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21 May 2021

By email to: Electricity.Roadmap@dpie.nsw.gov.au

Re: Tranche two regulations to support the Electricity Infrastructure Roadmap

The Australian Competition and Consumer Commission welcomes the opportunity to comment on the issues paper covering 'tranche two regulations' to support the NSW Government's Electricity Infrastructure Roadmap.

The issues paper touches on a number of matters that can have important implications for energy affordability, which is a continuing concern for consumers and has been a significant focus of our recent inquiries into the National Electricity Market. A reliability standard that is set too high can lead to over-investment and consumers paying higher prices for services they do not value. Similarly, long-term agreements for the construction and operation of electricity infrastructure can lead to consumers unfairly taking on risks and ultimately paying higher prices if those agreements are not well designed.

While we welcome the NSW Government's focus on affordability as it develops its framework for the Roadmap, we make the following comments about some of the risks for consumers.

Energy security target

There is a reliability standard for the National Electricity Market that is implemented by the Australian Energy Market Operator under the National Electricity Rules. The reliability standard is defined as a maximum expected unserved energy in a region. It will continue to apply, and the National Electricity Rules are flexible enough to enable the Australian Energy Market Operator to adapt its approach to operationalising it, as the electricity sector shifts towards increasing amounts of intermittent generation.

In contrast, the *Electricity Infrastructure Investment Act 2020* applies a deterministic standard for the energy security target. Specifically, the Energy Security Target Monitor will be required to report when the level of 'firm capacity' in NSW falls short of the energy security target, which is defined as the sum of the 'maximum demand' and the 'reserve margin'. The 'reserve margin' is defined as the capacity of the two largest generating units in NSW. There is an expectation that, if the Energy Security Target Monitor forecasts a breach of the energy security target, the NSW Government will intervene to ensure that additional generation capacity will be procured with the costs to be borne by NSW electricity consumers.

It is not clear whether the energy security target is a higher or lower standard than the reliability standard implemented under the National Electricity Rules, but there is a risk that it could lead the NSW Government to implement a higher reliability standard. This is because load shedding would not arise unless (a) NSW demand (less the amount served by the interconnectors) exceeds a one-in-ten-year level, and (b) there are outages of scheduled generating capacity in NSW exceeding the size of the two largest generating units, and (c) the wind and solar farms in NSW are producing less than their nominal capacity multiplied by a 'derating factor'. If the probability of this occurrence is very small then the extra costs borne by consumers for the additional generation that is built to meet the standard will likely exceed the benefits.

There is an inherent trade-off between reliability and affordability, and even marginal increases in reliability can have significant and enduring negative impacts on affordability. For example, an increase in network reliability standards in Queensland and NSW following outages in 2004 contributed to significant investment in network infrastructure in those states. Although the reliability standards were subsequently lowered after they were found to be overly cautious, the investment had already occurred and could not be undone. Consumers continue to pay for the over-investment through higher electricity charges even though they do not necessarily value the increased reliability by an equivalent amount.¹

The Reliability Panel acknowledges this trade-off when reviewing the reliability standard implemented under the National Electricity Rules and takes consumers' willingness to pay into account when deciding whether to change the standard. The Australian Energy Regulator's value of customer reliability estimates are useful for informing such an assessment.

We urge the Department to consider how the regulations can mitigate the risks of a reliability standard that is too high and in excess of consumers' willingness to pay. One way could be requiring the Energy Security Target Monitor to take these matters into consideration in its report for the Minister. For example, the Energy Security Target Monitor could be asked to report on the expected volume of load shedding in NSW and how much it would likely cost to reduce this volume. This would assist the Minister to make more informed decisions about what, if any, action should be taken in response to an identified breach of the energy security target.

Tenders for Long Term Energy Service Agreements

To the extent that the NSW Government considers it necessary to intervene in the market to procure additional generation, we support that being done through competitive tenders for Long Term Energy Service Agreements to ensure the additional generation is delivered at least cost to consumers.

The Department's proposed principles to guide the Consumer Trustee's tender processes for Long Term Energy Service Agreements touch on the critical elements necessary to ensure an open, fair and competitive process. However, we suggest that the second principle clarify that the objective is for tender participants to offer agreements on terms that deliver the highest long-term **net** financial value **to electricity consumers**.

The Consumer Trustee's Infrastructure Investment Objectives Report will be important for providing transparency about tender processes and expected cost impacts for electricity consumers. Given the above discussion about the risks and negative consequences of over-investment, we support the Consumer Trustee also being required to consider various options, costs and consumers' willingness to pay in its preparation of the report and suggest

¹ ACCC, *Retail Electricity Pricing Inquiry final report*, June 2018, pp. 163-165.

that the Department ensures these aspects are appropriately covered in its proposed list of matters to be considered.

We appreciate that regulations relating to the assessment of tender bids by the Consumer Trustee and terms and conditions of Long Term Energy Service Agreements are expected to form part of the third tranche of regulations. It will be important for those regulations to include principles that appropriately balance the amount of risk to be taken on by investors versus the NSW Government and, ultimately, consumers.

An example of how some such agreements have worked in practice is where significant wholesale cost savings currently available across the National Electricity Market will not flow through to consumers in the Australian Capital Territory owing to fixed price contracts that were struck years ago. Consumers will end up paying more as a result.

In our view, the Consumer Trustee should have a guiding principle to give greater weight to tender bids that reflect the minimum amount of underwriting that is necessary to address any perceived market failure that is preventing that investment from taking place in the absence of government intervention.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Rod Sims', is positioned below the 'Yours sincerely' text.

Rod Sims
Chair