansion project.

Gas storage

As discussed above, the regulation of pipelines is reasonably well developed (but needs reviewing), however, there are limited frameworks covering the nodes (or points where pipes interconnect). With more pipeline development there is likely to be greater a number of nodes across the network. There seems little benefit in developing a well defined regulatory framework for pipelines without incorporating the oversight of nodes. Currently there are no defined mechanisms to ensure that nodes are operated efficiently and subject to the right incentives and signals. We recommend that nodes form part of a broader review of pipeline regulation.

Gas storage is another area of limited policy focus. It will become increasing important as the gas market develops. It will provide users additional flexibility to manage their gas supply options in a relatively tight market. It is likely that gas storage will be available at shared facilities, which are not currently subject to any regulatory consideration. Consideration should be given to options for improving the arrangements for gas storage and assess whether applying a regulatory framework to these facilities would assist in driving more investment. Not only will this consider the issue of developers, but ensure gas users have the confidence to utilise storage as an option to manage their gas positions. As a start, this should consider the access arrangements and connection and pricing issues.

On a related matter, we note Hydro Tasmania has proposed the development of high level objectives to guide the development of the market. This proposal would involve the development of a blank sheet approach to market design taking the existing gas assets in Australia and designing an ideal market arrangement without any recognition of the current ownership or the long term contracts which exist. The NGF considers there is merit in the AEMC considering the benefits of conducting such an exercise. The AEMC have already commented publicly that they have difficulty in considering rule changes in the gas market as this context is missing. Notwithstanding these points, all options including those that might result in more substantive changes should be considered in the context of the overall costs and benefits, including the practicality of introducing such changes given the existing structure of the market as well as the level of disruption to the market.

Market arrangements that encourage efficient investment and flexibility

The NGF accepts the points made by the Commission regarding the transparent regulatory and policy change process that exists within the stationery energy sector and is confident that appropriate processes are followed once an issue is initiated. In- line with our earlier comments on the need for policy stability, we have a number of points for the Commission to consider in regards to ensuring market settings encourage efficient investment and flexibility. These are detailed below.

1. No requirement for significant market reform of wholesale markets

The NGF considers the fundamental elements of the NEM are sound. The design is fit for purpose in the Australian context and has the capacity to deliver efficient outcomes to wholesale customers. We note, however, that the impact of other government policies may limit the effectiveness of the NEM to deliver efficient pricing and signals to new investors. There appears to be a belief amongst some policy makers that the market is indestructible and will continue to deliver efficient outcomes no matter what exogenous policies are implemented.

Presently the NEM has an over-supply of generation, which is largely a function of external policy influences rather than inadequate market signals. For example the combined impact of the Renewable Energy Target (RET) and State Solar Feed-in Tariffs has encouraged large blocks of new generation and a fall in energy demand from the main grid. The New South Wales Greenhouse Gas Abatement Scheme (GGAS) and the Queensland Gas Electricity Certificate Scheme (GEC scheme) have also contributed to new generation build.-. We do note that GGAS was recently abolished and the GEC Scheme is being removed from 2014.

The NGF does acknowledge that these broader policy questions fall outside the scope of the Commission. We encourage the Commission, however, in any interactions with Government to highlight the root cause of the issues facing the market (i.e. due to the out workings of policy in contrast to any issues that may be caused by ineffective market design) and consider options for change at a policy level rather than seeking a solution that alters the operation of the market.

In addition, the Commission should focus on priority areas that would benefit from reform such as retail pricing and competition and the development of gas markets. Consistently presenting options (such as the Transmission Frameworks Review recommendations), that would substantially redesign the market to address small problems which might arise, creates unnecessary uncertainty for players without delivering substantial benefits.

Institutional structure

The NGF appreciates the extensive and transparent policy-making processes that exist within the stationery energy sector. We are, however, concerned at the level of interest by other market related bodies (such as Australian Energy Regulator (AER) and Australian Energy Market Operator (AEMO)) in policy and regulatory matters (e.g. this was observed as part of the Transmission Frameworks Review and the Major Energy Users Rule Change proposal).

The NEM institutional and governance framework has been established to provide clear separation of market operation (and system security), rule making and enforcement. The Commission is the principle body established to consider market design issues. While it is important to ensure a broad debate of the issues, the level of engagement by other market bodies goes beyond their core functions and delays the Commission's processes, which adds to market uncertainty. To address our concerns, we request the Commission initiate a process to more clearly define the roles of our market bodies particularly regarding policy and regulatory matters.

A further priority – Distributed generation and associated network management and cost allocation issues

On a related matter, one of the key issues facing the NEM is the significant growth of small embedded generation. This includes rooftop solar PV's, embedded cogen and small wind farms. They cause three major issues in the power system. These are power system stability, increased costs from the need to cater for bidirectional distribution networks and a revenue problem for distribution businesses as their volume from connected customers declines. The likely evolution of this trend is for customers to disconnect from the network as solar PV's decline in cost and storage technologies improve. AGL have referred to this as the "death spiral" as less customers face increasingly high distribution costs from a lower customer base over which to spread the largely fixed costs.

The NGF considers that this issue should also be a focus of a priority. The issue is still relatively small but it may be possible, if this is seen as a credible scenario, to institute some policies to minimise the impact. In these situations early action can be very beneficial for small increases in cost. Some of the possible solutions could be to assume a much shorter life for vulnerable distribution upgrades, limitation of investment in new network capability with it being replaced with local generation or other solutions. Local generation, if this scenario plays out will eventually be superseded by embedded generation owned by customers and can then be relocated.

The opportunity exists to act early on this issue and it is consequently a very strategic issue. The potential benefits to society from early action on this are, we believe, significant.

The NGF would welcome the opportunity to discuss these matters further.

Yours sincerely

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