



28 September 2007

The Reliability Panel
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215
By email: panel@aemc.gov.au

Dear Sir/Madam,

RE: Comprehensive Reliability Review Second Interim Report

The Energy Retailers Association of Australia (ERAA) appreciates this opportunity to provide a submission to the Australian Energy Market Commission (AEMC) Reliability Panel's paper, "Comprehensive Reliability Review: Second Interim Report".

The Energy Retailers Association of Australia (ERAA) is an independent association representing 12 retailers of electricity and gas throughout the National Electricity Market (NEM) and Jurisdictional gas markets. ERAA members collectively provide electricity to over 11 million customers in the NEM and represent the first point of contact for end users in the energy supply chain. The Association has a strong interest in ensuring our customers receive reliable and low cost electricity and it is with this in mind that we provide our response to the Second Interim Report.

The ERAA is generally supportive of the recommendations in this report, including: facilitating the improved demand forecasting by NEMMCO, the retainment of the 0.002 reliability standard, the introduction of a more holistic three yearly review of VOLL, the incremental improvements to the Reserve Trader mechanism and the need to review the Administered Price Cap as a matter of urgency.

The Association remains unconvinced of the need for the proposed Energy Adequacy Assessment Projection (EAAP). The Association considers that the

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Panel must better demonstrate that the costs associated with the EAAP are likely to be low and commensurate with the benefits to the market, before the proposal can be accepted by retailers.

We discuss these issues in more detail below.

Matters relating to the First Interim Report

Unserviced energy

The ERAA supports the Commission's decision to maintain unserved energy (USE) at 0.002% as a target rather than a cap to be achieved on an annual basis NEM-wide. We also agree with the scope of the standard including both generation and bulk transmission factors, and that exogenous events such as industrial disputes, or terrorism, should not count towards the standard. This is because no amount of investment in generation or interconnection will ever be able to avoid the potentially large USE which can occur during such events.

The ERAA also supports the current Reliability Panel approach of reporting the actual reliability from generation and transmission experienced by customers from the previous year, as actual reliability is important and needs to be regularly assessed. And as noted, the ERAA support the current process of clearly demarcating those issues which affect 'reliability' being addressed by the Panel, and those issues which do not, such as system security incidents, being addressed by either NEMMCO or the AEMC.

However, the ERAA is unsure of the benefits that could be obtained from reporting extreme cases around the average. We believe this may only serve to lead to alarmist reporting.

Value of lost load (Market price cap)

ERAA members have differing views on the appropriate value of lost load (VOLL) and its affect on investment decisions and reliability. At a fundamental level retailer views differ on the trade-off in risk versus reliability implied by an increase in VOLL. It would appear that further modelling work would have been undertaken by the Panel to assuage retailer concerns in this regard.

The ERAA believes that reliability could be improved more substantially by improving network performance, as it is the level of constraints and congestion within networks that is often the key factor to determining reliability in the regions. We are therefore concerned with the Second Interim Report's excessive focus on generation investment in reliability outcomes. As noted in our first submission to this Review the overwhelming majority of supply interruptions to end-use

customers are distribution related and this should therefore be the key focus for addressing reliability concerns¹.

In relation to the process of determining VoLL, the ERAA supports the replacement of the annual VoLL review with a holistic review of all reliability settings every three years. The Association also accepts the proposed rolling three year schedule, where participants are given 26 months notice of changes to VoLL and 14 months notice in urgent circumstances (when a participant makes a Rule change to amend VoLL).

Matters relating to the Second Interim Report

Administered price cap and cumulative price threshold

The ERAA is of the view that the changes to the administered price cap (APC) are urgently required. The APC needs to be reviewed in combination with the cumulative price threshold (CPT) and other settings in the market in order to deliver a sustainable approach which increases the integrity of the market and removes the possibility of a prudently hedged retailer facing financial collapse.

The intent of the CPT arrangements was originally to protect retailers from high prices associated with extreme events. However, as the Rules are drafted appear to allow generators to claim compensation on the basis that their supply offers were in the market at the time the APC was triggered. The ERAA considers that this can leave retailers exposed to substantial compensation payments, given that supply offers during those times are likely to far exceed the APC. We believe that this risk is unhedgeable because swap payments to retailers will occur on the basis of the APC, yet compensation will be determined on the basis of generator bids in the market at that time. The ERAA considers this to be inconsistent with the original intention of the CPT mechanism, and believes compensation would be more appropriately determined on the basis of the SRMC of the generation required to come on during extreme events.

The ERAA also notes that compensation may be less of an issue if the APC itself was to more closely reflect the SRMC of generation. The ERAA looks forward to commenting on these issues in more detail when the review of the administered pricing arrangements commences.

The ERAA further notes that an additional role of the CPT mechanism was to act as a force majeure provision, but this role has been weakened by the lack of a physical trigger. Market events such as the Bayswater² generation outages or

¹ We note that the AER and IPART are already improving upon current incentive programs for distribution and transmission.

² On 13 August 2004, six generation units tripped in the Bayswater area during a non-credible system disturbance following the failure of a CT in the Bayswater switchyard.

the 16 January 2007 network outage can cause large windfall gains and losses to participants. We note that the AER is proposing some changes to reduce the large fluctuation in prices on the day, but consider that a physical trigger, based on non-credible events, would provide better risk protection for participants. We therefore urge the Panel to consider such a trigger during its review of the CPT mechanism.

NEMMCO Reporting

The ERAA supports the Commission's recommendation to improve NEMMCO's reporting, especially its demand forecast monitoring process and its review of short term capacity reserves. This should reduce the incidence of RERM being triggered unnecessarily and increasing costs to customers.

