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Dear Commissioners,

AEMC 2018, Enhancement to the Reliability and Emergency Reserve Trader, Consultation paper

We welcome the opportunity to comment on the AEMC's consultation paper on AEMO's rule change request, Enhancement to the Reliability and Emergency Reserve Trader (RERT). EnergyAustralia is one of Australia's largest energy companies with over 2.6 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion dollar energy generation portfolio across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market (NEM).

EnergyAustralia recognises that the NEM generation mix is rapidly changing as older traditional generation is retired and replaced more commonly by variable renewable generation. The NEM has also moved in just a few years from having a significant oversupply of generation capacity to a much more balanced supply and demand outlook.

In its RERT rule change proposal, AEMO raises concerns that there may be a heightened risk of unserved energy (USE) across the 2018-19 and 2019-20 summers in both South Australia and Victoria.[1] AEMO suggest that due to this heightened risk longer procurement times are required, and to limit the risk of load shedding, that the risk assessment framework should be broader than just the current reliability standard.[2]

The cost of AEMO's extensive procurement and use of the RERT over the summer of 2017-18 was over $51 million dollars across consumers from Victoria and South Australia.[3] We recognise that AEMO is facing increasing challenges in operating the power system and that there can be increased risk of USE at times, but there is no evidence that customers are willing to pay for a tightening of the reliability standard.[4] As

[1] Page 6, AEMO rule change request, https://www.aemc.gov.au/sites/default/files/2018-06/Rule%20change%20request.pdf
[2] Reliability standard, https://www.aemc.gov.au/markets-reviews-advice/reliability-standard-and-settings-review-2018
[3] Page 5, AEMO Summer Operations Review, https://www.aemo.com.au/-/media/Files/Media_Centre/2018/Summer-2017-18-operations-review.pdf
[4] Page 11, AIG Eastern Australian Energy Prices, https://cdn.aigroup.com.au/Reports/2018/AiGroup_Report_Eastern_Australian_Energy_Prices_July_2018.pdf

the AEMC notes in the consultation paper the setting of the level of reliability standards involves a trade-off between the price consumers pay for electricity and the costs of not having energy when needed. Consumers are not often directly involved in these decisions and have limited awareness of the trade-off they are being asked to make; however, they ultimately bear any increased costs.

1. Current operation of the RERT

As discussed in the consultation paper, prior to 2017 the RERT had never been dispatched. During 2017, AEMO identified Low Reserve Conditions (LRC) through its Medium Term Projected Assessment of System Adequacy (MTPASA).[5] In July and September 2017, AEMO released tenders for RERT providers and procured over 1,100MW of out-of-market reserves across Victoria and South Australia for the summer period of 2017-18. During this period AEMO activated the RERT twice (on 30 November 2017 and 19 January 2018). Across both events, AEMO only activated approximately 168MW of reserves with this coming at a cost of over $51 million to the market which is recoverable from customers in both regions.[6] These are the direct costs only. The indirect costs should also be considered - this includes the distortionary effect the RERT can have on the market.

We note that prior to the summer of 2017-18, AEMO was still able to enter into long notice reserve contracts prior to their powers ceasing on 1 November 2017.[7] On 21 June 2018 the AEMC made a final rule reinstating the lead time for AEMO to procure reserves to 9 months. This rule came into effect on 13 July 2018.[8] AEMO can now procure short notice RERT between 3 hours and 7 days ahead; medium notice RERT between 7 days and 10 weeks ahead; and long notice RERT between 10 weeks and 9 months of a projected shortfall.

2. Procurement lead time and contracting length

In its rule determination on the reinstatement of the Long Notice RERT, the AEMC stated that extending the procurement lead time to 9 months can have benefits to the procurement process in terms of increasing the number of potential providers of economically-efficient reserves. However, they also identified that the counter argument remains. That is, longer procurement lead times may also carry additional costs including market distortions such as crowding out market arrangements, e.g. retailers offering demand response to their customers.

AEMO proposes increasing the procurement lead time of the long notice RERT to 1 year and that the contracting period (duration of reserve contracts) be extended to up to 3 years in circumstances where this would be at a lower cost. Under AEMO's multi-year contracting proposal the long notice RERT procurement time would in practice become 3 years. It should be noted that the National Energy Guarantee (NEG) procurer of last resort function may utilise the RERT if the reliability obligation was triggered. The 9-month procurement time should be sufficient for this requirement.

