

Dr Kerry Schott AO
Energy Security Board

5th April 2019

Submitted via e-mail to: info@esb.org.au

Dear Dr Schott,

Retailer Reliability Obligation Draft Rules Consultation Paper

The Australian Energy Council (the “**Energy Council**”) welcomes the opportunity to make a submission in response to the Energy Security Board’s (“**ESB**’s”) *Retailer Reliability Obligation Draft Rules Consultation Paper*, and acknowledges the efforts of the ESB in preparing the document so quickly, while still engaging industry in the process.

The Energy Council is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to over ten million homes and businesses, and are major investors in renewable energy generation.

Discussion

Interaction with other rule changes being considered

The Energy Council appreciates the challenges the ESB faces in ensuring the Retailer Reliability Obligation (“**RRO**”) is in place by 1st July 2019. One such challenge is to ensure that the rule changes proposed agree with other rule changes being contemplated at the same time. The Energy Council notes that the Consultation Version used (dated 8th March 2019) does not match the current National Electricity Rules (Version 119 dated 1st February 2019).¹ In particular the draft RRO rule includes changes possible as a result of the Enhancement of Reliability and Emergency Reserve Trader (“**RERT**”) Draft Amending Rule.² The Energy Council has lodged a submission suggesting that the rule should not be made as drafted,³ since the extension of the period allowed for AEMO to secure RERT contracts would compromise the ability of market participants to secure the same capacity in satisfaction of their Retailer Reliability Obligation. Therefore the Energy Council recommends the ESB take the final RERT rule, and stakeholders’ comments, into account when it finalises its own RRO rule drafting.

Role of the Regulator

The Detailed Design documents anticipated the Australian Energy Regulator (“**AER**”) reviewing and authorising a triggering decision by the Australian Energy Market Operator (“**AEMO**”). The Energy Council assumed that a review would be a full merits-style review, where the AER would effectively attempt to replicate the result achieved by AEMO. Instead, the proposal is for an administrative review, where the AER will assess whether AEMO has followed its own guidelines. This is a considerably lower level of scrutiny than the Energy Council considers is warranted by the significance of a trigger decision.

The introduction of consulted forecasting guidelines, in which the AER will be involved, is very welcome, however it seems likely the AER will remain largely a bystander to AEMO’s actual operational processes. The Energy Council is uncertain that this role is sufficient to provide market confidence in AEMO’s forecasting. At a minimum the Energy Council suggests the AER should arrange peer review of AEMO’s forecasting by independent, competent consultants. If alternatively the AER’s role required, ultimately, an obligation for them to independently reproduce the result, then the AER would necessarily be continuously, and intimately, involved in the complex and often opaque judgements required in operational forecasting.

¹ Available at <https://www.aemc.gov.au/regulation/energy-rules/national-electricity-rules/current>

² Available at <https://www.aemc.gov.au/sites/default/files/2019-02/Draft%20amending%20rule.pdf>

³ Available at <https://www.aemc.gov.au/sites/default/files/2019-03/Australian%20Energy%20Council.pdf>

If this is considered too substantive a role for the regulator, another approach could be for the AER to independently endorse the inputs and assumptions feeding into the forecasting process. This could be in the form of a statement of compliance with respect to the forecasting guidelines. The RRO rules could identify an appropriate timing window with respect to the annual preparation of the Electricity Statement of Opportunities (“ESoO”) for such a statement to be issued.

Irrespective of the exact role assumed by the AER, the AEC’s members encourage more input and assumptions information being made available to industry (to the extent possible without breaching confidentiality obligations), detailed descriptions on methodologies employed being published, and ultimately more detailed outputs with greater granularity of results being shown, thereby allowing market participants to understand report conclusions better, and be able to conduct their own analyses in order to form their own views.

The Use of Guidelines

In order to meet the implementation deadline, simplify the rules, and allow future changes to be made without the complication of passing legislation, the ESB has delegated much of the detail to a series of guidelines which will be developed by AEMO and the AER in accordance with the timetable set out in Chapter 9 of the Consultation Paper. The Energy Council supports this approach as it has an expectation that as the power system’s generation mix changes, the policy landscape changes, and any shortcomings from using the rules in practice are identified, there will be a need for the RRO arrangements to be varied. These variations may take the form of changes to the rules (through the normal Australian Energy Market Commission (“AEMC”) process) or through changes by AEMO and the AER to the guidelines for which they are individually responsible. The Energy Council recommends that the Draft Rules include a routine review by the AEMC of the relevant guidelines one year after commencement, to identify any necessary rule or process improvements, and then every four years thereafter.

