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## EnergyAustralia Response to National Electricity Rules Amendments – Retailer Reliability Obligation

EnergyAustralia provides gas and electricity to 2.6 million household and business accounts across the National Electricity Market (NEM) with a diverse generation portfolio of coal, gas and renewable energy.

We welcome the opportunity to comment on the Energy Security Board's (ESB) draft National Electricity Rules (NER) for the Retailer Reliability Obligation (RRO) consultation and thank the ESB for the work done to date and consultative approach adopted. This consultation is the first opportunity that industry has had to gain a clear understanding of the full details of the RRO. While we believe that it is an overall improvement on previous designs, we see that there are still significant challenges in ensuring that the RRO is workable for the market and customers, particularly given the desired 1 July 2019 start date.

The implementation of the RRO comes at a time of significant regulatory and policy reform occurring in both the retail and wholesale energy markets. The compressed timeframe for implementation is challenging for all participants and there needs to be some recognition that 'teething' issues may occur. The AER and AEMO are tasked with developing the reliability forecasts and several important guideline documents under the draft rules, for example the contract firmness guidelines, with the obligation start date coming well before these details have been finalised. This creates further uncertainty and challenges across the market and we encourage the AER and ESB to maintain its collaborative consultation approach, even after the rules and RRO commence.

EnergyAustralia suggests that the ESB considers the interaction of the RRO with other regulatory changes that are occurring, both at a jurisdictional and national level, such as the Victorian Default Offer (VDO)[1] and the AEMC's Co-Ordination of Generation and Transmission Investment (COGATI)[2]. We see inconsistencies and implementation

[1] https://www.esc.vic.gov.au/electricity-and-gas/inquiries-studies-and-reviews/electricity-and-gas-retail-markets-review-implementation-2018/electricity-and-gas-retail-markets-review-implementation-2018-victorian-default-offer
[2] https://www.aemc.gov.au/market-reviews-advice/coordination-generation-and-transmission-investment-implementation-access-and

challenges between these reforms and note that changes to retail and wholesale markets should be enduring and drive harmonised outcomes in the interest of consumers.

We look forward to further open consultation between industry and regulatory bodies to ensure the RRO has every chance of achieving its aims.

For further information on any issues raised in this submission, please contact Andrew Godfrey on 03 8628 1630 or Andrew.Godfrey@energyaustralia.com.au.

Regards

**Sarah Ogilvie**
Industry Regulations Leader

## EnergyAustralia – Further comments on the RRO draft rules

### 1. Interaction with other regulatory and policy changes

EnergyAustralia sees a number of inconsistencies and implementation challenges between reforms currently being progressed at both a national and jurisdictional level and we encourage the ESB to consider these issues in more detail. For example, in Victoria the Essential Services Commission's (ESC) proposed approach when assessing wholesale market costs for its VDO assumes that retailers progressively hedge their load right up until the start of the quarter. This appears to contradict the draft rules of the RRO which requires retailers and liable loads to have hedged to their one-in-two-year demand by one year before the forecast gap period.

The AEMC is also currently considering changes to transmission access and charging, including moving the NEM to dynamic nodal pricing. This reform is likely to create challenges and uncertainty for the financial contract markets depending on the final design of the changes. For example, depending on generators risk appetite they may only be comfortable selling hedging contracts at their local nodal price, therefore reducing the availability of contracts at the regional node. This is likely to create challenges in the availability of contracts for the RRO and market in general and raises further questions around the operation of the Market Liquidity Obligation (MLO).

We would also encourage the ESB to consider the impact of likely transmission developments and their impact on the changing generation mix. For example, the market benefits of ElectraNet's Project EnergyConnect interconnector between South Australia and New South Wales relies on the closure of local dispatchable generation in South Australia[3]. The closure of local generation is likely to create contracting challenges in South Australia as these generators are the natural sellers of these contracts. This not only makes the state more reliant on hedging products across interconnectors, but it also appears contrary to the policy intent of the RRO to incentives new or ongoing investment in dispatchable capacity.

