Dr Kerry Schott AO
Energy Security Board

21st December 2018

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

Dear Dr Schott,

Retailer Reliability Obligation Consultation Papers

The Australian Energy Council (the "**Energy Council**") welcomes the opportunity to make a submission in response to the Energy Security Board's ("**ESB**'s") three consultation papers simultaneously issued 5th December, being:

(1) *Material Reliability Gap Definition and Communication Consultation Paper*;
(2) *Compliance / Procurer of Last Resort Cost Recovery Consultation Paper*; and
(3) *Firmness Principles for Qualifying Contracts Consultation Paper*.

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

Introduction

The topics covered in the three consultation papers set out some of the principles to be applied to the matters the subject of the draft legislation.[1] The additional detail is welcome, and the Energy Council supports continued further industry consultation to ensure that the obligations intended to be imposed on industry are adequately considered, equitable and flexible enough to allow changing market circumstances.

Discussion

Material Reliability Gap Definition and Communication Consultation Paper

Materiality of a forecast reliability gap

The Energy Council agrees that when assessing the reliability gap it is important that materiality is considered. This was a consistent theme in the ESB's papers throughout the design of the National Energy Guarantee ("**NEG**").

The ESB considers a number of issues which may affect the determination of an appropriate materiality threshold, including the Reliability Standard, the proposed Enhanced Reliability and Emergency Reserve Trader ("**RERT**") Rule Change, the Australian Energy Regulator's ("**AER**'s") Review of the Value of Customer Reliability Framework and the Australian Energy Market Operator's ("**AEMO**'s") Forecasting Reliability. The issues cited confirm that any reliability gap assessment will not be definitive and materiality needs to be taken into consideration. The Energy Council supports the ESB's intention that "the basis of the materiality test at T-3 and T-1 will be the same".[2]

The consultation paper discusses a number of possible metrics to determine materiality. The Energy Council supports the existing form and level of the reliability standard as an average of 0.002% unserved energy ("**USE**") across all simulations. The fact that actual yearly outcomes will have significant variations around the average is well understood, and has been reviewed many times.[3] Contrary to the cited AEMO submission,

[1] National Electricity (South Australia) (Retailer Reliability Obligation) Amendment Bill 2018 Consultation Draft, November 2018
[2] Energy Security Board, *Material Reliability Gap Definition and Communication Consultation Paper*, December 2018, p.6
[3] See, for example, Reliability Panel, *Reliability Standard and Settings Review 2018 Final Report*, 30th April 2018, pp13-17 & pp50-77

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the issue of an asymmetric USE scenario was in fact more significant in the historical power system where the main source of USE in forecasts were simulations of coincident extended outages of large generating units. These caused very rare but extremely severe USE events. In contemporary reliability modelling, USE is progressively being affected more by brief stochastic weather patterns which tend to be more common but less severe.

For those reasons the metrics C and D that effectively introduce a "loss of load probability" concept are not supported. Were they adopted, as the future power system will over time tend to have more frequent but less severe USE events, they will result in effectively a more conservative standard than has been well-established as the economic optimum.

Metric B is consistent with the standard and is therefore supported. The buffer is also consistent with the ESB's previous insistence that the gap be "material".

The Energy Council supports the AER having the discretion to not trigger the Retailer Reliability Obligation ("**RRO**") (or narrow the period for the stated gap) even when the threshold is reached, by considering the costs involved should the RRO be triggered, and agrees that AEMO should notify the AER of its estimated costs of exercising the RERT to maintain reliability in the absence of adequate market investment. For consistency the National Electricity Objective should be used for this assessment, but in order to expedite this evaluation the Energy Council suggests the AER develop, in conjunction with stakeholders, a guideline to use.

Forecast reliability gap period
While it is important for industry to receive as much investment certainty as possible, it accepts that forecasts made at T-3 will have less precision than those made at T-1. Accordingly it seems logical that T-3 instruments should identify particular months and sensitive hours of the day to which a RRO is likely to apply, and the T-1 instrument should narrow the period to which the RRO should apply to specific hours in specific days or weeks, as long as these periods fall wholly within the original T-3 instrument reliability gap period. However as contracting will be driven primarily by the T-3 determination (the T-1 determination being only a few months before compliance), the T-3 periods should be as specific as reasonably possible.

