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Dr Kerry Schott AO
Chair
Energy Security Board

Dear Dr Schott

RE: Post-2025 Market Design Issues Paper

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Energy Security Board's (ESB) post-2025 market design issues paper (the Issues Paper).

About ERM Power

ERM Power is an Australian energy company operating electricity sales, generation and energy solutions businesses. The Company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load¹. A growing range of energy solutions products and services are being delivered, including lighting and energy efficiency software and data analytics, to the Company's existing and new customer base. The Company operates 662 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland. www.ermpower.com.au

General comments

ERM Power appreciates the consultative approach the ESB is taking as part of the post-2025 National Electricity Market (NEM) market design review. We consider that this review has the potential to develop a common pathway for the industry and provide a detailed assessment of the true state of the market. Ideally, we would like to see evidence-based decisions, backed by quantitative analysis, that has broad support from industry and will deliver genuine benefits for consumers over the long-term.

In saying that, we are unconvinced that there is a case for a major change in the design of the NEM. The NEM has been subject to intervention and interference by state and territory governments regularly over the past decade or more. Governments have driven investment into specific generation types, incentivised different technologies and some have a compromised position through their ownership of generation, retail and network assets. Normal economic signals are being muddled by constant interventions. This has undoubtedly affected levels of private investment and we consider it to be a key reason for the current state of high wholesale prices and a tight supply-demand balance. Regardless of the result of this review, we consider it unlikely that any market design can withstand this degree of intervention on a long-term basis.

Furthermore, we contend that the decision-making bodies have also suffered from some degree of political pressure resulting in a range of rule changes or policy reforms that have layered reforms on top of each other without allowing enough time to assess the impacts of single reforms. In some instances, we believe that decisions are being made before any market failure is even likely.

¹ Based on ERM Power analysis of latest published financial information.



As an example, the Bidding in Good Faith rule change came into force in 2016 to address concerns about disorderly bidding in the NEM. Before this rule change had even entered into force, the AEMC began work on the Five-Minute Settlement rule change, which sought to address the same issue. As another example, the Retailer Reliability Obligation (RRO) came into effect on 1 July 2019 following extensive consultation with industry. The purpose of the RRO is to ensure reliability in the NEM by incentivising investment in firm, dispatchable capacity. Yet, as part of this review, the ESB is looking at market design options to achieve the same goal.

We note that in the Issues Paper the ESB states that part of the rationale for this review is to “put in place a holistic view of the future development of the market and avoid the risk of simply layering incremental changes and potentially producing an inefficient outcome.” ERM Power strongly agrees with the importance of avoiding this outcome. We consider that over the past few years a series of incremental changes have contributed to the problems we are seeing in the NEM.

We contend there is a real risk that this review will lead to a further series of incremental changes without waiting to see if other changes have delivered the promised (but untested) benefits. For example, the ESB argues that any recommendations from this project will be consistent with, for example, the AEMC’s coordination of generation and transmission investment (COGATI) review.

From our perspective, the COGATI review could result in a fundamental shift to the NEM. This is the kind of reform that needs careful consideration as part of a suite of reforms given the pace of change in the sector. Rather than being ESB’s post-2025 market design review being consistent with the results of COGATI, we would recommend that the COGATI review be rolled into the ESB’s review. This would allow consideration of these kinds of changes to transmission connections charging and access, to be considered as part of a potentially broader set of reforms designed to meet the aims of the ESB’s review.

Ultimately, ERM Power contends that it is essential that as part of this review, the ESB clearly defines the actual problems that need to be solved. For instance, at a basic level, the spot market serves to deliver reliability in the system, while ancillary services markets are designed to maintain system security. We consider the ESB needs to remember this premise and not seek to upend the wholesale spot market if the problems it is trying to solve relate to system security. The ESB then needs to determine, in consultation with stakeholders, whether any proposed solutions will in fact solve the identified problem. In the current environment, we observe that there is great pressure to implement changes without having a clear picture of what problem the changes are meant to address.

Finally, any major reform or package of reforms that are developed as part of this review should require quantitative analysis to determine whether there are net benefits for consumers. Rule changes can impose significant costs on the market, and by extension consumers, with limited attention paid to whether the rule change will deliver net benefits to consumers. Going forward, ERM Power sees that rule changes, particularly those with a large expected cost impact (e.g. \$50 million or greater) should be subject to an increased level of analysis, including quantitative analysis, to ensure that they are likely to deliver net benefits to consumers. Any proposals arising from the ESB’s review should go through this process.

