



12 June 2020

Dr Kerry Schott
Energy Security Board
Submitted online to: info@esb.org.au

Dear Dr Schott

Submission: Interim Reliability Measures – Reliability Reserve Consultation on Draft Rules

CS Energy welcomes the opportunity to provide a submission to the Energy Security Board's (**ESB's**) consultation on the draft rules for the Interim Reliability Measures – Reliability Reserve.

About CS Energy

CS Energy is a Queensland energy company that generates and sells electricity in the National Electricity Market (**NEM**). CS Energy owns and operates the Kogan Creek and Callide coal-fired power stations. CS Energy sells electricity into the NEM from these power stations, as well as electricity generated by other power stations that CS Energy holds the trading rights to.

CS Energy also operates a retail business, offering retail contracts to large commercial and industrial users in Queensland, and is part of the South-East Queensland retail market through our joint venture with Alinta Energy.

CS Energy is 100 percent owned by the Queensland government.

Development Process of the Interim Measure

The ESB was tasked by the Council of Australian Governments Energy Council (**Energy Council**) to develop potential measures to address short-term reliability in the National Electricity Market (**NEM**) which were subsequently presented to the Energy Council on 20 March 2020. The Energy Council accepted the ESB's recommendation to implement interim measures to establish an out-of-market capacity reserve and amending triggering arrangements for the Retailer Reliability Obligation (**RRO**).

This process continues a disturbing trend in market changes being developed external to the established frameworks and thus lacking the appropriate consultation and due diligence necessary to avoid undue cost impost on the market and consumers. This is epitomised by this consultation, with the ESB presenting the out-of-market capacity reserve as a *fait accompli* and only providing stakeholders with the opportunity to comment on the specifics of the draft rule amendments.¹ No consultation has been undertaken on the perceived risks to reliability in the short-term or the preferred mechanism to address these.

¹ Concomitant to the out-of-market reserve mechanism, the ESB also presented two papers related to the longer-term market reform which sought endorsement to progress specific options for a level of "aheadness" in the market as well as a two-sided market. These concepts similarly had not been consulted on, and through their presentation to the Energy Council stand-alone to the market reform project, automatically biases the Energy Council's view on the 2025 process.

The ESB has also seemingly disregarded the extensive stakeholder consultation in the development of the RRO and the rationale for the timing of the instruments for which the obligation could be triggered, representing the best outcome for consumers.

CS Energy does not agree with the need for more stringent reliability measures in the short-term. The increase in “community appetite” for greater reliability cited by the Energy Council is inconsistent with the outcomes of The Reliability Panel and the recent review of the Value of Customer Reliability (**VCR**). If implemented, this boutique mechanism will distort market signals for reliability, and will result in increased cost to consumers.

Interim Reliability Measures – Understanding the Need

CS Energy acknowledges that the ESB was requested by the Energy Council to explore potential reliability options however, is disappointed that it provided a recommendation for a preferred mechanism rather than first publicly challenging and dissecting the need for such measures and consider a recommendation that no changes were necessary. This is particularly important given:

- Annual market performance reviews conducted by the Australian Energy Market Commission (**AEMC**) assessed the reliability in the NEM to be satisfactory; during 2018-19 the standard was not breached and the number of lack of reserve notices issued by the system operator had been less than previous years.²
- Only 4.3% of Unserved Energy (**USE**) from FY2009-2018 was attributable to the wholesale market, with **only 0.3% caused by reliability** events.³
- The Reliability Panel, who is charged with reviewing the reliability settings every four years, concluded in 2018 that no change was required to the standard to apply from July 2020.⁴
- The review process conducted by the Panel is comprehensive, conducted over twelve months and has representation from key stakeholder groups such as major load and consumers who are most impacted by any changes in the reliability standard. Input from these groups do not seem to have been included in the ESB’s determination, including input into the supporting consultancy works, perhaps reflective of the much shorter three-month timeframe of the assessment.
- The December 2019 review of the VCR by the Australian Energy Regulator (**AER**) did not provide compelling evidence of a desire for a tightening of the reliability standard.⁵

Justification for the proposed mechanism instead relies on the reference to increased community expectation, the outcomes of the 2019 Electricity Statement of Opportunities (**ESOO**) and the consultancy work engaged by the ESB.

(a) Increased Community Expectation

The ESB has failed to properly articulate the level and source of community expectation in this context given that the VCR and submissions to previous rule changes related to reliability have clearly indicated the opposite⁶. The consultation paper defers to the Energy

² AEMC, *2019 Annual Market Performance Review*, March 2020

³ Australian Energy Market Commission, <https://www.aemc.gov.au/energy-system/electricity/electricity-system/reliability>

⁴ Reliability Panel, *Reliability Standard and Settings Review 2018*, April 2018

⁵ AER, *Value of Customer Reliability Review*, December 2019

⁶ See for example, Energy Users Association of Australia, [Submission to draft rule determination on RERT](#), March 2019

Council's Terms of Reference for the review⁷ on this topic as an *a priori* assessment of the changing expectations rather than an evidence-based approach.

In addition to the VCR, it has been clear in submissions from consumer groups, particularly major energy users that further measures to increase reliability are not favoured. Large consumers, while having the highest VCR, also bear a greater portion of the costs of such measures as evidenced by the Reliability and Emergency Reserve Trader (**RERT**).

