Major Energy Users Inc.

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Australian Energy Market Commission
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By direct lodgment

Enhancement to the RERT
Options paper
ERC0237

The Major Energy Users Inc (MEU) welcomes the opportunity to provide its views to the AEMC regarding the rule change proposed by AEMO to enhance the Reliability and Emergency Reserve Trader (RERT) process. The comments the MEU makes in this submission are informed from the experiences of some MEU members that provided offers to AEMO for the RERT needs during the summer 2017/18, as well as the responses the MEU has previously provided over the years to the AEMC on the issue of RERT.

As with all MEU responses to proposed rule changes, this submission is predicated on two basic aspects – the end user perspective and the need to increase competition in the wholesale market to drive lower prices. The MEU points out that the issue of reliability of supply is essentially an issue for consumers so the MEU counsels the AEMC when assessing responses to this rule change proposal, to give the most weight to the views expressed by consumers.

About the MEU

The MEU specialises in addressing issues that impact on the **cost, reliability, quality** and the long term **sustainability** of gas and electricity supplies across Australia; membership of the MEU comprises some 20 major energy using companies in NSW, Victoria, SA, WA, NT, Tasmania and Queensland and many have multiple sites. The electricity used by MEU members is significant proportion of electricity used in the NEM.

In developing its response to the Options Paper, the MEU makes a number of general observations which have assisted it in reaching its conclusions.

An overarching observation

With regard to the Options Paper, the MEU has two standout issues that the AEMC must take into consideration as it assesses this proposed rule change – the price of electricity to end users and the cause and magnitude of unreliability of the electricity supply.

Consumers are already expressing considerable concern that the prices of electricity supplies are much too high (even by world standards), and that prices must come down. While the MEU accepts that the total price seen by each consumer is an aggregate of the costs from the wholesale market, the networks and from retailers, the MEU points out that wholesale prices have doubled in recent years and the ACCC has observed in its report to Government on retail electricity prices, that retail costs have also risen[1].

With this issue top of mind, it is clear that the large majority of consumers do not wish to see higher prices, even if accompanied by increased reliability of supply. While a few consumers have expressed a view that their current reliability levels need to be improved, this is a result of distribution network unreliability rather than a concern with reliability of supply in the wholesale market.

Consumers accept that there will be times (hopefully few) when there is a shortage of supply at the wholesale level. The agreement with consumers is that unserved energy (USE) of 0.002% (about 10 minutes each year) is an acceptable level for loss of supply. In fact many consumers see more loss of supply than this due to failures in the distribution networks.

Despite accepting that USE of 0.002% is the point that consumers accept is the level of unreliability in the wholesale market, over the 20 year history of the NEM, this level has been rarely exceeded, and in most years there has been no loss of supply at all at the wholesale level. This is due to both to sensible investment in new generation (resulting from the setting of the Market Price Cap) and the availability of back up supplies through the RERT process for the very few times when these have been needed[2].

A tightening of the reliability standard can be achieved in two ways – reducing the base number (ie 0.002%) to a lower number, or measuring the outcome over shorter periods.

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[1] Retail margins include the costs to manage the risks inherent in the wholesale market

[2] The MEU also notes that the introduction of the National Energy Guarantee reliability leg will, if it is implemented, would also add to the security of supply in the wholesale market

Initially, the reliability standard was to be a long term annual average which, effectively, allowed for there to be a "bad" year as the effects of this are spread over a number of years (eg over a 10 year period). More recently, the standard has been effectively reduced by making it an annual target which provides for actions to be taken each year if it is thought the Reliability Standard will be breached in any year. The effect of this has been to effectively reduce the standard so that the USE will be less than the standard when measured over a number of years. Shortening the period for which the target will be set, (as contemplated in option 3) has the same effect of reducing the amount of USE over time.

The MEU sees that, if anything, there is a stronger argument for increasing the level of USE than for reducing it as this might result in lower costs for consumers without resulting in a discernable reduction in reliability. Equally, it has been demonstrated on many occasions[3], that any reduction in what is already a tight reliability standard is highly likely to increase costs significantly. The MEU considers that consumers accept that 0.002% of USE is at the lower end of the "sweet spot" between balancing price and reliability as required by the NEO.

