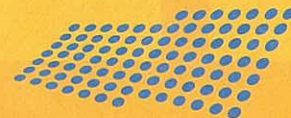


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EnergyAustraliaTM
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28 September 2007

The Reliability Panel
Australian Energy Market Commission
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By email: panel@aemc.gov.au

AEMC Reliability Panel Comprehensive Reliability Review – Second Interim Report

EnergyAustralia welcomes the opportunity to provide comments on the Australian Energy Market Commission (AEMC) Reliability Panel's (the Panel) Second Interim Report on the Comprehensive Reliability Review (the Review).

EnergyAustralia supports the conclusions reached by the Panel regarding the form¹, level² and scope³ of the reliability standard as outlined in the Review. EnergyAustralia believes the reliability settings have performed adequately to date, and that the current energy-only format of the NEM is largely delivering sufficient supply to cover demand.

Regulatory uncertainty is a major barrier to long term investment in the market (in particular investment in base load generation). EnergyAustralia supports the Panel's recommendation to replace the current annual review of the Value of Lost Load (VoLL) with a comprehensive and holistic review of all the reliability settings every 3 years on a 3 year rolling schedule. EnergyAustralia agrees with the Panel's comments that this will offer increased certainty for consumers and potential investors, which in turn will benefit reliability. The grace period of 26 months for implementing a change to the level of VoLL as proposed in the Review is also supported.

¹ Unserved energy (USE) measured over ten years looking backwards, targeted to achieve prospectively on an annual basis, NEM-wide and in each region.

² 0.002% USE.

³ Extended to generation and bulk transmission capacity only, and not applying to security events and external events such as terrorism, industrial action or 'acts of God'.

As previously stated in our submission dated 17 May 2007 to the Interim Report EnergyAustralia remains of the opinion that the current level of VoLL of \$10,000/MWh seems to be sending sufficiently strong price signals to facilitate new generation, to increase this level higher (even by an index) would only increase the risks faced by market participants and may translate into generally higher prices to end-use customers in order to manage this additional exposure.

EnergyAustralia is of the view that the current level of VoLL is allowing generators to earn a fair return on investment, is promoting liquid financial markets and limiting exposure of market participants to high spot prices while still meeting the reliability standard.

EnergyAustralia believes the current policy uncertainty of the Australian Government in respect of reducing greenhouse gas emissions is a major impediment to future investment in Australia's energy sector (especially base load generation). Continued uncertainty could compromise the timely investment in generation required to meet the reliability standard in the future. This is of particular concern to EnergyAustralia.

The Reliability Emergency Reserve Mechanism (RERM)

EnergyAustralia supports the proposal to replace the current Reserve Trader with a RERM. EnergyAustralia believes the modifications and enhancements proposed to the design of RERM should further reduce distortion in the operation of the NEM and increase NEMMCO's flexibility when contracting for reserve.

As a general comment, the operation of the RERM should continue to encourage either new uncontracted supply or demand side capacity to the market (as per the current Reserve Trader mechanism).

The current arrangements for recovering the Reserve Trader's operating costs from Market Customers (in affected regions) at the end of the reserve contract period in EnergyAustralia's opinion is more efficient, practical and simpler than the alternative mechanism proposed. Creating an ex-ante compensation fund (which may never be used) would complicate the process and would be less efficient than the current process. EnergyAustralia believes the alternate approach as outlined in the Review is not as equitable as the current arrangements. EnergyAustralia does not support a charge on market customers (and therefore customers) in a period when reserve contracts are not required.

Reliability Directions

EnergyAustralia supports retaining NEMMCO's power to issue reliability directions without a specified sunset period. Reviewing this power as part of the comprehensive review of reliability when the RERM is reviewed is also acceptable.

Energy Adequacy Assessment Projection (EAAP)

EnergyAustralia supports the design, operation and information dissemination process of the EAAP as outlined in the Review. EnergyAustralia also believes further improving the NEM market information systems to explicitly address generation input constraints of this type (energy rather than installed capacity) will help ensure the potential impacts of energy constraints on reliability in the NEM are better managed.

With regard to the Generator Energy Model (GEM), EnergyAustralia believes commercially sensitive information provided by individual scheduled generators regarding GEM parameters and associated anticipated generation capacity should be treated as confidential. However information that is aggregated by NEMMCO during the preparation of the EAAP should be disclosed to the market.

The three proposed energy input constraint scenarios NEMMCO is to consider when preparing EAAP are supported. The EAAP guidelines which the Reliability Panel is to prepare should define each scenario to ensure long term analysis and that comparisons can be made in the future. A process or perhaps some principles for allowing 'one off' scenarios to be studied by NEMMCO as deemed necessary should also be detailed in EAAP guidelines.

