Ref EMO0025

Mr. John Pierce
Chairman,
Australian Energy Market Commission

Lodged on line to submission www.aemc.gov.au
Monday 27 May 2013

Dear John,

REVIEW OF AEMC STRATEGIC PRIORITIES

GDF Suez Australian Energy (GDFSAE) welcomes the opportunity to contribute to the review of AEMCs strategic priorities and supports the broad strategic themes as outlined in the discussion paper.

GDFSAE encourages the AEMC to include two further strategic themes - The need to actively support the TFR, and Market Design - and recommends a change of emphasis for the proposed customer priority theme.

We participated in the previous Strategic Priorities forum held in Melbourne two years ago, where many of the stakeholders were present. The more recent use of multiple venues was more effective in engaging interaction with stakeholders and the summary notes from all of the forums were also useful.

Our detailed response is as follows:

Transmission Frameworks Review - TFR

GDFSAE welcomes the work done to date by the AEMC on the Transmission Frameworks Review (TFR). The integration of transmission planning and operations with the competitive market arrangements of the NEM has remained unfinished business since before the commencement of the NEM.

The comprehensive TFR project has taken considerable time and effort and represents a real opportunity to increase efficiency of the NEM trading arrangements by effectively managing transmission constraint risks, and over time reduce costs to customers (ie, by enabling generators to manage their risks of being constrained off and also due to a portion of transmission costs borne by generators).

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The Optional Firm Access elements are complex by necessity as they revolve around complex transmission arrangements, and will require substantial effort to implement. It is important to effectively manage the potential risk of this review being sidelined as 'too difficult' by the policy makers.

With this in mind, we strongly urge the AEMC to continue to widely advocate the case for transmission reform, and work towards the establishment of the industry panel as proposed in the TFR final report.

Equally, the AEMCs support and leadership regarding the TFR-OFA is essential, and we encourage the AEMC to remain actively involved in the SCER process.

Market design

One consequence of the existing NEM energy only market design is to allocate most residual risks to generators. These risks include policy and regulatory risks, as well as market risks. Policy risks have and will continue to impact the supply-demand balance in the short to medium time frame (eg, efficiency measures, forcing uneconomic generation (RET) into the supply mix). Other policies impact plant economics and result in shortened asset lives (eg price on CO_2). Clearly private investors in generation are not the parties best placed to manage such government created regulatory and policy risks effectively.

Whilst risks to generators have increased, since market start investors in generation have not been able to maintain adequate returns on their investments. Added to this there have not been commensurate risk premiums as a result of policy and regulatory changes. (It should be noted that risks are not borne just by high carbon intensive plant. Some of the most efficient gas fired generators struggle financially due to high gas prices and low or zero CO_2 costs).

In summary, the generation sector needs to compete for global capital and generators are not attractive to investors. Thus future investment in the sector, particularly high capital cost plant, is likely to be problematic.

The EOM wasn't designed to deal with large volumes of subsidised renewable generation. Services that are necessary to deliver a secure and reliable supply, such as system inertia and spinning reserves, are not valued by the market.

It is therefore imperative that the AEMC review the current trading arrangements in recognition of ever increasing volumes of renewable and distributed generation, and in the context of system security and energy affordability.

We urge the AEMC to review the existing trading arrangements in light of the above challenges and in recognition of global developments in market design.

Customer priorities

GDFSAE would like to emphasise the following points in relation to customer response:

- Demand side response is broadly supported provided it is in response to market signals and not reliant on the use of subsidies and market distortions (ie, it is essential that there is equal treatment of supply and demand responses).
- Cost reflective network charges (not TOU tariffs) are critical in driving economically efficient responses
    - Network costs are largely fixed and driven by peak demand; specifically these costs do not vary with time of use or volumes transported (with the exception of marginal losses which are a third order issue).

      However existing retail tariff structures do not reflect network cost structure but smear fixed costs using a variable charge. This leads to a range of problems and inefficiencies as follows:
        - Cross subsidies between high energy and high capacity factor loads (efficient use of networks) and low energy and low capacity factor loads with high peak demand (ie, summer air conditioners with gas winter heating);
        - Households with solar PVs avoid network charges when such households rely on networks for backup and export of local generation;
            - Solar PVs also create localised network issues and increase costs of distribution networks (local voltage control issues);
        - Remaining (non-PV) households are burdened with additional network costs which incentivises them to install solar PVs;
    - The current arrangement is unsustainable from a number of perspectives:
        - It is economically inefficient as it ineffectively signals distributor-to-retailer, and retailer-to-customer, and encourages behaviours that use existing networks inefficiently;
        - Over time, this leads to over-investment in networks; and
        - Therefore inefficient price signals to consumers will continue to increase costs of electricity delivery.
    - Introduction of TOU tariffs does not address the core issue of fixed network costs. Pass through and will lead to other economically inefficient responses;
    - As a principle, the end user charge should reflect the marginal value of capacity (cost to customers increasing their demand and a saving to customers reducing demand). It is expected that the marginal value would be low in underutilised networks and may approach the LRMC in heavily utilised network elements; However the overall structure should only recover sufficient revenue in line with the regulated returns on assets;
- Renewable generation delivers energy without capacity, and increases network costs (free rides on the network capacity);
- Information and education of customers is essential when contemplating fundamental changes to retail offers; and

- Obligation on networks to charge cost reflectively to retailers is seen as essential first step. However any service offerings must be retailer led. Retailers need to be free to structure offers to suit customers either by managing network risk on behalf of the customer, or to provide network cost reflective offers (ie large fixed charge based on maximum demand).

Additional issues

The NEO should not be modified to include environmental considerations. In a mathematical sense, multiple objectives are incompatible in an objective function, as there can only be a single objective (ie maximise / minimise subject to a range of "constraints"). To introduce constraints on NEO to include environmental outcomes would amount to a regulatory intervention at the expense of market efficiency. GDFSAE would like to emphasise that environmental policy objectives are best dealt with outside of NEO and should, where possible be compatible with a market based approach (eg, well-designed emissions trading scheme).

Should you have any enquiries regarding this submission, please do not hesitate to contact David Hoch (Manager Regulatory Strategy and Planning) on 03 51 35 5363 or 0417343537.

Yours sincerely,

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Director Strategy and Regulation