The MEU therefore does not consider it appropriate or a required action to change the Reliability Standard. With the Reliability Standard in place, this should be the only tool used for identifying the needs of the wholesale market with regard to when the RERT should be triggered and to what extent AEMO should acquire RERT contracts to ensure that the Reliability Standard is met.

Should the USE for a period include voluntary load shedding?

What also been noted is that the RERT is agnostic with regard as to whether the contracts entered into for its provision are either additional supply or voluntary load shedding. The Reliability Standard is based on the amount of unserved energy. This raises the point as to whether the Reliability Standard should include or exclude the amount of energy foregone by voluntary load shedding.

The MEU considers that load shed (whether voluntary or involuntary) should be included in the calculation of the Reliability Standard. Voluntary load shedding (whether paid for or not) has an impact on the end user providing the service and it reflects a loss of supply to the end user that the end user would have otherwise used for its purposes.

The reliability standard and "peaky" supply

The wholesale market already has a tool for incentivising new generation – the Market Price Cap (MCP). The MCP is set based on the market as it is now and as it is expected to be into the near to medium term. It also accommodates a variance

[3] Such as the reviews by the Reliability Panel

in electricity usage between regions. Most importantly, the MCP is derived from the Reliability Standard for the wholesale market.

While AEMO comments that there is an expectation that the wholesale market will become more “peaky” as more intermittent generation is added to the generation fleet, the MEU points out that some regions already have significantly “peaky” load shapes compared to other regions. While the MEU expects that there will be increasing amounts of intermittent generation added to the wholesale market, the MEU also considers there will be more interconnection between regions that will add diversity to the source of generation in the wholesale market, offsetting the impacts of increased intermittent generation.

In the Reliability Panel’s Comprehensive Reliability Review (and in some more recent assessments by the Reliability Panel regarding market settings) it is clear that there could be different values for MCP in different regions, reflecting the differences each region has. Greater interconnection will tend to bring the different MCP values from each region to a common point, as a result of any increase in diversity of supply.

Such future assessments of MCP will take into account the increase in “peakiness” in the wholesale market but it also will take into account the increased diversity of supply and the impacts of more inter-regional connection.

The MEU does not consider that a different tool to the reliability standard for AEMO to use to address a more “peaky” demand is warranted for application of the RERT.

Use of the value of customer reliability (VCR) in the wholesale market

The MCP has been set at a level that is considered to provide sufficient incentive to ensure new generation is provided as and when it is needed, and it also has been used already by some consumers to voluntarily not to take supply (ie load shed). While the current levels of demand side responsiveness to the wholesale market price signals has been muted, the MEU along with many others considers this muted response is more a function of the rules preventing third party aggregators of acquiring and implementing voluntary load reduction rather than the MCP being too low.

Analysis behind the setting of the MCP shows that increasing the MCP (eg to the VCR) would result in increased prices in the wholesale market. As noted above, consumers have consistently identified over the past decade that electricity prices are much too high and increasing the wholesale price of electricity would aggravate this.

The VCR is a very blunt tool as the values for VCR vary considerably depending on each customer’s needs, the time of day, the time of the week, the season and the degree of notice available for the loss of supply. The 2014 AEMO review

identified that the VCRs for customers directly connected to the transmission network and at a subtransmission level in the distribution networks were significantly lower than those for customers deeply embedded in the distribution network. It is questioned whether the higher VCR values for customers deep in the distribution networks are an outturn (or even influenced by) of the lower levels of reliability caused within distribution networks rather than caused by the wholesale market.

As there is demonstrably an adequate tool for incentivising supply or a decision to voluntarily not to take supply in the wholesale market (ie the MCP) the MEU does not consider that VCR should be used in the wholesale market for any purpose and specifically should not be used for developing the RERT supplies by AEMO.

