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The Chairman
Energy Security Board
C/- CoAG Energy Council

Sent by: email to info@esb.org.au

**Interim Reliability Measures – Reliability Reserve
Response to Consultation Paper May 2020**

Major Energy Users Inc (MEU) is pleased for the opportunity to provide its views to the Energy Security Board (ESB) on its Consultation Paper issued in May 2020 regarding the Interim Reliability Measures – Reliability Reserve.

The MEU was established by very large energy using firms to represent their interests in the energy markets. With regard to all of the energy supplies they need to continue their operations and so supply to their customers, MEU members are vitally interested in four key aspects – the cost of the energy supplies, the reliability of delivery for those supplies, the quality of the delivered supplies and the long term security for the continuation of those supplies.

Many of the MEU members, being regionally based, are heavily dependent on local staff, suppliers of hardware and services, and have an obligation to represent the views of these local suppliers. With this in mind, the members of the MEU require their views to not only represent the views of large energy users, but also those interests of smaller power and gas users, and even at the residences used by their workforces that live in the regions where the members operate.

It is on this basis the MEU and its regional affiliates have been advocating in the interests of energy consumers for over 20 years and it has a high recognition as providing informed comment on energy issues from a consumer viewpoint with various regulators (ACCC, AEMO, AEMC, AER and regional regulators) and with governments.

The MEU has some very deep concerns about what the ESB is seeking to implement regarding these Interim Measures for Reliability. In particular, the MEU observes that in

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the last year or two, there have been a significant number of rule changes to enhance reliability of the wholesale market due to concerns about the increasing incidence of intermittent generation. Such changes include the introduction to the Retailer Reliability Obligation, enhancements of the RERT and the Victorian government derogation to allow multi year contracts for RERT. What is concerning is that despite these changes, none have been in operation long enough to test whether they will deliver the targeted impacts to the wholesale market.

This new change is apparently made with the view that these earlier changes will not deliver sufficient reliability yet the ESB process has not even explained why this might be the case.

The proposed change

The MEU notes that the ESB has not recommended a change in the Reliability Standard, but what is changed is the forecast level of unserved energy at which point AEMO will effectively cause the trigger of the Retailer Reliability Obligation (RRO) and the point at which AEMO can commence acquiring reserves for the RERT.

So, while the Reliability Standard has not been changed, the effect of the changes will result in increased reliability in the wholesale market and increased costs for consumers as both AEMO and the retailers will pass through to consumers the additional costs that are incurred to meet the effects of the earlier triggering of the RRO, decoupling the T-1 trigger from the T-3 trigger and acquiring reserves for the RERT.

In its review of the VCR, the AER report on VCR identified that >40% of consumers expressed that their willingness to pay for increased reliability was zero dollars. In other AER reviews (eg network resets) the consumer input to the AER processes again highlights a consumer view that electricity prices are too high and that consumers are seeking lower prices. The MEU considers that the ESB is wrong to seek increased reliability in the wholesale market as consumers clearly do not agree with the ESB.

In its 2020 Annual Market Performance Review, the AEMC provided data that shows that the amounts of unserved energy over the decade to 2018/19, unserved energy due to distribution network issues averaged over 91 GWh yet from reliability issues in the wholesale market there was less than 1 GWh of unserved energy. Even in 2018/19 the unserved energy from distribution outages was over 56 GWh and from reliability issues in the wholesale market was ~1 GWh of unserved energy.

Consumers assess their reliability of supply at their connection point with the electricity supply system with the overwhelming majority being connected at the distribution network level. If most of the loss of supply is from causes within the distribution network then any marginal change in unserved energy from improved reliability in the wholesale market will make little difference to how consumers see reliability, yet the proposed change will significantly increase the costs they see.

What is important to note is that there is an assumption implicit in the change that consumers see a need for greater reliability, yet this assumption is unfounded. The MEU points out that many reviews carried out prior to the ESB recommendation to the CEC, such as the 2018 Reliability Panel review of market settings where significant consultation occurred, determined that the current reliability settings are adequate and achieving their purpose, yet by early 2020, the ESB effectively determined this was not the case and required new settings to be applied, based on limited assessment and, in the MEU's view, either flawed modelling by its consultants or incorrect assessment of what the consult's work revealed.

The MEU also notes that the new reliability standards and settings are only interim, pending the post 2025 review underway and are due to expire by mid 2023, ie only three years hence. As the changes are only going to apply for such a limited period, the MEU questions the value of changing reliability standards for such a short period of time when the current standards and settings have only recently been endorsed. The MEU does not see that the wholesale market conditions will change so much in the next three years that warrants such a significant change.

The MEU does not consider that there is any justification for this change considering the cost that will be added to consumer's bills.

The MEU also notes the decision to decouple the T-1 trigger from the T-3 trigger for the Retailer Reliability Obligation (RRO) and this is discussed later in this submission.