ERM Power sees this as equivalent in many respects to the existing Regulatory Investment Test (RIT) process for transmission and distribution investments, where capital investments costing more than \$6 million require analysis to determine that the project will deliver net benefits to consumers; larger projects require a more thorough process.

Assessment framework

Broadly, ERM Power considers the assessment framework the ESB proposes, as a sensible set of criteria with which to consider market design options. However, these kinds of criteria are regularly used to assess policy options, and in practice are often compromised. We urge the ESB to keep to its principles in how it assesses market design options, especially with regards to efficiency.



We also caution that in assessing potential market design options, there will inevitably need to be trade-offs between different principles. A single option, or collection of approaches, is unlikely to meet all principles completely, and may strongly meet one or more, while faring poorly against others. This is not a problem per se – it is entirely expected – but rather an issue we consider must be acknowledged up-front.

We agree with the inclusion of innovation as part of the assessment framework. In designing an electricity market, there is a tension between allowing enough freedom for innovation to occur while maintaining the kind of prescriptive requirements that may be necessary to meet other aspects of market design. Ultimately, innovation is the by-product of a well-designed market rather than a feature of designing a market. ERM Power considers that the ESB needs to be mindful of this fact as it approaches this review. We don't believe that every issue be solved or specified in the NER, NERR or NEL. There must be room in the market to develop solutions organically.

Additionally, we consider that the ESB should add a principle around good governance – specifically, that any market design is enabled by strong, independent oversight – to the assessment framework. Good governance is a critical factor in any market. The NEM needs genuinely independent decision making, free from government interference. ERM Power is concerned that that over the past few years, political pressure has influenced certain decisions rather than a genuine assessment of the merits of proposals.

This flows through to the principle around market design being robust to future government policy changes. For several years now, ERM Power, and many others in the industry have called for a bipartisan approach to energy and climate change. In practice, we have seen continued disagreements around energy policy and attempts to reduce greenhouse gas emissions. State and territory governments have launched their own policies to reduce emissions in the electricity sector leading to a fragmented and inefficient approach. Aside from this issue, we have also failed to see the emergence of genuine national consumer protections as part of the National Energy Customer Frameworks (NECF). Some states have chosen not to enter into the NECF, while others have used derogations which lead to inconsistencies between approaches in different states.

Related to this, is that for each of the five key opportunities and challenges the ESB is exploring as part of this review, ERM Power notes that government intervention is mentioned as being a key risk. We agree that this will be one of the major challenges of any market design, be it existing or future. At best, continued government interference in generation and retail markets may limit the benefits of any changes as a result of this review, or from existing rule changes. At worst, continued interference will harm the investment environment, only serving to exacerbate existing problems in the market. It is important that in making recommendations as part of this review, the ESB should resist political pressure to modify its design and recommendations during the course of the process.

Conclusion

This review has lofty goals, and while we agree with the ESB's intentions and aims, it will be a challenging process. There is already significant change underway in the NEM through the implementation of reforms such as Five Minute Settlement, the RRO and the Wholesale Demand Response Mechanism. Given the timing of this review, it may be impossible to determine if any of these have achieved their aims and delivered benefits to consumers before more changes are made.

The scale and pace of regulatory reform in the NEM over the past few years has proven challenging. Changes are being layered without any consideration of recent reforms or upcoming reviews. Most of these decisions are being made with untested claims of the benefits they will deliver consumers and limited consideration of the costs they will impose on consumers.

We urge the ESB to clearly define the problems it is trying to solve as it approaches this review. The five challenges and opportunities the ESB has identified are not problems as such, and the ensuing discussion takes a high-level perspective, rather than a detailed look at what problem needs to be solved.



Finally, this review should establish a solid process for assessing any reforms in the NEM, be it an AEMC-led rule change or this review, which includes quantitative analysis. For major reforms such as those this review may lead to, a thorough test of the costs involved in implementation and the potential benefits to consumers is essential to establish whether there will be net benefits for consumers. We consider that major rule changes should be treated in a similar manner to the Regulatory Investment Test for transmission or distribution investments.

Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

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