SUBMISSION

AEMC RELIABILITY STANDARD | DECEMBER 2017

EUAA
Energy Users Association of Australia

INTRODUCTION

The Energy Users Association of Australia (EUAA) is the peak national body representing major Australian electricity and gas users. Our membership covers a broad cross-section of the Australian economy including significant retail, mining, manufacturing, materials and food processing industries.

The EUAA is a strong advocate for energy users and firmly believes that the primary objective of energy markets should be to serve the long-term interests of the consumer as stated in the NEO and NGO. There can be no doubt that energy users, both large and small, are experiencing unprecedented increases in both electricity and gas costs while there are potentially significant risks to both the availability and reliability of energy for some consumers. This situation is clearly at odds with both the NGO and NEO.

Over the last 10 years Australia has given up its comparative advantage in competitively priced, highly reliable energy that has underpinned significant industrial development and employment for many decades. It is inconceivable to think that a country with resources that are the envy of the world cannot deliver competitively priced energy to its own population. If allowed to continue on this trajectory this comparative advantage will be permanently lost and along with it, a majority of energy intensive industry including many industrial, food processing and manufacturing industries.

In this context, the EUAA welcomes the opportunity to comment on the AEMC Reliability Panel Report Draft Report on reliability standard and settings review for the period 2020-2024 (Draft Report).

SUBMISSION - SUMMARY

While the EUAA supports the Panel's recommendations on the existing reliability standard, the administered price cap and the market floor price, we do not support the Panel's recommendation on the market price cap (MPC), and, by implication, the cumulative price threshold (CPT).

Therefore, the MPC that is the focus of this submission.

In regard to the MPC, the Panel concludes (p.1) that:

- "The market price cap and cumulative price threshold have been effective at limiting market participants' exposure to excessive high prices with the overall market integrity maintained. These settings appear to be sufficiently high to allow investment in enough generation so there is not more unserved energy expected than that allowed for by the reliability standard.

- The Panel considers that providing regulatory stability through no changes will benefit consumers and market participants, given the current impact of policy uncertainty on investor confidence, the rapid technological change underway in the national electricity market, and the absence of sufficient evidence in support of a change to the price settings".

By contrast this submission argues that:

- The current level of the MPC, developed in the 2014 review, was designed to address a market based NEM. However, the NEM that exists today and will likely exist in the period from 1 July 2020 - 30 June 2014 and beyond diverges significantly from a market based approach.

- In the market based NEM, it was appropriate for the AEMC to set the market price cap to give the right incentives for market participants to:

    - invest in new dispatchable generation capacity to achieve the reliability standard, and
    - protect market participants and consumers from excessively high prices

- In the years since, deployment of new generation capacity has almost entirely been driven by the RET, CEFC, State Government and Territory reverse auctions and investors' view of risk e.g. carbon and gas fuel supply

- This expansion in renewables generation, increased carbon risk, a number of supply interruptions, political uncertainty and the exit of coal fired generation has led to:

    - a reluctance of the private sector to build any new generation capacity other than renewables
    - a view of both State and the Federal Government that the "energy market" broadly defined (and the various settings like the MPC) cannot ensure the reliability standard will be met

- The response of Governments has not been to strengthen the market signals for new dispatchable generation, but the very opposite which is direct intervention in the market that is unrelated to any particular MPC value. This in turn has dulled private sector interest in investing in dispatchable generation given that it does not want to have to compete with a Government owned generator.

- It is our strong contention, supported by observed behaviour of market participants, that the level of MPC is not a major factor (if a factor at all) in this new generation build and indeed the NEM is moving away from being a market relying on 'market' signals.

- A primary example of this is the National Energy Guarantee (NEG), which, from what limited details we have seen so far, will drive new investment via regulatory requirements on-market participants, and in doing so effectively replace the need for an MPC. Essentially, the more the NEM moves towards a capacity market the less is the need for an MPC anywhere near the current level.

- The Panel acknowledges that there is a lot of change going on in the NEM and for that reason supports the "stability", "certainty" and "predictability" that comes from leaving the MPC unchanged. Yet apart from a qualitative statement around the desirability of "stability" we do not believe that the Panel has met its own materiality criteria to justify its position.

- We contend that MPC stability in the current and expected market for 2020-2024 is not in the long-term interests of consumers. WE note that the only submissions to the Issues Paper supporting the concept of stability in the MPC came from generators. There were no submissions from consumers supporting the Panel's approach.

