



Retail Electricity Pricing Inquiry Preliminary Report response

Submission to ACCC

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The leading industry body representing the resources sector in SA

Executive Summary

The Retail Electricity Pricing Inquiry is an essential and timely review of the National Energy Market. The Preliminary report delivers essential findings on the state of the retail market, and identifies practical measures on the next steps to address the issues raised by stakeholders.

SACOME is pleased to make this submission on the preliminary report, outlining directions the ACCC can potentially take to ensure large commercial and industrial users have access to affordable electricity.

SACOME's response is made in the unique context of the South Australian (SA) electricity market and is mindful of the changes over the past decade, and in particular the last two years. The changes in the South Australian market in over this period have culminated in increased price volatility, a decline in system security and reduced confidence.

To address these challenges, SACOME has coordinated a collective bargaining group of major resource sector members which has expanded to include other vital sectors of the South Australian economy. In doing so SACOME has sought to increase competition and lower wholesale prices, and continued to provide assistance and advice to energy market bodies.

The Preliminary Report has identified four main concerns identified by consumers:

1. Insufficient competition
2. Over-investment in transmission
3. Inequitable environmental programs
4. Inconsistent retail deregulation

These generally align with the advice and feedback SACOME has sought from members. While concerns over network investment and deregulation are not frequently discussed in the South Australian context with members, these are areas that do require consideration.

Of importance to SACOME are:

- Enhancing market knowledge for consumers to be able to effectively contract affordable and competitive contracts;
- The increased access to affordable and plentiful supplies of gas;
- Further analysis on price impacts to commercial and industrial consumers; and,
- Encouraging of new competition in the South Australian market.

SACOME recommends that the ACCC undertake further investigation of these areas of importance and suggests that there may need to be additional powers to ensure appropriate use of energy resources of national strategic significance (i.e. no moratoria on gas extraction) while maintaining a long-term view to ensure that any new policies or rules are of net benefit to the operation of the National Electricity Market (NEM).

SACOME

The South Australian Chamber of Mines and Energy (SACOME) is the peak industry association for all companies with business interests in the resources industry in South Australia. This includes those with business, vocational or professional interests in minerals exploration, mining and processing, oil and gas exploration, extraction and processing, power generation, transmission and distribution, logistics, transport, infrastructure, and those with clients in these sectors.

Context

The South Australian electricity market has been subject to various events of the last two years. The July 2016 price volatility event spanning two weeks; the 28 September 2016 system black and subsequent outages; the November load shedding; and February 2017 Lack of Reserve 3 (LOR3) event notice have demonstrated a market that is constrained, volatile and prone to price, reliability and security shocks.

Commercial and Industrial wholesale consumers fundamentally have two options; either purchase on the spot market or contract to a generator (with a retail licence) to supply their demand. Some commercial and industrial (C&I) consumers will operate under a mix of both contract options.

The concentration of the wholesale electricity market in SA means end-users are unable to attain cost competitive prices on long term contracts, with the spot market alternative being highly volatile and heavily influenced by only a few players. Volatility adds to the risk management cost of electricity portfolios.

Generation mix

Over the last decade there has been 1,881 MW of wind and solar PV generation added into the South Australian region of the National Electricity Market (NEM). This has been facilitated by the Commonwealth Renewable Energy Target that requires 33,000GWh of large scale renewable generation in addition to State Renewable Energy targets.

Integrating large volumes of non-synchronous renewable generation at low marginal operating cost, with the ability to bid into the market at low or negative prices has resulted in large thermal generation plants operating infrequently in a load follow mode or retiring from the market entirely.

The closure of Northern Power Plant in May 2016 is a clear example of this and immediately decreased total thermal generation in the State by 786MW. Prior to Northern Closure the mothballing of Pelican Point was another example of a generator exiting the market. This plant has recently come back online. Closure of thermal plant decreases market competition in SA, and in the case of Northern a hedge option in the wholesale market is now unavailable to manage spot exposure.

Historically synchronous generation operated in consistent output mode providing a stable price with limited risk management costs. The retirement of both the Northern and Playford power stations combined with lower utilisation rates from other thermal generation has reduced dispatchable reserves. This is placing a higher reliance on the Heywood interconnector when wind and solar conditions are low.

The high volume and intermittent nature of wind and solar generation has thus produced a system that is characterised by synchronous generation operating infrequently or at high cost.

To compound the problem, there has been a lack of certainty and consistency in the supply of gas which is essential for the remaining high efficiency thermal generators to dispatch affordable electricity.

This adds further complexity and volatility to gas market contracts between producers, shippers and consumers. Costs throughout the gas-electricity supply chain rise rapidly with increasing volatility, combined with gas supply constraints for all users.

Competition

Competition in the generation and retail space is low in South Australia. The Preliminary Report acknowledges this concentration by noting three major gentailers¹ have market shares of 74% and 80% of generation capacity and generation dispatch respectively². As these gentailers own large thermal generating assets, able to provide long term power purchase agreements (PPA) contracts, the lack of liquidity has resulted in higher contract prices for large consumers of electricity.

This concentration in market power is further illustrated in the Herfindahl-Hirschman Index (HHI); used by the AER to measure competition in the NEM. A HHI value of 2000 is used by the ACCC to highlight competition concerns.

A recent report by the Melbourne Energy Institute estimated that the HHI for SA for 2015/16 was 2900-3000 following the closure of Northern power station³. The report also estimates the HHI was even higher at 3300-4000 with the mothballing of Pelican Point, making the SA market "exceedingly concentrated". This compares to a value of 1700-2000 for the previous three years.

