

4th September 2018

Dr Kerry Schott AO
Energy Security Board

Submitted via e-mail to: info@esb.org.au

Dear Dr Schott,

National Energy Guarantee Reliability Requirement Pre-condition Options

The Australian Energy Council (the “**Energy Council**”) welcomes the opportunity to make a submission in response to the Energy Security Board’s (“**ESB’s**”) *National Energy Guarantee Reliability Requirement Pre-condition Options Consultation Paper*.

The Energy Council is the industry body representing 21 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over ten million homes and businesses.

Introduction

The Energy Council acknowledges that the alternative policy options for activating the reliability obligation as presented in the consultation paper are as a result of the Council of Australian Governments Energy Council meeting of 10th August, but expresses alarm that the options differ from the final detailed design developed in conjunction with industry and other stakeholders over the past few months. Industry and the ESB have worked collaboratively and conscientiously to determine the best design to satisfy all the goals set for the ESB and it is disappointing that a key part of the reliability obligation trigger mechanism may be overturned by a hurried consultation in response to assumptions about the mechanism’s political acceptability.

The Energy Council does not believe that any of the options presented in the consultation paper are acceptable, since in all cases their effects are detrimental to the market. These concerns are outlined below.

Discussion

Addition of a T-5 Determination

Although the Australian Energy Market Operator (“**AEMO**”) produces its Electricity Statement of Opportunities (“**ESoO**”) annually, which would show impending reliability shortfalls, the addition of a T-5 trigger would put liable entities on notice that they would need to have arrangements in place, whether that be qualifying contracts or necessary plant built, so that they could meet the reliability obligation in five years’ time. In addition, the presence of a T-5 determination would empower AEMO to commence a voluntary book-build from that year, and every year, until T-1.

From the Energy Council’s perspective a T-5 determination provides no additional comfort that the reliability obligation will be met in Year T. Forecasts of shortfalls five years in advance of them possibly occurring will necessarily be vague and uncertain given likely and possible changes in supply and demand over the intervening period, not to mention possible

- governmental policy changes (either at state or federal level);
- market changes such as increased distributed generation;
- declining technology costs; and
- regulatory environment changes.

The ESoO already telegraphs coming shortfalls to market participants and prospective generation plant builders, therefore there is no need for a reliability obligation to be imposed on the market so far out. The key

modern dispatchable technologies, such as storage and gas peaking plant, have very rapid, and declining, build times. It is also unreasonable to expect financial markets to transact positions so far in advance of the year in question, undermining the purpose of the trigger.

On this basis the Energy Council rejects the addition of a T-5 Determination as a means to add comfort that reliability obligations will be more likely to be met.

Removal of T-3 Determination

The final detailed design, consistent with its previous drafts, contained a “double gate” system, where a shortfall had to be identified at both T-3 and T-1 before triggering the retail compliance requirement. The trade-offs in this design were considered at length. A concern raised was that, despite the inclusion of the three year generator closure notice rule, conditions may still deteriorate between T-3 and T-1 due to *force majeure*-type events, and so the necessity of the T-3 gate was frequently questioned. The consultation process however confirmed that it was unreasonable to expect retailers to anticipate *force majeure*; an event which, by definition, is not able to be anticipated. A T-3 trigger allowed time for retailers to take reasonable steps to procure additional capacity (e.g. building a new peaking unit or battery system) in response to a foreseen shortfall, or risk facing additional penalties. Triggering the Reliability Guarantee for unforeseen shortfalls after that cut-off would merely penalise retailers, for no improvement in reliability. Instead, last-resort safety-net interventions exist for such unfortunate eventualities, for example the Reliability and Emergency Reserve Trader (“**RERT**”).

Removing the T-3 Determination also leaves an element of surprise for liable entities, since a T-1 determination can be called at any time. Although liable entities will be monitoring the ESO’s forecasts as they come closer and closer to the reliability gap year, Year T, the entities may not have entered into the required qualifying contracts when a T-1 determination is sprung upon them, since their internal forecasts, and indeed the most recent ESO itself, may have indicated no likely reliability shortfall.

