



COAG  
Energy Council

**ENERGY SECURITY BOARD**  
**National Energy Guarantee**  
**Reliability Requirement**  
**Pre-condition Options**

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## 1 Reliability requirement pre-condition options

At the request of the Council of Australian Governments Energy Council (Energy Council), the Energy Security Board has developed alternative policy options for activating the reliability obligation. These options have been developed in response to concerns raised by Ministers at the 10 August 2018 Energy Council meeting that a reliability gap could emerge at any time across the 10 year forecast period. Stakeholders are encouraged to make written submissions on the options presented in this paper. Submissions should be sent to [info@esb.org.au](mailto:info@esb.org.au) by 5 September 2018.

This paper outlines alternative pre-conditions for activating the reliability obligation under the National Energy Guarantee. The alternative options are being presented for stakeholder consideration and feedback during the consultation period for the amendments to the National Electricity Law. This paper should be read in conjunction with the [Final Detailed Design](#) of the National Energy Guarantee.

In the Final Detailed Design, a pre-condition to the reliability obligation being activated is that the AER must make a determination three years out (T-3) that a reliability gap forecast by AEMO is 'material'. The AER must make another determination one year out (T-1) that the forecast material gap remains, which then requires liable entities to submit their net contract positions to the AER. The T-3 and T-1 determinations are referred to as reliability instruments in the draft Bill. The intent of the T-3 determination is to give liable entities notice that the obligation will be activated if the material gap is not closed and to give adequate time to bring forward new capacity to the market. What amounts to a material gap will be determined in the Rules.

The draft amendments to the National Electricity Law to give effect to the Final Detailed Design of the National Energy Guarantee also allow the National Electricity Rules to provide for circumstances when liable entities would be obliged to submit their contract position at T-1 without a T-3 determination being required. The inclusion of this provision is to address the concerns of Energy Council that a material reliability gap could emerge at any time across the 10-year forecast period. Alternative options to address this concern are presented below.

The first alternative considers the addition of a five years ahead (T-5) determination of a material reliability gap, responding to concerns that industry may need more than three years to respond to a forecast gap. It is important to bear in mind that industry would be given notice of forecast reliability gaps through AEMO's annual forecasting process, which extends over a 10 year timeframe. Industry would therefore have up to seven years prior to the T-3 determination to respond to any forecast reliability gap.

The second option proposes removing the T-3 determination, such that liable entities will be expected to monitor AEMO's Electricity Statement of Opportunities (ESOO) forecasts and manage their contract positions in the event that a T-1 reliability instrument is made. Should stakeholders not support this second option, it has been suggested that a transitional measure could be created to allow a jurisdiction's Minister to activate the reliability obligation in their region at their discretion. This option is therefore also included for consultation.

The forecasting process would be expected to remain unchanged for all of the options presented below, as this is an integral element of the overall reliability requirement. AEMO would continue to forecast whether the reliability standard is likely to be met through the ESOO in each

NEM-region over a 10-year outlook. If it is forecast that the reliability standard may not be met under an objective metric of materiality, AEMO will identify the size of any gap.

Under the current proposed design, to support liable entities to make informed decisions, additional descriptive information will be provided to give further context to AEMO's forecasts including:

- an indication of the additional capacity required to close the gap
- the pipeline of potential generation projects over the forecast period, along with progress of their development, and
- likely time of occurrence of the shortfall, such as month and time of day.

To provide confidence to market participants in the quality of the ESOO forecast, AEMO will also be required to assess its forecasting process against AER best practice guidelines.

Under the options presented below (except the Ministerial power to activate at any point), the AER would retain the discretion to not activate the requirement for liable entities to submit their contract positions to the AER at T-1, even if the materiality metric is met objectively, having regard to matters set out in the Rules. The materiality test for the reliability gap is to be set in the Rules.

The approach to qualifying contracts, liable entities, compliance, procurer of last resort and penalties would also remain unchanged from that outlined in the Final Detailed Design paper. However, there would be some changes to the Market Liquidity Obligation and voluntary book-build under the options as detailed below.

## **2 Addition of a T-5 determination**

Under this option AEMO could request a T-5 determination, as well as a T-3 determination, if there is a forecast material gap in reliability. A T-1 reliability instrument, which would require liable entities to hand over their contract positions to the AER at T-1, would require either a T-5 determination or a T-3 determination.

If AEMO forecasts a reliability gap at T-5, which it considers to be sufficiently material, AEMO would be required to submit a request to the AER (as the independent entity) to make a determination. The threshold for a material reliability gap at T-5 would be significantly greater than the threshold for a material reliability gap at T-3 to facilitate further information for the market without prematurely seeking a T-5 determination. If AEMO does not consider the gap to be sufficiently material at T-5 or the AER does not approve the application, AEMO would continue to monitor the reliability gap via its annual updates through the ESOO forecast.

