Dr Kerry Schott AO
Energy Security Board

12th June 2020

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

Dear Dr Schott,

Interim Reliability Measures – Reliability Reserve

The Australian Energy Council (the "**AEC**") welcomes the opportunity to make a submission in response to the *Interim Reliability Measures – Reliability Reserve: Consultation on Draft Rules*.

The Energy Council is the industry body representing 24 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 Energy Council acknowledges that the Energy Security Board ("**ESB**") has prepared the consultation paper and draft rules at the direction of the COAG Energy Council. Nevertheless it is important, as a matter of public record, to challenge the COAG Energy Council's assertion that there is "community expectation" that the level of power system reliability needs to be improved.

The appropriate level of reliability is one which is set near the optimal trade-off between the cost of additional supply and the cost of customer interruption inconvenience. From this, key market settings, such as the market price cap, are derived. The Reliability Panel is charged with reviewing the reliability settings every four years, and did so as recently as 2018, concluding that there was no change required in the standard to apply from July 2020.[1] In its deliberations, the Reliability Panel, which has representatives from a range of stakeholders including industry, major users and consumers, considered a range of topics including the Value of Customer Reliability ("**VCR**"). (The AEC notes that the COAG Energy Council doesn't have the Reliability Panel's advantage of this cross-spectrum of stakeholder interests.) In December last year the Australian Energy Regulator ("**AER**") completed a review of VCR, and concluded that VCR values were similar to those the Australian Energy Market Operator ("**AEMO**") found in 2014.[2] This suggests that there is no impetus for a change in the reliability standard.

AEMO's use of the Reliability and Emergency Reserve Trader ("**RERT**") is also linked to the reliability standard. As recently as May last year the Australian Energy Market Commission considered

[1] Reliability Panel, *Reliability Standard and Settings Review 2018 – Final Report*, 30th April 2018
[2] Australian Energy Regulator, *Values of Customer Reliability – Final Report on VCR Values*, December 2019, p.12

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enhancements to the RERT,[3] and received advice from the Reliability Panel on the proposed rule change.[4] This advice considered:

- whether the reliability standard remains appropriate for the National Energy Market;
- evidence that the standard may need to be tightened, in some or all conditions, to meet community expectations;
- potential costs and benefits arising from the tightening of the reliability standard; and
- consideration of different metrics for the reliability standard.

While acknowledging the changes occurring in the power system, the Reliability Panel confirmed its findings from its 2018 review, noting that,

> "Increasing the levels of reliability involves increased costs. This is a fundamental matter that must be taken into account when considering reliability frameworks."[5]

The AEC notes that the ESB commissioned ACIL Allen Consulting to conduct economic analysis to support the review of the Reliability Standard,[6] and is concerned that the assumptions provided by AEMO to inform the consultant's work resulted in unwarranted additional conservatism, for example by limiting the range of scenarios to only one reference year, and using the one hour value of customer reliability for outages up to six hours' duration.

The enthusiasm to change the reliability standard must also be assessed in light of the COVID-19 pandemic. The COAG Energy Council is concerned that the supply-demand balance has tightened, and there is a risk that outages will occur. In contrast, economic commentators are predicting Australia will experience a recession, which will reduce demand markedly. Furthermore, there is no indication from market reports such as the Medium Term Projected Assessment of System Adequacy[7] that there will be any shortfall within the next two years.

Evidence such as this defies the COAG Energy Council's assumptions that there is an issue with the supply-demand balance, and that "community expectation" requires a tighter reliability standard.[8] The AEC does not believe that the proposed changes, which will inevitably increase costs for consumers, are in any way justified.

Discussion

Consistency with the National Electricity Objective

The National Electricity Objective ("**NEO**") is "to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to

> (a) price, quality, safety, reliability and security of supply of electricity; and
> (b) the reliability, safety and security of the national electricity system."[9]

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[3] Australian Energy Market Commission, *Enhancement to the Reliability and Emergency Reserve Trader – Rule Determination*, 2nd May 2019

[4] Reliability Panel, *Reliability Panel Advice on the Enhancement to the Reliability and Emergency Reserve Trader Rule Change*, 28th September 2018, available at https://www.aemc.gov.au/sites/default/files/2018-10/Letter%20of%20Advice%20from%20the%20Reliability%20Panel.pdf

[5] Ibid., p.4

[6] ACIL Allen Consulting, *Reliability Standard – Economic Analysis to Support Review*, 6th March 2020

[7] Available at https://aemo.com.au/en/energy-systems/electricity/national-electricity-market-nem/data-nem/market-management-system-mms-data/projected-assessment-of-system-adequacy-pasa

[8] The AEC notes that the reliability standard cannot be changed in isolation. The associated market settings would also need to be reviewed, which has historically been the work of the Reliability Panel.

[9] *National Electricity (South Australia) Act 1996*, Clause 7

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The AEC notes the reasons set out in the Consultation Paper, but believes that the proposed rules fail to meet the primary consideration of the NEO, efficient investment. The Reliability Panel has established the most appropriate level for the Reliability Standard and associated market settings, therefore the imposition of a stricter standard, and the associated increased investment to meet that standard, cannot be construed as "efficient investment … for the long term interests of consumers…", given that the additional investment required will result in increased costs for consumers.

These additional costs are corroborated by the ESB's consultant's analysis, which reports an expected increase of $8-16 p.a. for 4MWh p.a. households.[10] Larger users will have commensurately higher costs.