Regulatory and policy changes need to drive harmonised outcomes in the interest of consumers across retail and wholesale markets.

### 2. South Australian additional powers under the Legislation

Under the final Legislation that is progressing through the South Australian Parliament the South Australian Minister still has the power to call a T-3 instrument with only 15 months notice[4]. The Minister is able to use these powers for a reliability gap before 1 July 2022[5]. We are concerned about the interaction and inconsistency between the draft rules being progressed by the ESB and the additional South Australian ministerial powers and urge the ESB to work closely with the South Australian Government to ensure the rules are workable with any additional power under the Legislation.

Triggering a T-3 (and hence a likely T-1) in the South Australian region with only 3 months-notice creates significant challenges in meeting potential RRO obligations in such

[3] https://www.electranet.com.au/wp-content/uploads/projects/2016/11/SA-Energy-Transformation-PACR.pdf
[4] 19B(8), National Electricity (South Australia) (Retailer 5 Reliability Obligation) Amendment Act 2019.
[5] 19B(9), National Electricity (South Australia) (Retailer 5 Reliability Obligation) Amendment Act 2019.

a short period. This will impact not only retailers but also customers who will be required to contract before the T-1 Net Contract Position (NCP) day. This also creates challenges for any Market Liquidity Obligation (MLO) that is envisaged to operate in such a short time period given obligated parties are likely to have limited contracts still available to offer.

We understand that the South Australian Government is currently developing a number of regulations that would overwrite the draft rules to provide for the additional powers. It is imperative that stakeholders are provided with a clear understanding how the South Australian Ministers additional powers interact with the RRO mechanism and timeline. We would encourage the South Australian Government to consult with participants before finalising any additional regulations.

There appears to be limited need for these additional powers as AEMO still retains its ability to contract under the RERT mechanism[6]. This allows AEMO to procure reserves at approximately T-1 to fill any potential reliability gaps that may arise.

## 3. Forecasting the reliability requirement

It was initially envisaged that the AER would review AEMO's forecasts and gap instrument decisions in detail in a full merits-style review. While we recognise that AEMO is best placed and skilled to complete the reliability forecasts we remain concerned about the lack of independent detailed assessment of forecasts. Given the compliance impact on participants of an RRO instrument being made it will be important that forecasts and reliability instruments do not become pressured or political and are independently reviewed.

EnergyAustralia recognises the challenges that AEMO is facing to develop the reliability forecasts and welcome further consultation and stakeholder engagement on this process. We note that the forecasting requirements on AEMO represent a shift in AEMO's role from forecasting as information provisions, to forecasting as a regulatory tool. Given this, it will be imperative that AEMO commits to a transparent, comprehensive and robust consultation process and the rules allow sufficient overview from the AER. To this end, AEMO should provide stakeholders with all data from their Electricity Statement of Opportunity (ESOO) including non-commercially sensitive input assumptions and the half-hourly results and outputs of their modelling. This will allow both the AER and stakeholders to review AEMO's assessment of the gap periods and trading intervals proposed in the reliability instrument. This will assist in the AER conducting consultation on the reliability instrument.

While the AER has been tasked with developing Forecasting Best Practice Guidelines[7] which informs AEMO's ESOO forecasting we see that it is important for the AER to also have oversight on the inputs and assumptions that AEMO uses in creating these forecasts. The AER could have a role under the NER to formally sign off that sufficient consultation has been completed when developing inputs for AEMO's forecasting processes[8]. This would give participant additional confidence in the ESOO forecasting process.

[6] AEMO RERT procurement timeframe likely to be extended to 1 year.
[7] Draft Rules, 4A.B.5
[8] This could include independent consultants reviewing AEMO's assumptions and methodology.

As previously suggested EnergyAustralia sees that there could still be a role for the Reliability Panel to be consulted before a reliability instrument is made by the AER given their established role and expertise in the area[9]. At a minimum the Reliability Panel should still continue to take the lead on any changes to the reliability standards and settings that may impact the level of USE needed to trigger a reliability gap.

