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Energy Security Board
By email: info@esb.org.au

Post 2025 Market Design Consultation Paper – September 2020

BlueScope Steel (**BlueScope**) welcomes the opportunity to provide comments to the Energy Security Board (**ESB**) on the Post 2025 Market Design Consultation Paper.

BlueScope is Australia's largest steel manufacturer and the only flat steel producer. We employ 6,500 people in Australian regions and cities to supply our nationwide customers in the building and construction, manufacturing, transport, and agriculture sectors. BlueScope also exports steel products and is a global leader in premium coated and painted steel products, operating in 18 countries.

As a large energy user, consuming ~1,200 GWh of electricity per annum, energy affordability, reliability and security are fundamental to the competitiveness of our business. Over recent years, BlueScope has transformed its operations to return to profitability. Keeping domestic production costs competitive remains paramount and energy is a major cost in steelmaking. More expensive energy directly affects our capacity to invest and provide employment.

BlueScope welcomes the ESB's comprehensive work program and consideration of what market elements may be required to facilitate an efficient, low emissions market that complies with the National Electricity Objective (NEO). While the review has been segmented for obvious practical reasons, BlueScope hopes that the review will deliver a comprehensive road map, not too dissimilar to AEMO's ISP. Such a road map should provide a complete and integrated work program and picture of the market as well as a level of optionality or "forks in the road" to provide flexibility and in recognition that there is a great deal of uncertainty in how the market will transition and adapt over time.

As a sophisticated energy user, BlueScope engages proactively with the market in a range of ways, but we do this with the objective of optimising our energy costs and not to maximise revenue from the electricity market. This is the fundamental difference between consumers and other market participants and a difference that the new market design must fully reflect in order to convincingly meet the NEO. To this end, we would encourage the ESB to continue to engage proactively and meaningfully with consumers to ensure the ESB have a deep level of understanding of the different types of consumers, their drivers and, their capabilities and constraints as potential market participants.

Thank you for the opportunity to provide input into this important market reform initiative. We offer the following feedback for the individual market design initiatives overleaf and would welcome ongoing engagement with the ESB as the market design progresses.

If further comment or clarification is required please contact Bridgette Carter, Manager Energy Sourcing & Utilisation on 02 4240 1749 or David Jenkins, Manager Government Relations on 03 9666 4022.

Yours sincerely

Bridgette Carter
Manager Energy Sourcing & Utilisation

MDI Initiative A: Resource Adequacy Mechanisms

The need for further resource adequacy mechanisms is underpinned by the belief that the market is not providing adequate signals for investment yet the need for electricity and the potential for electricity demand to increase into the future have never been more ostensible. Rather, price uncertainty and a lack of clear market and policy direction are leading to investment uncertainty. Therefore, we believe that the focus should be on ensuring that the market values the required services provided by generators and demand-side participants rather than adding to or expanding current mechanisms. The ESB should focus on developing market design initiatives B to F as a priority over this initiative before making a final determination on whether further resource adequacy mechanisms are still required.

If the ESB still considered that an additional resource adequacy mechanism was appropriate after progressing other initiatives, BlueScope would suggest that an operating reserve mechanism that was co-optimised with energy and also essential services would be the preferred mechanism of those presented. Co-optimising is important to ensure the most efficient outcome and that consumers are not paying for services twice. Further, incorporating the cost of any additional services in the energy price (rather than pass throughs to large customers as market charges) allows large customers to meaningfully compare the true procurement costs and ensures competition in retail markets. It is also important to manage the mechanism to no more than the 0.002% reliability standard and to create oversight of procurement limits by a governing body, possibly the Reliability Panel, to ensure transparency and independency over required levels and costs.

MDI Initiative B: Ageing Thermal Generation Strategy

BlueScope supports the ESB's characterisation of the risks to consumers related to thermal generation closures. While there is rightly focus on early closures, it is important that any reform also seeks to address the risk of a generator leaving the market later than expected.

Given the risks and impacts on consumers of closure timing uncertainty, BlueScope supports the further consideration and development of provisions and the penalties around the Notice of Closure requirements, noting that generators should be held to account for both providing sufficient notice and for compliance to the notified closure timing.

BlueScope also believes that the ESB should also give careful consideration to the definition of closure to ensure that generators are active and generating in the market up to the point of closure. Reduced maintenance and availability over time as the asset ages, particularly during summer, could have an equivalent impact to early closure. The market is relying on that capacity and needs to have some transparency to a phased withdrawal or "sweating the asset" as well as an early closure.

The ESB should also consider whether it is appropriate to formalise summer preparedness commitments made by generators to AEMO to ensure there is as much in-market generation available as possible during peak demand periods.

MDI Initiative C: Essential System Services

BlueScope believes that this is an important initiative that should be a clear priority for the ESB in their market design development, as the cost of ESS are continuing to increase and are largely uncontrollable for consumers.

Different services under the ESS category can be offered by different market participants. For example, demand response can provide operating reserve and fast frequency response, but not inertia, while grid

forming inverters may be able to provide synthetic inertia in the future but not operating reserve. BlueScope would recommend that, in order to ensure the competition in delivering these services, each specific ESS is valued separately rather than being bundled as “synchronous services”.