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[5] AEMO MTPASA, https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Data/Market-Management-System-MMS/Projected-Assessment-of-System-Adequacy

[6] Page 5, AEMO Summer Operations Reviewhttps://www.aemo.com.au/-/media/Files/Media_Centre/2018/Summer-2017-18-operations-review.pdf

[7] AEMC Final Rule, https://www.aemc.gov.au/rule-changes/extension-of-the-reliability-and-emergency-reserve

[8] AEMC Final Rule, https://www.aemc.gov.au/sites/default/files/2018-06/Final%20determination_1.pdf

We do not support the extension of the procurement or contracting timeframe past a period of 1 year. We view the RERT as a blunt market intervention that should be used only as a last resort by AEMO. Procuring long notice reserves for an extended period (e.g. 3 years) does not give the market sufficient time to provide a market response to the LRC conditions identified (in fact it may preclude the opportunity for any market response). The current 9-month procurement trigger would allow AEMO and other market participants to use learnings from the previous summer. As an example, market events in the previous summer may trigger participants to signal that they are investing further in demand response.

As discussed in the consultation paper, the AEMO and ARENA RERT trial has demonstrated that there are more resources, primarily demand response, that can change their usage in response to price signals.[9] In their rule change proposal, AEMO note that their industry working group favoured longer term RERT contracts (nominally 3 years) as this would provide greater investment certainty allowing investment in new resources (e.g. smart meters, storage, diesel gensets etc.).[10]

We highlight that the RERT process should not encourage *'new investment'* as this is the purpose of the market.

One benefit of the AEMO/ARENA RERT trial has been to raise the profile of demand response among customers. This has encouraged some customers who have not participated in the past to participate – but the enduring least cost solution for customers is to have participation through the market and not through the RERT.

There is increasing concern from consumers about the significant cost of the RERT mechanism. While the ability to sign multi-year long notice reserve contracts may reduce the megawatt (MW) capacity price per year cost ($/MW/Year), the fact remains that consumers still bear these long-term reserve costs regardless if the reserves are required. The mechanism to limit the cost to consumers of the RERT is to encourage the energy market to deliver the reliability standard without intervention, dispatching reserves if required at the latest time possible.

Additionally, the ability to accurately forecast reserve margins out to a multi-year period should also be considered when proposing a longer-term procurement.

3. Procurement trigger

We do not support any change to the procurement trigger and the reliability standard should remain as the trigger for the procurement of RERT. If it is deemed that the current standard is insufficient then the reliability standard should be reconsidered by the Reliability Panel. There is no evidence that there is a need for a new mechanism to trigger the procurement of the RERT.

In its rule change request, AEMO proposes a broader risk assessment is required to act as the trigger for procuring reserves that should also consider the risk of USE and not

[9] Page 26, AEMC Consultation Paper, https://www.aemc.gov.au/sites/default/files/2018-06/Consultation%20paper_0.pdf

[10] Page 6, Enhanced RERT high level design proposal, https://www.aemc.gov.au/sites/default/files/2018-06/Rule%20change%20request.pdf

just the expected value. The AEMC notes in the consultation paper that the changes proposed by AEMO around the context of a broader risk assessment are not clear.

The Reliability Panel recently determined that the current reliability standard is achieving its purpose and will continue to do so for the review period (2020-2024).[11] Submissions received during the consultation on the reliability standard review supported the Reliability Panel in keeping the standard at its current level. We note that the AER will be completing a review of Value of Customer Reliability (VCR) by December 2019 and their findings may trigger a review of the reliability standards.[12]

Independent modelling for the Reliability Panel showed no identified LRC conditions in the forecast period out to 2023-24. [13] In addition, AEMO's current MTPASA shows no low reserve conditions over the next 2 years.[14] While some risk of USE will always remain, AEMO currently has sufficient tools through the short and medium notice RERT to procure reserves over a shorter period if a LRC is identified in the MTPASA /STPASA (Short Term Projected Assessment of System Adequacy) process. As a last resort AEMO is also able to direct in the market to either increase generation output or direct a large energy user to reduce usage.[15]

By moving to a '*broader*' assessment of the power system there is a risk that consumers will incur higher RERT costs if AEMO takes a more risk adverse approach to triggering reserves. The reliability standard review found that to improve the USE to 0% in Victoria the cost to customers would be in the order of $200-600 million per year.[16] While AEMO is not attempting to achieve 0% USE, they are taking decisions that have the potential to reach this cost level or beyond.

