20 August 2018

The Chairman
Energy Security Board
C/- CoAG Energy Council

Sent by: email to info@esb.org.au

National Energy Guarantee
Response to Reliability Requirement
Precondition Options

1. Introduction

The Major Energy Users Inc (MEU) welcomes the opportunity to provide its views on the Energy Security Board (ESB) Precondition Options for the Reliability Requirement for the National Energy Guarantee (NEG).

The MEU and its regional affiliates have been advocating on behalf of energy consumer interests for over 20 years and they have high recognition as providing informed comment on energy issues from a consumer viewpoint with various regulators (ACCC, AEMO, AEMC, AER and regional regulators) and with governments.

In its response to the Detailed Design Consultation Paper on 13 July 2018, the MEU commented about the proposal from the SA government to exclude the T-3 trigger:

> **"The SA government proposal**
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> The South Australian government has proposed a modification that would eliminate the exercise of the trigger at the three year point of the reliability obligation process (ie T-3) and require participants to monitor the market so that they are aware that AEMO is forecasting a shortage in particular year and that it will trigger a gap at T-1. The import of this change is that there would be an enduring obligation rather than one set when needed.
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> The MEU points out that there is no analysis provided with the SA government proposal so this lack makes if difficult to assess whether the option has any benefit over the proposed arrangement. On balance, the MEU cannot see there is any benefit but it can see there is significant detriment.

The purpose of the trigger at T-3 is to allow sufficient time for liable entities to implement their reliability obligations with the knowledge that such an obligation exists. While the market has, over the years, implemented investment in sufficient time to consistently deliver the Reliability Standard in each region, there has been no explicit enforced obligation to back this up with penalties. To enforce an obligation without clarity that an obligation existed prior to the imposition of penalties is unreasonable.

With this in mind, the MEU supports retention of the three year forward notice to impose the obligation. To impose an enduring obligation as proposed by the SA government is likely to increase costs in the market for little benefit. The value of the three year notice period is three fold:

Firstly it identifies there will be an obligation, that there is a two year time frame to implement investment needed to manage that obligation and to report the obligation has been fulfilled to the AER by T-1. To eliminate the trigger date increases risks for Market Participants and large end users that there is likely to be insufficient time to implement the lowest cost options to address the forecast shortage. Already AEMO has identified that they would prefer more time to implement their Reliability and Emergency Reserve Trader (RERT) process from the current 9 month period just recently implemented. To expect other stakeholders to implement in less time the same processes that AEMO will undertake is unrealistic. Further, the RERT process is intended to be implemented only if there is not sufficient reliable supply in the year when the shortage is identified. AEMO needs to be able to assess if there is going to be sufficient reliable supply before it implements its RERT process. As AEMO already has advised, it will need more than 9 months for the RERT, so stakeholders need to be well down the path of implementation of their processes before AEMO commences theirs.

Secondly, AEMO has identified that the lowest cost option for the market requires an ability to contract longer than just for one year when they are looking to implement the RERT. To limit taking action just one year out, will not result in the lowest cost option. This means that there needs to be more time provided to allow stakeholders the ability to identify the lowest cost options and having a two year notice period allows this to occur.

Thirdly, the MEU notes that if a reliability shortage is triggered, stakeholders will need sufficient time to identify the most appropriate option, design it and then complete a build and commission process. If the assessment results in the construction of a new dispatchable generation plant, an overall 2-3 year time frame is likely to be needed to have the new plant available before the forecast time of the shortage occurs. While it is possible that such plant might be available to add output to the market in a shorter time, this could result in higher costs.

The NEO requires that changes need to be the most efficient (ie lowest cost) option so to unnecessarily limit the time to investigate and implement the lowest cost option does not comply with the NEO.

On balance, the MEU considers that the three year notice is a pragmatic and sensible option."

The MEU comments that these views are still as pertinent as they were when it provided its 13 July response and this response to the “precondition options” paper reflects these observations.

The Options Paper includes, in addition to the base detailed design, three additional options for consideration, viz.

1. An option for AEMO to impose a T-5 trigger and delete the T-3 step
2. Removal of the T-3 step (the SA government option)
3. Ministerial powers to activate a reliability trigger

The MEU provides the following comments.

1. AEMO option for a T-5 step to replace the T-3 step

As the options paper points out, increasing the time for a determination to T-5 will introduce a greater potential for error as the forecasts will be made further out than under a T-3 trigger, and therefore resulting in a requirement that the “gap” for a T-5 trigger would need to be larger than for a T-3 “gap”, due to the greater uncertainty inherent in a longer term forecast. The MEU recognises that AEMO has consistently tried to provide accurate forecasts over the years but its ability to do so even 3 years out has demonstrated significant errors and these are even more evident when forecasts are made 5 years out. The MEU considers that this is not so much an inability of AEMO but that market conditions and weather can and have changed massively in relatively short periods of time. Because there are significant financial risks due to the application of penalties should there be a reliability shortfall in addition to the costs in buying the reliability contracts which may or may not be needed, the MEU considers that increasing the forecast period will result in consumers incurring unnecessary costs based on forecasts that have a significant element of unreliability.

