



Energy Security Board Contracts Technical Working Group

Procurer of Last Resort – Reliability Requirement

Issues Paper

Introduction

The purpose of this paper is to facilitate discussions with Jurisdictions and the Technical Working Group (TWG) on how the Procurer of Last Resort function should operate. Following the Senior Committee of Officials (SCO) Reference Group and TWG meetings, a more detailed technical working paper will be developed. The technical working papers and draft final design document will be available for public consultation in mid-June.

High level design

- If a gap in reserves persists **three years** out from the **period** in which it was forecast in the Australian Energy Market Operator's (AEMO) Electricity Statement of Opportunities (ESoO), and is confirmed by both AEMO and the independent entity responsible for reviewing its supply adequacy forecast, the reliability requirement is triggered. Liable entities may then be expected to demonstrate future compliance with the requirement by securing sufficient qualifying contracts to cover their share of system peak demand.
- If the market response has been insufficient and the gap persists **one year out**, AEMO would procure the necessary resources through its '**Procurer of Last Resort**' function. Resources procured through the Procurer of Last Resort would be held out-of-market, consistent with the current Reliability and Emergency Reserve Trader (RERT).
- **Cost recovery** of resources procured through the Procurer of Last Resort would be based upon the actual peak demand which eventuates and the degree to which liable parties (retailers and large users) have complied with their obligations.
- If, at any time, AEMO and/or a relevant state government feels that specific circumstances in a particular jurisdiction dictate that prudent action is required to ensure the ongoing reliability of the electricity system, then either AEMO and/or a relevant state government can make a rule change request that could be processed via a six week, expedited, process. The rule change could enable AEMO to commence its Procurer of Last Resort function **earlier than one year** before the forecast reliability gap given the extenuating circumstances in that jurisdiction at that time.

The Procurer of Last Resort is an important 'safety net' in the event that the market fails to deliver adequate resources to meet the reliability standard. This situation might arise if there are sudden changes in market or economic conditions or substantive errors in forecast supply and demand. Consistent with the RERT, the Procurer of Last Resort's focus on out-of-market resources is intended to minimise wholesale market distortions (e.g. bidding behaviours and/or weakened price signals for investment in new capacity) which lead to less efficient / higher cost price outcomes.

The design of the Procurer of Last Resort will need to be determined in conjunction with rule change requests submitted by AEMO to extend and enhance the existing RERT mechanism respectively. A determination on the rule change request to reinstate long-notice RERT is due early June 2018. The rule change request for an enhanced RERT will be initiated by the Australian Energy Market Commission (AEMC) in June 2018.

Detailed design elements for TWG input

1. The interaction between the Procurer of Last Resort function and existing and proposed RERT arrangements.
2. Whether an independent entity is responsible for reviewing decisions by AEMO to exercise the Procurer of Last Resort one year out from a forecast gap.
3. How competition between AEMO and liable entities for the same resources can be avoided.

Issues for discussion

1. How does the Procurer of Last Resort interact with existing and proposed RERT arrangements?

Currently, AEMO is only able to procure resources up to 10 weeks ahead of a forecast capacity gap. It has put forward a rule change request to extend the window for procurement of resources to 9 months (a re-instatement of the 'long notice' RERT which was in place until November 2017), along with a rule change request for an 'enhanced RERT' or 'strategic reserve' which would standardise the types of RERT contracts and consider the appropriate procurement lead time for RERT, including allowing for multi-year procurement where this is more economic.

The main differences between these current and proposed arrangements and the features of the Procurer of Last Resort outlined in the Energy Security Board's (ESB's) high level design document are:

- The trigger decision for the Procurer of Last Resort occurs one year ahead of a forecast gap. This contrasts with the current allowed lead-time of up to 10 weeks ahead and the proposed lead-time of 9 months ahead.
- The trigger decision for the Procurer of Last Resort is linked to whether there is a 'material' capacity gap, whereas the trigger for the RERT is less prescriptive and based on guidelines set by the AEMC Reliability Panel.
- The cost recovery for the RERT involves 'socialising' costs across all market customers in the relevant region. The Procurer of Last Resort is expected to recover costs in the same way if demand is less than a threshold (the P₅₀ demand forecast at the point the Procurer of Last Resort is triggered). But if demand is above the threshold, costs would be recovered based on the degree to which liable entities complied with their contracting obligation under the Guarantee.

