Dr Kerry Schott
Chair
Energy Security Board
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30 September 2019

Dear Dr Schott,

Post 2025 Market Design Issues Paper

ENGIE Australia & New Zealand (ENGIE) welcomes the opportunity to contribute to the Post 2025 market design review (the Review) issues paper.

ENGIE is a global energy operator in the businesses of electricity, natural gas and energy services. In Australia, ENGIE has interests in generation, renewable energy development, and energy services. ENGIE also owns Simply Energy which provides electricity and gas to more than 710,000 retail customer accounts across Victoria, South Australia, New South Wales, Queensland, and Western Australia.

Introduction

ENGIE supports the timing of the Review noting that issues around market design and performance are an ongoing feature of market frameworks that are dependent on regulation and policy arrangements. Given the substantial transformation that is taking place and is expected to continue, now is an appropriate time to take stock of the performance of the National Electricity Market (NEM) and consider possible changes.

Much of the recent debate around the NEM energy only market has focused around the extent to which interventions have impacted market outcomes or whether preferable outcomes exist. In other words, it is generally accepted that the NEM is well structured and in theory should be able to provide customers with the most efficient outcomes but that circumstances may have prevented this. ENGIE also holds this view.

ENGIE does not intend to comment on the merits of various interventions and the extent to which in their absence the NEM could have operated more or less efficiently. It is more important to note that the days of expecting that the NEM might be “left alone” so as to be enabled to function as intended seem to have passed. As such, a primary consideration for ENGIE, and indeed all investors, is likely to be how political and regulatory risks are managed and costs allocated during the energy transition.

To this end, changes to the market structure will not be an improvement on the current NEM unless it leads to: (a) better management of ongoing interventions; (b) appropriate allocation of risks; (c) revenue certainty and costs recovery; and (d) maintaining high levels of reliability and system security at an efficient cost.

While ENGIE welcomes exploration of reforms which could lead to an improvement across all these criteria, ENGIE is unlikely to support selective reforms which work to improve some measures but undermine others.

What does a sustainable trading arrangement need to function?

At its core, the purpose of the NEM is to maximise benefits to all parties involved in the exchange of electricity, from generators through to consumers. Under any market arrangement, there are several key outcomes that will be required in order to maximise the benefits to all parties.

When these key attributes are satisfied then a market should be self-replicating. In other words, investors will continue to develop assets that meet consumers needs based on market signals. Those signals will also be strong enough to ensure the risks of under and over supply are managed so that neither consumers or investors are inefficiently burdened with unrecoverable costs. Some of the relevant key attributes have been outlined below.

- Investors have a reasonable prospect of achieving competitive (with other sectors) risk adjusted returns, while managing economic and business risks. In short, capital will flow where it is treated well, and the electricity sector must be competitive against other investment sectors.
- Market and technology risks are manageable and are priced into investment and passed on to customer in an efficient manner which includes exposing investors to their poor decisions.
- Unpriced services are captured in order to evert a market failure and to minimise the tendency towards unpredictable policy interventions.
    - System inertia requirements, ancillary services, and various other mechanisms are recognised as valuable and rewarded accordingly.
    - Firming up generation required to support intermittent generation technologies and customer response also need to be included in the mix
    - Ramping/load following capability are provided.
    - Contingency reserves are maintained at known limits, if an agreed feature of the market.
- Ensures required level of reliability under a variety of scenarios, not only those scenarios which capture current expectations.
- Encourages innovation – including distributed energy resources - and can adapt to changing patterns of use and consumer preferences.
- Regulatory and policy risks created by governments should be borne by governments (on behalf of consumers) not allocated in a disorderly fashion to investors. The role of government in the market framework should be known, understood, and supported.
- Arrangement is broadly consistent with the economic efficiency test embodied in the National Electricity Objective which has, and can continue to, serve consumers well.

The Review has effectively captured many of these attributes and ENGIE looks forward to further detailed discussion.

Is a new market needed?

It is likely that change will be required. However, even if reforms could drive improvements they are not without significant risks. While the prospect of a new market may elicit generic support, a decision to change the NEM should not be taken lightly and therefore ENGIE tends towards support for incremental changes.

Risks of a new market arrangement

Instituting an alternative arrangement creates several implementation risks as detailed below.

- Any new design will create winners and losers, will likely face significant opposition, and will be difficult to implement without political compromises which are likely to stymie potential efficiency gains.
- Effective transitional arrangements will be critical to a successful implementation of a new arrangement.
- Transitional arrangement will reduce risks to some participants and increase them to others not part of the new arrangement.
- Increasing regulatory intervention or government oversight of investment and operational decisions to gain investor certainty is somewhat counter-intuitive and requires management.
- For a change to succeed it relies on government to have the same implementation objectives as market participants and that those objectives do not significantly change over time.
- Change will require years to implement, may create further uncertainty and undermine business value if not handled effectively.
- Participant behaviours influence outcomes regardless of trading arrangements.

Management of implementation risks needs to be carefully considered during the Review and is an area that may be underappreciated amongst some stakeholders. Further, it could lead to further review and reform if expectations are not achieved. This latter point should be a fundamental concern managed by the Review.

When considering implementation risks and stakeholder expectations, ENGIE suggests the Review examine possible changes against the questions listed below in addition to the subject matter issues raised thus far.

- What impact will the design have on delivering a reliable and secure operation? What level of assurance will be available to stakeholders?
- What revenue can investors reasonably expect to receive?
    - How will that compare to long run marginal cost over time?
    - How stable is the revenue stream and how susceptible to future decisions by others?
- Can customers (wholesale market and end users) reasonably expect to pay an efficient price?
- Where are risks allocated and are there mechanisms to allow parties that are exposed to risks to either mitigate the risk or efficiently price them?
- Given the experience of the NEM to date (shifts in capital markets, economic activity, technological changes/innovations) how resilient is the design to future policy shocks?
- Is the design capable of supporting investment with different levels of capital availability?
- Will the arrangement support different business structures and sizes?
- Will there be significant costs of transition?
- What is the expected implementation timeframe?

- What is the risk of the new arrangement leading to similar/new problems (i.e. grass not being greener on the other side)?
- What level of support can be expected from industry and policy stakeholders? Will roles be accepted once allocated, including by government and market operator?

What types of market arrangements should be examined during the Review?

ENGIE suggests there are a spectrum of options available for consideration during the Review based on existing and evolving overseas and domestic models. A simple spectrum of the broad categories of market has been outlined below. ENGIE has used the measure of central control versus market based in this instance.

This spectrum is not intended to be exhaustive or definitive but is provided to give a sense that there are significant differences between the philosophies underpinning each arrangement. While currently the NEM rightfully focuses on market efficiency, it seems not to be delivering the level of control wanted by some, which can explain, in part, several of the interventions experienced.

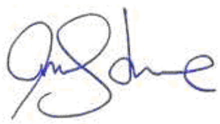
Whether current trends are enduring and need to be formalised or form a passing phase needs to be deeply considered and concluded. If some stakeholders are not willing to let prices signal the need for new investment, are unwilling to let private investors make decisions over asset locations and timings, and are unwilling to expose customers to competitive markets, then that cannot be ignored.

Conclusion

ENGIE looks forward to continuing to work with the Review in order to assess potential changes to the NEM or alternative arrangements. There are several considerations ENGIE encourages the Review to include in its future work as detailed in this submission.

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

Yours sincerely,



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