

Dr Kerry Schott
Independent Chair
Energy Security Board
info@esb.org.au

13 July 2018

Executive Summary

Emissions Guarantee

We have reviewed the Emissions Guarantee elements of the NEG and are in general agreement with the approach adopted by the ESB.

The introduction of the Emissions Registry (the registry) is a welcome step towards greater coordination of the various state and federal emissions reduction activities.

We encourage the ESB to consider the ability of commercial and industrial customers to “opt-in” to manage their own abatement. This could be facilitated in the same way as the proposed liability transfer protocol proposed for the Reliability Guarantee and would increase competition and improve commercial outcomes for consumers.

We support providing liable entities with flexibility in managing compliance through carrying forward of overachievement or deferring compliance (banking and borrowing) and welcome the inclusion of State and Territory schemes in the Emissions Guarantee as this will lead to achievement of Australia’s Paris commitments at least cost to consumers.

We support the exclusion of EITEI load to ensure domestic emissions reduction activities do not place energy intensive exports at a competitive disadvantage.

We support the exclusion of voluntary Green Power load from the Emissions Guarantee to maintain the integrity and consumer confidence in the scheme.

While the EUAA is supportive of limited use of offsets and are supportive of abatement being sourced from State and Federal renewable energy schemes, we would encourage the ESB to consider the concept of additionality as applied in other international jurisdictions when assessing emissions reduction eligibility, especially in the case of offsets, to ensure consumers do not “pay twice” for abatement that has already occurred.

Reliability Guarantee

We are pleased to see that concerns of a potential “gold plated” response have been recognised by the ESB and that a robust eight step process is proposed. The proposed forecasting methodology and accountability framework will provide a significant boost to the market’s confidence that the forecasts provide an appropriate basis for identifying and measuring a reliability gap.

We agree with the proposed governance framework for development of best practice forecasting. We see one of the greatest challenges in demand forecasting to be the impact of distributed energy resources, including batteries

and demand response. The EUAA has some reservations around the current AEMO approach to forecasting in this area.

The EUAA agrees with the proposed approach to defining the reliability gap based on the current 0.002% USE reliability standard, agree that the definition of “material” will be difficult balancing exercise (and that more work needs to be done) and agree with the proposed assessment of materiality to reflect inter-regional transfer capacity between regions.

We agree with the proposed framework for the AER’s independent review of the AEMO forecast of a material gap, however we would suggest that more clarity be given around the timetable for any AER review.

In addition to the safeguards that are proposed, we suggest that a customer reference group be established to provide an additional perspective on the value of reliability and to understand the materiality of the costs, especially in the case of T-1 being triggered and potential AEMO intervention via RERT (acting as the safety net).

It is the view of the EUAA that the obligations under the Reliability Guarantee should first sit with energy retailers and that large customers should be given the opportunity to “opt-in” because:

- Most large customers do not currently participate in the energy market and are ill prepared to take on this task that would also add cost and risk to their energy procurement task.
- Analysis by Schneider Electric strongly suggests that it would be more efficient for large retailers to manage this task due to the size a diversity of their portfolio. This efficiency is likely to mean less-firm contracts will be required to meet future reliability obligations and as such, the market avoids “gold plating” the reliability solution.
- “Opting in” would represent the free option the ESB intended to create with the original design of the scheme.

We agree with the ESB approach of flexibility in the description of qualifying contracts. In addition to the type of contracts described, we would suggest the inclusion of any internal activity undertaken by a large customer to reduce their exposure to high spot prices such as demand response.

We commend the ESB for listening to stakeholder concerns about market power and liquidity and welcome the proposals put forward such as the use of trade repositories and the establishment of the market liquidity obligation. The market liquidity obligation in particular will be very important to ensure large customers and small retailers have access to sufficient qualifying contracts, to enhance liquidity and to provide a level of price discovery that is unlikely to exist in its absence.

EUAA members have expressed concern that contracts, negotiated in good faith over many months, should be “grandfathered” and for the purpose of the Reliability Guarantee be deemed as qualifying contracts. We suggest that all contracts finalised before the August COAG Energy Ministers Meeting should qualify for grandfathering.

We are very supportive of the proposal for AEMO to conduct a voluntary book build process on triggering T-3 and encourage AEMO to run this book build process regardless of an obligation being triggered as this will assist with transparency and price discovery. There have been some comments made that, with the inclusion of the market liquidity obligation, that the book build is not required. We reject this suggestion as we believe that all efforts should be made to improve transparency and market liquidity.

We support allowing demand response to play a role in meeting the reliability guarantee. However, we are concerned that while demand response could play an important role, without market reform to remove existing barriers, it will remain at the fringes of the market.

The 2017/2018 summer RERT activation by AEMO resulted in a cost to consumers of \$51 million and is a salutary lesson for all market participants that without a more structured approach to the transformation of energy markets, we should expect not only more direct intervention but more costly intervention as well. It is also clear that significant improvement to RERT is required.