It is also unclear how this mandate of increased community appetite will align with the ESB's longer-term market reform program and whether it will allow potential new frameworks to be considered appropriately. For example, there is an apparent conflict with the two-sided markets design initiative which seeks to explore a desire for consumers to opt for lower reliability.

(b) Electricity Statement of Opportunities

The perceived need for reliability measures has been derived from the ESOO, and the lack of contextualisation on the objective of the ESOO.

The role of the ESOO is to provide investment signals to the market about potential shortfalls in supply. It is the main signal of the need for supply-side investment alongside market prices. Establishing an out-of-market mechanism for reliability based on a tighter target of USE will distort market signals for new investment, and thus may have the perverse outcome of increasing short-term reliability risk. Even though the proposed reserve mechanism is out-of-market, it has a real impact on the market.

The reliability concerns in the 2019 ESOO are in respect of high impact co-incident events (tail risks), and not a lack of supply to meet the 0.002% standard. Concerns about tail risks exceeding the 0.002% standard and thereby redefining the standard based on this sets a dangerous precedent. The ESOO is a probabilistic model and always will be, meaning there will always be tail risks. There will be tail risks for a 0.0006% target of USE, so will the reliability standard be tightened further again? Any reliability measure needs to have a clear and transparent metric to which it is anchored. For the NEM, that is the standard itself and the associated market settings. If not, the associated uncertainty of continued revision will increase costs that will be borne by consumers.

(c) Cost Benefit Analysis

CS Energy is concerned that the modelling conducted by the consultants does not provide an adequate assessment of the costs and benefits. Both consultants performed their analysis using data from the 2019 ESOO 2023-24 financial year projections.

- Given that the ESOO included the scheduled retirement of the Liddell Power Plant in April 2023, while an important year for reliability considerations, it is hardly representative of a "typical" profile that should be considered in the development of new mechanisms that extend multiple years. This suggests that the purported benefits are likely to be inflated.
- The assessment excludes new investment that will be online over the next few years as the ESOO includes existing and committed generation and transmission projects only.

⁷ ESB, *Consultation Paper on Interim Reliability Measures*, p.4

- The upgrade of the Queensland to New South Wales interconnector (QNI) was not included as it was yet to receive full regulatory approval. This project has since been fast-tracked with the AER acknowledging its role in “*continuing to provide reliable supply at the lowest cost by deferring the need to build new generation and storage capacity in New South Wales ahead of the forecast retirement of Liddell Power Station*”.⁸ Expected completion is September 2021.
- There are currently 58 GW of proposed projects that are not captured in the modelling, and of these, about 8 GW are scheduled to be commercially operating by the 2023-24 reference year considered in the cost benefit analysis.⁹
- The technology costs utilised do not consider any opportunity costs of market participation or utilising electricity for production. Thus, the expected increase of \$8-16 p.a. for 4 MWh p.a. households is likely to very much be a lower bound. As discussed above, the impact to larger customers will be significantly higher.
- It is unclear how they have separated costs for RERT activated for reliability versus security in their assessment.

CS Energy notes that there will be further indirect costs of the scheme, as there is a risk that this mechanism will crowd out any potential demand response participation in the Wholesale Demand Response Mechanism, a mechanism that has a material cost associated with its implementation next year.

Proposed out-of-market mechanism

CS Energy remains concerned that the proposed interim measure is inconsistent with market design philosophy as it has decoupled the reliability standard and its associated market settings.

Despite this, CS Energy has only limited comments on the proposed drafting of the rules. AEMO should not be limited to procuring reserves specific to each region’s projected needs but should have to consider whether some reserves can be activated to meet a neighbouring region’s interim reliability measure without compromising that of the host region. This would reduce the overall volume of reserves procured and thus costs of the mechanism.

CS Energy also agrees that AEMO should only enter into multi-year contracts if there is a forecast interim reliability exceedance in two out of the three years.

Amending the Trigger for the Retailer Reliability Obligation

The Interim Reliability Measures also propose amending the trigger for the RRO to which CS Energy is strongly opposed. The opposition stems not only from the lack of justification as discussed above, but the impact that amending the RRO will have on the market.

The proposed amendments effectively make the T-3 instrument redundant and are contradictory to the intent of the mechanism. Retailers were to rely on the T-3 instrument to

⁸ AER, [Determination – Expanding NSW-QLD transmission transfer capability](#), March 2020, p.5

⁹ AEMO, [Generation Information Page](#), accessed 9 June 2020

provide enough lead time to make arrangements to meet their obligations, including sourcing demand side response, new supply contracts or direct investment in new generation.

Overall removing the T-3 trigger will serve only to increase both the administrative costs of the scheme and market risk. Enabling the T-1 trigger to be activated without a previous T-3 trigger creates significant uncertainty in the market; retailers either will be exposed to the risk of an unexpected T-1 instrument or operate as if the T-1 instrument will be triggered each year. The former will likely result in a shortfall should T-1 be triggered leading to additional costs to those exposed retailers. The latter may result in capital investment in new supply and demand side assets which may not be warranted or could lead to the deferral of maintenance at existing assets which in turn represent a longer-term risk to reliability.

CS Energy strongly opposes both the need of the reserve mechanism and the removal of the T-3 instrument. Both will only increase overall costs to consumers with little demonstrable benefit.

Please contact us if you would like to discuss this submission further.

Yours sincerely



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