

REVIEW OF THE FORM OF THE RELIABILITY STANDARD & ADMINISTERED PRICE CAP REL 0086

04 MAY 2023

INTRODUCTION

The Energy Users' Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing, building materials and food processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and in many cases are exposed to the fluctuations and challenges of international trade. Our membership covers most of the major gas users in the east coast gas market who all rely on reliable and competitively priced gas for their business sustainability.

CONTEXT

In summary the EUAA:

- Supports the current form of the reliability standard and consider the current form is still the best option in a renewables dominant grid
- Supports continued use of the AER VCR values to assess what consumers are prepared to pay for reliability
- Recommends that the Panel takes account of the impact of jurisdictional schemes designed to achieve reliability to ensures consumers are not paying twice for the same level of reliability
- Recommends that the Panel considers the impact of the Gas Mandatory Code on the setting of the APC

We support the current form of the reliability standard

In our submission to the Panel's recent review of the reliability standard we strongly supported the retention of the current form of the standard - expressed in terms of the expected USE in a region. We said there¹:

"We did not see any material consumer benefit in moving to alternative measures such as loss of load expectation or loss of load probability. Nor do we see any benefit in introducing a supplementary or secondary standard with regards to the monitoring of so called "tail risk" associated with high impact low probability (HILP) events. We understand that historically most of the HILP tail events in the NEM have been security events, not USE events. So, it seems that inclusion of tail events would lead to over estimation of the probability of a USE event occurring and a higher than necessary market price cap. Following careful review of the discussion in the Draft on the changing reliability risk profile, we are not convinced of the case for change from a singular USE based measure for the period to when some form of capacity market will be introduced.

¹ <https://www.aemc.gov.au/sites/default/files/2022-07/EUAA%20Submission%20%E2%80%93%202022%20Review%20of%20Reliability%20Standard%20and%20Settings%2007%20July%202022%20draft%20report.pdf>

The reliability standard considers reliability events, not security events. The impact of the latter on consumers is much greater than the impact of the former. When combined with distribution network outages, which are the overwhelming majority of outages experienced by consumers, the level of risk from wholesale market reliability events is negligible. We think the Issues Paper does not draw out this distinction enough. We are concerned that the reliability standard, set for the wholesale market, is perceived to be addressing reliability issues on the distribution system where almost all supply interruptions occur.

The current reliability standard considers both frequency and severity of loss of load expressed in MW of lost load. Other methods proposed generally focus on only one of these measures or seek to bias the probability of USE risk. Our perception of how the reliability standard is operationalised and communicated by AEMO is that very conservative modelling results. E.g. the 2022 ESOO leading to a T-1 trigger in South Australia for Q1, 2024 which was then cancelled a few months later; the level of RERT procured, the way the risk of potential USE is communicated by AEMO in meeting a perceived 'political' reliability standard of close to, if not zero. The most recent Panel Annual Market Performance Review shows that the market has easily met the 0.002% reliability standard, even during the period of market suspension².

Our concern with a change in the form of the standard will result in increased costs to consumers well above the level that consumers have indicated, through the AER VCR work, they are prepared to pay. We consider that the current USE measure does take account of tail risk given it is a probability measure and don't want to see a repeat of the past "gold plating" in distribution networks in the area of wholesale market reliability.

We consider that the Issues Paper should have given more consideration to how wholesale reliability USE is experienced by consumers. These reliability events are controllable by AEMO implementing rotating load shedding over various time periods in feeders without critical loads. This approach enables consumers to 'share the pain' and in some cases this rotating timetable can be communicated beforehand to impacted consumers to assist them in preparing for the interruption. While AEMO will experience the full duration of a load shedding event, in our view this should not be a factor for consideration as part of this review, as the economic costs to the market operator is negligible.

Further, we are not convinced that a move to a power system based on increasing amounts of weather-dependent supply resources results in an increase in the potential for either unserved energy or tail risk, as this is also a function of the firming resources available to manage this risk. It's possible that the electricity market transition may improve tail risks as unit size decreases and dispatch flexibility increases given that fluctuations in weather dependent supply side resources is somewhat forecastable and able to be modelled in the planning timeframe. We accept the need for sensitivity testing around the efficient level of firming resources by artificially engineering tail-risk events in the modelling. Though the base case must be modelled on the efficient level of firming resources with reference to a range of reliability settings such as the market price cap (MPC) and cumulative price threshold (CPT). To do otherwise may result in an inaccurate assessment of the risks the proposed modelling is attempting to understand.

The other issue that needs to be considered is the impact of jurisdictional policies on consideration of risk. The Issues Paper notes (p.1):

² <https://www.aemc.gov.au/sites/default/files/2023-03/2022%20Annual%20Market%20Performance%20Review%20%28Clean%29.pdf>

“The existing standard is ‘risk neutral’. It does not provide scope for recognising any possible insurance value of investments to address a higher degree of consumer risk aversion to severe, but low probability, tail risk reliability events.”