We would encourage greater transparency about the size of the gap to be met, sufficient notification of when RERT is going to be triggered and the likely cost. The AEMO run book build will also provide AEMO with greater insight into the availability of resources, which, along with significantly enhanced forecasting tools should help improve the RERT process to deliver a more cost-effective outcome in the future.

The EUAA are committed to working with large customers to improve their understanding of energy markets and encourage them to play a role in ensuring system reliability, as it is in their best interests to do so. With this in mind we suggest that the ESB consider developing an information and market education package directed at large customers with the objective of making them more “market ready” and therefore better able to participate more fully in the NEG and energy market in general.

Introduction

The Energy Users Association of Australia (EUAA) is the peak body representing Australian industrial and commercial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing and materials processing industries. Combined our members employ over one million Australians, pay annual energy bills in the many billions of dollars and are desperate to see a lasting national energy and climate change plan that puts downward pressure on electricity costs.

The EUAA welcomes the opportunity to comment on the *Draft Detailed Design Consultation Paper* and commend the Energy Security Board (ESB) for the consultation with stakeholders undertaken to date given the challenging time frame that has been set by the Federal Government. The EUAA have been working closely with the ESB on the design elements of the National Energy Guarantee (NEG) and have been pleased with the willingness to listen to stakeholder concerns, consider alternatives and provide solutions.

Energy markets have been in transition for the last decade and the EUAA understands this transition will continue, at pace, for at least another decade. We understand that climate change risk must be managed from a social, environmental and economic perspective and in doing so we will see significant changes in the structure of energy markets and the nature of its participants. The inevitable retirement of legacy fossil fuel assets adds additional complexity to this scenario.

We observe that the first half of this transition has been dogged by the chaos of policy inconsistency and unhelpful public debate leading to increased risk for all investors and higher costs than necessary for consumers. This chaos can't continue, which is the primary reason for our support of the NEG.

We are supportive of the NEG as we believe it has the potential to provide a level of stability to the transition of energy markets that is already underway and is set to continue for some years to come. If the architecture of the NEG is coupled with enduring bipartisan support we believe it will create greater investment certainty for all market participants and, over time, put downward pressure on energy costs while providing the system reliability and climate risk management that we need.

We observe there are those who criticise the NEG because it doesn't include explicit support for renewable energy while others criticise it because it doesn't include explicit support for fossil fuels. It is our view, that both renewable energy like wind and solar and fossil fuels are mature technologies and therefore do not justify special treatment.

Despite this, it would appear that many are still seeking a consumer funded free lunch and because the NEG doesn't provide it they are critical of it.

From an energy user perspective, we see this as a significant positive of the NEG as it seeks to be technology neutral ensuring all technologies can both play to their strengths but also requires them to manage their weaknesses.

In the case of renewable energy, we note with interest that it is projected to achieve 40% market share by 2030, even in the absence of any additional policy or regulatory support. Clearly, renewable energy has become the lowest cost energy source, the challenge now is to find low cost ways to "firm up" its variable generation.

In the case of fossil fuels, we see the NEG as an opportunity for the owners of thermal generation to look at new ways to operate their assets in a manner that will play a key role in maintaining system reliability as more variable and dispersed generation enters the market.

While not providing the same opportunities for all thermal generators, the Reliability Guarantee aspects of the NEG provide a new level of certainty for owners of relatively new thermal generation to reinvest in these existing assets to improve efficiency, output and flexibility that will allow them to continue to play a vital role in the national energy market.

We think that the combination of the Emissions Guarantee and Reliability Guarantee elements of the NEG will, for the first time, provide the potential to achieve lower energy sector emissions without sacrificing reliability.

Importantly, provided the NEG has enduring, bi-partisan support, we also believe it is the best available opportunity to put downward pressure on energy costs and to avoid future market interventions such as RERT. While RERT may have fulfilled its technical objective, the cost to consumers of \$51 million to preserve system reliability during the 2017/18 summer period is seen as excessive by many commercial and industrial energy users who are shouldering a significant portion of this cost.

We are hopeful that the NEG will ensure this situation will never happen again and that if such an intervention is required in the future then only those who have caused the problem will be required to pay.

Our submission will focus on those areas that EUAA members have raised concerns about since the release of the detailed draft design.

Substantive Comments

Emissions Guarantee

The EUAA are of the view that it is in Australia's best interests to be part of a global climate change solution that minimises overall costs of decarbonisation of its economy and takes advantage of new technological and economic opportunities.

Australia's Paris commitment of a 26% to 28% reduction below 2005 levels by 2030 creates a minimum emissions reduction obligation which is also aligned with many of our international trading partners. The EUAA supports the achievement of this target in a way that is both economically efficient and that drives the necessary changes in the domestic energy market to put downward pressure on consumer energy costs.

Domestically, the transition to a low carbon energy market is already underway and we need to ensure it is both economically and environmentally efficient. Therefore, investment grade policy that endures is a "must have" requirement.