EnergyAustralia believes the EAAP Guidelines will be an important component to the proposal and looks forward to providing further comments following their release for consultation.

Ten Year Projection of Energy Adequacy

EnergyAustralia supports the proposal to extend the scope of the Statement of Opportunity (SOO) as outlined in the Review to require NEMMCO to include a ten year projection that provides a view of the impact of generation energy constraints and the impact of such constraints on reliability of supply. EnergyAustralia believes this increase in available information should be of assistance to market participants when making investment decisions for new generating plant.

Cumulative Price Threshold (CPT)

There appears to be some consensus between retailers that the current level of the CPT and the Administered Price Caps (APC) are too low. EnergyAustralia does not support this view. Despite exacerbated market events in June 2007 which were caused by a number of extreme factors⁴ the CPT still has not been triggered. This reinforces EnergyAustralia's previous statement in our submission to the First Interim Report that the current level of the CPT cuts in too late and, therefore the threshold does not remain faithful to its principle of offering protection in extreme system stress.

⁴ As noted in the Australian Energy Regulator's State of the Energy Market 2007 Report, a combination of factors lead to an extremely tight supply-demand balance during the early evening peak hours, particularly in New South Wales. These included a number of generator outages, network outages and generator limitations accompanied by record electricity demand as cold winter days increased heating requirements.

EnergyAustralia believes the current APC levels are appropriate. EnergyAustralia's concern is not with the setting, but rather how the current compensation provisions under clause 3.14.6 of the National Electricity Rules (NER) would operate following an event where the CPT is exceeded and APC and floor are invoked.

EnergyAustralia believes there are three issues regarding the current compensation provision that must be addressed. These are as follows:

1. The current compensation provisions result in costs that are recovered outside the spot price and therefore are unhedgeable by existing forward contracts. Following the invoking of the APC, and in the event a generator is successful in its claim for compensation based on bid prices under the NER, retailers may be exposed to extreme clearing prices for 100% of their demand rather than the small percentage of exposure for a judicious retailer outside of the APC period. EnergyAustralia believes that if the current Rules were applied in this way that it would lead to an inequitable and unjustified outcome that would be inconsistent with the NEM objective.

Retailers such as EnergyAustralia may be able to pass through compensation payments to commercial and industrial customers and possibly through to regulated customers in its network area through a price change event under the current regulated retail pricing determination. Other than the time this might take to achieve (from several months to a year or more) EnergyAustralia believes this is a cost that customers should not be required to bear. Simply passing on to consumers the cost from a monopoly rent is not consistent with the NEM objective.

2. As currently drafted, the Rules do not contain clear criteria on how compensation is calculated - leaving the determination of what is a 'fair and reasonable' amount of compensation to the panel's broad discretion (clause 3.14.6(e)). The NER merely provide for the panel (and presumably the AEMC) to take into account the surrounding circumstances, actions of relevant registered participants including NEMMCO and the difference between the spot price paid to the generator and the generator's dispatch price. This lack of specificity is likely to lead generators to claim compensation up to their bid price.
3. Under the current Rules, retailers would be exposed to significant risk if bid prices were to be the basis of compensation. EnergyAustralia believes the current provision leaves it open to generators who suspect the CPT could be exceeded to rebid their offer prices to VoLL in anticipation, thus gaming the Rules and, in effect, making the CPT process ineffective. This potential for generators to exercise market power under the current compensation provisions is of great concern to EnergyAustralia.

EnergyAustralia believes the administered price provisions of the NER are an important component of the national electricity market safety net, which operates when triggered to limit participants' exposure to the wholesale spot market during periods of prolonged high prices (essentially market failure). As the market is quite volatile, such sustained high prices can result from both normal and abnormal market conditions, and without these provisions the market would experience substantial financial stress.

EnergyAustralia welcomes the Panel's recommendation for the AEMC to initiate a consultation process to re-examine the APC. However, EnergyAustralia believes the scope of this review should be extended to include the full set of applicable clauses in the NER which are associated with the CPT mechanism, including the compensation provisions. EnergyAustralia believes the AEMC should approach this review in a manner which looks at the risk each stakeholder group faces in responding to the CPT being invoked.

Any issues regarding insufficient capacity in the market are not necessarily due to deficiencies in the market itself but in the wider environment. For example the lack of certainty around the regulation and pricing of carbon must be addressed to enable investment in generation capacity. Efficient investment in, and operation of, the transmission network would also improve the reliability of the system and would enhance competition in the NEM.

Should you have any questions in relation to this submission please contact myself on (02) 9269 4911 or Philip Dixon-Flint, Regulatory Strategy Manager, on (02) 9269 2317.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Mike Bailey', written in a cursive style.

Mike Bailey

Executive General Manager Retail