- We see the changes going on in the market and the increasing role of direct Government intervention indicating that maintaining the MPC at its current level is a policy for yesterday's market, not the market of 2020-2024.

- While the current MPC is not needed for new investment, its role in mitigating the risks of consumers being exposed to excessive prices still remains. The Draft Paper agrees with this role for the current MPC level, so

> presumably a lower MPC would achieve the role of consumer protection even better. The need to exercise restraint on excessive prices seems to be an increasingly important issue to the NEO given comment around the likely operation of the NEG; we see a lower MPC fulfilling that role

So, in summary, "stability" in the MPC is not in the long-term interests of consumers – a lower MPC is.

Given the Panel's recommendations are referring to the 2020-2024 period and the current four-year cycle to review the reliability settings, we need to be aware of the risk of locking in policy in a period of such disruption and a period when there are immense changes underway through implementation of the Finkel recommendations and the work of the Energy Security Board.

The EUAA is pleased to see that (p.4):

> "The Panel is monitoring policy developments, including the status of the AEMC's rule on five-minute settlement and the National Energy Guarantee. If new decisions are made before our final report is published we will address their impact on the recommendations of this review as time permits in our final report, suggesting further work where needed including deadlines for completion.

The EUAA strongly recommends that, irrespective of the final decision on the MPC level, the Reliability Panel should reconsider the reliability settings once details of the NEG are agreed.

Finally, this submission supports many of the comments made by PIAC in its original submission on the Issues Paper and its submission on this Draft Report.

SUBMISSION - SUBSTANTIVE COMMENTS

What is the purpose of the regulatory framework for reliability?

The Panel argues (p.2) that:

> "The regulatory framework for reliability in the national electricity market is primarily market based. Under this structure, market participants decide to invest in electricity generation, operate and maintain units and retire plant based on price signals and incentives from both the wholesale market and contract market. Expectations of future spot prices provided by the contract market, and the need for investment in new capacity to manage price risk, also impact on their decisions."

And that the purpose of the reliability settings is to (p.3):

- Maintain the overall integrity of the market, by protecting market participants and consumers from excessively high prices.
- Allow for sufficient investment to provide electricity to the agreed reliability standard.

What changes are going on in markets today and how are these expected to develop over the period to 2020?

The NEM is a substantially different market today that what it was even 5 years ago when the current reliability settings, including MPC, were decided. Based on current and proposed policy and regulatory settings, that difference will only be greater by 2020-2024. We believe the fundamental change will be a move away from the market based NEM to an increasingly regulated NEM with substantial Government intervention and regulation.

This means the role of the MPC to influence investment to achieve the reliability standard is fast disappearing and will be virtually irrelevant by the 2020-2024 period.

(i) The generation being built over recent years and up to the 2020-2024 future is renewable which is not built on the basis of a particular MPC

Renewable generation bids in at zero (or less) to ensure dispatch. It does not rely on price volatility inherent in an energy only market to reclaim the "missing money". Renewable generation gets its "missing money" from the RET certificate revenue stream or strikes an offtake PPA, not the NEM.

The deciding factors for renewable generation build include the availability of a site, preferably close to exiting network infrastructure, the ability to get an acceptable long term PPA and the availability of finance. State Governments are now giving PPAs to support the development of new renewables generation e.g. the SA Governments deal with the developers of the Port Augusta solar thermal plant to provide power to the State Government schools, hospitals and railways[1].

In the four years to 30th June 2017 the Clean Energy Finance Corporation had made cumulative debt and equity commitments of $4.3b to projects with a combined value of $11b[2]. In 2016/17, it financed 10 large-scale solar projects in total exceeding 500MW capacity, delivering more than $440m in new investment commitments to accelerate projects with a combined value of $1.3b[3].

(ii) There is much more direct Government intervention in the market

The South Australian Government's recent energy policy announcement [4] made no reference to the role of the MPC in its discussion of how to ensure electricity reliability in that State:

> "Recent events, however, have highlighted the need to fast track South Australia's energy transformation to rebuild confidence in the reliability of supply."[5]

instead it laid out a policy framework and mix of measures including a battery storage and renewable energy fund, a State Government owned gas fired power station and back-up diesel generation. All of these initiatives had nothing to do with the level of the MPC and everything to do with the desire of the South Australian Government to ensure reliability of supply for South Australians. In announcing the plan, the South Australian Government's policy expresses serious doubts about the ability of the NEM regulatory framework to achieve the reliability standard. The Government is not only building new generation but also legislating to enable the Minister for Energy:

> "…to direct the national market in the case of an electricity supply shortfall. Ministerial direction includes the ability to direct generators to operate and direct the Australian Energy Market Operator to control flow on the interconnector.[6]

South Australia is not relying on the MPC to ensure enough generation is available to meet the reliability standard in South Australia. It's contracts for the 100MW Tesla battery and the 276MW of back-up diesel capacity for the next two summers and perhaps beyond, are independent of the MPC level.

