



11 February 2016

Mr John Pierce
Chairman, Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney NSW 2000

Dear Mr Pierce,

Reserve Capacity Mechanism, Position Paper

GDF SUEZ Australian Energy (GDFSAE) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) 'Extension of Reliability and Emergency Reserve Trader' consultation paper.

GDFSAE owns and operates around 3540 megawatts of renewable, gas-fired and brown coal-fired generation in South Australia, Victoria and Western Australia. GDFSAE's retail business, Simply Energy, serves customers in Victoria, South Australia, New South Wales and Queensland.

GDFSAE supports the extension of the Reliability and Emergency Reserve Trader (RERT) given current market conditions but remains unconvinced the RERT is the best mechanism to overcome the existing challenges, notes that many of the issues relevant to this discussion have been raised previously, and that an extension of the RERT will not manage the large risks that are present in the market, most notably in South Australia.

Adequacy of electricity supply

For some time, market participants have highlighted that the National Electricity Market was likely to be compromised by a range of policy factors. Notably the development of wind projects and solar photovoltaic pursuant to the Renewable Energy Target and jurisdictional programmes in excess of that which would be delivered by the market in isolation.

While consumers have been advised by some that this would result in significant benefits, citing the merit order effects and the benefits of "free" wind and solar, the system outcomes in South Australia are likely to be more challenging.

What can now be seen is that the ability for synchronous generators to recover costs in the market is compromised as additional subsidised wind continues to be developed and centrally dispatched thermal generation is marginalised and its load factor reduced significantly. GDFSAE, and through its parent ENGIE,

GDF SUEZ Australian Energy

Level 33, Rialto South Tower, 525 Collins Street
Melbourne, Victoria 3000, Australia
Tel. +61 3 9617 8400 Fax +61 3 9617 8401

www.gdfsuezau.com

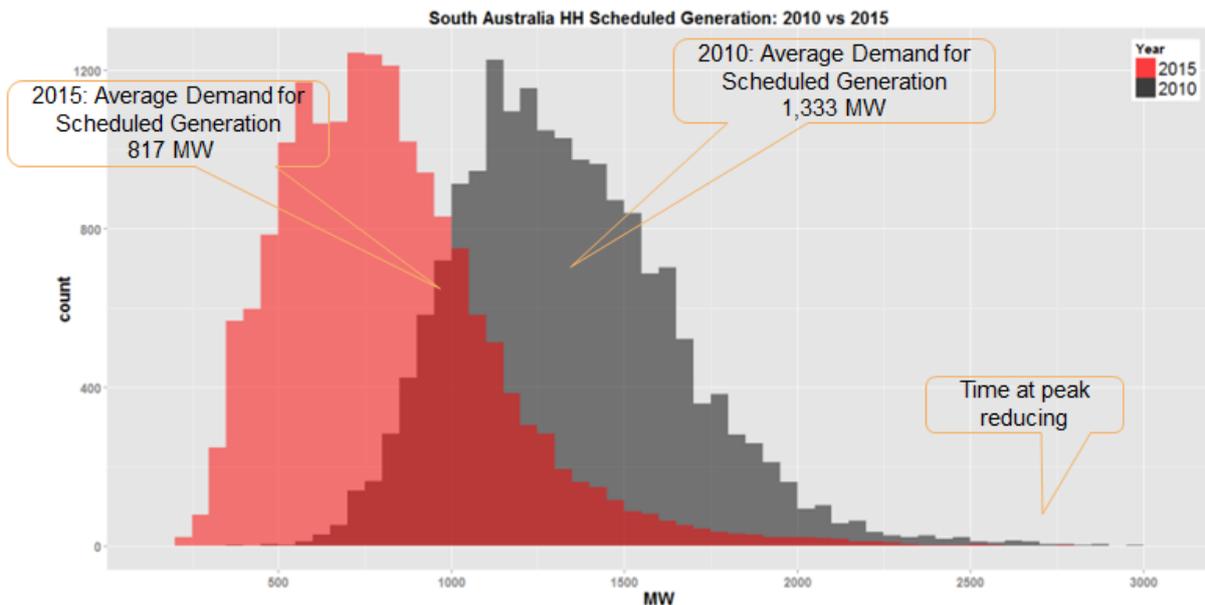
INTERNATIONAL POWER (AUSTRALIA) PTY LTD
ABN 59 092 560 793

supports the development of renewable technologies but believes that this should not compromise system security.

It is clear that in South Australia at least, and potentially more widely in the National Electricity Market, uncertainties regarding system security have emerged and continues to cause concern. As it stands, the National Electricity Market needs to be better able to support the energy transition that is occurring to avoid market failures and minimise costs to consumers.