Services such as inertia and frequency control that used to be largely bundled into the wholesale energy price are now at times not compensated for or are procured out of market due to the influx of non-synchronous generation. The more out of market, directional, centrally procured services there are, the less leverage large energy users have to negotiate a favourable price outcome as these services are then largely deemed pass-through costs and non-negotiable. Therefore, BlueScope supports a market-based approach rather than central procurement.

Further to this, BlueScope believes that implementing a market design for ESS that pulls these costs back into the wholesale market may provide an efficient outcome for consumers. BlueScope supports the imposition of obligations on generators to provide these services as part of their registration and technical requirements (eg mandatory primary frequency response), either by the inclusion of appropriate equipment in their facilities or external procurement where that is the more efficient option. If the obligation lies with generators to procure these services and the bids into the wholesale market reflect the total cost for secure energy, this would then flow through into the futures market and ensure that there is transparency of pricing of secure energy even without setting up spot-based markets for each of the services. There may not be transparency in the different elements without a spot market, but we believe that this coupled with valuing each service separately would be a more efficient outcome than Option 2 with just as effective innovation and investment signals.

MDI Initiative D: Scheduling and Ahead Markets

BlueScope supports further work on the UCS mechanism, system service ahead scheduling and the integrated ahead market. We strongly agree that an ahead market may facilitate further demand-side participation as price uncertainty is a significant concern and barrier to effectively offering demand-side response particularly for slower acting demand response units.

MDI Initiative E: Two-Sided Markets & MDI Initiative F: Valuing Demand Flexibility and Integrating DER

There appears to be material overlap between the issues being addressed in MDI E and F and therefore it makes sense to combine these workstreams.

When designing a two-sided market, it is important to keep front of mind that consumers are consuming electricity to power their business. There are varying levels of sophistication amongst consumers but the one thing they have in common is that their day job is to run their business not be an energy trader. Their focus is on optimising their costs, not on maximising revenue from the electricity market.

A two-sided market should therefore be designed with the primary objective of offering engaged consumers an opportunity to actively manage their energy costs. Any definitions, rules and obligations on demand-side participants should reflect this.

To meet the objective of efficiently balancing supply and demand there needs to be a focus on metering and digitalisation to allow for efficient flow of data between both sides of the market and AEMO. This objective should not impose onerous obligations on consumers that will not only increase cost but also may deter participation.

The Wholesale Demand Response Mechanism (WDRM) currently being implemented by AEMO is a good step in the right direction to more engagement and flexibility for demand-side participation but it falls short in recognising that large energy users are not the same as generators. BlueScope has been a strong supporter of the implementation of a WDRM but stresses that this mechanism is a first cut and not necessarily the best mechanism on which to model further market reform. To elicit meaningful demand-side participation there will need to be a suite of solutions that recognise the differences in participants; their capability, constraints, risk appetite and level of price sensitivity.

MDI Initiative G: Transmission Access and the Coordination of Generation and Transmission

While BlueScope appreciates the work undertaken by the AEMC and the theoretical underpinnings of nodal pricing, BlueScope strongly believes that the COGATI workstream should be paused for the following reasons.

First, COGATI is incredibly complex and represents a fundamental reform to the NEM. BlueScope considers the modelling which shows that it delivers substantial benefits is flawed. In particular, we do not believe the economic benefits will be realised and even so the model is suggesting that most of the benefit will not be realised until after 2035 (given 5 years of grandfathering of financial transmission rights).

Second, the Integrated System Plan and other measures discussed above address many of the underlying issues related to the transition to renewables and should be given a chance to work. For example, the priority transmission projects under the ISP will strengthen the grid backbone. The introduction of renewable energy zones as contemplated in the ISP and the recent announcements of the NSW and Queensland Governments should facilitate further large-scale renewable investments in a co-ordinated and efficient manner. The scale of the REZs being considered would suggest that, in the future, the majority of new renewable investment will be in areas where the grid has been planned and developed to support it.

Third, there seems to be an underlying assumption in COGATI that renewable projects and batteries have insufficient locational signals for their siting. BlueScope questions this. In 2018, BlueScope entered into a corporate power purchase agreement with Finley Solar Farm. As part of the procurement process, BlueScope can confirm that congestion risk was a critical issue for both projects and offtakers and was assessed carefully and valued. Ultimately, a number of factors affect project siting, not least of which is the resource yield. Ultimately, COGATI does not remove the physical constraints and its value in managing that risk is overstated. It is noteworthy that there appears to be very little support for COGATI from those parts of the industry that it actually impacts. In BlueScope's view, the complexity of COGATI will make it much more difficult for large corporates to directly support future projects.

Finally, as noted earlier, the ESB reform process needs greater consideration and prioritisation as a package. The individual workstreams can hide the interconnectivity. It is BlueScope's view that the COGATI workstream is overly complex and expensive and the case for it has not been established given the other measures. The speed and scope of reform in the energy markets means that most stakeholders cannot meaningfully assess and comment on the proposals and "reform fatigue" has set in. We consider priority and resources should be focussed on the measures in initiatives B to F above and to regulatory changes that facilitate REZs in an efficient way which involve generators bearing some of the transmission and system security costs to fully reflect their impacts on the system.