Many of our member companies already price carbon risk into investment decisions and it is clear that those who own, operate and finance energy generation assets are compelled to manage carbon risk, even in the absence of a domestic trading regime or explicit price on emissions.

Many EUAA members have been self-managing compliance obligations for State and Federal policies such as the Renewable Energy Target (RET) for a number of years including entering into Power Purchase Agreements with renewable energy projects. Additionally, many have also invested heavily in energy efficiency and sustainability projects to both reduce cost and to meet internal triple bottom line objectives.

We have reviewed the Emissions Guarantee elements of the NEG and are in general agreement with the approach adopted by the ESB.

In the absence of a national emissions trading regime that would consolidate a range of State and Federal emissions reduction, environmental and renewable energy schemes, liable entities including commercial and industrial energy users face a myriad of compliance frameworks. This is adding complexity and cost to compliance.

The introduction of the Emissions Registry (the registry) is a welcome step towards greater coordination of the various emissions reduction activities where compliance obligations can become more centralised, reducing cost and complexity. We support the proposal that AEMO administer the registry and that the data exchange with the Clean Energy Regulator continue.

While retailers and market customers are identified as the liable entities for the Emissions Guarantee, we encourage the ESB to consider the ability of commercial and industrial customers to “opt-in” to manage their own abatement. This could be facilitated in the same way as the proposed liability transfer protocol proposed for the Reliability Guarantee where:

- The customer formally notifies their retailer of their desire to self-comply with the Emissions Guarantee.
- The retailer formally notifies AEMO (proposed system administrator).
- Customer registers with AEMO as a “non-market liable entity”.
- AEMO allocates the appropriate emissions reduction obligation to the customer.
- Customer submits appropriate evidence of compliance into the registry.

Giving commercial and industrial customers the ability to “opt-in” to the Emissions Guarantee will improve competition and deliver better financial outcomes. In addition to this, to help facilitate greater liquidity and competition we suggest that the emissions registry is open to all interested parties and providers of new abatement opportunities.

We support providing liable entities with flexibility in managing compliance through carrying forward of overachievement or deferring compliance (banking and borrowing) as outlined below (*NEG Commonwealth Elements – Setting and Reviewing Electricity Emissions Target*). Consideration should be given to allowing any additional abatement to be used to offset emissions reduction objectives outside of the energy sector to help facilitate a deeper abatement market.

We welcome the inclusion of State and Territory schemes in the Emissions Guarantee as this will lead to achievement of Australia’s Paris commitments at least cost to consumers.

We acknowledge the general approach adopted by the ESB of using as much as possible of the existing regulatory and market infrastructure to manage compliance under the Emissions Guarantee. Therefore, we welcome the approach to allocate generator output and emissions to market customers through the registry in a way that is similar to AEMO current reallocation procedures for determining settlement amounts in the wholesale market.

Ensuring clarity of ownership of emissions abatement will be important for both customers who have negotiated power purchase agreements with renewable energy projects or where owners use intermediaries to “market” the project output. AEMO needs to ensure that it is clear that emissions abatement is allocated to the rightful owner within the registry.

We support measures to maintain and enhance competition including the proposal to exclude the first 50,000 MWh of any market customers load from compliance under the Emissions Guarantee, spreading this load across the broader market in the same way as EITE load is dealt with. This will ensure that smaller retailers and market customers do not have to incur additional costs or add risk to their business by entering into long-term contracts to cover what is relatively small compliance obligation.

We support the exclusion of EITEI load (see comments [NEG Commonwealth Elements – Exemptions for EITE activities](#)) to ensure domestic emissions reduction activities do not place energy intensive exports at a competitive disadvantage.

We support the exclusion of voluntary Green Power load from the Emissions Guarantee to maintain the integrity and consumer confidence in the scheme.

While the EUAA is supportive of limited use of offsets (see comments [NEG Commonwealth Elements – Role of Offsets](#)) and are supportive of abatement being sourced from State and Federal renewable energy schemes, we would encourage the ESB to consider the concept of additionality as applied in other international jurisdictions when assessing emissions reduction eligibility.

The treatment of pre-1997 renewable generation as it relates to the potential creation of offsets or other environmental credits needs to be carefully considered. While all output from renewable generation contributes to the emissions intensity objective of the NEG, financial benefit through the creation of offsets or other environmental derivatives should only be available to additional output above a baseline year.

The 1997 baseline was applied for the purpose of creating renewable energy certificates under the Federal RET program and may not be appropriate for use under the NEG. Therefore, for the purpose of creating offsets or other environmental derivatives, consideration should be given to applying a new baseline year of 2005 to align with the Paris commitments.

We also suggest that offsets sourced from abatement activities already paid for under State and Federal programs like the Commonwealths Emissions Reduction Fund, should not be eligible for use under the Emissions Guarantee.

We support the approach of allocating non-market embedded generation and solar PV as this will provide a complete picture of both load and emissions.

In addition to comments already made in response to this submission, the EUAA have made a submission to the to the *National Energy Guarantee Draft Detailed Design Consultation, Commonwealth Elements* consultation paper that specifically focuses on key elements of the Emissions Guarantee. Following is a brief summary of our comments in that submission.