While changes in the market as a consequence of technological innovation should be welcomed and should be in the interests of consumers, where policy drives this change and not competition and economics the risk of imbalance arises. In South Australia, this imbalance has been reached, and it is now clear that scheduled generators required to support reliability and security are not staying in the market.

A quick comparison of the distribution of half-hourly scheduled generation in South Australia shows a rapid transformation in market outcomes which are sending strong signals for retirement of plant reliant on energy only revenues, the revenues on which the market is premised.



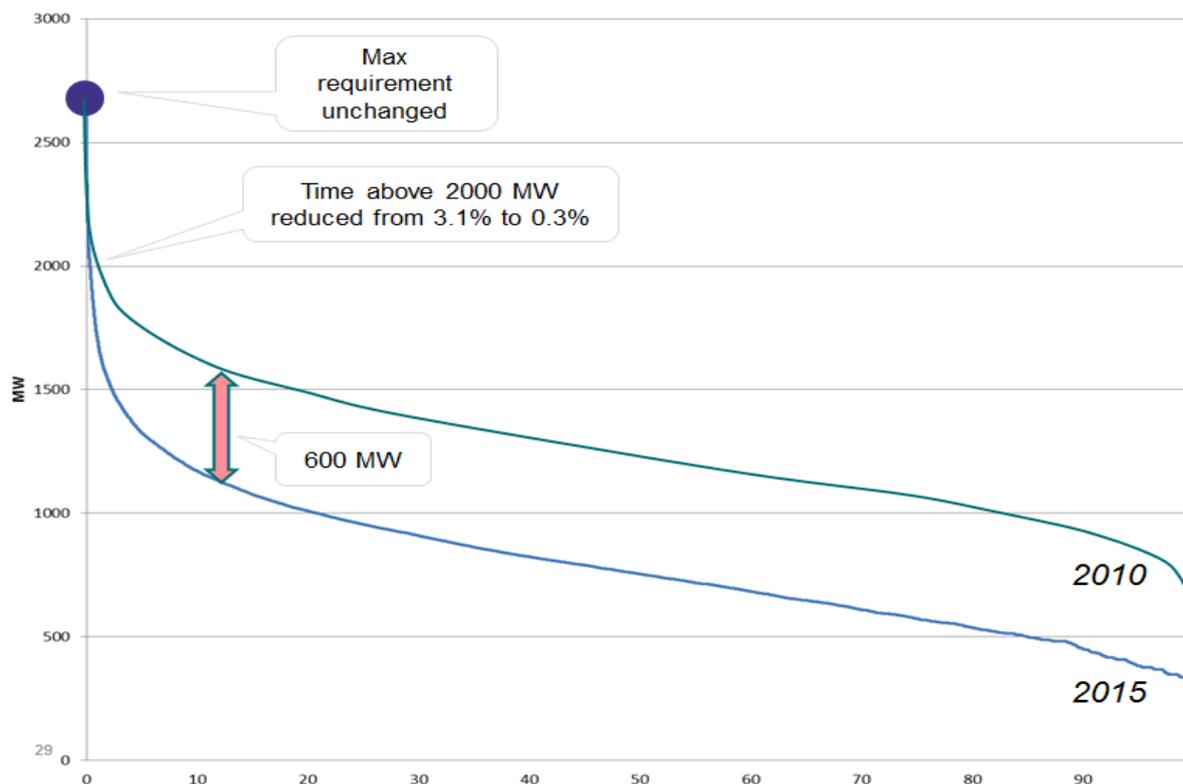
Were this an outcome driven by new technology, competition and consumer choices alone there would likely be little cause for concern; however, it is apparent that this is not the case.

As a consequence there should be little surprise that baseload generators and scheduled generators more generally are struggling to cover costs and that large fixed cost maintenance or investment decisions are not being made which leads to mothballing and retirements.

This issue was expressed as a potential consequence of climate change policies and in South Australia especially, give the abundant wind resource and the additional incentive provided by the Renewable Energy Target.

Another way to look at this change is the loss of market for scheduled generation based on the load duration curve. While the peak remains and needs to be satisfied, the market share where synchronous generation competes has rapidly decreased; GDFSAE suggests a decrease of around 600 megawatts between 2010 and 2015.

In the diagram below, while only comparing two recent years, it can be seen that peak scheduled generation remains unchanged although the value that can be captured by scheduled generators who cater to peaks has decreased, as has the synchronous share of the market.



While decreases in consumption and reduced time at maximum demand are not negative outcomes in isolation, in fact energy efficiency and moving peak consumption to the off-peak period are sensible policy positions, the nature of these developments, combined with the wider issues in South Australia, present acute challenges.

