

14 October 2015

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

Dear Mr Pierce

AEMC STRATEGIC PRIORITIES (EMO0030)

Thank you for the opportunity to comment on the AEMC proposed Strategic Priorities. This is a really valuable process which helps us look forward and anticipate the issues which will be significant in the future.

The following submission comments on the draft priorities which the AEMC have identified and describes a priority which Hydro Tasmania believes should be included. We are also concerned that the existing priorities are not looking forward far enough into the future and that they are not sufficiently focussed on the key issues.

Strategic

The notation used is for “strategic” priorities. However, the issues listed as priorities appear to be much more tactical in nature. In an environment like the National Electricity Market it is very expensive to not foresee trends and respond to them in a timely way. It is expensive for both businesses and consumers when insufficient foresight is used.

The best example of this is the current gas arrangements. There is a proposed gas market priority but it is at least five years too late. The LNG plants did not spring up overnight. They were planned for years. But only now are we trying to develop a coherent gas market for the east coast.

Strategic priorities need to be strategic, not tactical issues looking into the immediate future.

Priorities

Similar to the conceptual approach taken on determining what is “strategic”, it is equally important to adequately consider the meaning of “priorities”. The current draft “priorities” appear to prioritise almost everything. This is somewhat concerning given our perspective that the most significant issue relating to “market fundamentals” is absent (this is discussed the following section of this submission). The issues which AEMC have identified are certainly significant issues in their own right with each having merit. However, given the limited resources of the AEMC and participants, it is vital that there is a real prioritisation of issues. The current draft discussion paper appears to have failed to make the hard choice of setting one issue above another.

One possible approach to this problem would be to identify the issues and nominate one single issue for immediate action, based on its level of development and potential impact. The other issues could be slotted into later years.

Market Fundamentals

One strategic priority which is missing is the market fundamentals. The strategic issue is what the market design should look like to meet the needs of customers when the majority (or all) of the future supply is zero marginal cost. The market design here needs to be broadened to embrace future policy objectives, not only for energy but also for carbon and renewables.

At the centre of our market arrangements is a spot market which targets an efficient dispatch of generation units with different short run marginal costs. As we move into a world of solar PV, wind and storage we have a set of technologies which all have low or zero short run marginal costs. A key question is how should we dispatch a group of generators who all have very low marginal costs and are potentially very distributed? COAG EC have been proactive in this space and commissioned AEMO to undertake some work in this area. In July 2013 AEMO looked at how the NEM demand could be met entirely from renewable resources at the request of COAG EC. However this work only considered the resource costs and reserve margins. It did not consider any market issues.

The key strategic issue for the market is how to manage a fleet of zero marginal cost renewable resources. Is a market a useful mechanism for achieving policy objectives and delivering a low cost energy solution for consumers? What does that market look like? Does it provide investors with the right signals for investment? Should the AEMC be the body undertaking this work? This work requires a fundamental rethink of the market principles and could benefit from a "blank sheet" approach to the design task.

With SA's minimum load already being projected to be met by solar PV in a few years, it is important that this issue be considered now although no change may be made for several years.

Consumer Priority

A significant trend is the development of "prosumers" and the observation that the largest generator in the NEM is now aggregated domestic solar PV panels which is larger than the biggest thermal power station. Clearly the cost curves and Government's enthusiasm for rewarding solar will see a continuing surge in this space.

What is important is that thousands of individuals are investing their money in embedded generation. It is absolutely critical that the industry and Government's energy bodies get the regulatory arrangements right, stable and sustainable.

One potential issue which is emerging is the intersection of tariff reform and embedded generation. Under tariff reform cost recovery is changed from the existing volume basis to a maximum demand/usage basis which will reverse the volumetric network cost savings existing solar PV customers have enjoyed to date. It will also significantly impact the economics for future installations.

Whilst network tariffs will deliver more cost reflective price signals, there will be an impact on existing investments made by customers. This creates significant political risk that governments will come under pressure to slow tariff reform. Whereas customers currently typically pay a variable cost of 25c/kwh for their consumption which is displaced by their solar panels, in the future, tariff reform will reduce this significantly.

Hydro Tasmania sees this as part of a strategic priority and there is still time to address the issues before they impact significantly.

Gas Priority

Gas has formally been a priority for the last 2 years and the need for more transparency in both gas and pipeline resources has been identified. However, now that significant work is underway in this area, we no longer view this priority as strategic in nature. Work is underway on developing a market but it needed to have happened some time ago. The ACCC is also investigating the extent to which there are competition issues in the current gas market.

With the significant forecast increases in gas prices, it is also no longer obvious that gas will be a strategic part of our electricity supply infrastructure for energy but it may still have a role in providing capacity through OCGT's. However, an efficient market is still required for the other users of gas so that they can make informed energy supply choices for their investments.

The work that is underway needs to incorporate the findings from the ACCC review and must continue. Once the ACCC's findings are known, the AEMC should act quickly to introduce the relevant changes for a revised gas market framework.

Market and Network Priority

This is really two priorities, the market and the network. The strategic issue for the market is the one raised at the beginning of this submission under Market Fundamentals. However the relevant issue which was raised in the discussion paper but not addressed in the Market Fundamentals section of this paper is the integration of environmental measures and the market. The strategic issue in the future is to have environmental measures which are compatible with the market and support the incentives which exist in the market. One example of a compatible measure is a carbon price. This changes the merit order of dispatch to favour low emissions generation but does not distort the basic supply/demand drivers in the market. It does not force new plant into the market; it favours low emission new entrants.

The strategic issue for networks is competition from new entrants in the form of solar PV and storage. According to widespread perception, these will soon allow people to choose not to use networks. This requires that network pricing should move from its current cost plus basis to some other basis. This could be pricing just below the new entrant prices, recognising that the pricing would need to be cognisant of the impact of energy prices on this equation.

This network issue needs addressing now as the sooner the new path forward is identified, the smoother and less painful is the transition.

Summary

To summarise this submission, the AEMC needs to choose strategic priorities which are truly strategic in nature. That means addressing issues which are expected to be an issue five years out. In response to the draft priorities identified in the discussion paper, our summary comments are:

| Issue | Comments |
|-----------------------------|---|
| Market fundamentals | Not identified as a priority but should be. The challenge of a generation fleet made up of only zero marginal cost renewables needs consideration and the need for a holistic approach to multiple policy objectives |
| Consumer Priority | Agreed. Need to develop a stable regulatory framework |
| Gas Priority | It has been a strategic issue for a while but the problem is almost upon us. Timeframe is too short for it to remain a strategic priority. It is important to complete existing work streams and incorporate ACCC Review findings |
| Market and Network Priority | Need environmental measures to be compatible with the market Fundamental rethink of network pricing to acknowledge new entrants is required |

Yours sincerely



Steve Davy
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