The Retailers' main concern is that costs are kept as low as possible so that end use customer prices remain as low as possible. It is for this reason that ERAA members are not convinced that there are net benefits for expanding the NEMMCO Statement of Opportunities (SOO) to include a Ten Year Projection of Energy Adequacy. The Ten Year Projection of Energy Adequacy aims to make probabilistic assessments for long term horizons on the projected reliability of supply and generation energy constraints and this analysis may be useful to some participants but we are concerned about the robustness and feasibility of this assessment.

Energy Adequacy Assessment Projection

We are unable to fully support the addition of an Energy Adequacy Assessment Projection (EAAP) because we are unsure of its costs. As we understand it, the inclusion of an EAAP would effectively result in NEMMCO producing additional reports to assess energy shortages in the short and long term and result in:

1. an expansion of the MT PASA
2. generating load profile forecasts for each region
3. the creation of a Generator Efficiency Model (GEM)

1. Extension of the MT PASA

The current MT PASA is a deterministic process and concerned with "security", while, the proposed extension would be a probabilistic assessment of adequacy and would be concerned with "reliability". Projected energy availability in the presence of generator energy constraints would be assessed and measured by a regional projected USE. It would cover the next 24 months from the commencement of the next quarter and would be published quarterly. Most retailers already undertake their own analysis on this, however provided the cost of producing this report is low retailers would support this.

2. Regional load forecasts

The ERAA believes the introduction of regional load forecasts would require NEMMCO to forecast load profiles for each region, effectively using information found in the SOO. Again, most retailers already undertake their own analysis on this, however provided the cost of producing this report is low retailers' would support this as it would improve NEMMCO's forecasting.

3. Generator Efficiency Model

The Generator Efficiency Model (GEM) would describe energy constraints/adequacy of generation units from the next quarter, 2 years ahead. Generators would have a GEM tailored to suit their technology and fuel source etc - max annual energy, forecast monthly energy, dependency between months, fuel storage capacity and pumping strategies etc; this data would only be seen by NEMMCO. Scheduled generators would be required to lodge a GEM with NEMMCO on a quarterly basis with updated parameter values and projected shortfalls. These would then be published to provide investors with signals of where to invest. We perceive that this is more of an issue for generators.

We note that the EAAP marks a shift from capacity to energy forecasting, so we see this as a significant expansion of NEMMCO's reporting boundaries.

We appreciate the intent of the Energy Adequacy Assessment Projection (EAAP) - to increase the level of information in the market place so that existing participants as well as new entrants are more informed, and can make more informed investment signals. The ERAA believes that this information will only be of value if it is robust and accurate otherwise it will simply represent an additional cost to customers. Without more information on this mechanism and its guidelines the ERAA is unable to support the EAAP, as it is unclear whether there are net benefits. We consider the Panel needs to better demonstrate that the costs of the EAAP are likely to be low and commensurate with the benefits to the market before it can be accepted.

Reliability Emergency Reserve Mechanism

As stated in our submission to the First Interim Report we believe that a reserve trader scheme is an unnecessary market mechanism, notwithstanding this we believe that the proposed refinement of the existing Reserve Trader to a Reliability Emergency Reserve Mechanism (RERM) is an improvement. As we understand it, the main changes are:

- NEMMCO is given an additional three months to seek reserve suppliers to contract with whenever a reserve shortfall exists
- Contracts will be negotiated in a rolling tendering process, thereby allowing the most efficient contract to be negotiated

- NEMMCO will be informed by the quarterly EAAP and therefore have more information than it has presently when deciding whether to invoke the RERM.

We remain concerned, however, that the Panel is not fully addressing the “double dipping” issue that the ERAA has previously raised. While there is a need to ensure that a non-scheduled source of reserve (either demand side response or supply) does not offer their capacity twice, the major problem is that the capacity to be provided to the RERM must not otherwise be available to the market, and therefore add new reserves. Unfortunately the proposed rule does not address this problem.

The RERM will be triggered depending on the outcomes of the following 2 stage process.

- Stage 1 - Use EAAP in combination with MT PASA.
- Stage 2 - Review Stage 1 information again in combination with ST PASA, pre-dispatch data, reserve data and any other relevant data.

We support the two stage process, and believe it to be sensible but we are concerned that the data from the EAAP will be insufficiently robust to be used in an objective trigger process. We would therefore suggest that the EAAP be only used as supporting data and not directly in the trigger.

The Commission proposes:

- to spread costs of RERM over a number of years from a fund administered by NEMMCO
- a review of RERM in three years so that it can be removed prior to the four year sunset if the future CRR recommends it
- RERM to have its own section in the Rules (to the extent possible)

We support all of these proposals and offer the following more detailed comments. In relation to a fund administered by NEMMCO, we note that more stable long term arrangement should make cost recovery more manageable for retailers and customers. More stable costs would better allow retailers to include these costs in their regulated tariff proposals, and minimise the impact of unbudgeted imposts on customers. However it is important that cost recovery only occurs in arrears rather than before they become known, to ensure funds recovered over time reflect the actual costs of the Reserve Trader. For this reason we recommend the Panel modify its proposal to remove a requirement for a fund to be set up prior to a RERM event occurring.

The ERAA would support the RERM rules being collated into a separate section to improve the clarity, (currently reserve trader provisions are scattered

throughout Chapters 3, 4 and Part 7 derogation) and to minimise amendments to the Rules when it expires.

Should you require any further information in relation to this matter please feel free to contact me on (02) 9437 6180 or Con Van Kemenade, the Chairman of the ERAA's Wholesale Electricity Market Standing Working Group on (02) 8345 5278.

Yours sincerely

[Transmitted Electronically]

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Energy Retailers Association of Australia