The consultation paper has also proposed that, despite the removal of the T-3 Determination, a market liquidity test would be conducted by the Australian Energy Regulator at T-3, and if necessary, a Market Liquidity Obligation imposed upon large, vertically integrated retailers. In addition, AEMO would have the ability to commence a voluntary book-build from that year, and every year, until T-1.

The Energy Council takes issue with the proposal to impose a market liquidity obligation upon a subset of the market. Not only would such an obligation add to market uncertainty, but singling out particular market participants for action in response to perceived competition shortcomings is not appropriate for the National Energy Guarantee. The Energy Council submits that the identification of any competition issues should correctly be addressed by the Australian Competition and Consumer Commission, and the design of the Reliability Guarantee should not contemplate the proposed market intrusion. Instead the market as a whole should be allowed to address the problem of correcting the foreshadowed reliability gap in good time.

Ministerial Powers to activate the Reliability Obligation

Under the final option proposed, Ministers for each National Electricity Market (“**NEM**”) jurisdiction would be able to trigger a T-1 Determination with a minimum of three months’ notice. No material reliability gap would need to be present for a Minister to make a determination, and there would be no limit to how far in advance of Year T a determination could be made. As in the other proposed options, AEMO would also have the authority to conduct a book-build every year from the Minister’s determination until T-1.

Although the consultation paper suggests that this should be a transitional arrangement to be reassessed five years after implementation, the interventionist nature of the proposal is absolutely inappropriate, and would seriously distort the physical and contractual basis for the NEM. With unfettered powers to call a reliability determination with as little as three months’ notice, market participants will be in suspense, awaiting a ministerial determination which may never come. This will affect their planning, purchasing, building and contracting strategies, and will lead to businesses inefficiently allocating capital and expending money to address risks which may never materialise.

Investment confidence arises only when market operational decisions are taken by national institutions separate from governments. The Energy Council opposes this option in the strongest terms on the basis of its distortionary, parochial and interventionist characteristics.

Voluntary Book-build

In addition, each of the options proposed also includes the ability for AEMO to conduct a voluntary book-build. The Energy Council argues that AEMO's role is to operate the market rather than facilitate the market, therefore conducting book-builds, even though they will be voluntary, will divert opportunities, and hinder the market from developing the most efficient solutions necessary to addressing the forecast reliability gap. It also places the market operator in a difficult position of perceived bias regarding those participants who use its book-build, as opposed to conventional market investment.

While the Energy Council does not believe that AEMO's participation in a voluntary book-build is required at all, in keeping with the consultation which took place between industry and the ESB to finalise the detailed design, the Energy Council recommends that AEMO have the option of conducting a book-build only if the T-3 Determination is triggered, and the likely shortfall in Year T will be sufficient to warrant new capacity development.

Conclusion

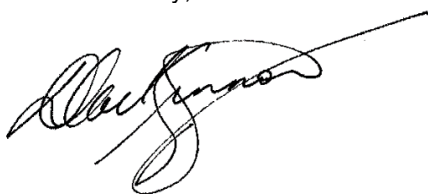
After such a long period of policy uncertainty industry remains keen for both elements of the National Energy Guarantee, the Emissions Reduction Requirement and the Reliability Requirement, to be developed in tandem. Due to its development in collaboration between industry, stakeholders and the ESB, the Final Detailed Design remains the most appropriate model to be progressed. The Energy Council is therefore disappointed that the Reliability Guarantee is being considered as a separate mechanism for the NEM.

In relation to the options proposed in the consultation paper, the Energy Council considers that none of the proposals improve on the design in the Final Detailed Design Paper to offer additional comfort that any reliability gap will be addressed, and in all cases they distort the market, therefore they cannot be supported.

It may be that the ESB considers these significant last-minute adjustments are necessary to confirm the passage of the Reliability Guarantee. However the present market outlook does not indicate a level of reliability concern that justifies such urgent passage. Given the suspension of development of the Emissions Guarantee, if these proposed variations are considered politically necessary to progress the Reliability Guarantee's passage, the Energy Council instead suggests deferring its implementation until further detailed consultation can be carried out. These consultations would be similar to those the ESB used in the development of the detailed design.

Any questions about this submission should be addressed to the writer, by e-mail to Duncan.MacKinnon@energycouncil.com.au or by telephone on (03) 9205 3103.

Yours sincerely,



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