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Dear Commissioners

Amendment of the Market Price Cap, Cumulative Price Threshold and Administered Price Cap (ERC0353) — Consultation Paper — 11 May 2023

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts across eastern Australia. We also own, operate and contract a diversified energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 5,000MW of generation capacity.

EnergyAustralia's core business is in developing and operating flexible generation and storage assets alongside a large retail portfolio. We have credible first-hand experience in committing to significant capital investment in the face of price settings and related market design issues that are relevant to this rule change.

The Commission's consideration of this rule change provides an opportunity to remind policy-makers that the long-term interests of consumers will be best served by placing primary weight on market signals, rather than on government schemes, to enable the transition. The NEM's reliability framework has important governance arrangements whereby an independent representative body recommends price settings, in line with the value of customer reliability determined by the AER. These price settings are explicitly determined with an aim of achieving efficient levels of new investment. Moreover, it is often forgotten that these price signals also guide decisions on maintaining existing thermal assets, encouraging contract market liquidity, and operating flexible plant and demand response at times of system stress, all of which are critical for the NEM.

We recognise the Panel's findings that current price settings are inadequate to support new investment, with reliability risks for our customers. We therefore support the Panel's recommended settings for the market price cap (MPC) and cumulative price threshold (CPT) and consider they should be accepted. We expect the Commission will have regard to submissions to the Panel's 2022 Review, including our own.[1] Our comments below reflect market circumstances to date, namely energy price increases and the importance of assets that provide 'duration', and the presence of jurisdictional investment schemes which were explicitly disregarded in the Panel's Review.

[1] https://www.energyaustralia.com.au/document/2022-review-reliability-standards-and-settings-draft-report

The need for stronger price incentives in the current market

There may be some reluctance from policy-makers and the broader community on the need to increase the MPC or CPT as a means to deliver necessary investment, especially to the full extent suggested by the Panel's modelling, and especially in the wake of significant price increases.

As a large retailer we are acutely aware of pricing pressures arising through various market reforms and interventions, including those that individually have relatively small impacts on end user bills. We note the dissenting views of the two Panel members representing customers on the justifications for increasing market price settings, given their considerations that the:

- reliability standard is unlikely to be exceeded during the review period
- financial impact and risk for some retailers and spot-exposed customers may be too high
- Panel's modelling assumes limited volumes of demand response are available under the existing price cap which does not reflect anticipated changes to the Wholesale Demand Response Mechanism (WDRM)
- modelling does not include revenue from jurisdictional schemes, such as the NSW Electricity Infrastructure Roadmap when calculating the MPC and CPT required to support marginal new entrants.[2]

Stakeholders have not yet had an opportunity to respond to these views. Should they be of interest to the Commission, our responses in turn are:

- we would not wish to speculate on the likelihood of particular reliability events or outcomes over the review period. However the Panel's recommendations reflect a transitional pathway, with an eye towards efficient price settings that would be necessary to meet system needs beyond 2028.
- we agree in principle that raising price caps beyond a certain level could have a counter-productive impact on resource adequacy as price risk becomes excessive, particularly for fuel-limited resources. For this reason, it is important for price settings to be predictable and for any changes to be communicated to participants well ahead of time, such that they can manage physical or other resource constraints. So again we support the Panel's recommendation to adopt a progressive approach to changing price settings, in view of longer-term and 'underlying' efficient parameters.
- the WDRM has less than 100MW of registered capacity[3] and this is well below expectations of up to 6,000MW of demand response capability in the NEM that were quoted in the WDRM's initial rule change proposal.[4] Amendments to this mechanism could encourage more demand response into the market, and the

[2] Reliability Panel, *2022 Review of the reliability standard and settings - Final report*, September 2022, p. 82.
[3] Microsoft Word - WDRM Annual Report_2022_DRAFT v4 (aemo.com.au)
[4] Microsoft Word - WDR rule change request 30 August FINAL.docx (aemc.gov.au)

Commission should explore whether this materially affects modelled outcomes to the extent they were not previously considered.

- we agree that the interaction between market price settings and jurisdictional schemes should be squarely addressed as part of the Commission's rule change deliberations.

Signals from government mechanisms should complement market signals

On this final point, it is worth repeating the majority Panel's views:

> The Panel considers a market with very strong scarcity price signals can also include other complementary measures to provide a higher degree of certainty in supporting investments that are critical for maintaining reliability in a transitioning power system. In particular, when those complementary measures are needed to support investment while also avoiding MPCs which create systemic risk challenges and approach the VCR. The Panel notes, however, that any complementary mechanisms should be efficiently coordinated with market operation and price signals. The presence of such mechanisms should and ideally would enhance the scope and performance of a market rather than replace it and promote the long-term interests of consumers.[5]

