

Review of the form of the reliability standard and administered price cap

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About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is leading social justice law and policy centre. Established in 1982, we are an independent, non-profit organisation that works with people and communities who are marginalised and facing disadvantage.

PIAC builds a fairer, stronger society by helping to change laws, policies and practices that cause injustice and inequality. Our work combines:

- legal advice and representation, specialising in test cases and strategic casework;
- research, analysis and policy development; and
- advocacy for systems change and public interest outcomes.

Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program works for better regulatory and policy outcomes so people's needs are met by clean, resilient and efficient energy and water systems. We ensure consumer protections and assistance limit disadvantage, and people can make meaningful choices in effective markets without experiencing detriment if they cannot participate. PIAC receives input from a community-based reference group whose members include:

- Affiliated Residential Park Residents Association NSW;
- Anglicare;
- Combined Pensioners and Superannuants Association of NSW;
- Energy and Water Ombudsman NSW;
- Ethnic Communities Council NSW;
- Financial Counsellors Association of NSW;
- NSW Council of Social Service;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW;
- Salvation Army;
- Tenants Union NSW; and
- The Sydney Alliance.

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Public Interest Advocacy Centre



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The Public Interest Advocacy Centre office is located on the land of the Gadigal of the Eora Nation.

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Introduction

PIAC welcomes the opportunity to respond to the AEMC Review of the form of the reliability standard and Administered Price Cap (the review).

PIAC supports the aim of increasing the accuracy of the reliability standard, including the accurate assessment of consumer preferences, system capabilities and system risks.

PIAC supports the addition of a tail metric to the reliability standard. The form of both the existing standard and the additional tail risk metric should remain in the form of an unserved energy (USE) proportion.

The standard must reflect consumer preferences. It should balance the expected cost of reliability outages with the willingness of consumers to pay for avoiding such outages. Further, the standard should reflect consumers' willingness to pay for marginal units of reliability both in typical and atypical years. More work is needed to gauge consumer preferences in relation to both of these.

The standard should appear in the reliability regime as a basis or starting point, not as the only or final tool in the delivery of reliability outcomes. Underestimating or not recognising the role played by the many reliability tools beyond the reliability standard and reliability settings will result in consumers paying more for the marginal unit of reliability than they would prefer.

The standard should be treated as a target, not an upper boundary. The standard is derived as a balance between the expected cost of reliability outages and consumers' willingness to pay for avoiding such outages. Treating the standard instead as a boundary that should not be exceeded results in consumers paying more for the marginal unit of reliability than they would prefer in most years.

The Administered Price Cap (APC) should be returned to its standard level of \$300/MWh. At its current level it does not adequately protect market participants from extreme price volatility.

The aims of the standard

The aims of the standard should be limited and precise.

The reliability standard should not include outages from security events. Including security events in the mandate of the reliability standard would lead to very substantial over-investment in energy assets and cause consumers to pay more for reliability than the value they assign to the avoidance of outages.

The standard should also not be relied on to protect vulnerable consumers from the risks associated with outages on extreme temperature days. Part of the move to a variable energy-based system involves reliability risks that are less predictable. In the thermal generation-based system, most reliability events were caused by spikes in demand at the height of Summer and depth of Winter. In the new system, reliability risks may appear at any time during the year and

be caused by both from supply side issues (dark doldrums and generator outages) and demand side behaviour (very high demand), as well as new interactions between them (reduced demand-side PV generation during a period of dark doldrums). While risks of extreme temperature-driven reliability risks remain in the new system, these risks are best managed through the provision of back up generators and storage, building and town design, and a slew of other measures available to policymakers. Using the comparatively blunt and expensive tool of the reliability standard to manage this issue would cause consumers to pay more for reliability than the value they place on the avoidance of outages, without removing the underlying risk of outages on extreme days.

The reliability standard and wholesale market settings are the foundation, or starting point, of the reliability regime. The reliability standard should not be designed or used as if it is the only tool regulators employ to achieve reliability outcomes or as if it is a direct producer of the reliability outcomes experienced by consumers. In fact there are very many other tools available within the reliability regime.

- AEMO's forecasting outputs: the Electricity Statement of Opportunities (ESOO) and Projected Assessment System Adequacy (PASA) tools. These provide investors information about specific locations and future times where demand for energy may not be served, and so where profitable investments in dispatchable energy may be made within an appropriate timeframe.
- The Interim Reliability Measure (IRM), which triggers AEMO's Retailer Reliability Obligation (RRO) tool.
- Jurisdictions and the Federal Government have a number of tools to provide investors in dispatchable energy with incentives and locational signals. Examples at the jurisdictional level include the NSW Roadmap, which includes both the Electricity Infrastructure Investment Safeguard, backed by Long Term Energy Services Agreements (LTESAs) and the Renewable Energy Zones (REZs). Examples at the NEM-wide level include the coming Capacity Investment Scheme (CIS), which is particularly targeted at driving new renewable dispatchable capacity. Transmission access reforms (TAR) being developed by the Energy Security Board also aim to improve the locational effectiveness of batteries and other dispatchable energy projects, within and outside of REZs.
- Australian governments also have the capacity to initiate and direct new dispatchable energy projects directly, as has occurred in cases like the Canberra Big Battery or Snowy 2.0.
- In the short term, AEMO has powers to procure capacity directly, using the Interim Reliability Reserve (IRR) or Reliability and Emergency Reserve Trader (RERT) contracts.
- AEMO also has powers to direct a scheduled plant or market-generating unit to take relevant actions to maintain or restore the security or reliability of the power system or instruct an action from a transmission or distribution system or non-scheduled load for the same reason.¹

¹ NEL Section 116; NER clause 4.8.9.