NEG Commonwealth Elements – Setting and Reviewing Electricity Emissions Target

We are in general agreement with the Commonwealth approach to setting and reviewing electricity emissions targets as proposed in the consultation paper. The Federal Government have been very clear that they will meet the emissions reduction target under the Paris commitment and it would appear the electricity sector will play at least it's proportional role in achieving this.

While setting an initial 10-year emissions reduction target is welcomed, as it provides a level of investment certainty, we would see this as playing the role of a target "floor" rather than it being seen as a ceiling on innovation and investment.

We support the principle of a straight-line emissions reduction trajectory to provide a level of certainty to participants. Other trajectories that seek to delay the emissions reduction task risk the non-achievement of our Paris commitment and could result in higher costs by concentrating the purchase of abatement into a smaller, end of period window and a lack of timely investment in new generation to replace end-of-life fossil fuel plants.

However, we would encourage a level of flexibility to adjust the target trajectory (but not the overall quantum of the target itself) that considers material changes in demand. This could be facilitated by the 2025 review proposed

in the consultation paper. We would also encourage flexibility over the coming years to align with changes to international consensus and future agreements along with changes in technology and cost.

We observe that many abatement activities tend to come into the market in relatively large blocks rather than in a linear fashion. Therefore, we support the concept of banking and borrowing (also referred to as carry forward or deference in the *Draft Detailed Design Consultation Paper*) being available to liable entities to manage their annual compliance obligations. This will also be an important flexibility mechanism for liable entities attempting to “true up” obligations at the end of a compliance period.

We support an ability to bank or borrow up to 15% of the electricity emission target per MWh of annual load with the potential to narrow this down to 10% in future years as the abatement task and Emissions Guarantee mechanisms become more well known.

We also support allowing energy consumers to “opt-in” to manage their own environmental compliance under the Emissions Guarantee as they currently do for other State and Federal schemes (i.e. RET).

We note that a number of recent reports estimate that renewable energy will make up to 40% of the NEM by 2030, well in excess of current targets and in the absence of any further federal regulatory or policy incentive. If this is the case then the energy sector is well placed to make a greater contribution to national emissions targets than currently contemplated without additional regulatory or policy impositions and associated cost.

We would also encourage the inclusion of other non-NEM jurisdictions in the Emissions Guarantee to avoid the creation of market barriers and “free riding” by non-scheme participants.

NEG Commonwealth Elements – Exemptions for EITE activities

The existing EITE arrangements as applied to the Renewable Energy Target are well understood by industry and appear to be achieving the objective of neutralizing the impact and cost of domestic policy on international competitiveness of energy intensive industries.

We note the amendments made to the *Renewable Energy (Electricity) Act 2000* on 14 December 2017 to include the addition of an electricity use method for calculating exemptions. While this has added some relatively small costs to compliance it does provide a far more accurate assessment of EITE activities.

We support the continuation of these arrangements in the Emissions Guarantee. We also support the proposal to streamline the RET and Emissions Guarantee to minimize regulatory cost for participants.

NEG Commonwealth Elements – Role of Offsets

The EUAA supports the limited use of domestic and international offsets in meeting compliance under the Emissions Guarantee provided:

- The creation, validation and tracking of domestically used offsets meets strict criteria (including an “additionality test” discussed below).
- The creation, validation, tracking and trading of domestically used offsets is highly transparent so as to provide all market participants, including investors in future energy generation technologies, with a clear “line of sight” to volumes and value. This will be critical to ensuring investors can have a sufficient level of confidence in making new investments in generation capacity.
- Consideration should be given to the interaction between energy and non-energy related abatement activities and their role in the NEG. A key aspect of the NEG is to ensure sufficient generation capacity enters the market. The Commonwealth should consider the impact of large quantities of non-energy

related offsets (i.e. land use change) crowding out investment in new generation capacity such that the Reliability Guarantee obligations (T-3 and T-1) are triggered.

- We note that the Commonwealth is already considering some limits to the use of offsets in general to meet obligations under the Emissions Guarantee. We would encourage the Commonwealth to consider greater use of offsets than outlined in the consultation paper (currently 5% to 10%) especially for the use of domestic offsets that meet the additionality test as described below. This needs to be balanced against the “crowding out” discussion in the previous point.
- It may be that the significant use of offsets will not be required, especially when you consider the growth projections for renewable energy (40% market share by 2030). However, consideration should be given to lifting the level of offsets to between 15% to 20% with assessment of the appropriateness of this level taking place at the same time as the 2025 target review and subsequent reviews. The aim should be to ensure consumer costs are reasonably minimised while encouraging an appropriate level of domestic abatement.
- Any offsets that are to be used must be sourced from “additional” abatement activities over and above those that have already been incentivised through federal or state programs or from those activities that are occurring anyway. Consideration should be given to developing an “additionality test” to ensure consumers are not paying twice for abatement activities and that only new abatement is drawn into the Emissions Guarantee framework.