The MEU notes that a generator is required to give only 3 years notice of a closure so it is possible that a reliability obligation decision made at T-5 might not include a subsequently announced generator closure making the T-5 decision severely understated. While the MEU accepts that rules could be made to allow a resetting of the overall reliability obligation should such an announcement be made subsequent to a T-5 trigger determination, this increases the risks faced by liable entities, detracting from the certainty required by the process and highlighting the higher level of risk inherent in attempting to make such binding decisions so far ahead of time, especially when these decisions are backed up by severe penalties on liable entities.

The MEU also notes that the “gap” is derived from two basic assessments – the first forecasting the peak demand and the second, forecasting the expected additional generation to be added over time. This means that the estimate of the “gap” includes any cumulative error from both estimates. The MEU has observed over the years that investment in new generation has responded to the ESoO, so a potential gap identified 5 or more years ahead of need has, to now, been filled by actions taken in the intervening period such that there has not yet been a “gap” eventuate.

This raises the question as to what benefit will result by having the T-5 option over what has been occurring in the market anyway. The MEU has a concern that having a determination made so far out has the potential to result in over investment with a resulting cost to consumers.

It is clear that the move to have a T-5 option might allow liable entities longer time to build new generation such as needed by coal or some large hydro storage options[1] but these longer term options would have already been flagged as needed by the ESoO. Accordingly, proponents considering such options would have assessed the commerciality of the various options with sufficient time to allow for the lead times involved. In contrast, as the MEU pointed out in its 13 July response, 3 years provides adequate notice for almost all other forms of dispatchable generation options.

The Electricity Objective requires rules that deliver the lowest cost outcome for consumers when balancing competing requirements. It must be remembered that the Reliability Leg of the NEG enforces costs on the market with the threat of penalties if the required outcome is not achieved. If the balance between obligation and market driven action is pushed too far in one direction, this will increase costs for consumers[2].

While the option of a T-5 or a T-3 trigger might have some appeal, it also has the ability to cause consumers to incur increased costs due to inaccuracies in forecasting and is based on the assumption that the liable entities are not paying attention to the annual updates of forecast needs in the ESoO.

The MEU considers that an obligation backed by significant penalties needs to triggered at the latest possible time to allow the market to respond to the regular flow of information issued by AEMO. A T-3 trigger allows just sufficient time for the market to take action to ensure the continuity of reliability without imposing significant costs on consumers.

With this in mind, the MEU does not support AEMO having the option to trigger the Reliability Obligation at T-5 and that the obligation should only be allowed to be triggered at year T-3.

2. Removal of the T-3 obligation (the SA government option)

As noted in the introduction to this submission, the MEU remains of the view that the T-3 obligation provides a balance between the time needed by a liable entity to implement a program to avoid any penalties under the obligation and the impact of the inevitable errors that might result in AEMO forecasting.

The options paper provides no reasons for proposing the change nor does it provide explanations as to whether any benefits might result from the option, other than an implication that any AEMO errors are likely to be smaller due to the shorter period of time before the obligation has to be fulfilled.

The MEU also notes there remains a requirement that large end users have contracted with retailers in sufficient time to avoid being a liable entity. A T-3 step allows large end users to ensure they have contracted with a retailer before the liability is enforced and providing the retailer sufficient time to integrate the large end user's demand into its dispatchable generation portfolio.

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[1] Nuclear would require even more time

[2] In this regard, the MEU points to previous experience where excessive increases in reliability settings have resulted in significant consumer harm. The ACCC refers to this in its recent report on retail electricity prices where excessively high network reliability settings resulted in significant over-investment in networks causing unnecessary price increases for network services

The MEU considers that the risks to consumers by removing the T-3 step are significant, especially accepting that some large end users might elect to “opt in” and become liable entities; if they do, they will need sufficient time to implement actions while having the widest possible range of dispatchable generation available to them to minimise their costs.

3. Ministerial powers to activate the reliability obligation

The MEU notes that the introduction of the NEG was to eliminate government interference in the electricity market yet this option reintroduces it. Already the MEU has seen how political interference in the electricity market has caused significant harm to consumers such as through the reliability settings on networks. Further, consumers have seen extreme policy changes over the past decade that have led to the lack of certainty so necessary to provide confidence in investment.

The MEU points out that if Ministers have a concern about future reliability, they have the ability to implement investment of their own without directly interfering in the settings that a market needs to provide certainty and predictability to operate efficiently.

The MEU is very concerned about this option and considers that the inherent risk imposed by a Minister having unilateral power to interfere with market settings for the reliability obligation (noting the significant penalties that will still apply) increases risks significantly, and thereby will increase costs for consumers.

The options paper provides no guidance as to the benefits this option might deliver to the market or how this option will meet the NEO. As with the option to delete the T-3 step, this option introduces only a limited time available (3 months) between the ESoO being published (and the “gap” identified) and the time by which the obligation is to be fulfilled; this means that this option also suffers the same detriments noted for option 2 above..

The MEU is happy to discuss the issues further with you if needed or if you feel that any expansion on the above comments is necessary. If so, please contact the undersigned at davidheadberry@bigpond.com or (03) 5962 3225

Yours faithfully

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