



Assessment report on the AEMC's Final Report on  
the Review of the Impact of Climate Change Policies

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# 1 Introduction

This document is the final report in a series of three reports and submissions, that have been developed under an Advocacy Panel contract to support the EUAA in its contribution to the AEMC's review of the impact of climate change policies on energy market frameworks.

This document briefly summarises the main conclusions that the AEMC reached and the recommendations that it adopted (in Section 2). The next section considers next steps and suggested further action by the EUAA.

## 2 Outcome of the review

The Review has concluded that climate change policies will have a significant impact on Australia's energy market frameworks. It has proposed a number of changes that appear at first to be relatively innocuous but, depending on their implementation, may come to be highly significant. The next sub-section summarises and interprets the AEMC's main recommendations. The last sub-section itemises the actions that the AEMC has recommended be taken to implement its recommendations.

### 2.1 Summary and interpretation of the AEMC's main conclusions

#### 2.1.1 Retail competition

The AEMC reached an unambiguous conclusion that continued retail price caps could present significant risks to retailers if they were unable to pass through higher wholesale market costs that may arise as a result of climate changes policies.

#### 2.1.2 Energy market design

The AEMC did not examine the question of whether fundamental changes to the design of the NEM pricing mechanisms were needed to deal with climate change policies. They justified this on the basis that no evidence was presented to them that there was a problem to be solved, that the MCE suggested that they saw no need for fundamental changes to the market, and also because the AEMC considered that the changes it proposed were sufficient and proportionate to the changes that climate change policies were likely to give rise to.

The AEMC's main energy market solutions are to grant AEMO more flexibility in purchasing capacity if it thinks there are likely to be shortfalls; increasing AEMO's ability to direct generation; increasing the upper cap on prices in the NEM, and changing arrangements for cumulative price thresholds.

### 2.1.3 Transmission access arrangements

The AEMC asserted that to meet the expanded renewable energy target, 8000 MW of wind generation will be developed. The AEMC asserted that there was likely to be inefficient connection of these generators to the network, because they would undersize (and hence inevitably duplicate) their connection assets. Therefore the AEMC concluded that arrangements should be made for Scale Efficient Network Extensions (SENE) whereby transmission network service providers would develop network connections and energy users should bear risk of inefficient over-investment. The broad outline of their proposal is that:

- (New entrant) generators will be required to pay a cost reflective charge based on their contracted (connection) capacity. Should all generators connect as forecast, the asset will be fully funded by generators.
- Customers will underwrite the cost of any additional capacity in excess of the requirements of the first connecting generator.
- The SENE policy should be reviewed after a period of five years.

The implementation of these arrangements will involve substantial roles for AEMO, the AER and network service providers.

- AEMO will need to determine eligible SENE zones;
- Network service providers will propose the optimum specification and cost of network extensions;
- The AEMC and AER will review generation forecasts; and the AER will review and then approve, as it seems fit, the network service providers' network extension investments;
- Network service providers will establish connection contracts with connecting generators;
- The AER and NSPs will develop a charging framework and regulatory arrangements so that customers are charged for the recovery of any shortfall between the revenue recovered from connecting generators, and the approved efficient costs of the connection assets.

Appendix G to the Final Report is a Draft Rule setting out some of the detail of how the AEMC intends to implement this arrangement.

The AEMC also recommended changes to transmission access arrangements so that generators will be required to pay for use of the transmission system, and also so that intra-regional transmission price signals are provided.

## 2.2 AEMC's recommended actions

The AEMC's Final Report identified a number of actions, which we have ordered by date of intended completion:

- AEMC to develop draft Rule on expanding the demand management incentive allowance to accommodate connection of embedded generators (draft rule expected as part of Final Report on Demand Side Participation due shortly).

- MCE to reaffirm its commitment on retail competition and review AEMC's timetable for reviews of effective retail competition (AEMC intends to complete these reviews by 2012);
- MCE to submit rule change proposal to the AEMC on generation clusters (suggested by December 2009, for finalisation by AEMC in September 2010);
- AEMC to report to MCE by December 2009 on a work program to develop generator TuOS, firm access and intraregional congestion pricing arrangements;
- MCE to submit rule change proposal to AEMC to introduce load export charge between TNSPs (suggested by December 2009, for finalisation by AEMC in September 2010);
- Final decision on AEMC Rule change on Improved RERT flexibility and Short Notice Reserve Contracts due shortly; AEMC Review of the effectiveness of NEM Security and Reliability Arrangements in Light of Extreme Weather Events due in April 2010; three Reliability Panel reviews on related issues to be completed between January 2009 and July 2010;
- AEMO to provide a potential Rule Change to AEMC by July 2010 to improve the quality of information on demand side capability, and better utilisation of embedded generators (suggested for completion by June 2010).

## **2.3 Issues for energy users arising from the AEMC's recommendations**

### **2.3.1 Transmission access arrangements**

Our view is that the AEMC's proposals on this are likely to be administratively problematic. We are not convinced by the AEMC's assertion that energy users are the beneficiaries of this arrangement. Instead we suggest that the proposals are likely to amount to a significant expansion of network service providers' monopoly into services that are currently contestable. Based on the historic track record of network investment, particularly by Government-owned network service providers, and the AER's apparent inability to constrain their expenditure, an extension of the role of these network service providers into network connections, is likely to have a significantly detrimental impact on energy users.

In addition, while the AEMC's proposals are intended to be limited to connection of generators only in some locations and under some circumstances, there is likely to be significant pressure – to which we suspect the AEMC and AER is likely to be susceptible – to extend these arrangements to all generators throughout the NEM.

For this reason, we think the AEMC's proposals for generation connection arrangements is a significant step towards greater regulation and less competition in the provision of transmission services.

The AEMC's proposals for generators to pay transmission use of system charges, the possibility of price signals for intra-regional constraints, and inter-TNSP demand charges are, we suggest, positive developments that are likely support greater efficiency.

### **2.3.2 Market design**

The AEMC's proposed solutions may result in more volatile NEM prices (through an increase in the upper price limit) and higher costs to be borne directly by users through non-energy market charges (specifically in respect of contractual costs incurred by AEMO that are recovered from users directly through network charges). The validity of these concerns will become known in due course.

Perhaps of greatest concern is that the review failed to substantively examine the NEM market design. An opportunity for a thorough examination of important market design issues has been lost.

## **3 Next steps and suggested actions by the EUAA**

### **3.1 Participation in transmission access changes**

The debate on the implementation of the AEMC's proposed arrangements is moving to the detailed implementation phase. This phase will be very time and resource intensive, but significant decisions are likely to be made during this part of the process. It would be very helpful if the EUAA is able to participate effectively during this part of the process, to reflect the views of energy users. However, this will require significant commitment of time and resources.

### **3.2 Market design**

The AEMC's recommendations on changes to the price cap and contractual flexibility are currently being progressed through reviews being conducted by the Reliability Panel, and other urgent Rule Changes that are expected to be finalised shortly.

We suggest that the EUAA needs to consider carefully how it may influence this debate in the short term through the reviews being conducted by the Reliability Panel. In addition, it may be constructive to write to the MCE to draw their attention to our dissatisfaction that a thorough review of the energy market design has not been undertaken. Such letter should ideally be accompanied by a clear statement of the benefits of such a review.