



Energy Retailers Association  
of Australia Limited

31 March 2010

Australian Energy Market Commission  
PO Box A2449  
Sydney South  
NSW 1235

Reference Number: EMO 0010

**Re: Review of the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events – Consultation Paper**

Dear Dr Tamblyn

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) review into the effectiveness and reliability of the NEM in extreme weather events.

The ERAA is the peak body representing the core of Australia's energy retail organisations. Membership is comprised predominantly of businesses operating throughout the NEM as well as Western Australia. These businesses collectively provide electricity to over 98% of customers in the NEM and are the first point of contact for end use customers for both electricity and gas.

**Whole of power system security and reliability**

ERAA members remain unconvinced that changes to the reliability settings are the most efficient means by which to address the potential issue of more frequent extreme weather events. In extreme weather events (as with less extreme events), customer interruptions are most likely to occur in the transmission and distribution networks. The reliability settings are most relevant to consider the adequacy of generation capacity in the NEM to maintain the reliability standard, rather than dealing with network related interruptions. As the reliability setting does not *directly* address investment in networks and distribution, nor system security specifically, the ERAA does not believe that the reliability settings are the best mechanism to address the security issue of more frequent extreme weather events.

The ERAA acknowledges that the reliability setting does impact *indirectly* on investment in transmission, and to a lesser extent, distribution networks. This could be by new investment in transmission resulting from new installed generation capacity. Extreme weather events are nonetheless extremely rare by definition; to modify the reliability standard in order to indirectly encourage investment in networks and distribution would be inefficient in the ERAA's opinion.

## Reliability settings and standard

### The MPC as a mechanism to achieve reliability in light of more frequent extreme weather events

The ERAA is not convinced that altering the approach to determining the MPC is necessary to achieve reliability in light of more frequent extreme weather events.

As outlined in our recent submission to the Reliability Panel's reliability settings review, the ERAA believes that the current reliability setting mechanism of focusing almost entirely on the MPC oversimplifies the investment process. The drivers for investment are complex. There should be consideration of the broader market arrangements, such as the link between the contract market and the spot price, and their effect on stimulating investment.

An MPC that is set too low may limit investment. However, increasing the MPC adds to the volatility of the spot price and complexity of the market. Higher spot prices might cause AEMO to increase the prudential burden that retailers must hold. Concurrently, generators might offer fewer contracts to retailers if they prefer to receive the higher spot price instead of offering contracts. A potentially greater prudential burden and less market liquidity will place some retailers in financial distress and would also pose a barrier to entry for new retailers. Overall therefore, higher MPCs might adversely affect effective retail competition.<sup>1</sup>

Any increase in the MPC therefore needs to be compared to the mentioned impact on retailers and the market. Any changes to weather patterns (such as more frequent or extreme weather events) should be able to be picked up in the existing processes for determining reliability settings; we remain unconvinced that significant changes to approach are warranted purely on the basis of potentially changing weather patterns.

### Proposed variation of MPCs between regions

The ERAA does not support having regional MPCs. Such an outcome would produce perverse localised investment incentives, ancillary service problems and new complexities for managing settlements, and negative inter-regional settlement residues if the spot price reaches different MPCs in neighbouring regions at the same time. System security could also be impacted to the extent that participants face incentives to arbitrage between regions with different MPCs. Such a proposal is not sustainable for a national market like the NEM, and appears fundamentally at odds with the principles underpinning its development. For consistency and simplicity therefore, the MPC should not vary regionally. The AEMC should make the comprehensive reasons for this clear in its Final Report to the MCE.

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<sup>1</sup> For a detailed discussion of the consequences of increasing the MPC on retailers please see the ERAA's submission to the Reliability Standard and Settings Review Draft Report (Feb 2010).

### Ten year MPC trajectory

There is a balance between providing investment certainty and ensuring sufficient flexibility to respond to changes in market conditions. In some cases, setting a long-term MPC may lead to higher than necessary MPC levels to ensure unforeseen circumstances do not lead to the MPC impacting on investment. Such outcomes would provide increased certainty of the MPC but would also potentially increase costs compared to what may have occurred under a more frequently reset short-term process.

On the other hand, reviewing and resetting reliability settings more frequently (eg. every 2 years) does provide less certainty about future settings of the MPC, but parameters could be set at lower levels given less risk of major cost changes during the forecasted period. Participants familiar with the methodology used for determining the MPC can also take their own views on how it may develop in the longer term under this approach. In this way there is less certainty about the level MPCs may be in the future (compared to a longer term administratively-set scheme), however potentially more efficient MPC levels would be possible.

Overall the ERAA sees some merit in having a longer MPC trajectory but also sees risks with this approach. The quality of the modelling input assumptions tempers the value of a long-term outlook in the later years. It is difficult to forecast into the future with a high degree of accuracy. A workable solution would need to carefully balance the need for flexibility with the benefits of increased future information.

### **Governance arrangements – policy decision making on reliability standard and settings**

The ERAA broadly supports the First Option that was proposed in the Second Interim Report regarding how the AEMC could make reliability parameter decisions. This option allows some high level input from the MCE, whilst leaving the detailed considerations and mechanisms to the stakeholder expert panel.

The ERAA's view is that the current system works adequately. On this basis, any MCE input should be left to high level contributions, particularly given that the NER objective statement has already been provided by legislators to ensure that the long-term benefits to consumers is the focus of industry reform (including the establishment of reliability settings). MCE statements should avoid quantitative guidance, as quantitative analysis should be left to specialists at the Reliability Panel and AEMC levels. It is important that the detailed decisions come from the Reliability Panel because it is comprised of experts representing all industry stakeholders. In extreme weather events, significant decisions should be left to the experts and should not be compromised by politics, which is the risk if the MCE becomes too deeply involved. Excessive political intervention runs the risk of negatively impacting on the investment environment and should be avoided in favour of predictable independent decision making.

## Reliability forecasting and information

The ERAA is reasonably comfortable with the current set of tools and these can evolve incrementally, if required. However, the ERAA would like to see the ROAM report and modelling on the price reliability trade-offs before being submitted to the MCE. The ERAA stresses that industry input and consultation at every stage of the process are imperative for developing and submitting robust and proportionate recommendations for MCE consideration.

## Technical standard and issues

The ERAA also notes the importance of the technical review on the NEM's reliability standards. In fact, some technical issues further illustrate the limitations of the MPC as a system reliability management instrument. In particular, inter-regional transmission equipment operating capabilities can influence the NEM's reliability in ways outside the MPC's scope of change. For example, the operating temperature limits on inter-region transmission assets, such as the Basslink can trigger reliability events. This was the case in Victoria in January 2009. It is unclear if a higher MPC would provide a sufficient incentive for the transmission asset's owner to increase the operating temperature range of that asset.

A greater incidence of extreme weather events may cause assets, like Basslink, to reach their operating temperature limits more frequently, leading to more high-priced (MPC) events. This can increase the risks (and therefore costs) for retailers operating in the affected regions. Retail failure or exit is a possible consequence.

A review of technical standards and their appropriate level in the context of more frequent extreme weather events could improve the operating ability of inter-regional transmission assets in these circumstances. This could deliver both supply reliability and market competition benefits.

The ERAA would welcome further discussion on this submission if required. Should you have any queries, please feel free to contact me on (02) 9241 6556.

Yours sincerely



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