Various States have implemented jurisdictional policies specifically designed to ensure reliability as they transition to a renewables dominant grid. This is imposing additional costs that are met by either or a combination of higher electricity prices, increased Government expenditures and declining asset values of publicly owned assets.

Under the NSW Roadmap the Government has set a reliability standard of at least capacity equivalent to the two largest generating units in NSW, (currently 1,400 MW in all 10 years of the assessment period), of reserve supply side resource availability above the forecast 10% POE demand value allowing for monte-carlo simulation of other unplanned generator and transmission network outages. It is estimated this NSW standard is tighter than even the interim reliability measure which itself is tighter than the reliability standard. The total costs of various measures to achieve this standard are as yet unknown but are expected to increase with time and are passed through to distribution connected customers as an additional cost.

In Queensland consumers are being told that the Queensland Energy and Jobs Plan is explicitly designed to address any potential increase in consumer reliability risk from the transition. This is possible because of the Government ownership of most of the coal and gas plant (as well as ownership of the transmission and distribution network). It has the ability to vary the closure dates of that plant so that Queensland consumers do not have to bear that tail risk³. And if there is any remaining risk, it will be mitigated by Government rebates that are paid out of the dividends of these Government owned corporations to every residential and small business customer in Queensland over the last four years⁴. Queensland consumers are expected to be told their 2023 rebate in the next future and it is going to be bigger than the \$175 in 2022⁵.

We look forward to the Panel’s consideration of the form of the reliability standard to assure consumers that they are not paying twice for the same level of reliability.

The value of unserved energy should remain based on the AER’s research

We have great confidence in the robustness of the AER process for calculating and the value of unserved energy values. They result from a very comprehensive process covering all classes of consumers across all parts of the NEM. This means they are the standard assumptions used in all network investment studies. Consumers have confidence in their derivation and hence confidence in their use.

We are concerned that the discussion in Section 3.6 and 3.7 seems to cast doubt on the relevance of the AER’s values without any evidence of what consumers actually think. If the Panel wishes to promote a different value then we look forward to them developing it with the same rigour that the AER uses, rather than by speculation.

Reviewing the Administered Price Cap

³ <https://www.afr.com/companies/energy/coal-could-stay-in-qld-energy-grid-past-palaszczuk-s-2035-deadline-20230222-p5cmkh>

⁴ <https://statements.qld.gov.au/statements/95213>

⁵ <https://www.brisbanetimes.com.au/national/queensland/qld-homes-businesses-to-get-electricity-bill-relief-20230315-p5csbq.html>

The EUAA's submissions on the Alinta rule change in 2022 argued that there was insufficient information published for consumers to come to a view of whether it was in their interests⁶. What we did argue was that:

- Generators are not going to be out of pocket – the subsequent calculation by AEMO and the AEMC on compensation show that has proved to be the case
- That Commissions judgement that there should not be too much reliance of compensation should be based on modelling of what the level of compensation might be - the costs identified by the AEMC in participant compensation have proved to be relatively low given the rejection of claims for compensation for opportunity costs
- It was not in consumers' interests to have an APC driven by a spot gas price that reflects gas producers exercise of market power in being able to have some link between spot prices and LNG netback – the forthcoming Mandatory Code explicitly delinks contract gas prices from LNG netback; while spot markets are not covered by the Code experience since the introduction of the gas price cap suggests that this has had some influence on spot prices which have generally traded in the band of \$8-16/GJ.

We can understand the arguments for certainty in the APC level – the risks associated with a dynamic APC are likely to be passed on to consumers. However, we are not convinced that these costs would be higher than the costs of maintaining the \$600 (or the Panel's recommended \$500) in the face of substantially lower gas prices than the \$42/GJ used to set the \$600 cap last year (and lower than the prices used to set the Panel's \$500 level). The level of generator compensation – and the costs passed on to consumers at the \$300 cap level was relatively low.

We recommend the Commission consider the potential impact of the Mandatory Gas Code of Conduct as an additional option on how the APC might be set. This does not necessarily mean a fully dynamic APC, just regular reviews when the Code anchor price set by the ACCC is changed. This could mean the APC is reset following these ACCC reviews according to how spot gas prices might be influenced by the revised Code anchor gas price.

Do not hesitate to get in contact should you have any questions.

Sincerely,



Andrew Richards
Chief Executive Officer

⁶ <https://www.aemc.gov.au/sites/default/files/2022-10/EUAA%20-%20LATE%20Stakeholder%20Submission%20-%20ERC0347%20-%2020221014.pdf>