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Paper reflects a welcome change in the orientation of the Commission

Before reading the AEMC Paper, internally I suggested …

> *"I would be inclined to focus on:*
>
> *•Investment certainty across the supply chain – Need for a re-examination of the fundamentals under which we design the market;*
>
> *•Related issue – transmission certainty – need for a serious re-look at transmission rights that underpin investment certainty; and*
>
> *•Market Design – review of the suitability of Energy Only Market for delivery of capacity for energy and reliability. Particularly in the light of interventions for environmental outcomes."*

A certain alignment of themes …

Strategic Direction 1

A predictable regulatory and market environment for rewarding economically efficient investment

- Delivering the appropriate investment climate hinges heavily on manageable risk
- These risks are however not limited to policy uncertainty, and the impact of retail regulation
- Transmission risk is a critical additional risk in two forms:
  - Risk of transmission failure constraining output; and
  - Risk of loss of access "rights" or build-out
- Generators expect reasonable risks in merchant markets. Some risks do not fall into this category, eg

"Fair" Competition		Fundamental regulatory change impacting business viability	
Operational risks		Unmanageable transmission constraints	
Technology risk		Transmission build-out/loss of access	
Regulatory "tweaks"		Regulatory constraint of cost reflective prices	

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Strategic Direction 2

Building the capability and capturing the value of flexible demand

- Agree there is a deficiency in the current market, and this priority is supported
- This is an issue to be handled with care
- Any payment for demand response/reduction in excess of the value of energy saved is a capacity payment not available to the supply side
- To illustrate, if prepared to pay to facilitate demand response as a form of capacity contribution, should there not be a test whether supply increments would come forward with a similar level of facilitation?
- The processes for price signalling are important. It is possible inability for consumers generally to see prices has limited DSM development
- Important wires charges are cost reflective so as not to distort signals to the demand side
- Aligned to market structure (see later). Holistic approach needed

Strategic Direction 3

Ensuring the transmission framework delivers efficient and timely investment

- Proposed direction appears to be focused on optimising and improving current arrangements
- Consider this to be too shallow a course of action
- NEM approach to transmission still founded on the non-codified (hence highly open to interpretation) principle of “open access”
- Access rights seen as anathema to “open access”; need not be the case
- Results in farcical outcomes where payment for deep connection is unable to deliver an enduring right, and thus locational signals can be retrospectively negated
- As the network tightens, access is becoming an important aspect of investment certainty
- Transmission Frameworks Review a welcome opportunity to review this framework. Trust is will remain broad enough to consider developments beyond the incremental

A view of additional priorities

Some of the following points are addressed tangentially or inferred in the paper:

1.Evaluate broadening the base of certainty for market investment – modify the economic assessment to recognise the high capital inertia of large-scale, long lived investment. Aim to create a regime of stability for committed investments – generation and wires

- Market design effectively ignores sunk decisions and always optimises at the margin, but generation investment is neither temporally nor financially a marginal decision
- The NEM marginally assesses the worth of the asset for each of the 2.5 to 3 million successive 5-minute auctions it will face in its life
- The NEM makes short-term optimal allocations of the utilisation of transmission assets, no matter who paid for them, and makes the locational decisions of early generators subject to the locational decisions of later competitors
- These marginal economics also apply in some models of capacity markets

This is inconsistent with the time required to recoup the LRMC of capital-intensive plant

These are not “bicycle generators”

A view of additional priorities

2. Market sustainability

- Durability of the Energy-Only Market design needs re-assessment, suggested by:
  - Reliability Panel assessment that EOM delivers target reliability ONLY in the absence of distortion. The market faces heavy distortion through emissions reduction and renewables obligations already, and further policy instruments are likely
  - UK market examining the need for capacity arrangements because of the impact of environmental policy and low carbon intensity, high capital, low operating cost plant (see *Market Resilience*)
  - Theoretical work by Henney and Bidwell others
  - The tension between theoretical market price cap levels and risk allocation
  - Insufficiency of spot market revenue to fund LRMC of existing plant, in part influenced by mandatory renewables – Queensland needs capacity first, but has some of the lowest wholesale prices

Investment currently largely undertaken by retailers (identified in the paper). Do we want to rely on this characteristic?

An objective review is needed (we could follow the Brits)

A view of additional priorities

3. Gas market

- Agree it needs time to establish itself
- However, there is/must be a strong interaction with the electricity market
- Therefore important gas markets are not allowed to “set” in sub-optimal configuration

END