Reliability Guarantee

In previous submission to the ESB, the EUAA has raised concerns that consumers will end up with a “gold-plated supply” solution in the same way that we have a so-called gold-plated network solution if the Reliability Guarantee is not carefully managed.

Equally, the cost of inaction has recently been revealed as the Reliability and Emergency Reserve Trader (RERT) engaged by AEMO during the 2017/2018 summer cost energy users \$51 million. This has surprised and angered many large customers who, despite efforts to reduce demand and engage energy efficiency, are still required to “pay their share”. If this was repeated in future years it would largely negate a significant portion of the annual savings delivered by the NEG as envisaged by the ESB.

We are pleased to see that these concerns have been recognised by the ESB and that a robust eight step process is proposed to ensure consumers will not pay an exorbitant amount for unnecessary infrastructure. However, more work is clearly required to continue to improve processes, procedures and safeguards. We would also encourage a review process that allows the ESB to alter elements over the coming years to ensure the NEG remains fit for purpose.

We agree that the eight high level steps to the reliability requirement and make the following comments on each:

Steps 1 and 2 : Forecasting and updating the reliability requirement

As the Technical Working Paper notes, the Guarantee is dependent on the use of a well-regarded, robust and reliable forecasts. AEMO has sought to continually improve the quality of its forecasting over recent years. The proposed forecasting methodology and accountability framework will provide a significant boost to the market’s confidence that the forecasts provide an appropriate basis for identifying and measuring a reliability gap. We would particularly highlight the importance of AEMO publicly providing as much information as possible (respecting its confidentiality obligations) to enable the forecasts to be repeatable by an independent forecaster or reviewer.

We agree with the proposed governance framework for development of best practice forecasting - the AER’s best practice demand forecasting criteria, publication of supporting information and monitoring and publication of

regular forecast performance. Consideration should be given to developing a mechanism that would facilitate consumer involvement in the AER process when developing and reviewing these criteria.

We see one of the areas of greatest challenge in demand forecasting to be the impact of distributed energy resources – distributed generation, batteries and demand response. The EUAA has some reservations around the current AEMO approach to forecasting in this area.

The market is developing rapidly around how to respond to DER. Many new business models are being developed that will require a much more sophisticated approach to modelling the impact on both grid demand and grid supply. This issue has arisen most recently in the context of the SA Power Networks 2020-2025 revenue reset with the issues raised by the AER Consumer Challenge Panel.¹

The Technical Working Group paper highlights the important role that stakeholder consultation will play in developing well-regarded, robust and reliable forecasts. The EUAA looks forward to participating in this consultation through its membership of the Forecasting Reference Group.

The EUAA agrees with the proposed approach to defining the reliability gap based on the current 0.002% USE reliability standard. The key will be the level of granularity provided around the scale, timing and duration of any forecast reliability gap – as this decreases the probability of a reliability obligation being triggered and the Procurer of Last Resort safety net mechanism being triggered. We need to avoid the situation where too much longer term dispatchable generation is procured when shorter term measures to cover short duration peak demand is much lower cost to consumers.

We agree that the definition of “material” will be a difficult balancing exercise. At a general level we would prefer to see a more flexible approach to the determination of what is “material”. While a hard-wired approach may have been suitable to the electricity market of 10-20 years ago, the current emerging future market, driven by DER, requires flexibility. Again, this will be an important area for consumer involvement in determining the “materiality definition.

We agree with the proposed assessment of materiality to reflect inter-regional transfer capacity between regions.

We agree with the proposed framework for the AER’s independent review of the AEMO forecast of a material gap and triggering of the reliability gap.

We would suggest that more clarity be given around the timetable for any AER review – if the AEMO forecasting is meant to identify a material gap at T-3 years, does that mean that the AER review of the AEMO forecast will then only be complete at say T-2.75 years if the AER review takes 3 months?

We recommend that the ESB develop an indicative timetable of dates such as:

- the AER review to decide if the obligation to trigger should be exercised, has to be completed within xx days of AEMO publishing its forecast of a material gap
- AEMO publishes a further report within 6 months of the decision to trigger the obligation.

¹ AER Consumer Challenge Panel CCP14 “ [Response to the SA Power Networks \(SAPN\) approach to the challenges of the high penetration of embedded generation as part of their 2020-25 Regulatory Proposal early engagement” June 29, 2018](https://www.aer.gov.au/system/files/CCP%20subpanel%2014%20-%20Advice%20-%20Response%20to%20SAPN%27s%20approach%20to%20the%20challenges%20of%20the%20high%20penetration%20of%20embedded%20generation%20-%20June%202018.pdf)
<https://www.aer.gov.au/system/files/CCP%20subpanel%2014%20-%20Advice%20-%20Response%20to%20SAPN%27s%20approach%20to%20the%20challenges%20of%20the%20high%20penetration%20of%20embedded%20generation%20-%20June%202018.pdf>

Clarity around this timetable would assist liable parties understanding how much time they have to meet their obligations if the AER determine there is a material gap. Depending on when the AER review is completed, it may be a time period of less than 3 years.