Consultation about the process

The ESB is required under the National Electricity Law section 90F to consult prior to making a recommendation to the MCE (now CoAG Energy Council) and its Terms of Reference are more explicit in that the ESB

“Where proposing rule changes to the Council, the Board will present a package that:
J Demonstrates that appropriate consultation, consistent with the COAG best practice principles, has occurred beforehand with stakeholders and include in their advice to Council details of the consultation and a summary of views”

The ESB consultation paper comments (page 3) that

“...it also engaged in targeted consultation...”

in relation to the revised reliability standard that it recommended to the CoAG Energy Council (CEC); this recommendation was the result of the CEC seeking advice on the implementation of Interim measures to preserve the reliability standard in the NEM for the next few years pending a decision on the post 2025 NEM review, a task that the ESB is also undertaking.

The MEU points out that this “targeted consultation” was so targeted that most stakeholders were not consulted at all about the proposals, yet as it is consumers that

are required to pay for the outcomes of any change in reliability standards, it would be expected that at least consumers would be consulted – something that did not happen.

What is quite bizarre is that the ESB proposes to carry out a wider consultation on the words that are to be added to the Rules whereas the substantive issue as to the changes did not go through this process. The MEU considers this to be totally around the wrong way and is most concerned that the ESB has operated in this high-handed way where consumers will be required to fund enhanced reliability standards where previous investigations had identified that no changes were necessary.

The failure of the ESB to adequately consult with stakeholders (especially consumers) about such a major issue is quite concerning, especially when there is wide agreement amongst consumers that they are content with the current levels of reliability of supply they receive but have expressed a clear preference for lower costs than gaining increased reliability.

By not consulting more widely on the substantive issue of whether enhanced reliability settings were what consumers needed, the ESB has done a great disservice to them through its decision to recommend an enhancement of reliability in the wholesale market.

The modelling for the ESB recommendation

The MEU has carried out some preliminary assessment of the modelling carried out by ACIL Allen and by EY for the ESB, although the release date (6 May 2020) of the EY report would seem to imply that this report might not have been used by the ESB in making its recommendation to the CEC.

ACIL Allen uses the recently published VCRs to demonstrate the “value” to consumers in the higher reliability standard. The recent AER review of VCR provides the ability to adjust the VCR to reflect a value for each class of consumer that might be affected by a loss of supply but ACIL Allen elected to use average values of VCR even though the application of enforced load shedding is reasonably focused on a few end user classes.

When there is a shortage of supply in the wholesale market, it is typically aluminium smelters and residential customers that are load shed in preference to other consumers with a higher VCR. Because of this ACIL Allen should have applied a VCR that reflected those consumers that are most likely to be load shed, and not use the higher value they did which includes those consumers that have a higher VCR but are less likely to be involuntarily load shed. Further, as the MEU pointed out in its response to the AER WALDO VCR review, recent events colour the value consumers put on their assessments of the willingness to pay for reliability¹, again tending to overstate the VCR that should be used for wholesale market reliability.

¹ In its submission, the MEU pointed to the disparity between SA consumers assessment of VCR and those in other regions where lower VCRs were identified. The MEU contends that this disparity was driven by the recent experiences of SA consumers with their losses of supply caused in the networks and not the wholesale market

The MEU has been a consistent critic of the AEMO forecasting in that it considers the AEMO forecasting to be too conservative – this criticism especially applied to the 2019 ESoO where AEMO had taken a very pessimistic view on a number of issues (eg delayed return to service of Loy Yang and Mortlake generators and excluding the SA diesel generator fleet that has now been sold to private enterprise) and expected peak demands. Of concern is that even based on the 2019 ESoO, the small exceedance of unserved energy above the new trigger value of 0.0006% unserved energy in SA and Victorian regions does not warrant the need for triggering the RRO and acquiring reliability reserve generation, yet the costs of doing so will cause consumers to pay for losses of supply that are extremely unlikely to eventuate – effectively consumers will be paying for a loss of supply that they have expressed an unwillingness to pay for. Even for NSW, the ACIL Allen modelling indicates that the costs for triggering the RRO and reliability reserve even for the larger amount of unserved energy forecast still does not show a net benefit for consumers.

The EY report is also of concern in that it shows that setting the market price cap to deliver the lower 0.0006% of unserved energy would increase costs to consumers significantly. While the ESB recommendation does not seek this outcome, the EY report does clearly show that the new settings will lead to higher consumer costs.

What is of concern about the EY report is that it is not clear how its modelling shows that the outturn new settings will lead to new investment in generation capacity. The MEU points out that the costings used by EY imply that the marginal generator might only operate for 4-6 hours in a year so there is an incentive on the marginal generator to seek a contract with AEMO under the RERT, thereby reducing the generation committed to the wholesale market and effectively increasing the likelihood of AEMO forecasting a breach of the new trigger level for establishing the reliability reserve for RERT.

