TRU energy

Review of Energy Market frameworks in Light of Climate Change Policies

Response to Public Forum – 1 May 2009

A. Introduction

TRUenergy welcomes the opportunity to comment on the issues raised at the public forum which the AEMC hosted in Melbourne on 1 May 2009 in respect of its ongoing Review of Energy Market Frameworks in light of Climate Change Policies.

The following comments are offered in response to the discussion on selected issues raised at the public forum in Melbourne.

B. Short term management of reliability

Short term reliability in the NEM is under threat as a result of the CPRS (as currently proposed) and the expanded RET (eRET). It is critical that the AEMC is fully aware of the impacts the scheme outlined in the CPRS whitepaper will have on the finances of high emissions generators and the impacts this will have on power system reliability.

The CPRS (as it currently stands) will create significant financial dislocation in the coal generation sector. The key flaw in the existing policy is insufficient transitional assistance to high emission generators which will not enable a smooth transition to low emission technology. This is already beginning with the 1 May 2009 downgrade of TRUenergy's credit rating by Standard and Poors to BBB- (Negative credit watch). The analysis report by Standard and Poors states that:

"The ratings downgrade and CreditWatch reflect the group's ongoing debt-refinancing risks in the short term and TRUenergy's diminishing financial flexibility in the medium term due to significant uncertainty on the implications of any Carbon Pollution Reduction Scheme (CPRS). We note that CPRS uncertainty has already hindered the group's efforts to refinance A$950 million of facilities maturing between mid-June and late August 2009, a risk that is likely to be ongoing for TRUenergy's future refinancing requirements."

Critically, S&P make it clear that this downgrade is directly related to the CPRS scheme, and not part of the broader global financial crisis. The S&P report also makes it clear that the downgrade is not related to poor operations of the business. Indeed, it states that:

"....This is notwithstanding TRUenergy's strong operational

performance and debt reduction in fiscal 2008 (which significantly improved the group's financial profile) and the removal of Victorian retail price caps (which improved TRUenergy's ability to pass-through increased costs)."

While TRUenergy is a publicly rated entity, it also benefits from its exposure to gas and retail assets. It could be expected that other high emissions generators which are not publicly rated, with less diverse businesses and greater exposure to the coal fired generators would be experiencing even more significant financial difficulties.

In this regard we note the recent ESAA survey[1] which noted that $19 Billion worth of debt needs to be refinanced by the Generation sector over the next 5 years. If even a small percentage of this is not able to be refinanced due to the CPRS – the financial implications for the sector are likely to be severe.

Should the CPRS move to legislation in its current form, the pressure on the financial structures of the existing high emissions generators would further increase. This would be due to the accounting requirement to recognise impairments of asset values – which would in effect extinguish large percentages of debt and equity from company balance sheets. By this stage credit ratings of the generation sector would be completely destroyed.

Electricity market impacts of this outcome would come in several forms over several timeframes.

In the short term, at a minimum these generators would be unable to continue to fund maintenance expenditure to maintain the reliability of these high emissions power stations. The current $1Billion investment pipeline of low emissions generators currently underway at TRUenergy could be delayed indefinitely.

While the potential for supply side disruption and retail market failure in the short term are quite clear, longer term disruptions also need to be taken into account.

In the longer term, investors having watched this policy failure in the electricity sector, could become hesitant to continue to invest in it going forward. This would place into question the long term reliability supply as the few remaining viable entities in the sector would have great difficulties funding the total investment required. Evidence is widespread in the developing world of the impact of government policies that extinguish debt and equity in power projects leading to a lack of investment and regular daily load shedding.

Overall it can be seen that the market faces significant reliability risk due to a CPRS design with inadequate transitional arrangements to high emissions plants.

In this context, and given the AEMC's role in oversighting the Electricity market and its reliability – we urge the Commission to formally advise the federal government of the materiality of these risks and the implications of them occurring. This needs to take place urgently.

While clearly we believe the current CPRS design requires modification to create a stable financial transition to a low emission future, we agree with the AEMC's analysis that uncertainty about how carbon will be treated in the future is deterring investment in the sector. For this reason, a properly designed CPRS (ie. one that will deliver a smooth transition in the power sector) is required so that investors have a policy environment in which they can invest to deliver long term reliability.