The need to allow time for AEMO and the AER to draft, consult on, and finalise the necessary guidelines is understood, and it is logical for the ESB to contemplate transitional arrangements while these processes occur. Given AEMO does not contemplate a breach of the reliability standard for the next two years,⁴ ordinarily this would not cause an issue for industry, however under the National Electricity (South Australia) (Retailer Reliability Obligation) Amendment Bill 2019, the SA Energy Minister has the ability to make a T-3 reliability instrument if the Minister has reasonable grounds to believe “there is a real risk that the supply of electricity to all or part of South Australia may be disrupted to a significant degree on 1 or more occasions”.⁵ This means that a T-3 instrument can be called as soon as the legislation receives Royal Assent, and places greater emphasis on the transitional arrangements being suitable for immediate action. To this end, while the Energy Council understands the rationale for AEMO and the AER not being obliged to comply with the rules consultation procedures, it would be prudent for some industry consultation and review to take place, even if it is abbreviated.

One of the guidelines which is set out in the Draft Rules is the Forecasting Best Practice Guidelines. The Energy Council notes that the RRO is intended to be in place by July 2019, yet the Forecasting Best Practice Guidelines won’t be finalised until 30th November 2020 – a date after the publication of two ESoOs.

As it stands, the guidelines to be set out by the AER require that the forecasts are unbiased, subject to publicly available inputs, assumptions & methodologies, and undertaken in consultation with stakeholders. While this ensures that AEMO’s practices are robust, the Energy Council submits that there needs to be a test for their effectiveness. Striving is hollow if there is no target for which to strive. On that basis it would seem appropriate for the AER to include a statement of the standards expected by AEMO in its forecasting. Set at an appropriate level, perhaps by reference to international benchmarks, providing a measure against which performance can be compared will provide an incentive for AEMO to revise its procedures and processes to meet the standard.

The Reliability Standard

Meeting standards is also an important consideration for the treatment of the reliability standard and AEMO’s declaration that a forecast reliability gap exists. In the Energy Council’s previous submission it recommended that a buffer in the reliability standard assessment be included to ensure that any forecast breach is material.

⁴ See for example AEMO’s *Medium Term Projected Assessment of System Adequacy* published 19th March 2019

⁵ Clause 19B(2) of Part 7A

The ESB has rejected this view, stating that it “could change the nature of the reliability standard that is in place and create a new standard”.⁶ While the Energy Council understands the point being made, it must also be recognised that an RRO trigger sets off a major compliance exercise by the industry, irrespective of the severity of the breach. It seems unreasonable for such costs to be triggered by trivial excursions. On this basis the Energy Council repeats its recommendation that a materiality test be applied to whether the reliability standard is likely to be breached or not. One approach could be to provide discretion to the AER to determine whether a breach is material, given the circumstances of the forecast.

It is also important for the RERT and its adjunct, the Procurer of Last Resort, to be treated consistently with other market procedures. The Energy Council notes that Draft Rule 3.20.1(b) requires that “estimated load shedding VCR” be determined by AEMO, despite the AER currently undertaking a review of the value of customer reliability (“VCR”).⁷ The Energy Council prefers that the AER be the body responsible for determining the estimated load shedding VCR, since this is consistent with its current responsibilities.

Generator Retirement

One of the material items which is likely to affect AEMO’s forecasts is the retirement of a generator. Following the introduction of the National Electricity Amendment (Generator three year notice of closure) Rule 2018 No. 12, generators are obliged to provide three years’ notice of their expected closure, except under certain defined circumstances. The ESB has questioned whether the notice period should be extended to better fit the T-3 instrument timing. While in some situations plant nearing the end of its technical life may be able to provide a longer notice period, and are likely to voluntarily do so, other plant will be affected by plant and market conditions, which can change in short timeframes. Furthermore, as the notice period extends further into the future, general confidence in its accuracy necessarily declines as there is a greater chance for unforeseen serious events. Accordingly the Energy Council does not believe extending the generator notice of closure period is likely to be of value.