We note that the AER is not required to finalise their Forecasting Best Practice Guidelines till the 30th of November 2020 with AEMO having until the end of February 2021 to finalise their Reliability Forecast Guidelines[10]. Given that the intent of these guidelines is to provide confidence to participants in AEMOs reliability forecasts and these forecasts are regulatory tools, we see that it is imperative that these are implemented as soon as possible after the RRO is imposed on the market. Both the AER and AEMO should be required to finalise these guidelines to allow for any changes to be used in the ESOO process for the 2020 version.

The operational demand forecast produced by AEMO will now be a critical input into driving USE outcomes from the ESOO and subsequently the potential ROO obligation that will be triggered by this. Operational demand will also be a key driver for participants to understand their contracting requirements for a forecast one-in-two-demand as well as their liability once actual demand has been adjusted using AEMO's scaling factor. Given this we encourage AEMO to be absolutely clear on their definition of operational demand and any changes that may occur to the definition around unit exemptions[11].

The ESB has indicated that it is their intention that the gap period and gap trading intervals in a T-1 instrument can only be the same or shrink from what was specified in a T-3 instrument, we support this. The drafting of clause 4A.C.4(a)(3) is ambiguous and to EnergyAustralia it is not absolutely clear that the rules are drafted to reflect the ESB's intentions. We suggest that the term "within the same periods" be replaced with "within the same gap trading intervals" in 4A.C.4(a)(3) to make the rules absolutely clear.

EnergyAustralia continues to support the intent of the Generator Closure Notice rule to promote a reliable market by providing clear investment signals about future generation requirements. To this end, we are not against the extension of the Generator Closure Notice period to 3 and a half years. However, implementation of the rules needs to reflect the commercial realities of plant operations, the wholesale market and the changing nature of government policies and regulations. We note that the AER is currently also consulting on the Generator Closure Notice guidelines[12].

The RRO is one mechanism among several current and potential market changes that must deliver a secure and reliable power system to address challenges around frequency, system strength, voltage control and the number of market interventions occurring. AEMO's ongoing forecasting work including the ESOO and Integrated System

[9] EnergyAustralia submissions to final detailed design of the NEG, page 11, http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/EnergyAustralia%20Consultation%20Paper.pdf

[10] Draft rules 11.115.3 and 11.115.4

[11] http://www.aemo.com.au/-/media/Files/Electricity/NEM/Security_and_Reliability/Dispatch/Policy_and_Process/Demand-terms-in-EMMS-Data-Model.pdf

[12] https://www.aer.gov.au/wholesale-markets/market-guidelines-reviews/generator-notice-of-closure-exemption-guideline

Plan (ISP) should be capable of integrating any future market changes to address these issues.

## 4. Liable entities and opt-in requirements

We consider that the threshold for opt in customers is too low. As highlighted by the ESB this could theoretically result in over 80,000 customers being eligible to opt in. The opt-in threshold should be changed to a sophistication test at an entity level. For example, we consider that it would be more appropriate that an entity should only be allowed to opt-in to manage their own RRO if they meet one or more of the "wholesale client" tests under an Australian Financial Services License (AFSL) predominantly found in section 761G(7) of the Corporations Act 2001 (Cth). The RRO is a significant compliance obligation and a sophistication test would better balance potential administration requirements on the AER while ensuring the hurdle to apply to opt in is sufficiently high enough.

We also consider it important for the ESB to understand the risks that the RRO could present to customers around ensuring they contract before T-1. The closer to a T-1 the more challenging it will be for customers to obtain competitive contracting arrangements as the market finalises their NCP and AEMO potentially is also in the market looking to negotiate RERT contracts. Further the ESB needs to be aware of the risks facing customers who fail to contract by T-1 or their contract ends within T-1 to T and they have yet to sign a new contract. The mechanics of the RRO mean it will be challenging for customers who seek to hedge after T-1 for a gap period due to the limited ability under the rules for retailers to resubmit their NCP to the AER within this period.