The proposals currently under consideration by the Commission, can not address the policy failure outlined above. Indeed we do not believe that this could ever be addressed or

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[1] http://www.esaa.com.au/images/stories/GFCsurvey/gfcenergysupplysector.pdf

managed within the energy market framework that is within the Commissions purview. Despite this, we offer the following comments on the current Commissions proposals:

a. The concept of enhancing information being used by NEMMCO in determining the reserve position of the market is supported in concept. The definition of the Minimum Reserve Level (MRL) currently in use, has long been discredited, with the EAAP now routinely used by NEMMCO to make reserve adequacy assessments. Urgent review of the MRL should be progressed in order to prevent the triggering of spurious reserve trader events.

b. While greater information integrity is supported, we question the validity of the proposal to mandate retailers to provide more specific information about demand side opportunities available to them in the NEM. Retailers currently provide information to facilitate demand side to NEMMCO through the Statement of Opportunities (SOO) process. While this information is often vague, this is a reflection of the underlying contractual rights that the retailers enjoy. In addition, we are aware that many of our customers opt to manage their own demand by taking pool price pass-through tariffs (or other contractual flexibilities) and self curtailing during periods of high price. Placing further requirements on retailers will not uncover these potentially large scale demand resources. It may be necessary to consider placing requirements directly on customers if this information is desired – however the reliability of such capacity and the practicality of surveying consumers directly may make this impractical. In any event, good regulatory practice requires that further requirements on retailers should only be imposed if a clear case can be made the benefits of such actions outweigh the costs. To date the benefits outlined are speculative and so no case has been made.

c. The policy to provide wider powers under the RERT for NEMMCO to contract for reserve is a distortion which is likely to provide incentives for demand side providers to exit the commercial market, in preference for speculating on potentially uncapped returns from the reserve trader arrangements. Further to this, we are concerned that the proposed short term reserve trader panel may leave NEMMCO in the position of being a distressed buyer – thereby incurring inefficiently large costs to be recovered from market customers. Care should be taken to ensure that this short term panel approach is only exercised if the costs outweigh the benefits to the market. It should also be structured to maximise the incentive for potential providers to participate in the Commercial market – rather than holding out for reserve trader contracts. The compensation arrangements that apply for Directions are structured carefully to maximise incentives for market participation, and may provide useful insights into how the short term reserve contracting remuneration arrangements could be structured to achieve this objective.

c. We support the proposal to examine options to reduce the regulatory barriers to participation faced by small generators in the NEM. In particular streamlining the registration, metering and connection requirements would be valuable. In this regard we think it is worth noting that for generators less than 5MW the possibility exists to register the meter via a retailer with a pool price pass-through contract – which would appear to remove the need for direct registration (although not the need to negotiate a connection agreement). We would also propose that efficiencies in these areas could be usefully explored for generator connection in the 5MW to 30MW range, and not restricted to only very small generators.

C. Connecting remote generation

We continue to support the exploration of the creation of hubs for generation cluster areas so that economies of scale can be harnessed from network connection and extension assets, built to connect generators to the shared network. However:

1. We note that significant questions remain to be resolved such as what form of economic test will be used to select appropriate hub regions, how will the hub be sized etc. In this regard, we suggest the economic test would be likely to need to take into account a wider consumer benefit which would include the overall cost of renewable energy certificates. Such an economic test is clearly wider in scope than the existing RIT-T. We look forward to a fuller outline of the proposal in the upcoming 2nd interim report.

2. Whilst a number of key issues remain unresolved in the model, we appreciate that the proposal represents an improvement over the current negotiated services framework given it provides a capacity right to generators that fund an extension asset. While this is an improvement, it leaves unresolved the issues of any intra-regional congestion that develops down stream of the Hub in the shared network. As outlined below, we remain of the view that an inability for investors to have reasonable protection against future shared network congestion remains a significant gap in the current implementation of the NEM regime. This will need to be resolved if the hub concept is to be bankable by generation investors.

D. Efficient provision and utilisation of the transmission network (including inter regional transmission charging);

At the public forum the AEMC indicated it was still considering whether or not this was a material issue, and whether it was sufficiently related to climate change policies to warrant a place in this review.

We are firmly of the view that the answer to both questions is yes.

If the objectives of the CPRS and eRET are to be delivered, then the NEM must experience unprecedented levels of generation investment. This will be required to allow replacement low emissions and renewable plant to be constructed and replace existing high emission units. This level of mass investment will uncover any areas of the rules that will impede generation investment and that may have not proved too much of a problem to date (due to relatively low levels of historic investment). This issue of predictability of access for generators falls clearly into this category and must be addressed by this review.

In addition we note that the existing NEM transmission investment regime is prefaced on all relevant information related to investment in the industry being captured in the NEM spot price (at least for market benefit based investments). The imposition of the eRET results in a large quantum of investment of generation being based on an externality to the NEM (in this case the REC price). We note that much renewable generation will be unable to deliver reliability benefits (due to its inherent intermittency), and that the RIT-T market benefit test will not perceive the wider REC market price impacts (which are not factored into the electricity price). This situation is likely to lead to an inability of the current RIT-T to deliver a transmission system suitable to serve these new renewable generators. The Commission should examine incorporating the REC externality into the regulatory test in order to ensure that the transmission system continues to be developed in alignment with network user requirements.