Treating the reliability standard as an upper bound for USE without including consideration of the other measures in the reliability regime causes consumers to pay more for reliability than they value the avoidance of outages. The standard should provide the conditions under which regulators are able to employ other tools in the reliability regime to deliver reliability outcomes within preferred, acceptable bounds.

Finally, the standard should not be treated as an upper bound for USE. The use of the standard as an upper bound for the purposes of various regulatory tools creates a structural inflation of consumers' aversion to outages. This ultimately results in consumers paying more for the marginal unit of reliability than they would prefer.

While this is an issue of the setting of the standard more than its form, a change in the form could empower regulators to avoid this conflation of an optimal point with an upper bound. For example, defining the standard as a target, or even as a target band, could empower regulators to express the preferences of consumers more accurately, while still providing investors with equally effective information and signals.

The form of the standard

PIAC supports the addition of a tail metric to the reliability standard.

We agree with the need to refocus attention on tail risks and that simplistically adding a metric to the existing standard will have an overall tightening effect.

The form of the standard should remain as a percentage of unserved energy (USE) taken over a year. The additional metric aimed at capturing tail risks should also take the form of a percentage of unserved energy (USE) taken over a year. For example, if the standard remained at 0.002% USE, a tail risk contingency could be 0.004% USE. This could be triggered using AEMO's existing forecasting models, and set at a level expected to be triggered once every ten years.

Given the potential for reform, it is unclear what the final structure of market price settings will be. Whatever form the reliability standard takes, it should be compatible with multiple structures of market price.

Description of tail risks

Tail risks should be described accurately and intuitively.

Tail risks should be defined as one in ten year to one in twenty year events. This language, rather than standard statistical definitions of tail events, will provide consumers with more meaningful cognitive markers to value the expected costs of outages from tail events.

The qualitative differences between normal and tail reliability events should be described and appreciated in the reliability regime. Tail events are much more uncertain and unpredictable than normal reliability events, which are relatively predictable. Tail events are unpredictable both in terms of timing and in cause, with two main implications:

- The costs of avoiding tail risks are much higher than the costs of avoiding normal reliability events. This is because a much wider array of contingencies needs to be prepared for and defended against.
- Consumers' experiences of tail events are likely to be much more severe than their experiences of normal reliability events. Consumers are likely to be much more averse to long and/or uncertain duration, wide area-affecting outages caused by tail events than short duration, localised outages caused by normal reliability events.

The introduction of tail risks requires granularity in both the treatment of consumer preferences and the costs of different reliability remedies. The reliability standard should not be treated as the de facto or only available remedy for all reliability risks.

Tail risks expected to eventuate less than once in twenty years should not be considered by the reliability regime. They are too unpredictable to prepare for effectively without spending more than consumers are willing to pay.

Consumer preferences

The Values of Customer Reliability (VCRs) should be the anchor of the reliability regime.

The reliability regime as a whole should balance the expected cost of reliability outages with the willingness of consumers to pay for avoiding such outages. The reliability standard should aim to provide that the marginal unit of reliability is equal to the cost consumers are willing to pay for it. If a second metric in addition to VCR is added to the reliability standard to capture tail risks, the VCRs should be the basis of the standard for average and atypical years.

Additional work, including direct engagement, needs to be done to understand consumer preferences for risk in relation to high impact low probability (HILP) events and Widespread and Long Duration Outages (WALDOs). This should be done as part of the Australian Energy Regulator's (AER) workstream on VCRs for 2024. However, if this is not possible, the Reliability Panel itself should undertake direct engagement with consumers. The new reliability standard must work alongside the determination of the AER's 2024 VCRs.

The AEMC Reliability Panel and other market institutions should ensure all reliability settings are aligned with consumer preferences. The current application of the standard does not reflect these preferences in two notable ways.

- The tendency to treat the standard as an upper bound for USE. The standard is derived to balance the expected cost of reliability outages with the willingness of consumers to pay for avoiding them. The subsequent use of the standard as an upper bound for the purposes of various regulatory tools creates a structural inflation of consumers' aversion to outages. This results in consumers paying more for the marginal unit of reliability than they would prefer.
- The tendency to treat the reliability standard and the wholesale market settings as if they alone are intended to produce final reliability outcomes. This causes consumers to pay more

for the marginal unit of reliability than they would prefer. The standard should provide the conditions under which regulators are able to employ other tools in the reliability regime to deliver reliability outcomes within acceptable bounds.

The Administered Price Cap

The APC should return to its well-established level of \$300/MWh. The current level of the APC does not adequately manage market participants' exposure to price risk.

Due to government intervention in the prices for coal and gas, the conditions under which the increase in the APC occurred – thermal fuel prices exceeding levels conducive to profitable operation by generators under an APC of \$300/KWh – no longer exist. In addition, there are compensation mechanisms for generators whose running costs exceed the APC, which are more than sufficient.

Continued engagement

We welcome the opportunity to meet with the AEMC and other stakeholders to discuss these issues in more depth. Please contact Michael Lynch at mlynch@piac.asn.au regarding any further follow up.