The National Energy Guarantee (NEG) and the RERT

It was planned that the RERT would be the tool for enforcing the Reliability Obligation under the NEG. While the present Federal government has decided not to implement the NEG, it is still considered to be the best option politically available for establishing future reliability so there is a need to ensure that the RERT and the NEG will be consistent. Therefore the NEG provides some guidance in relation to establishing the RERT trigger and the amount of RERT that might be needed.

The intention under the NEG is that AEMO would forecast a demand and supply balance for a number of years into the future in order identify if there will be a shortfall in reliable supplies in each year forecast; this forecast is based on achieving (or not) the Reliability Standard. It would be inconsistent if the forecast shortfall was based on the Reliability Standard yet the quantum and the trigger for implementing the RERT was calculated on another basis.

In the development of the reliability leg of the NEG, various options were examined with regard to the notice period before the reliability obligation of the NEG was to be implemented. The initial proposal was that 3 years notice of the reliability obligation would provide sufficient time for retailers to be able to take action to minimise their exposure to any reliability shortfall. Once implemented, the RERT would be used to address any remaining shortfall to manage demand either through back up reliable generation or through voluntary load shedding.

A subsequent options paper suggested that the three year notice period should be either extended to 5 years or even eliminated (the SA government option). Recently, the AEMC has made a rule change that generators must give at least 3 years notice of a closure, effectively drawing the 3 year notice period for the NEG in concert with notice of generator closures.

The proposal for 3 or 5 years notice for the NEG reflects the reality that time is needed to implement the lowest cost option for providing the lowest cost for reliable supplies of generation.

The MEU considers that a similar approach could be considered for AEMO with regard to accessing RERT services, by allowing an amortisation of set up costs over a number of years rather than the one as at present, especially if AEMO has forecast that there could well be a need over consecutive years for RERT supplies to be available.

Costs for the supply of RERT

A number of MEU members have been involved with responding to AEMO about providing RERT services and they have provided views regarding the provision of the RERT; the MEU considers that the AEMC should take the thoughts of these demand side providers into consideration as it addresses the RERT proposal.

MEU members comment:

- Providing the RERT services is not costless, even if it is not called
- Attempting to recover all of the costs involved for a single RERT program reduces the ability to provide the lowest cost for providing RERT services
- Sufficient notice is required to safely provide the RERT services so load shedding can be carried out under controlled conditions to avoid damage to equipment and production processes
- Providing some RERT services, such as load shedding for short periods of time, for some end users can be just as expensive as for longer periods, whereas other end users can provide the response quickly but for limited times before their production processes are impacted
- Extended periods for providing RERT services (eg load shedding) can have significant impacts on production schedules.

With regard to the first and second points, it is probable that some RERT service providers might need a commitment to multiple year contracts to assist in defraying the set up costs incurred and so deliver a lower price for providing the RERT service. In particular, the MEU can see that if there is significant set up costs in order to provide the RERT services, amortising the costs over a longer term could lead to lower overall RERT costs.

This outcome is consistent with the comments made above, in that an ability of AEMO to be able to amortise set up costs over a long period than one RERT program has the potential to minimise the costs of its provision, particularly if the RERT needs are identified to apply for consecutive years.

Comments on the options

Based on its responses to earlier papers issued by the AEMC regarding RERT, the comments above and the advice provided by MEU members, the MEU makes the following comments on the three options.

Option 1

The MEU supports this option and the reasons for this support are based on the commentary above.

To make the use of the Reliability Standard an explicit element of the RERT process reflects the reality of the current approach and the current approach has served the NEM well. There is a clear consistency about using the same basis for identification of need for RERT, the volume of RERT required and the trigger for its implementation in order to avoid unintended consequences.

As noted above, the MEU considers that AEMO should have the ability to contract RERT services longer if the outturn results in overall lower costs for the provision of the RERT but this action should only be allowed if AEMO determines that there will be consecutive years where the RERT is expected to be needed.

Option 2

The MEU does not support this option.