Energy customers are now facing extreme cost of living pressures. We appreciate concerns that price increases, whether it be the notion of lifting 'price caps' or the indirect bill impacts that result, could be seen as undesirable or unnecessary given taxpayer and customer-funded subsidies through NSW Long Term Energy Services Agreements (LTESAs), the federal Capacity Investment Scheme (CIS) and others. These concerns are best directed at ensuring government incentive mechanisms are well-designed, rather in preventing market parameters adjusting towards efficient settings. Government mechanisms involving tendering will deliver better outcomes for customers and taxpayers when developers have a clear and shared view on future market price settings when submitting competitive bids for government support. Similarly, the performance incentives under LTESA and similar contracts rely on operators being exposed to high prices that are associated with scarcity events. Customers may also be concerned about 'paying twice' for capacity investments through multiple incentive mechanisms. The Australian Energy Council commissioned CEPA last year to examine these dynamics.[6]

On the expected price impact of this rule change, IES found that the recommended price settings would result in a 3 per cent increase to end user bills by 2028. This may or may not seem material in the context of price rises recently experienced by customers. Although it would be a large and complex exercise, it would be useful for the Commission to publish detailed analysis of the various expected bill impacts (positive and negative) of the full range of interventions currently under consideration in its upcoming retail price trends report. The Commission's cost-benefit assessment of this rule change should consider the effect of not incurring this 3 per cent (or similar) increase in terms of longer-term ramifications on the investment outlook. That is, the Commission would be rejecting the recommendations of an independent advisory panel. It would need to carefully justify its decision in the face of detailed market modelling, much of which suggests price settings should be much higher than those recommended.

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[5] Reliability Panel, p. 84

[6] Microsoft Word - CEPA_AEC_FinalReport (energycouncil.com.au); A high Market Price Cap plus a capacity mechanism is not "double dipping" (energycouncil.com.au)

In more practical terms, leaving price settings unchanged would simply shift underwriting burden onto government investment schemes. These schemes bring distortionary effects and inefficiencies as they are not necessarily calibrated against the Reliability Standard and value of customer reliability, ultimately meaning higher costs for consumers or increased reliability risk. Distortions from government schemes also flow through the demand side of the market as their costs are recovered through average electricity prices (e.g. LTESAs through network tariffs) rather than at times of scarcity events that would otherwise promote efficient demand response.

The growing importance of 'duration', contracting and plant operation

We generally support expanding the hours of MPC before CPT is triggered. Incentivising technologies capable of providing longer duration will be critical as system risk moves away from temperature driven peak events to energy scarcity events. The Commission would be aware of the results of the first round of long-duration storage LTESA auctions in NSW and we encourage it to confer with AEMO Services Limited on any differences between battery and pumped hydro projects, noting the latter were also offered recoverable grants to help overcome technology-specific risks.[7]

The Panel's recommended price levels are still below what might be necessary for some technologies and jurisdictions, particularly short duration storage and open cycle gas turbines in Victoria:

> The review's modelling indicates an MPC of above $35,000/MWh may be required to fully incentivise 4-hour storage investments in Victoria. While not explicitly modelled, a significantly higher CPT, in combination with a higher MPC is likely required to incentivise longer duration storage from spot market revenues.[8]

As we noted to the Panel, its modelling reflects limiting assumptions like perfect foresight which tend to understate the price levels and revenues that might be needed to encourage new investment in reality.

More broadly the Commission's exploration of how price settings flow through to contract markets provides an opportunity to remind market bodies and governments that the business cases for flexible assets depend heavily on signals from forward cap markets. These signals should reflect efficient reliability outcomes, in proportion to risks faced by the operators of flexible assets in selling and defending their cap positions. This includes the willingness to cover risks associated with longer duration events of energy scarcity that are captured within the reliability standard.

We generally encourage the Commission to continue to engage with governments in their investment scheme designs:

- developers of firm capacity should be incentivised to seek revenues from hedge contracts, which has important benefits for contract liquidity and ultimately lowering costs for customers, and not just reducing subsidy burden which may be their primary concern

[7] Pumped Hydro Recoverable Grants | EnergyCo (nsw.gov.au)
[8] Reliability Panel, p. 83

- some policy-makers appear reluctant to acknowledge the important role of existing thermal assets to deliver reliability, ahead of new cleaner capacity coming online, which can involve considerable maintenance and refurbishment expenditures
- enabling these outcomes through better price signals will only be effective where governments minimise uncertainty arising from their policy decisions.

Leave the APC at $600/MWh

As noted by the Commission, the Panel's recommended APC value of $500/MWh was superseded by Alinta's urgent rule change, which took effect in December 2022. The current value of $600/MWh reflects considered evaluation by stakeholders and the Commission on substantively the same issues raised by the Panel. For the purposes of providing predictability and stability for market participants we therefore consider this value should be retained until 1 July 2028.

If you would like to discuss this submission, please contact me on 03 9060 0612 or Lawrence.irlam@energyaustralia.com.au.

Regards

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