Policy Actions

A full review of the NEM has been undertaken through the Independent Review into the Future Security of the NEM (Finkel Review). It developed 50 recommendations to address the energy trilemma of affordable, reliable and low carbon electricity. SACOME supports the general direction of the Finkel Review and will provide comment to the relevant agencies as further detail on each recommendation is released.

Proposed infrastructure upgrades such as the construction of an interconnector to NSW could meet the objective of supply, demand and stability of electricity to SA. However, these are long term propositions which do not address the short to medium term price volatility in the market. Major interconnection and asset development will require a thorough analysis to ensure these interventions do not cause long term negative impacts.

Attracting additional dispatchable generation is expected to improve Frequency Control and Ancillary services (FCAS) (grid stability) in SA which would in turn reduce the chance of load shedding events. The benefits will also extend to lower contract pricing for all users (domestic and businesses) through a system that is more resilient and less volatile.

These projects will require a stable policy environment to realise benefits of encouraging further competition in the market, greater flexibility of supply and a more secure system. The National Energy Guarantee is a good response to a current problem of policy uncertainty. It incorporates affordability and reliability equally with environmental requirements which align with the recommendations from the Finkel Review.

Additionally, SACOME has been actively facilitating a group of large South Australian electricity users that are seeking to collectively negotiate long term contracts for electricity supply and price to

¹ A Gentailer is a retail electricity company that also has generation assets in the group company's portfolio.

² ACCC, *Retail Electricity Pricing Inquiry – Preliminary Report*, ACCC, Sydney, September 2017, p. 79-80

³ D. McConnell & M. Sandiford, *Winds of change: An analysis of recent changes in the South Australian electricity market*. Melbourne Energy Institute, University of Melbourne, August 2016.

potentially bring into the SA electricity market new retail and generation options that improves competition and provide certainty in the level of dispatchable electricity in SA.

Response to next steps

The Preliminary Report notes several potential solutions to improve outcomes in the NEM from increasing generation capacity to improving affordability and availability of gas. The Actions taken by SACOME and its members are intended to encourage new entrants into the South Australian electricity market align with the ACCCs objectives of encouraging new market entrants, additional gas supplies, and addressing market failures i.e. illiquid markets.

As noted in the Preliminary Report, care should be taken of the flow on effects of encouraging new market entrants. In discussions with market participants SACOME has acknowledged that there is the potential for existing generation to retire, mothball or operate at lower utilisation rates when new competitors enter the market (particularly, for existing generation that is of mature age). This would potentially negate any improvements in competition from new market entrants.

Gas markets

Access to affordable and plentiful gas is essential to lower the short run marginal cost (SRMC) of generators. A lower SRMCs will decrease the upper pricing ranges of the volatile wholesale electricity market in South Australia. As gas generation comprises 50% of SA generation dispatch it is essential that gas is affordable in both long-term and short-term markets in South Australia.

The recommended measures from the ACCC Gas Inquiry 2017-2020 Interim report note that long term supply side options for each gas project must be assessed on a case-by-case basis rather than using blanket moratoria⁴.

This is recognised in the Productivity Commission's 5 Year Productivity Review (2017) Energy Supplement⁵. This report concluded moratoria on onshore gas exploration and production is contributing to gas price pressures on the east coast and that there are better ways to address community concerns.

SACOME has recommended in previous submissions there needs to be a market mechanism where energy resources of national significance will be protected from ad-hoc, unsubstantiated, moratoria.

In instances where gas supply shortages are recognised and are negatively impacting businesses, industry and households, moratoria can be overridden to allow the development of gas in the national interest. This policy should include advice and reports from authoritative government scientific bodies to justify and address any environmental and operational concerns.

⁴ ACCC, *Gas Inquiry 2017-2020 – Interim Report*, ACCC, Sydney, September 2017, p. 23

⁵ Productivity Commission, *Supporting Paper No.11 – Energy*, 5 Year Productivity Review, Australian Government, Canberra, August 2017, p. 122

Improving outcomes for large users

The Preliminary report contains extensive detail and evidence from residential consumers and associated groups on the impact of the market. While this is essential and a necessary component of the Retail Pricing Inquiry, more analysis is needed to assess the impacts for commercial and industrial users.

These users have different retail and contractual pricing arrangements compared to residential users, with wholesale costs comprising a large component of the final cost of electricity. SACOME welcomes the ACCC's note to improve the level of information on impacts to commercial and industrial (C&I) consumers in the Final Report.

SACOME views this as an essential component of the Inquiry as these users comprise 64% of consumption in South Australia, and are large employers.

Through the actions SACOME has taken in relation to issues faced in the South Australian portion of the NEM, collective bargaining and NEM review participation, it has become apparent there is a knowledge and ability gap to contract and "shop around" for competitive electricity prices.

The knowledge base required to be able to interpret and negotiate competitive C&I electricity contracts is a specific skillset. Programs to assist businesses interpret and negotiate competitive contracts would assist in this regard. SACOME through its collective bargaining group is progressing such a program with these group members. Into the future, SACOME will be looking to assist other resources and energy businesses to enhance their market knowledge to contract affordable, reliable and secure electricity.

Conclusion

SACOME welcomes the ACCC's release of the Preliminary Report into the Retail Price Inquiry for comment. The concerns identified in the report reflect the feedback received from SACOME from our members over the past two years about problems within the South Australian electricity market.

Further action should be taken to ensure that additional competition has an overall net benefit to consumers through:

1. increased knowledge to businesses on retail and other market contracts and services;
2. access to affordable and plentiful gas for generation and industry; and,
3. further investigation into the impacts to commercial and industrial consumers to inform the Final Report.

The ACCC should consider these areas to ensure affordable, reliable and sustainable energy for all South Australian businesses.