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[1] "Power prices to drop due to investment in renewables" Press Release Tom Koutsantonis 18 December 2017 https://www.premier.sa.gov.au/index.php/tom-koutsantonis-news-releases/8457-power-prices-to-drop-thanks-to-investment-in-renewables

[2] CEFC 2016/17 Annual Report p.12 http://annualreport2017.cefc.com.au/media/1399/cefc-annual-report-2017.pdf

[3] Ibid p.20

[4] See "It's time to take charge of our future" http://ourenergyplan.sa.gov.au/

[5] Ibid p.7

[6] Ibid p.4

The Federal Government's proposed expansion Snowy Hydro 2.0 also seems independent on the MPC level. It is driven by Federal Government's ability to use its partial ownership (and it is seeking to go to 100% ownership with the purchase of the shares of the NSW and Victorian Governments) to respond to confidence to meet market concerns about system reliability with expanding renewables penetration.

The reverse auctions for renewable generation by the Victorian, Queensland and ACT Governments is driven by carbon reduction objectives, not a MPC level.

(iii) If coal power station is built it will be on the basis of some form of Government subsidy, not the MPC level

All the evidence is that the private sector will not finance a new coal fired power station, no matter the MPC. The modelling by the Minerals Council of Australia seeking to justify the competitiveness of a new High Efficiency Low Emissions coal fired power station arrived at its LRMC and hence its viability by assumption – that the WACC required by investors had no risk premium and was the same as for any other generation type – because it output would be purchased under a long term PPA[7]. Again, in this case the MPC was irrelevant. At present and at least up to the 2020-2024 period the only off-taker would be a Government entity.

(iv) It appears the NEG is going to provide a very strong incentive to build new generation to meet the reliability standard

While we only have a high-level information on how the NEG will work, as the Panel notes (p. 23):

> "The Guarantee is made up of two components that will require electricity retailers across the national electricity market to contract for reliable and lower emissions generation each year.
>
> - A reliability component will be set to deliver the right level of "flexible dispatchable resources" which include any "form of technology, generation, batteries and demand that can respond to a request by the operator to increase or decrease their output over a defined time interval".

There is the potential that this reliability component will render the need for an MPC to encourage investment to meet the reliability standard, redundant.

What these developments indicate is that the NEM we have now, and will increasingly have in the 2020-2024 period, is not "market based". As Governments are increasing their explicit intervention to achieve reliability and emissions objectives, investors re-evaluate their risk appetite, technology developments change relative generation costs, demand response expands etc., the energy only market that the MPC setting was developed to support as a market solution, is disappearing.

There is a need for a much more holistic approach to the issue of reliability that takes account of the myriad of other developments underway in the NEM, rather than seeking to simply review existing mechanisms on the assumption that they are still relevant.

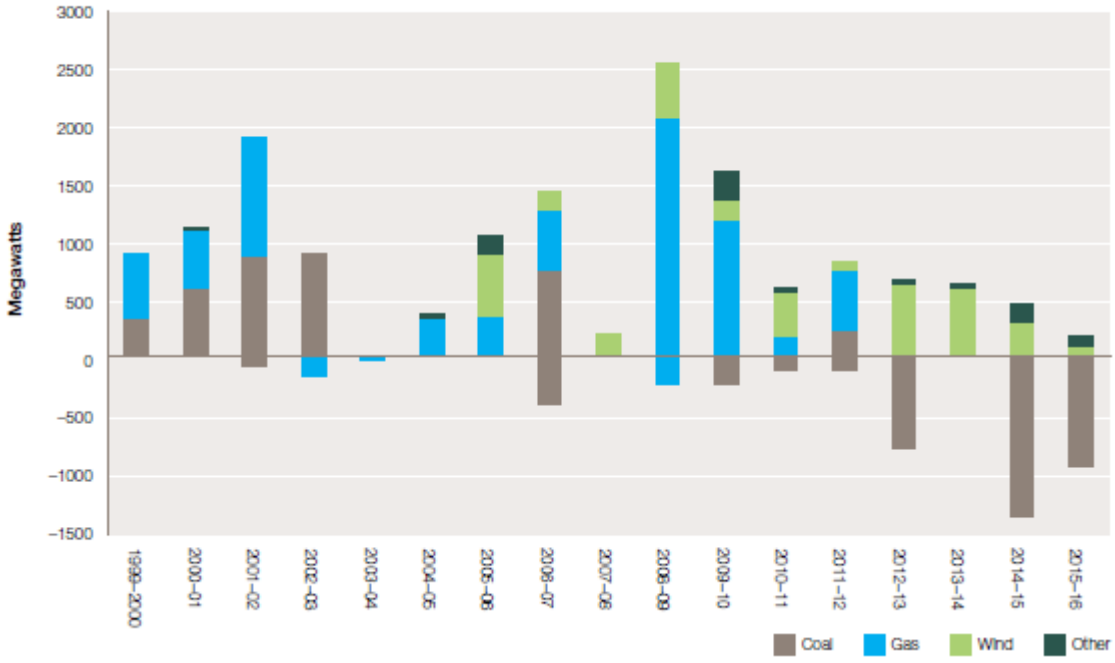
[7] Soltice Development Services "Prospects for a HELE USC Coal fired Power Station" June 2017 p.87
http://www.minerals.org.au/news/independent_report_backs_modern_coal_generation_for_australia