Interim Reliability Reserve Rule Changes

Setting aside the AEC's strong misgivings regarding the justification for the introduction of the proposed rule, the AEC finds that the drafting is generally acceptable.

In particular the AEC supports the inclusion of proposed Clause 11.xxx.4(g)(3), which obliges AEMO to have regard to whether total payments under a multi-year reserve contract are likely to be lower than the aggregate of a number of shorter reserve contracts.

In addition, the AEC suggests that latitude should exist within the Rules so that the costs associated with a reserve contract can be further reduced, by AEMO being allowed to consider if a reserve contract can address interim reliability exceedances across multiple regions at the same time. For example, a reserve contract could simultaneously fulfil South Australia's and Victoria's needs, at reduced cost.

Under the proposed rules AEMO has the ability to enter into multi-year reserve contracts, the term of which may exceed the duration of an interim reliability exceedance for that region.[11] While proposed Clause 11.xxx.4(i) obliges AEMO to ensure that for three year contracts, at least two of those years must relate to a forecast interim reliability exceedance, this still may result in AEMO over-contracting, with additional costs passed on to the market. The AEC prefers that the clause should be reworded as follows:

> "For a *reserve contract* for interim reliability reserves for a *region* that is a multi-year reserve contract, *AEMO* must ensure that, at the time of entering into that contract:
>
> (1) the term of the *reserve contract* is no longer than three years and at least two of those years must relate to years in which there is an interim reliability exceedance for that *region* of which one of those exceedances must occur in the first year of the term; and
>
> (2) the amount of *reserve* procured under the *reserve contract*:
>
> (i) for each year of the term is no more than *AEMO* considers is reasonably necessary to address the largest interim reliability exceedance that is forecast to occur during ~~the term~~ that year of the term; and
>
> (ii) is no more than *AEMO* considers is reasonably necessary to ensure the reliability of *supply* in that *region*."

[10] Ernst & Young, *Assessment of Potential Market Impacts associated with moving to a Higher Reliability Standard*, 6th May 2020, p.3
[11] Proposed Clause 11.xxx.4(f)

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The AEC disagrees that Clause 3.20.6(d)(4)[12] should not be applicable, since it is important for independent scrutiny that AEMO outlines its reasons for entering into a multi-year contract which does not coincide with forecast interim reliability exceedances. The AEC therefore suggests that it be amended to cater for reporting multi-year contracts, in a similar fashion to the other reporting clauses, or else a similar requirement be included within proposed Clause 11.xxx.5(d).

Amending the Trigger for the Retailer Reliability Obligation

The arguments espoused above regarding the justification for the Interim Reliability Rule changes are similarly applicable to the proposed amendment to the Retailer Reliability Obligation trigger, and the AEC opposes the COAG Energy Council even contemplating the amendment on that basis.

However setting aside what the appropriate reliability measure should be, the mooted neutering of the T-3 instrument will have costly implications for how retailers run their businesses, and consumers will bear the brunt of the additional overheads, increased market risk and extra compliance burdens.

The T-3 instrument was designed to give retailers notice that a reliability shortfall may be possible in three years' time. The time period was set to allow retailers the time necessary to install additional supplies (whether this be via new build generation, restoration of mothballed plant, or developing technologies such as batteries) or to put in place demand response arrangements. These arrangements, with their long lead times, would therefore be tested if AEMO requested an *ad hoc* T-1 instrument, and it was subsequently made by the AER, since it would afford retailers at most months before the contract position day, at which time retailers would need to have all their preparations made.

Having the ability for a T-1 instrument to be made at any time will remove the utility of the T-3 instrument. As a consequence this means that there will be increased uncertainty for industry, which will mean either:

(a) due to the lead times for installing new supplies, retailers will build plant in anticipation of a T-1 instrument and then find their assets unwanted and stranded, thereby wasting capital which could have been better spent elsewhere, and incurring the cost of holding and maintaining the assets; or

(b) retailers will discount the likelihood of T-1 instruments being made, and then be left exposed when the reliability obligation is required. This will result in additional costs to the exposed retailer, and not address the reliability obligation at all.

In addition, the increased likelihood of the T-1 instrument being made creates an anomaly with the market settings. Both ACIL Allen[13] and Ernst & Young[14] estimated, based on the inputs provided, that the market price cap should be at least three times higher to support the proposed changes. The absence of any recommendation to change the market price settings further compounds the incapacity of the proposed Retailer Reliability Obligation trigger to incentivise market investment, thereby increasing risk and uncertainty.

On this basis, the AEC strongly opposes amending the National Electricity Law and National Electricity Rules in the manner proposed.

Conclusion

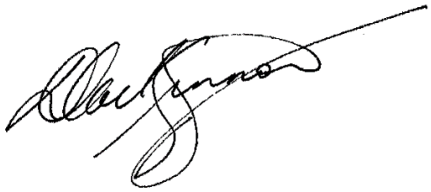
In conclusion, the AEC strongly opposes the recasting of the reliability standard, and the removal of the T-3 instrument as a necessary trigger for the Retailer Reliability Obligation. The need for these

[12] Information to include in RERT report – reserve contracts
[13] ACIL Allen Consulting, *Reliability Standard – Economic Analysis to Support Review*, 6th March 2020
[14] Ernst & Young, *Assessment of Potential Market Impacts associated with moving to a Higher Reliability Standard*, 6th May 2020

initiatives is not supported by the evidence, and both these actions will cause significant increases in 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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