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AEMC Review of the Operation of the Retailer Reliability Obligation: Consultation paper

The Australian Energy Council (the "**AEC**") welcomes the opportunity to make a submission in response to the AEMC's Review of the Operation of the Retailer Reliability Obligation Consultation Paper ('the Consultation Paper').

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 per cent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

The AEC believes a reliable (and affordable) electricity system is critical for households and businesses. However, the Retailer Reliability Obligation (RRO) is neither a necessary nor efficient method to accomplish this. Especially when considering it has been modified substantially since its introduction. These modifications include the 0.0006 USE IRM as the trigger instead of 0.002 USE and energy ministers now having the power to invoke a T-3 instrument without reliability breach justification. In addition to these changes the multi-year RERT scheme introduced with the IRM has been extended.

The RRO is a complex and costly mechanism and consideration should be given to removing it. It interferes in the efficient operation of the market leading to inefficient contracting and undermines the work of the Reliability Panel's reliability standard and market settings. Furthermore, the initial driver for implementing the RRO was events in the second smallest jurisdiction in the NEM, South Australia. In summary the RRO is another example of 'tinkering' in the NEM whereby rules and processes (developed over decades) that have resulted in efficient market outcomes and reinforced the requirements of the National Energy Objectives are disregarded and subsumed by additional non-market-based rules and policies.

Nevertheless, under the assumption that the RRO will be retained the AEC is keen to participate in the process and offer suggestions for improving the operation of the RRO based on discussions with our members.

QUESTION 1: PROPOSED ASSESSMENT FRAMEWORK

It is unclear from the Consultation paper what the scope of this review is. As stated on page 3, "the review is not intended to assess the overall efficiency of the Obligation as determining the overall impact of the scheme would require a longer assessment horizon." However, the AEMC has decided to conduct a longer review than required which should enable it to consider the efficiency and efficacy of the RRO. The AEC supports the longer review and notes the AEMC states that it will enable it to consider:

- the form and function of the Commonwealth's Capacity Incentive Scheme (CIS)
- the AEMC's draft recommendation to extend the application of the Interim Reliability Measure (IRM) to the RRO
- the Australian Energy Regulator's (AER's) final *Retailer Reliability Obligation Compliance Procedures and Guidelines.*

The AEMC would like more clarity as to whether the efficiency and efficacy of the RRO will be considered.

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QUESTION 2: PROCESS FOR T-3 AND T-1 TRIGGERS

The AEC is of the view that there needs to be more rigour when the AER is deciding to create a T-1 instrument. In keeping with the Forecasting Best Practice Guidelines, scrutiny and rigour in data collation, interpretation and analysis is required for elements considered material. Our understanding is that the AER does have a fair degree of discretion on the level of its scrutiny of AEMO processes when making its decisions but has not exercised it. For example, the AEC and some of its members submitted to the recent SA T-1 decision (September 2022) regarding the 128 MW Bolivar Power Station. On this matter the AER relied on AEMO's representations[1] without further assessment even when the proposed recategorisation would have eliminated the reliability gap. Evidently, the forecast shortfall at that time has now been revised by AEMO such that it is no longer projected.

The AEC understands the need to strike a balance between providing the retailers enough lead-time to acquire compliant hedge positions (and include such costs in their customer contract pricing) and inappropriately burdening retailers when the latest AEMO forecasts project no reliability gaps.

Given the system-wide implications of RRO T-1 instruments and the cost they impose on consumers, the AEC recommends provisions be implemented to improve the quality, timeliness, assurance and transparency of AEMO's ESOO. We offer the following indicative suite of provisions to address these objectives:

- AEMO's NEM Electricity Statement of Opportunities (ESOO) should be independently audited (whereby the external auditor is selected and appointed by the AER or the AEMC).
- If a T-1 reliability instrument is issued, then AEMO should be required to provide continuous updates utilising their weekly MT-PASA outputs. In the circumstance where MT-PASA updates, across 3 or 4 consecutive weekly datasets, show an elimination of the reliability gap, then an AEMO ESOO update (reopener) is triggered.
- If after AEMO's updated ESOO, a forecast which resolves the reliability gap is confirmed, the AER should be required to revoke the T-1 reliability instrument. The ESOO update should, once again, be subject to independent review.
- As part of the AER's consultation process to approve an AEMO requested reliability instrument it could be required to conduct a public forum.

It may be argued that provisions to enhance pivotal activities as laid out above appear onerous and costly to AEMO and/or the AER, however by improving forecast quality, these centralised activities will reduce the risk of 'false positive' T-1 outcomes and thereby reduce the greater system-wide (by jurisdiction) cost of T-1 retailer obligations which are ultimately bourn by consumers.

QUESTION 3: MARKET LIQUIDITY OBLIGATION

Semi-scheduled and/or non-scheduled generation should not be included as by its nature it does not provide firm capacity. As the market continues to evolve and less traditional firm generation is available excluding no firm generation may become problematic. However, the AEC is of the view that the implementation of a Capacity Investment Scheme (CIS) will occur well before there is a shortage of traditional firm generation. And the introduction of a CIS will make the RRO redundant as tool for achieving governments' aims to employ excessively conservative reliability policies.

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[1] Australian Energy Regulator,'*T-1 and T-3 Reliability Instruments, South Australia 2024 and New South Wales 2025-26'*, Commonwealth of Australia, October 2022, page 9. www.aer.gov.au/system/files/AER%20-%20T-1%20and%20T-3%20reliability%20instruments%20decision%20-%20FINAL.pdf

With respect to the MLO, the AEC supports the current AER guideline where the spread is calculated based on the offer.

QUESTION 4: VOLUNTARY BOOK BUILD MECHANISM

The AEC supports removing this mechanism.

QUESTION 5: QUALIFYING CONTRACTS

In calculating the firmness of cap contracts, the AER applies five per cent as a benchmark of a firm cap contract.[2] The current Market Price Cap (MPC) of $15,100 per MWh results in a $755 cap having a firmness of one whereas a cap with a strike price of $1,000 has a firmness factor of 0.97.[3] Applying a 10 per cent benchmark would increase a firmness of one cap's strike price to $1,515. When the AER's guidelines were published in 2019, the Administered Price Cap (APC) was $300 per MWh, recently it has been doubled to $600 per MWh. The AEC believes the benchmark should be increased to 10 per cent of the MPC.

With respect to options which currently require cost bespoke firmness compliance processes, the AEC considers that 'knock in' swaptions based on a linkage to demand that become a swap once a demand threshold is exceeded, should be included as standard contracts and that they should have a firmness factor of one when the demand trigger is aligned to the RRO obligation of exceeding the one in two year peak demand forecast (ie, POE50).

QUESTION 6: LIABLE ENTITIES

No comment.

QUESTION 7: OPT-IN MECHANISM

The AEC does need see any need to make changes to the opt-in mechanism.

QUESTION 8: COMPLIANCE PROCESSES

The AEC is aware of significant compliance costs incurred by its members and will leave them to provide more specific detail in their submissions.

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

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[2] https://www.aer.gov.au/system/files/AER%20-%20Interim%20Contracts%20and%20Firmness%20Guidelines%20-%20August%202019.PDF
[3] https://www.aer.gov.au/system/files/AER%20-%20Interim%20Contracts%20and%20Firmness%20Guidelines%20-%20August%202019.PDF