If AEMO forecasts a reliability gap at T-3 and a T-5 determination has not already been made, AEMO would again need to be satisfied that the gap is 'material' under the objective test before it would submit a request to the AER make a T-3 determination.

Whether a determination is made at T-5 or T-3, AEMO would assess again whether a material gap remained at T-1 before making a request to the AER to review their forecast. If the AER confirmed a material gap remains, it would activate the requirement that liable entities submit their contract positions. As in the current policy design, compliance would only be assessed if regional demand exceeds a level expected one in every two years.

If the Rules provide for it, AEMO would also be able to request a T-1 reliability instrument be made without a T-3 or T-5 determination.

### ***Market Liquidity Obligation***

The Market Liquidity Obligation would only come into force at the T-3 point. If a T-5 determination was made, the Market Liquidity Obligation would not come into effect until T-3, as the contract market is largely untraded beyond a three year timeframe.

### ***Book-build***

If either a T-5 or T-3 determination is made, AEMO may run a voluntary book-build mechanism. AEMO would be able to run the book-build in that year and will have the option to re-run the book-build again every year prior to but not including T-1.

## **3 Removal of T-3 determination**

Under this option the proposed T-3 determination would be removed. With no formal determination at T-3, liable entities would be expected to monitor AEMO's ES00 forecasting framework and manage their contract positions to ensure they have sufficient qualifying contracts in place for their share of the forecast one in two year system peak demand in the event a T-1 reliability instrument is made.

Prior to T-1, AEMO would again review its forecast as part of the ES00 process. If the reliability standard is forecast to be met, there is no further action. However, if a material reliability gap exists, AEMO would request the AER to review the forecast. If the AER concurs that a material gap exists, it may create a T-1 reliability instrument which would require liable entities to provide their net contract position to the AER.

In the absence of the T-3 determination, it is proposed there will be a minimum notice period between the publishing of AEMO's ES00 and the reporting day on which liable entities are required to submit their net contract position to cover their share of a one in two year event to the AER. A minimum of at least three months is proposed to provide time for liable entities to finalise their contract positions in anticipation of providing details to the AER.

At present, the ES00 is published in August/September each year. Therefore, if a material reliability gap is forecast in the summer period of the following year, this would allow a three month window between ES00 publication and the expected calling of contract positions by the AER. If AEMO were to update its forecast due to a material change in the demand/supply outlook, a minimum timeframe of three months would still be required before liable entities' contract positions could be requested by the AER.

### ***Market Liquidity Obligation***

If the T-3 determination is removed, it is proposed the AER conduct a market liquidity test, using objective market liquidity metrics, in regions where a reliability gap is forecast in around three years' time. If the region failed the market liquidity test, the Market Liquidity Obligation would apply to large, vertically integrated retailers from the point it was activated (around three years ahead of a forecast gap) to T-1. The details of the liquidity test and metrics would be included in the Rules.

The interoperation of the Market Liquidity Obligation with the ACCC recommendation for a market making mechanism in South Australia will be considered before December 2018, and may include an ongoing market making requirement in South Australia.

### ***Book-build***

If a reliability gap is forecast, AEMO may invite parties to participate in a voluntary book-build mechanism three years' ahead of a forecast reliability gap. If the gap persists, AEMO would have the option to run the book-build again two years ahead of the forecast reliability gap.

## **4 Ministerial powers to activate the reliability obligation**

Under this option, Ministers for each of the NEM-regions would have the ability to make a T-1 reliability instrument for their region at any stage, taking into account input from AEMO. The Minister would specify the reliability instrument. The AER would not have a role in approving a Minister's decision to make the T-1 reliability instrument and liable entities would be required to provide their net contract positions to the AER by a specified point in time.

The same compliance and penalty framework for liable entities as is proposed under the existing policy design would apply. Compliance would only be assessed if regional demand exceeds the level expected one in every two years. AEMO would also retain its ability to request the reliability obligation be activated without a T-3 determination or ministerial determination, in the circumstances specified in the Rules.

In order to give liable entities adequate time to secure contracts to cover their share of a one in two year event, minimum notification requirements would be appropriate. As in the removal of T-3 determination option discussed above, liable entities would be notified at least three months in advance of a requirement to submit their contract position. A material reliability gap would not need to be present for the Minister to make the determination and there would be no limit to how far in advance the determination could be made.

This mechanism has been suggested as an alternative to removing the T-3 determination, as a way to address concerns as to how the T-3 pre-condition will operate in the early stages of implementation of the reliability requirement. It is proposed that this power would be a transitional arrangement and would be reassessed by the Energy Council five years after implementation.

### ***Market Liquidity Obligation***

The Market Liquidity Obligation would come into force at the time that a Minister made a T-1 reliability instrument until the date by which liable entities are required to submit their net contract position.

### ***Book-Build***

At AEMO's discretion, the book-build mechanism could also be activated at the point the Minister makes the reliability instrument. AEMO would have the option to re-run the book-build again every year prior to but not including T-1.

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