We make the following key points in response to the discussion on this issue at the forum in Melbourne. We support adjustments to the current framework that provide for:

1. Predictability of access to the market at the regional reference node for generation investors. The ability to forecast with a high degree of certainty the quantity of energy that can be compete for dispatch in the market for the life of the project is critical to new investors in generation. A lack of certainty with respect to the quantity of energy that can compete for dispatch leads to revenue uncertainty acting as an inefficient and unmanageable barrier to investment. This is already materialising for us in South Australia where almost certain future congestion is making investment in reliable capacity extremely difficult. Likely congestion in Western Victoria is proving similarly problematic.

2. Consistent with the need for predictable access for new investors, is a reasonable prospect of protection of access for existing generators against stranding by future connectors. Indeed if the NEM is to remain an attractive investment environment, it must demonstrate that assets once committed will not be stranded by future regulatory or connection outcomes. It needs to be clarified that this issue of access is not about shielding incumbents from more efficient new entrants. Indeed providing both generators have access to the market at the reference node, will ensure they can compete against each other (and all other generators in the region) to deliver a competitive contract market – and hence consumer price.

3. To this end we support further investigation of the southern generators' proposal presented in response to the 1st interim report that outlines how an acceptable investment regime, that enhances dynamic efficiency and creates a bankable generation investment environment consistent with the current rules framework.

4. The paper by Dr Biggar will require further more detailed exploration before we can comment on it in full. However at a high level it appears useful as it attempts to highlight the need for a consistent set of policy principles across a number of criteria. We have been of the view to date that the MCE has ruled out a nodal pricing approach, and therefore have focused on how to overcome barriers to generation development within the existing regional framework. In this regard Dr Biggar's Figure 3: - "Internally – consistent transmission policies based around zonal (regional) pricing" is of interest, and appears broadly consistent with the Southern Generators proposal (although with an increased focus on enhancing regulated investment as well). Dr Biggar also notes the need for predictability of access for the life of a generation investment at the time the investment is made. We will review this paper further and look forward to learning more on the Commissions views in its 2nd interim report.

E. Retail price regulation

We agree with the AEMC findings that retail price regulation in its current form will be unable to adequately deal with the uncertainty surrounding carbon price impacts on energy costs. While our preferred mechanism to deal with this matter is de-regulation of retail pricing, we support the AEMC initiative to facilitate a debate on how regulated price regimes may be modified to better deal with the uncertainties of carbon pricing in jurisdictions where regulated prices will continue post CPRS implementation.

We also believe that full pass through to eRET costs in regulated price caps is a critical issue that needs to be reviewed. In the past regulators have opted to use spot REC market prices to factor in a cost allowance. In contrast, retailers have had to pay the full penalty to project proponents in order to underwrite large scale REC projects (eg. Wind farms) developed. With the eRET to take the proportion of renewable energy up to 20% of all energy in the NEM, the disparity between the cost needed to underwrite large scale investment and the short term spot price historically used by regulators will not be sustainable for the retail sector. Clarity that the full costs of REC's contracted by retailers will be recoverable through regulated price caps is required if retailers are to have the confidence to underwrite the renewable projects demanded by the eRET.

On other points raised at the forum, we were concerned that some of the discussion focused around further regulating retail tariffs (eg. the proposal to impose inclining block tariffs) – which is inconsistent with the stated policy positions of all jurisdictions to transition to a de-regulated retail market. In relation to some of the commentary surrounding consumer hardship, we note that the federal government proposes to compensate consumers for increases in energy prices resulting from the CPRS – and therefore this issue has no role in this market framework review.

E. Conclusion

TRUenergy appreciates the opportunity to comment on the issues raised at the public forum which the AEMC hosted in Melbourne on 1 May 2009 in respect of its ongoing Review of Energy Market Frameworks in light of Climate Change Policies.

This paper adds comments that we hope will be helpful in shaping the policy for the energy markets framework in the future. However, these comments are only preliminary response to the AEMC's current considerations of the four material issues that it has raised in the context of this Review. We look forward to the AEMC's release of its 2nd Interim Report which will finalise the list of material issues and consult on the specific options for change. On reviewing this report, we will no doubt respond with a more comprehensive review of the issues found to be material by the AEMC.

Regards

Mark Frewin

Mark Frewin
Manager Wholesale Market Regulation