

Gallaugher & Associates Pty Ltd

ABN 96 081 652 673

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Dr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

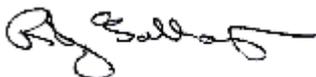
By email: submissions@aemc.gov.au

Dear John

Ref: EMO0011 - Strategic Priorities for Energy Market Development

Thank you for the opportunity to comment on the Commission's priorities for future energy market development work in the near term. Please find attached a brief submission in response to the Commission's Discussion Paper. I would be pleased to discuss any of the matters raised in this submission with you or your staff if you wish.

Kind regards



Director

Att.

Strategic Priorities for Energy Market Development

The Issue

Essential Ingredients for a Successful NEM



NEM Scorecard



The above broad-based qualitative assessment dates back to a presentation I delivered to an EUAA workshop in 2006. Arguably, the overall position has deteriorated somewhat since then, particularly

in the areas of policy settings, the level of competition within the industry, and access to capital markets.

Notwithstanding these concerns, any reasonable and objective comparative assessment would suggest that the NEM, and State-based industry and market reform initiatives undertaken prior to the introduction of the NEM in 1998, have delivered major improvements in industry performance and consumer value, and the NEM outcomes compare quite favourably with what has been achieved to date in other liberalised power markets around the world.

Therefore, one would expect that, in an environment where the NEM appears to have been working reasonably well and it continues to be one of the best performing liberalised power markets in the world, many will argue against the need for further major ongoing reform. At the same time, the very different interests of each stakeholder group and what each of them sees as being the highest priorities in terms of their own self interests will create many divergent views about the NEM's shortcomings and their relative priority for attention. In these circumstances, while building a broad-based consensus for prioritising further improvements to the NEM would be ideal, the AEMC should focus primarily on displaying strong leadership and conviction in “selling” to policymakers and market stakeholders what the future direction of further reforms to the NEM need to be, and why. From this perspective, the AEMC is to be commended for this initiative.

Strategic Priorities

The AEMC has proposed its work priorities focus on:

- a predictable regulatory environment for rewarding economically efficient investment;
- building the capability and capturing the benefit of flexible demand; and
- ensuring the transmission framework delivers timely and efficient investment.

Looking at each of the 8 key ingredients for NEM success listed above, there are major challenges regarding almost all of them which have either been around since market start or have emerged more recently as a result of recent changes in the market environment. The history of the development of the NEM since the early 1990s and its subsequent operation since 1998 points to the following issues and concerns:

- In the interests of getting the market up and running within a reasonable timeframe, many simplifications, approximations and transitional arrangements were built into the initial NEM policy settings, functionality and delivery systems. After 12 years of further market development and actual operation, far too many of those things still remain, and their adverse effects on NEM investment and operational efficiency continue to grow.
- The emergence of the “gentailer” model and excessive reliance on the very few private gentailers to make the necessary investments in new generation is creating an undue concentration of participants in the competitive sectors of the industry which will inevitably lead to an unacceptable lessening of competition in the industry.
- Transmission planning and investment, and access and pricing have been an ongoing source of frustration and concern for a diverse range of market stakeholders even dating back to some years prior to market start, and there is no sign of this abating.
- The extremely slow emergence of demand side participation in the NEM has arguably being

its most serious failing to date. Even for those customer groups where interval metering has been in place for years, the growth in active demand side involvement in clearing the spot market, the provision of ancillary services and/or the provision of network support services has been minimal.

- While the NEM appears to have been quite robust since market start with few participant failures and no major reliability concerns, the market's capacity to withstand a major catastrophic event, either physical or financial, with unintended and quite unnecessary adverse consequences remains unproven, and, given some of the quite bizarre risk allocations that still persist within the current market arrangements, this issue deserves considerably more attention than it's been given to date.

The 3 strategic priorities as listed by the AEMC are all oriented towards medium to long term economically efficient investment outcomes and, as such, are completely aligned with the NEO and should receive quite broad-based support from all market stakeholders. Participant views however will quickly diverge when considering what specific aspects of the multiplicity of legal and regulatory arrangements need modification, their relative priorities, and the extent and direction of the modifications needed in each case.

The discussion paper seems to imply that the AEMC believes its current work program already addresses these strategic priorities to the extent required. In essence, the work already completed in recent times combined with its intention to continue to advise Governments re policy settings as needed, regularly undertake retail competition reviews, proceed with the DSP3 Review, and continue on with the Transmission Frameworks Review is enough.

I'm not convinced this is the case. I believe additional work streams are needed in relation to the NEM to:

- address the emerging market concentration and market power issues;
- address the inappropriate risk allocations and risk management options inherent in the current market arrangements;
- comprehensively test the robustness of the market when placed under severe and sustained physical and/or financial stress of one form or another;
- enhance the current price signals throughout all elements of the supply chain;
- broaden the Market Rules coverage so that it encompasses all key market functions including the wholesale contract market, electricity retailing and distribution network access; and
- develop a uniform national regime for smart distribution grid development and operation including the operational management and coordination of embedded generation and controllable demand.

Finally, I believe the Commission should also give serious consideration to developing and implementing a highly targeted energy market research, development and testing program with a medium to long-term perspective to support future energy market policy development and guide longer term evolution of Australia's stationary energy markets.