The detailed design of the Guarantee will need to establish what 'fit-for-purpose' arrangements, beyond those currently in place or contemplated for the RERT in rule change requests before the AEMC, are required for the Procurer of Last Resort to effectively intersect with other elements of the Guarantee. Key considerations are: the timing of its introduction; the basis on which 'trigger' decisions are made; what trade-offs should be established between availability payments and usage charges; to what extent multiple year procurement can operate with a one year trigger compliance timeframe for the Reliability Requirement; and the cost recovery mechanism, including the incentives provided to market participants to invest in capacity to address any forecast gap.

For example, both the Procurer of Last Resort and the proposed Enhanced RERT would support capital investment; that is, upfront investment in capacity to ensure the reliability standard is met. The structure of contracts entered into by AEMO and the trade-offs between the payments made to capacity providers to 'be available' versus deployed (i.e. usage charges and activation payments) are more critical. Similarly, multiple year procurement through the Procurer of Last Resort may have implications for the determination of liable entities' contracting obligations under the Guarantee - i.e. the rules around multiple year procurement and the timing and process for allocating costs in this scenario (including whether there is scope to release contracted parties if supply-demand conditions improve) – will need to

be determined. These issues are also being looked at under the **Compliance and Penalties** work-stream.

Questions for the TWG:

- Are there any specific constraints that should be applied to the Procurer of Last Resort to support its role under the Reliability Requirement of the Guarantee?
- Should there be constraints on the scale and duration of contracts with resources procured through the Procurer of Last Resort?
- What information reporting requirements from the exercise of the Procurer of Last Resort and related contracts should be required?

2. Should AEMO's decision to trigger the Procurer of Last Resort be subject to independent review?

AEMO's decisions to exercise the RERT are not currently subject to external review. Decisions to exercise the Procurer of Last Resort function could be made on the same basis or the independent body responsible for assessing any recommendation to 'trigger the reliability mechanism' could also have the final say on any decision to exercise the Procurer of Last Resort.

An independent check on AEMO's decision to exercise the Procurer of Last Resort would provide liable parties (and consumers) with additional confidence that cost/reliability trade-offs have been adequately considered.

But independent review may reduce AEMO's flexibility and lead to delays in resolving a pressing issue.

Questions for the TWG:

- Should the decision to activate the Procurer of Last Resort be subject to independent review and if so by whom?

3. How should competition between AEMO and liable entities for the same resources be avoided?

If there is a need for AEMO to procure RERT resources, it is likely to coincide with expectations of high prices, and retailers will be seeking ways of managing their pool exposure through demand response and other means. The RERT addresses the potential for competition by excluding any resources that are already available to the market from consideration. The challenge is that the payments under the RERT may be more certain and potentially higher than the payments available from the spot or contract markets. Non-scheduled demand response is also difficult to quantify and there is always a risk of 'double dipping' between retailers and AEMO.

The Guarantee aims to deal with these issues by requiring retailers (and other liable entities) to submit their contract positions to the Australian Energy Regulator (AER) at the same time that AEMO exercises the Procurer of Last Resort. The intention is that resources that have been contracted by retailers would be counted towards their compliance obligations and so would be unavailable for AEMO to procure under the Procurer of Last Resort. The timing and nature of information provided to relevant bodies one year ahead of a forecast gap and exercise of the Procurer of Last Resort will need to be designed to support this.

Questions for the TWG:

- Does the requirement for liable parties to submit their contracts to the AER one year out from a forecast gap (i.e. in parallel to a decision by AEMO to exercise the Procurer of Last Resort) adequately address the risk of AEMO and liable entities attempting to procure the same resources?
- Is there potential for unintended consequences? For example, AEMO not having access to adequate resources, such as demand response.

Interdependencies with other elements of the Guarantee

- Forecasting methodology and assessment of material gap
- Independent trigger
- Demand response
- Compliance and Penalties