We consider that the threshold to adjust your NCP after T-1 for mass market or small customers is to high (15%) and could result in impacts to mass market retail competition between T-1 and T when the RRO binds. The ESB should seek to minimise this cost by setting a lower threshold to adjust NCP for mass market and small customers. A threshold of 5% should balance this risk with potential additional administrative burden on the AER.

The extension of the opt-in cut-off date to 6 months before T-1 should give retailers sufficient clarity around large customers that they will be responsible for when determining their share of one-in-two demand.

## 5. Market Liquidity Obligation

We consider that there continues to be no justification for any compulsory market making obligation in the NEM as it enjoys fairly high levels of liquidity in all regions, with the exception of South Australia which faces a number of structural issues inhibiting greater liquidity[13]. Further, the existence of the Market Liquidity Obligation (MLO) will be a disincentive on larger customers to change their current behaviour as they will always know that the liquidity obligation can be relied upon when the market has hit an investment shortfall - potentially decreasing the incentive for new supply. The MLO could therefore act against the intent of the guarantee.

[13] For more detail see page 3, EnergyAustralia's submission to the AEMC market making consultation, https://www.aemc.gov.au/sites/default/files/2019-02/Rule%20Change%20SubmissionERC0249%20-%20Energy%20Australia%20-%2020190207.pdf

If the ESB still considers that an MLO is required, then EnergyAustralia considers that the MLO should only be used as a backstop if no other formalised market making arrangement is currently operating in a region between T-3 to T-1. An example of formalised market making arrangements could be the ASX's market making incentive scheme that is expected to be in operation by mid-2019[14], or the tender for market making responsibilities currently being considered by the AEMC in their rule change consultation process[15]. We understand that the ASX arrangement broadly aligns with the requirements under the MLO and that the ASX is likely to have multiple market makers in each region, including South Australia.

The ESB has some concerns around monitoring the compliance of obligated parties under alternative arrangements, though these concerns exist for the MLO as well. We encourage the AER to be clear in their MLO guidelines their expectations around compliance of obligated parties.

The draft rules stipulate that an entity will be obligated under the MLO if they have control over at least 15% of scheduled registered capacity in a region that a T-3 reliability instrument has been made. We would question if testing MLO requirement using registered capacity of scheduled units only in a region is enduring given the likely future change in NEM generation mix? EnergyAustralia understands that previously the ESB intended to use semi-scheduled and scheduled generation as a test for the MLO and we consider this is still a more enduring solution.

It is not clear how the rules are intended to apply to batteries and other storage technologies which AEMO requires to be registered as both a Market Generator and Market Customer. If the ESB decides under the final rules to continue using scheduled generation as the test for the MLO then it is our view that for similar reasons to excluding variable renewable generation (inability to support sold swap or cap position) that developing technologies, such as batteries, should be excluded from the MLO at this point. We would also suggest that that these bi-directional resources should be treated as generators only and should not be included in a liable entity's load for compliance as it is unlikely to be charging across peak periods. AEMO is currently considering an additional class of participant to capture bi-directional resources and it is also unclear how these would be captured under the current rules[16].

We do not support the bid/offer spreads that are proposed in the draft rules. It was EnergyAustralia's understanding that a bid/offer spread of 5% for MLO products (flat base load, peak load contracts) and 10% spread for cap contracts with a minimum of $1/MW had been previously agreed between participants and the ESB. We would encourage the ESB to provide further information to stakeholders around the nature of this change.

EnergyAustralia considers that MLO products should also include financial and calendar year contracts. Including these products would likely improve the reliability of the NEM as it encourages generation to be available to the market across a longer period (not just the gap period) while also allowing peaking plant to recover their fixed costs over a longer period. Only allowing monthly or quarterly products does not align with the

[14] https://www.asxenergy.com.au/newsroom/industry_news/market-making-expressions-of-
[15] https://www.aemc.gov.au/rule-changes/market-making-arrangements-nem
[16] https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Initiatives/Emerging-Generation-and-Energy-Storage-in-the-NEM---Grid-Scale

intended aim of the RRO to provide certainty to suppliers to invest in new or existing plant.