To further ensure that industry is fully aware of the likelihood of instruments being made and be able to react to them accordingly, the Energy Council supports the notice periods proposed,[4] but would like to clarify the expectation that AEMO's request would be made public, and not needing to be deduced from the Electricity Statement of Opportunities.

Compliance / Procurer of Last Resort Cost Recovery Consultation Paper

Calculation of compliance shortfall
The Energy Council appreciates the challenges the ESB faces in setting an appropriate calculation method for the compliance shortfall. The Energy Council considers that market confidence is enhanced by having a clear, fixed penalty regime for non-compliance, expressed in $ per MW p.a. The evaluation of the appropriate penalty should be transparent to the market, and the Energy Council suggests that the principles by which the Western Australian Wholesale Electricity Market's Benchmark Reserve Capacity Price[5] is determined could provide a starting point for the development of the necessary NEM value.

Procurer of last resort cost recovery
As the draft legislation is written, AEMO will have the ability to procure sufficient reserves to cover the reliability gap in a region as set out in the reliability instrument. It is not expected that this procurement would be any different from AEMO's current approach to RERT procurement, that is, it would be based on the RERT framework and the reliability standard.

The reliability gap is defined as the shortfall which occurs when the amount of electricity forecast for a region does not meet the reliability standard (to an extent that is material),[6] and AEMO will enter into contracts to secure the availability of electricity reserves in relation to such gap. The Energy Council's fixed penalty

[4] p.14
[5] Wholesale Electricity Market Rules, Clause 4.16
[6] Amendment Bill Consultation Draft, Clause 14G(1)

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proposal can be used to offset AEMO's RERT costs. Given the complexity of refunding customers thirty weeks after the event, the ESB should consider setting aside the penalty costs in order to offset future RERT costs.

Firmness Principles for Qualifying Contracts Consultation Paper

Principles for firmness adjustment of qualifying contracts
The Energy Council agrees with the criteria set out by the ESB in assessing the firmness of contracts, being:

- the strike price;
- the variability and profile of volume settled under the contract;
- the likelihood of the contract providing cover to the buyer during the reliability gap; and
- other contractual terms.

In particular, the principles should ensure that contracting innovation is not stifled, and parties are free to develop arrangements which suit their individual corporate intentions, satisfy their RROs and are properly recognised by the AER. These principles appear to meet this objective. While many contracting arrangements are standard, there are complex arrangements that may not be able to be adequately specified in the guideline or by the principles, and the Energy Council recommends that any guidelines developed include consideration of such instruments as weather derivatives and settlement residue auction units. In this regard the Energy Council supports liable entities submitting their methodology to the AER for approval before T-1 (but after a T-3 trigger). However to reduce costs, this should be an optional approach and for standard contracting arrangements the AER's guideline (developed in consultation with industry) should specify how to make the firmness adjustment.

Compliance framework
To assist in the assessment of qualifying contracts, the Energy Council supports the AER developing, in conjunction with industry, a guideline setting out its proposed treatment of different types of contracts, and agrees that it should be regularly revised to incorporate contract market developments.

The ESB has proposed an audit of the qualifying contracts position prior to submission of T-1 contract position. This appears to be an evolution of the proposal developed in the NEG detailed design where the audit was understood by industry to be an audit of the firmness methodology. The ESB's new proposal of AER pre-approval of the methodology appears to replace the previous audit concept.

The Energy Council does not support the new concept of an audit of contract positions prior to T-1 and suggests a less burdensome approach would be for the AER to have the right to conduct post-compliance checks, if necessary. As liable entities are continuously updating their positions (including after T-1 in the case of taking on new eligible customers) conducting an audit limits the flexibility for liable entities to optimise their position. This will also guarantee that retailers are not deterred from competing for new customers due to the possibility of a compliance shortfall.

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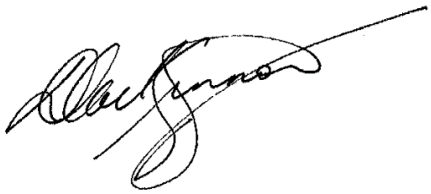
Conclusion

In conclusion, the Energy Council considers the principles proposed by the ESB in the three consultation papers to be broadly acceptable, however it notes that further detailed industry consultation with both the ESB and the AER will be required to ensure that the RRO is fair to market participants, sufficiently flexible to cater for market changes and innovative product development, and not an undue burden which will increase consumers' costs.

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

Yours sincerely,



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