The MEU considers that, as a minimum, there has to be some basic and widely accepted tool for identifying and then triggering the need for RERT as RERT is an additional cost to consumers above the market based prices. There is an inconsistency innate in this option because there is a difference between the identification of the need and the volume requirement assessment and trigger for the RERT. This disparity could also lead to more expensive outcomes for consumers and retailers if the Retailer Reliability Obligation is introduced.

While AEMO has provided some additional information as to how it would implement this option 2, there is an unstated aspect in the explanation of "AEMO knows best" that underpins its arguments that its RERT tools should not be based on the more widely accepted measure of the Reliability Standard.

This option may well provide an overall lower cost outcome for consumers, but this is not certain and tends to move the RERT from being a safety net towards the traditional approach to wholesale reliability through having a standing reserve. While the decision about the Reliability Obligation under the NEG is still not fully resolved, having a standing reserve under the control of AEMO will make it more challenging for retailers to procure their own reliable supplies as these may already be contracted to AEMO under the RERT. Such an outcome would increase retailer costs and impose on consumers the cost of providing this "standing reserve" as well as the increased costs passed on by the retailers.

The MEU has a preference for market based solutions being given priority over more centrally controlled options and considers that option 2 provides an outcome that will not provide the best avenues to give the market the best ability to provide the reliability needed for the NEM.

The MEU can see that this option has the potential to increase the market distortions that the AEMC has in the past decided were unacceptable and to increase the complexity between assessing market based solutions and directed solutions, especially with relation to demand side actions.

Option 3

While there are some features of option 3 that are consistent with option 1, the MEU does not support this option.

The MEU is concerned that, as the RERT is needed only occasionally[4], to include significant direction in the rules has the long term potential to lock in processes that in the future may not be appropriate to generate the lowest cost for the RERT or for the wider market. Allowing AEMO some discretion as to how it will best operationalize the RERT process to suit the needs at the time to deliver the lowest cost to consumers is the approach preferred by the MEU.

Further, as noted above, the MEU has a concern that implementing a change in how the Reliability Standard is structured (eg making it a monthly target rather than an annual target) has the potential to not only increase the costs in the wholesale market but also increase the quantum (and therefore the cost) that the RERT will be required to provide

Conclusions

There is a fundamental issue that underlies the proposed changes to RERT – that even though there is an assumption that there will be periods of loss of supply (the USE of 0.002% implying there will be an average of 10 minutes loss of supply each year) the AEMO approach and government expectations are that there will never be a loss of supply at the wholesale level. The MEU considers that effectively ensuring there is never any loss of supply will significantly increase costs in the wholesale market and in the provision of back up services like the RERT. The NEO accepts clearly there is tension between price and reliability and to set reliability at such a high level that there is never any loss of supply in electricity is not consistent with the NEO expectations as a lower price would apply if there were allowed some loss of reliability.

In analysing the RERT proposals, it is essential that the forecasting performance of AEMO should be taken into account. The MEU accepts that AEMO uses a best endeavours approach to providing its forecasts, yet history shows that AEMO

[4] If the RERT is required more regularly then this signifies a market failure and in that case a much wider investigation will be required to "repair the market".

forecasts have consistently been conservative, in that most of the time, the forecast peak demands have nit been met. The MEU also accepts that conservative forecasts provide greater certainty that the Reliability Standard will not be exceeded but they also increase the costs that consumers ultimately incur. This observation supports the view that if the forecasts are considered to be conservative, there is no need to increase the overall conservatism by implementing a conservative approach to the RERT processes.

This assessment of conservatism reinforces the MEU conclusion that option 1 provides a better outcome for consumers in terms of cost and reliability and which also better manages the tension between reliability and price.

The MEU notes that there is the potential for the contracts under the RERT to also have some coincidence with demand side responses provided to the market, resulting in some double counting between contracted DSR and the RERT contracts. However, the MEU considers that these aspects do not impinge on the essential aspects of what the RERT is to provide – a last resort provision of reliable outcomes to be used occasionally in order to maintain supply to the bulk of consumers.

Should the AEMC require additional explanation as to the concerns expressed herein, please contact the undersigned.

Yours sincerely

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