We also suggest that the ESB review the required number of sessions that MLO parties are required to place bids/offers as 35 sessions per month may be unattainable due to non-trading days. A solution may be to move compliance to ensuring that an obligated party places bids/offers for >50% of sessions for December and January[17], and >75% of sessions for all other months, for example. Alternatively lowering the number of sessions required to 30 per month except December and January where only 20 sessions are required would also be an option.

The assessment of obligated parties should be based off scheduled registered capacity at the time of a gap, not at the time that the T-3 instrument is made. This would avoid the risk that an obligated parties' generation closes between T-1 and T (for example) and therefore is unavailable in the gap period. Yet, that party is still forced to sell contracts under the MLO obligation regardless of their ability to defend the sold position. This is likely to be an unmanageable risk for parties.

## 6. Firmness and qualifying contracts

While we support the rules providing only high-level guidance on firmness and qualifying contracts we remain concerned about the lack of detail still available to stakeholders around this. The draft Rules provide that the AER must finalise an interim Contracts and Firmness Guideline by the end of August. The potential for a T-3 (and subsequent T-1) to be called by the South Australian Minister as soon as the RRO starts (from 1 July 2019) could mean that liable entities still have very limited visibility of what may be classified as a qualifying contract. We would encourage both the ESB and the South Australian Government to consider the significant challenges this poses to the market and liable entities.

We understand that the Contract and Firmness Guidelines will set out a range of default methodologies for determining the firmness factors of standard contracts[18]. Further, bespoke firmness methodologies will be allowed to be used provided these have been previously approved by the AER and then audited before submission to the AER to ensure the approved methodology has been applied. EnergyAustralia is supportive of allowing bespoke methodologies to calculate contract firmness as this will allow parties to utilise a range of products to meet their obligation. The over prescription of firmness methodologies or factors could result in market distortion on different products used to manage financial risk, forcing participants to use higher cost alternatives. Any firmness factor needs to be applied to both buys and sells consistently.

The alternative solution that the ESB is proposing where entities can engage a pre-approved auditor appears to have merit. This would allow entities to use additional new contracts, without having to get their bespoke methodology re approved by the AER, allowing the approved auditor to work with the entity during contract negotiations to ensure the product satisfies the requirements for a qualifying contract.

## 7. Net Contract Position

[17] Due to holiday periods.
[18] Draft rules 4A.E.(1),(2),(3)

It will be beneficial if the AER can provide clear guidance as to what is required to be submitted to the AER for an entities NCP, for example the AER could provide a template (along with examples) to ensure obligated parties clearly understand their requirements.

For the AER to assess compliance AEMO will scale a liable entities actual demand on a day back to a forecast one-in-two-year demand using a single scaling factor. While a single scaling factor is easier to administer for AEMO we consider that it will advantage liable entities that have a higher share of load that does not 'flex'. That is, load that is not highly sensitive to high temperatures, for example commercial and industrial load. EnergyAustralia considers that separate scaling factors should be applied to the different classes of load to ensure that liable entities are treated fairly, regardless of their portfolio make up.

As highlighted in our submission to the AEMC draft determination for the Enhanced RERT we have some concerns around RERT interaction with the RRO[19]. At the same time as retailers are finalising their contract positions under the RRO AEMO will also likely be in the market tendering for RERT contracts. This could potentially create a supply squeeze and increase contract prices. The draft rules for the enhanced RERT do not prevent AEMO from negotiating with potential tenders in relation to RERT contracts at any time, the rules only stipulate that AEMO cannot enter into these contracts more than 12 months prior to the period.

## 8. Ongoing review of obligation

We suggest that there should be an ongoing review of the RRO reforms to ensure that it remains fit for purpose, for example every 2 years, this could be completed by the AEMC. There should also be a formal requirement for all AEMO and AER guidelines to be reviewed utilising a consultation process at this time as well.

[19] https://www.aemc.gov.au/sites/default/files/2019-03/Energy%20Australia_0.pdf