For this reason, GDFSAE believes that extending the RERT as an emergency measure that is likely to provide a low cost option to avoid failure is better than taking no action at this time.

Nonetheless, the greater question is can the National Electricity Market, and especially South Australia given its size, continue to support the energy transition in the absence of reform. And for South Australia is there a need for a tailored solution that extends across multiple years to manage the present challenge.

Market impacts and costs

GDFSAE agrees the RERT is a second best to market based solutions; however, such solutions are unlikely to be forthcoming for the policy reasons already canvassed. As such, and given the small cost of the RERT in comparison to the annual turnover of the National Electricity Market, GDFSAE does not object to the RERT on a cost basis.

GDFSAE does note that AEMO’s management of the RERT in real time needs to be carefully considered to minimise costs and ensure there are limited, if any, market distortions.

As it relates to costs being in excess of the market price cap, the Australian Energy Market Commission should consider that if the RERT values capacity in excess of the market price cap then it may be the case that the market price cap is too low. The existence of the cap itself is an impediment to the market delivering value to generation and over the course of a number of reliability settings reviews a number of generation businesses have argued an artificial cap by its very nature mutes investment and contracting signals, undermines existing asset values, and is likely to lead to premature retirements.

The balance between managing risks via the reliability settings and incentivising generation investment is an area that the Australian Energy Market Commission may wish to reconsider now and not wait to the next reliability settings review. Clearly, if unserved energy objectives continue to be met, but generation is not incentivised and reliability risk is potentially increasing, there are some issues to reconsider.

Benefits of the RERT

While GDFSAE supports investigation of mechanisms to allow the National Electricity Market to better support the energy transition and revisiting the reliability settings those changes do not provide an immediate lever for the Australian Energy Market Operator to use in the event of a crisis situation.

For this reason alone, the benefit of the RERT cannot be discounted at this time.

Management of reliability in the absence of the RERT

GDFSAE is strongly of the view that directions are not sufficient to manage reliability in the National Electricity Market. Furthermore, the ability to direct plant decreases commensurate with the general availability of that specific plant in the market as merchant plant.

For instance, gas plant that does not hold firm contractual gas arrangements or only has provision to use gas within limited conditions, is unlikely to be able to respond to direction on the day or even with a few days' notice. This is because that plant will have no available fuel to generate to satisfy a direction. In this instance, can the Australian Energy Market Operator obligate gas suppliers or pipeline operators who are not registered participants to take steps to assist generators to meet directions? Would such powers be desirable or workable?

Alternatively, a plant which elects not to conduct maintenance and mothballs would similarly be unable to satisfy directions inside any reasonable window. There are numerous plants that are technically available but may require long recall times. Further, even if plant can be recalled with long notice the reliability of recalled plant is often less than desired, at least initially, than plant that hasn't been mothballed long-term.

Leaving strict legal provisions aside, the complexity of trying to direct plant in the current environment, and where that plant's commercial interests are best served by not being available in the market, weakens any case that directions can be relied upon to manage reliability.

Demand side participation

The lack of demand side participation is not considered a sufficient driver of itself to retain the RERT, but that is not to suggest there is not a greater role for demand side participation in supporting system reliability.

As it pertains to the RERT, demand side participation can be contracted to shed load at times of system insecurity, can offer products and operate in the market and be exposed to spot prices, enter into network support agreements or agreements with retailers, and potentially operate as a RERT provider. None of these issues impact the rationale for extending or not extending the RERT.

As such, GDFSAE does not consider the references to the RERT extension being needed because of demand side management policies not being fully resolved as legitimate.

That said a market mechanism or ancillary service that valued availability, of generation and demand side, would potentially obviate the need for the RERT. However, this is not a demand side issue per se, but a view that the National Electricity Market does not adequately value the flexibility and availability needed to manage reliability concerns whether provided by demand side or generation.

This issue is beyond the scope of this submission and is an issue that GDFSAE wishes to further investigate.

RERT expiry date

GDFSAE supports a sunset clause consistent with good regulatory practice and to encourage a more fulsome debate on the current challenges. This requires an acknowledgement of the limitations of the RERT and that the market would be better placed if the RERT was permitted to expire.

GDFSAE support for the RERT at this present time is based on the view that the current period of market stress as a consequence of policy developments and technological change is relatively unique. Further, those challenges are best managed in the long-term by a more robust approach to the energy transition.

Suggesting the RERT provides a long-term solution is likely to be false. Thus a sunset clause is deemed desirable.

Should you have any queries in relation to this submission please do not hesitate to contact me on, telephone, 03 9617 8415.

Regards,



Jamie Lowe
Head of Regulation