Step 3: Triggering the reliability obligation

The EUAA appreciates the intent and efforts of the ESB and AEMO to significantly improve forecasting and to put safeguards in place such as transparent assessment of the reliability gap and independent approval before the reliability obligation is triggered. We are also supportive of the safe harbour provisions as it will allow a level of flexibility to manage compliance in a market that can be quite volatile.

In addition to the safeguards that are proposed, we suggest that a customer reference group be established to provide an additional perspective on the value of reliability and to understand the materiality of the costs, especially in the case of T-1 being triggered and potential AEMO intervention via RERT (acting as the safety net). In this case, the materiality of the gap and expected cost can be flagged well ahead of time so that liable entities and customers are better informed and able to prepare accordingly.

We would also suggest the ESB consider the following feedback from EUAA member companies that:

- Large customer sites should not trigger the Reliability Guarantee where their load does not contribute to the reliability gap (i.e. if peak demand does not coincide with the reliability gap at T-1).
- The timeframe for T-1 should be related to the quarter during which the shortfall is forecast to ensure the obligation is not triggered prematurely or for a longer period than required.
- The peak demand threshold should be based on the 12-month historical peak demand measured in the month that is relevant to the forecast reliability gap. Specifically, where a large customer has seasonal load and peaks in winter it should not incur a reliability obligation for a summer reliability gap unless it has historically exceeded the threshold in that summer month.

It will be important to allow sufficient time for market participants and liable entities to adjust to these new reliability requirements and in the case where T-3 is declared, sufficient time to organise resources, budgets, contracts and approvals. Therefore, we would encourage the ESB to ensure that, for the purpose of applying costs and imposing civil penalties, that liable entities will not be penalised for a breach of a reliability obligation any earlier than 1 January 2022 (assuming the obligation is in place by 1 January 2019).

Step 4: Liable Entities

Over the last few months the EUAA have raised concerns regarding some of the detailed design elements of the NEG, especially the Reliability Guarantee and the proposal that some large customers will be liable entities, albeit with an ability to enter into a negotiation with an energy retailer pass this obligation to them. This has been referred to as an “opt-out” provision.

A number of our member companies have expressed some concerns that, given they are not active participants in the energy market, they are ill equipped to manage this liability and that it should sit first and foremost with energy retailers to manage. They are of the view that large customers should be given the ability to “opt-in” when and if they feel able to understand and manage this potential liability.

There is also a question of the efficiency of large customers managing individual sites with maximum peak demand of 5MW as opposed to a retailer managing a large portfolio of sites and achieving efficiencies through volume and maximum peak demand smoothing effect.

At the ESB Public Forum held in Melbourne on Monday 2 July 2018, Brian Morris VP of Schneider Electric Australia provided some high-level analysis of the large customer sites in their portfolio.

Specifically, Schneider looked at the total volume of firm contracts that would be required to be purchased if large customers managed the liability themselves and compared it to the firm contracts that would be required if it was managed as a portfolio e.g. via a retailer.

The analysis showed that the sum of the total demand of the individual 36 sites was 360MW, meaning that the customers would be required to buy 360MW of firm contracts. Whereas the maximum demand of the portfolio, due to the non-coincident peaks, was 240MW. This represents a 33% efficiency by having the reliability guarantee managed by the retailer.

This analysis also indicates that the availability of firm contracts may become an issue, especially in markets dominated by one or two very large generators. While the ESB are proposing a number of measures to help counter this we remain concerned about the ability of large customers, many of whom have little if any energy market or trading expertise, to successfully manage this liability. In addition, this analysis suggests that unnecessary assets (120MW in this case) may be deployed if large customers are required to self-manage compliance, leading to an overinvestment or “gold plating” of the reliability solution.

Therefore, it is the view of the EUAA that the obligations under the Reliability Guarantee should first sit with energy retailers and that large customers should be given the opportunity to “opt-in”. It is the view of EUAA members that this would represent the free option the ESB intended to create with the original design of the scheme.

As an alternative to the “opt-in” path, consideration should be given to significantly lifting the threshold from 5MW to 200MW. The Schneider analysis shows that lifting the threshold would significantly reduce the number of large customers involved in the scheme without significantly reducing the total volume of energy captured by it (a reduction of 2% to 3%). Large customers could still “opt-in” if they wish.

Step 5: Qualifying contracts

As previously stated, the EUAA are of the view that the compliance obligation should first and foremost lie with energy retailers, with large customers given the opportunity to “opt-in”.

We agree with the ESB approach of flexibility in the description of qualifying contracts as any wholesale contract with direct links to the electricity market which a liable entity uses to reduce exposure to high spot prices. While we recognise these contracts are well known to market participants most large customers are not familiar with them and would require, at the very least, to invest time and resources to establish appropriate knowledge and systems as part of the compliance task.