Opt-in Customers

The Retailer Reliability Obligation will also be affected by Opt-in Customers. The Energy Council broadly supports the proposed treatment of Opt-in Customers in the draft rules, including the ability to opt-in for all or a part of their load. There does appear to be a discrepancy however, between the Consultation Paper, which refers to such customers being only able to opt-in for the full reliability gap period,⁸ and the proposed Clause 4A.D.4(a), which refers to “a reliability gap period”, implying that there can be some selection of reliability gap periods for which a customer will opt-in.

In addition the Energy Council notes the credit implications of such customers participating. In the past large customers have sought to reduce their energy costs by participating in the spot market rather than contracting with a retailer, and there is the possibility that large customers may choose to opt-in to manage their obligation in the expectation that they will reduce expenses compared with having their retailer assume their obligation. While this strategy may be successful for periods of time, there is a risk that it will fail, and the customer will either be saddled with crippling costs, or the broader industry will be required to accept the customer’s costs. To counter this exposure the Energy Council supports AEMO developing procedures to ensure Opt-in Customers have sufficient credit support.

Market Liquidity Obligation

The Consultation Paper discusses triggering the Market Liquidity Obligation (“MLO”) when a T-3 instrument is made. This topic is another instance of parallel processes in train, given the Market Making Arrangements in the NEM Rule Change Request being contemplated by the Australian Energy Market Commission.⁹ The Energy Council believes that to encourage flexibility, liquidity and market efficiency, voluntary mechanisms are to be preferred, in the absence of compelling evidence that there is a market failure. Therefore it would be reasonable for the draft rules to accommodate the AEMC’s rule change process and not prescribe a MLO until the AEMC’s assessment has run its course. The Energy Council also notes the inclusion of spreads in Clause 4A.G.18(f) of the proposed rules and suggests that for transparency the ESB publishes its analysis which determined these spreads to be appropriate.

⁶ Consultation Paper, p.13

⁷ See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/values-of-customer-reliability-vcr>

⁸ Consultation Paper, p.21ff.

⁹ Available at <https://www.aemc.gov.au/rule-changes/market-making-arrangements-nem>

This view that the AEMC's rule change process should be considered in the ESB's deliberations is supported by the complexity of the provisions necessary to ensure that obligated parties are identified correctly. The Draft Rules set out a number of mechanisms to identify trading right holders, ascertain their participation in trading groups, pinpoint their controlling entities and trace their tradable capacity. Such complexity will inevitably create inadvertent loopholes, as well as encourage market participants to set up their trading arrangements to optimise their exposure. This confirms that a voluntary arrangement for the MLO is preferred by the Energy Council and its members.

The Energy Council also notes the proposal for AEMO to conduct a voluntary book-build. The Energy Council does not believe that such a measure is necessary, since it may either prove to be unused by the market, or if used, compromise the ability of the market to develop its own mechanisms to arrange supply and demand. However, another major concern is the treatment of AEMO's costs. Draft Rule 4A.H.5 specifies that book build fees are recoverable by AEMO "in accordance with the structure of Participant fees", and the Energy Council's members would prefer that any costs incurred by AEMO were borne directly by participants in the book build process, rather than being smeared across the broader market.

Nett Contract Position

It is understood that liable entities will need to provide a statement of their nett contract positions on or before the reporting day. This is a reasonable obligation which the Energy Council supports, but suggests that the requirement under proposed Draft Rule 4A.E.6(c)(3) be mollified by specifying that an authorised officer (who can warrant that he or she has the authority to do so) rather than a director, be able to certify the return. This will streamline the administrative overhead for market participants without diminishing the scrutiny the statement will receive within each business.

Conclusion

In conclusion, the Energy Council commends the ESB for preparing such fulsome Draft Rules, but recommends that consideration be given to rule changes and other market changes presently being considered by other market bodies. In addition, it is imperative that the guidelines developed be detailed and include comprehensive expectations which provide transparency to stakeholders and confidence that the outputs are appropriate.

Any questions about this submission should be addressed to the writer, by e-mail to Duncan.MacKinnon@energycouncil.com.au or by telephone on (03) 9205 3103.

Yours sincerely,



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