What role has the market price cap played in supporting new generation since the last reliability settings review?

The AER State of the Energy Market 2017 p. 37 concluded:

> "Since 2012–13, capacity additions to the NEM have largely been in wind and solar plant. All plant retirements over this period have been in coal fired plant, but some gas-powered plant has been mothballed.
>
> Of the 2000 MW of plant capacity added over the five years to 31 March 2017, 92 per cent was in renewables (80 per cent wind and 12 per cent solar), which the RET scheme subsidises. The balance of investment was in waste coal mine gas and diesel plant. Table 1.3 lists capacity added since 1 July 2015. At March 2017, a further 125 MW of solar capacity and over 600 MW of wind capacity was committed to the market (table 1.4)

Figure 1.16
Investment in new generation, and plant retirements



Further, the AER report showed that all of the generation plant exiting the market since 2011 has been dispatchable plant.

Table 1.5 **Generation withdrawals from 2011–12**

YEAR	POWER STATION	REGION	GENERATION TECHNOLOGY	CAPACITY (MW)	STATUS
WITHDRAWN					
2011–12	Swanbank B	Qld	CCGT	480	Decommissioned progressively between April 2010 and May 2012
2012–13	Munmorah	NSW	Coal	600	Retired
2012–13	Tarong	Qld	Coal	700	Closed 2012 to 2014
2012–13	Collinsville	Qld	Coal	180	Retired
2014–15	Morwell, Brix	Vic	Coal	205	Retired
2014–15	Wallerawang C	NSW	Coal	1000	Retired
2014–15	Redbank	NSW	Coal	144	Retired
2014–15	Pelican Point	SA	CCGT	249	Half capacity withdrawn. Announced return to full capacity in June quarter 2017
2014–15	Swanbank E	Qld	CCGT	385	Placed into cold storage. Expected to return December 2018
2015–16	Northern	SA	Coal	540	Retired
2015–16	Playford B	SA	Coal	200	Retired
2015–16	Anglesea	Vic	Coal	150	Retired
2016–17	Hazelwood	Vic	Coal	1600	Retired
ANNOUNCED WITHDRAWAL					
2017	Smithfield	NSW	Gas	171	Retirement
2017	Tamar Valley	Tas	CCGT	208	Mothballing
2021	Mackay	Qld	OCGT	34	Retirement
2022	Daandine	Qld	CCGT	33	Retirement
2022	Liddell	NSW	Coal	2000	Retirement

CCGT, combined cycle gas turbine; MW, megawatts; OCGT, open cycle gas turbine.

Sources: company announcements; AEMO, Electricity statement of opportunities (various years).

This data suggests that the MPC is not serving to encourage new dispatchable plant to enter the market to support achievement of the reliability standard. It is also not preventing existing dispatchable plant from exiting the market and, in doing so, creating risks to meeting the reliability standard.

The Panel seems to acknowledge the declining role of the MPC in new investment when it commented in response to the PIAC submission arguing similar points to those above (p.130):

> "The Panel notes that in almost all circumstances, the MPC does have a marginal impact on investment and capacity and notes the broader uncertainty in the market.