In addition to the type of contracts described, we would suggest the inclusion of any internal activity undertaken by a large customer to reduce their exposure to high spot prices such as demand response. Some large customers already undertake these activities to manage peak load and spot market exposure for commercial reasons and we encourage the ESB to recognise this commercial activity as also contributing to compliance under the Reliability Guarantee.

Some members are of the view that there should not be any restriction that limits a large customers ability to contract with a retailer either before or after T-1 being triggered. Where a large customer has entered into a retail contract, it should not have a reliability obligation unless it has opted in. Where a large customer opts in and subsequently enters into a retail contract with a term that covers the reliability gap, the large customer should be able to transfer their reliability obligation to that (or any other) retailer to manage on its’ behalf.

This is a commercial negotiation and provided sufficient qualifying contracts are in place the compliance task should be considered as complete.

In previous submissions to the ESB, the EUAA have raised concerns about market power and liquidity. We were concerned that the Reliability Guarantee will further entrench the market power of large, vertically integrated participants.

We commend the ESB for listening to stakeholder concerns on this issue and welcome the proposals put forward. With this in mind we generally agree with the use of trade repositories and the establishment of the market liquidity obligation as the most viable options to ensure market liquidity and transparency.

The Market Liquidity Obligation (MLO) in particular will be very important to ensure large customers and small retailers have access to sufficient qualifying contracts, to enhance liquidity and to provide a level of price discovery that is unlikely to exist in its absence. We suggest that the MLO window should be extended to one hour to give the market time to find an appropriate level (both volume and price) and for transactions to be executed.

A number of EUAA members have suggested that daily reporting via a trade repository will improve liquidity by providing transparency and aiding in price formation. It will also strengthen the MLO by providing visibility of vertically integrated retailer internal transfers as these provide a reference for the rest of the market.

If cost is prohibitive or burdensome for smaller participants, an exemption may be appropriate for these participants. This should not detract from the value of the repository as the majority of trading should still be captured. Where an entity is required to comply with the MLO and they are left with unwanted positions, we believe that this indicates uncompetitive pricing that needs to be addressed to clear the position and that it is not a cost imposed by being required to provide liquidity under the MLO.

Many EUAA members are concerned that contracts they have entered into recently, such as Power Purchase Agreements with renewable energy generators may result in a lack of firmness in their position and trigger either non-compliance with the Reliability Guarantee or require them to incur additional costs by procuring additional contract coverage.

These contracts, negotiated in good faith over many months, should be “grandfathered” and for the purpose of the Reliability Guarantee, should be deemed as qualifying contracts. We are pleased that the ESB appear to be of a similar view, however setting the most appropriate date on which contracts qualify for grandfathering is still to be decided.

We recognise the desire to avoid market participants from “gaming” this date by rushing through contracts to meet the deadline. We suggest that up until the release of the *Draft Detailed Design Consultation Paper* on 15 June 2018 and given the strict confidentiality of the Technical Working Groups, that insufficient information was known about the NEG for participants to make an informed decision.

Given the lack of definitive information and the uncertain nature of the COAG deliberations on NEG it would be unreasonable to expect counterparties to suspend contract negotiations during this time.

It is also highly doubtful that a contract negotiation could commence and conclude given the very short timeframe between 15 June and the August COAG Energy Ministers Meeting, which mitigates the ability of counterparties to take advantage of the grandfathering provision.

Therefore, we would suggest that all contracts finalised before the August COAG Energy Ministers Meeting should qualify for grandfathering, provided that the NEG is approved by all state and territory ministers at that meeting.

If not approved, it would be unreasonable to expect counterparties to suspend complex negotiations while they wait for a political outcome.

We are very supportive of the proposal for AEMO to conduct a voluntary book build process on triggering T-3. Further, if the objective is to ensure T-3 is never triggered, consideration should be given to AEMO running this book build process regardless of an obligation being triggered as this will assist with transparency and price discovery.

There have been some comments made that, with the inclusion of the market liquidity obligation, that the book build is not required. We reject this suggestion. Any and all efforts should be made to improve transparency and market liquidity, especially given that most large customers are concerned about the availability of contracts and the means by which they can self-manage a reliability obligation.

We support allowing demand response to play a role in meeting the reliability guarantee recognising there are process underway to remove barriers to greater, direct customer participation in demand response. Our concern is that while demand response could play an important role, without market reform such as day ahead markets and removal of other barriers, it will remain at the fringes of the market.

Step 6: Procurer of last resort

The 2017/2018 summer RERT activation by AEMO is a salutary lesson for all market participants that without a more structured approach to the transformation of energy markets we should expect not only more direct intervention but more costly intervention as well. We should be wary of an approach that is dominated by a reliability at all cost attitude, driven by technical solutions that do not balance consumer cost outcomes. While well intentioned, this could ultimately result in a gold-plated reliability solution that locks customers into ever increasing costs that negate any savings that the NEG may strive to deliver.

While we recognise AEMO should be primarily responsible for system reliability and therefore should have the role of procurer of last resort, significant improvement to RERT is required. As a minimum we would encourage greater transparency about the size of the gap to be met, sufficient notification of when RERT is going to be triggered and the likely cost.