What the EY report shows is that having a disparity between the Reliability Standard and the trigger for AEMO to seek RERT contracts will exacerbate the costs for the next few summers. This is because before the amount of unserved energy is forecast to reach 0.002%, AEMO will be contracting capacity once the forecast unserved energy passes 0.0006% and thereby reducing the amount of generation available for the wholesale market. This, in turn, will increase the likelihood that the RERT will be needed as forecast generation will be lower than otherwise would apply. If the cost of RERT is higher than the market price cap, then consumers will incur higher costs than if AEMO did not seek reliability reserve contracts until the forecast of unserved energy reached the Reliability Standard.

The MEU points out that the costs to consumers for the dispatching of RERT during summer of 2019/20 were higher than the market price cap and so if the new reliability levels had applied for summer 2019/20 then the process would have led to consumers paying more than was necessary. The experience of summer 2019/20 could easily be replicated in future years so unless AEMO can assure consumers that it can consistently acquire reliability reserves for less than the market price cap, it would appear that having a lower trigger point for acquiring RERT does not meet the requirements of the Electricity Objective.

The Retailer Reliability Obligation

The decision to decouple the triggers for the RRO (ie decouple T-1 from T-3) so that T-1 can be triggered without needing to have had T-3 triggered makes a mockery of the entire process and adds significant risk to retailers and opting-in end users thereby causing consumers to incur higher costs.

The T-3 trigger was seen to be necessary so that retailers and opting-in large end users had sufficient time to be able to acquire sufficient firm capacity to meet their reliability obligations. Decoupling the T-1 trigger means that those firms subject to the RRO have the potential to be exposed to their share of the RERT costs incurred by AEMO with little ability to manage the exposure should a T-1 trigger occur.

The MEU can see the circumstance where a T-1 trigger has been initiated and AEMO and firms subject to the RRO are all seeking firm capacity from the market. This highly competitive chase for firm capacity can only lead to higher prices for providing this firm capacity driving up costs for providing this reliability that in turn will be passed onto consumers.

The MEU does not agree that the T-3 and T-1 triggers should be decoupled. If the rule change proposed is implemented, it has to be modified so that T-1 for RRO purposes is a reasonable period of time ahead of when AEMO is permitted to seek firm capacity for RERT purposes.

The MEU notes that Market Liquidity Obligation was implemented to ensure that firms subject to the RRO, but which are not vertically integrated (such as second tier retailers and opting-in large end users), would be able to access firm supply options in the period between T-3 and T-1. Decoupling T-1 from T-3 means that the firms which are not vertically integrated will not have the protection that the MLO provides and puts them at a significant disadvantage to the vertically integrated retailers. Such an arrangement can only lead to higher prices for consumers. This issue needs to be addressed by the ESB in its development of proposed rules.

Transparency of AEMO actions

The MEU notes that AEMO has considerable flexibility as to how it addresses its responsibilities under the RERT rules and development of the forecasts it makes that will trigger the RRO and the RERT processes.

The MEU is aware that there is limited transparency of how AEMO uses its RERT, RRO and forecasting powers, what the outcomes of its actions have been in the past and what has been learned after each action is undertaken. Currently, when asked how well AEMO has performed, AEMO is able to conceal much of the information needed to assess how well it performed under the veil of confidentiality it has with its providers. While the MEU can accept that some of the information should be

confidential, the data could be shared through some aggregation to protect the confidential aspects of individual contracts.

The MEU considers that greater transparency through more comprehensive and timely reporting by AEMO in relation to the RERT (how much RERT was required, what was used, what its cost was, how much RERT is contracted for more than 12 months, etc) and by doing so will increase the transparency of the RERT process.

Summary of MEU position

The MEU is not convinced of the need for the proposed changes, especially that a number of rule changes have been introduced in recent years, despite them not being tested to see if they will deliver the targeted outcome.

The 2018 detailed review by the Reliability Panel determined that the existing Reliability Standard and settings are fit for purpose and did not need change. At the same time, consumers have expressed a strong view that they are unwilling to pay for increased reliability but do want lower electricity prices – this means they do not support paying for increased reliability.

Despite views to the contrary, the ESB embarked on a review without wide stakeholder input and made a decision to seek increased reliability in the wholesale market. In the recommendation it made to the CEC it did not reflect consumer views, or that other rule changes might address the concerns expressed by the CEC.

The modelling provided to the ESB has flaws within it and when interrogated it shows that the modelling does not support the view that the increased costs that will ensue from the changes will be offset by benefits to consumers that consumers value.

The MEU is very concerned at the proposed decoupling of the T-3 and T-1 triggers for the RRO as this is likely to increase costs consumers incur. Having AEMO, retailers and opting-in end users all seeking firm reliability contracts at the same time is not good practice.

More transparency of AEMO actions is required

The MEU is happy to discuss the issues further with you if needed or if you feel that any expansion on the above comments is necessary. If so, please contact the undersigned at davidheadberry@bigpond.com or (03) 5962 3225

Yours faithfully



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