But the Draft Report does not provide any evidence to support this proposition. There is no evidence provided of any discussions the Panel has had with potential developers of new generation in seeking to understand the factors driving their investment decision. The evidence in the market is that the factors driving investment now and in the 2020-2024 period are/will include:

- Level of behind the meter generation and demand response and hence level of grid demand
- Renewable Energy Target
- Level of CEFC support/subsidy
- The level of direct government intervention in new generation build
- Availability and price of gas
- Potential price on carbon
- National Energy Guarantee details

With not even a "marginal" impact of the MPC. Even if the MPC has a "marginal" impact on investment decisions, the Panel has not addressed the question:

"Will a fall in the MPC mean less than optimal investment will occur to meet the reliability standard?"

Will the proposed MPC protect market participants and consumers from excessively high prices?

The EUAA agrees with the Panel's view that a $14,000 MPC protects consumers from excessively high prices. Given the Panel's view we would expect that they would also agree with the proposition that:

> "A MPC of <$14,000 would offer even great protection for consumers from excessively high prices."

The Panel's response may then be something like "but we have to balance the need to protect consumers from excessively high prices against the need to provide a signal to investors to build new capacity to ensure the market meet the reliability standard". The Panel describes[8] the trade-off it has make "on behalf of consumers" between a higher MPC exposing consumers to greater price risk and a lower MPC sending inefficient price signals for operation and investment "resulting in higher costs over the long term".

The EUAA's view is that the trade-off made by the Panel on consumers' behalf in the Draft Report is not in the long-term interests of consumers. We are not suggesting the MPC go down to the $300/MWh in the Box 3.2 example. But it would be substantially lower than the current level given that a much lower MPC would not result in a change in the operation and investment in generation capacity that would lead to unserved energy above the reliability standard.

The debate on the likely impact of the National Energy Guarantee has highlighted concerns about the potential market power of some generators. This market power is enabled by a combination of the market concentration, bidding rules and the MPC. While we recognise the bidding, rules are not within the scope of this review, what is in scope is the level of the MPC and how that will, in the absence of any change in market concentration or bidding rules, potentially facilitate increased price risk for consumers under the NEG.

Even if this review does not result in a change in the MPC, it is imperative that the MPC be reviewed in the light of the details on the NEG and not have to wait for the regular 4 years review. To not undertake this review runs a high risk that the impact of bad policy will be magnified considerably.

Why is "stability" in the long-term interests of consumers?

The Draft Report argues that the MPC should not be changed because stability is inherently good. "Stability" is aligned with "certainty" and "predictability" as the Draft Report notes (p.3-4):

> "The Panel does not wish to unnecessarily exacerbate uncertainty in the market. We have therefore weighted our decisions in this review in favour of supporting certainty and stability in the national electricity market ".

Given the materiality test applied by the Panel, the Draft Report provides no supporting analysis that "stability" is materially better that a change. It seems the Panel has placed the onus of proof on those who advocate change rather than applying its own test to its own analysis and conclusions. Where it does apply the materiality test the arguments are more qualitative that quantitative.

[8] See Box 3.2 p. 54

The Panel claims that (p.8):

> "…there is value for market participants and consumers in maintaining policy stability, where warranted."

Yet we are unaware of any consumers submissions in this current process arguing for the benefits of stability over any other pathway. The Draft Report seems to justify the stability argument on the basis of a judgement that "there is lots of change happening in the NEM so the MPC has to be an island of tranquillity in a stormy sea":

> "…the national electricity market and the energy sector are in a time of transition. Market participants and potential investors are currently factoring into their business model's developments including: rapid technological change; the potential introduction of a National Energy Guarantee; the potential for a five-minute settlement period; the growth of distributed energy resources; changes in contract types; advances in demand response; and government-sponsored generation projects." (p.8)

The EUAA's view is that this "stormy sea" is the very reason to seriously question the need for, or benefit of, maintaining the MPC at its current rate. The Draft Report comments that (p.8):

> "The Panel notes that many stakeholders identified the importance of regulatory stability, and the uncertainty associated with any reassessment of the settings."

A review of Appendix A – Summary of stakeholders' comments on the issues paper, reveals that the importance of "stability" was explicitly mentioned only by Energy Australia:

- in the context of the reliability standard - "Stability is more beneficial to consumers until such time as the distortionary effects of policy instability are reduced" (p.124), and
- in the context of the MPC: "There is an inherent stability benefit form not changing the MPC" (p.127)

The EUAA considers that waiting for the distortionary effects of policy instability to reduce may be akin to waiting for Godot.

As always, the EUAA would welcome further discussion and consultation on this matter.

Andrew Richards

CEO

22nd December 2017