The AEMO run book build will also provide AEMO with greater insight into the availability of resources, which, along with significantly enhanced forecasting tools should help improve the RERT process to deliver a more cost-effective outcome in the future.

The Reliability Guarantee begins to move the market to a “causer pays” system for reliability, which is generally supported by the EUAA. Conversely, it should not penalise those that are not contributing to a future reliability gap, including where RERT is activated. Therefore, the EUAA supports both of the following member suggestions and encourage the ESB to consider incorporating these into the Reliability Guarantee framework.

- In response to both the Reliability Guarantee and RERT, some members are of the view that large customer sites should not trigger the Reliability Guarantee or incur costs under RERT where their load does not contribute to the reliability gap (i.e. if peak demand does not coincide with the reliability gap at T-1).
- Some members are also of the view that the peak demand threshold should be based on the 12-month historical peak demand measured in the month that is relevant to the forecast reliability gap. Specifically, where a large customer has seasonal load and peaks in winter it should not incur a reliability obligation or RERT cost for a summer reliability gap unless it has historically exceeded the threshold in that summer month.

Step 7: Compliance

Contributing to system reliability is a foreign activity for large customers and it would be unrealistic to expect that, even where best endeavours have been undertaken, non-compliance will occur.

Therefore, while we are in general agreement with what has been proposed we would suggest that large customers are:

- Provided with an opportunity to “make good” by demonstrating future compliance will be maintained in the case where a genuine error or inadvertent miscalculation has occurred.
- Afforded an opportunity to demonstrate “exceptional circumstances” existed that were outside of their control such as counterparty default resulting in non-delivery of firm contracts (aggregated demand response or small dispatchable generation).

Step 8: Penalties

We are in general agreement with the proposed penalty regime. All efforts must be made to ensure any penalty incurred by a retailer can't be passed through to customers.

Assisting Large Customers with the NEG

We are of the view that large customers must become more knowledgeable of the NEG (and energy markets in general) regardless of whether they are a liability under the Reliability Guarantee or Emission Guarantee or not.

The EUAA are committed to working with large customers to improve their understanding of energy markets and encourage them to play a role in ensuring system reliability, as it is in their best interests to do so.

With time and more information, we believe that many energy users will choose to “opt in” and actively manage their liabilities under the NEG or better still to play a proactive role to ensure system reliability is always maintained.

Ultimately, our goal should not be to comply with the Reliability Guarantee, our goal should be to ensure it is never triggered in the first place.

With this in mind we suggest that the ESB utilise the collective knowledge and resources of our peak regulatory and market bodies (AER, AEMC and AEMO) and consider developing an information and market education package directed at large customers with the objective of making them more “market ready” and therefore better able to participate more fully in the NEG and energy market in general.

The EUAA would welcome the opportunity to play a leading role in both developing and delivering this market education package.

Demand Response

The EUAA is pleased to see broad commit to the development of the NEG in concert with the development of a demand response mechanism for the wholesale electricity market to ensure that any demand response products developed also qualify for compliance. We agree with the ESB that demand response can deliver both benefits to the broader energy market and reward customers for their participation.

The EUAA has found that all too often the conversation is about building more supply side assets to solve our problems when we should be balancing this with the avoided cost benefit of greater consumer control and flexibility. We simply have to stop spending billions of dollars to meet demand for 5 days per year. We also have to stop the ability of retailers preventing the spread of demand response that threatens their control over the market.

A number of our members are engaged in demand response, but they are limited (apart from the 2017/18 AEMO RERT auction) in doing more through their retailer which sets the conditions. Consumers need to have greater access to receive competing offers for wholesale demand response. This should build on the recent experience on of the rule change that unbundled ancillary services to bring new players in the FCAS market which has led to a significant drop in FCAS prices.

Demand response should have the same freedom to bid into the market as a peaking generator. We look forward to the current AEMC Reliability Frameworks Review to bring forward the required changes and urge the ESB to support rule changes that deliver a customer first demand response mechanism.

The EUAA strongly supports retailers being able to buy dispatchable demand response contracts from independent aggregators to satisfy the reliability requirement. Parties should have the ability to aggregate this demand response from any electricity consumer in the NEM, independently of that user's retailer.

We also believe that the development of a day ahead market could also facilitate greater demand response and approaches to this, that are already active in other markets, should be seriously considered.

If we are able to achieve a stable, customer focussed demand response framework it will increase the likelihood of greater consumer investment in technology, systems and skills. This in turn could unlock significant consumer participation in demand response and potentially avoid billions of dollars in supply side and network investment while helping customers off-set higher energy costs.

Over the coming weeks and months, the EUAA will continue to engage with member companies on the details of the NEG as they are further refined. We would also like to acknowledge the stakeholder engagement of the ESB, especially given the complexity involved and time constraints imposed.

We look forward to our continuing discussions.



Andrew Richards

CEO

13 July, 2018