4. Transparency

There is limited transparency in the current RERT process. AEMO currently has some reporting requirements under the NER to report on the dispatch of RERT and the costs to the market of this reserve, but has no requirements to provide information earlier.[17] As an example, across the summer of 2017-18 the market was made aware that AEMO was tendering for RERT providers; however, no information was provided to the market and consumers about the estimated costs of these reserves. This creates a significant level of uncertainty for consumers in the market about the level of reserve costs they may be exposed to. While the previous summer the RERT cost consumers $51 million dollars (over 2 events) it could easily become significantly more if more reserves are consistently procured and activated in the future.

Numerous customers have raised concerns over the cost and the transparency of the RERT process last summer. While AEMO have represented these costs as $6 to the average household bill, the additional costs to medium and larger energy users is significant. AEMO should be required to provide more information to the market when

[11] Reliability Standard Review, https://www.aemc.gov.au/markets-reviews-advice/reliability-standard-and-settings-review-2018
[12] AEMC Final Rule, https://www.aemc.gov.au/rule-changes/establishing-values-of-customer-reliability
[13] Reliability Standard Review, https://www.aemc.gov.au/markets-reviews-advice/reliability-standard-and-settings-review-2018
[14] AEMO RESERVE NOTICE MT PASA PUBLICATION 17 July 2018
[15] NER Clause 4.8.9
[16] Page 72, Reliability Standard Review, https://www.aemc.gov.au/sites/default/files/2018-04/Reliability%20Panel%20Final%20Report.pdf
[17] NER Clause 3.20.6

requesting for tenders on the long, medium and short notice RERT. Given current concerns from customers around the extensive procurement and usage of reserves across the previous summer, transparency of the process needs to be improved.

Information such as the expected amount of capacity that is likely needed to be procured and the reasons for requesting tenders for reserves (e.g. USE breaching the reliability standard) need to be made available. Further, if reserve contracts are signed (both long notice RERT as well as signing members up to the RERT panel) then AEMO should be then required to publish a breakdown of expected costs in megawatt bands depending on the lead time and reserve required for each region. This would allow commercial and industrial customers to understand and forecast (to some degree) their potential exposure to RERT costs.

We see that the introduction of a cap on availability, pre-activation and activation payments would provide greater clarity to the market over the cost of reserves. The significant costs of pre-activation of reserves on 19 January highlighted a need for a cap on pre-activation costs. Caps would not only provide transparency to the market on the potential costs of dispatching reserves, but would also work to encourage participants to participate in the energy market by limiting any out-of-market payments.

If the RERT is used we suggest that there could be a requirement for the Australian Energy Regulator (AER) to complete a customer survey on the operation and costs of the RERT and publish an independent report on the process. This could build on AEMO's current requirements under NER clause 3.20.6. Alternatively, this could supplement the AER's requirements under the VCR.

5. Standardisation of Contracts

Under the current rules, AEMO is already able to 'standardise' RERT contracts. While we support the standardisation of contracts, provided these don't exclude certain providers, we would like to highlight the significant cost incurred to consumers from the usage of the 24-hour notice contact across the summer of 2017-18. In their rule change request, AEMO has indicated that it intends include a 24-hour notice standard product. By pre-activating reserve 24 hours out from a forecast LRC it can potentially lock in a significant cost to the market without the forecast conditions eventuating. We have concerns over the use of this contract going forward and the significant costs that could be passed on to consumers.

6. Out of Market Provisions

AEMO considers that multi-year contracts provide more certainty to reserve providers and may increase the number of reserve providers available. It would do this by offering long term RERT capacity payments which are not available in the NEM energy only market. Any mechanism that encourages demand response out of the market to be available to AEMO as reserve is a perverse outcome and not in the long-term interest of consumers. We need to encourage this load back to the market and the current out-of-market provisions should be tightened. For example, if a load has previously been contracted under a separate commercial demand response agreement in market then it should be prevented from participating in the RERT for the next two years.

We have recently had experiences with customers who were initially going to participate in demand response (in market), instead customers have signed onto a RERT contract as it was of more value. This is a prime example of the market distortionary effects that the RERT can create. By incentivising demand response out of market AEMO is required to rely on reserves more often as demand response that would normally have been commercially used in periods of tight supply and demand (reducing demand) is left out of market.

7. RERT Recovery

A key concern from consumers is the current cost recovery process of the RERT. As an example, a consumer could either be directly participating in the RERT process or have entered into a demand response agreement with a retailer across the RERT event and reduced load across the period in question (in response to either demand or price). In this case, although they have actively reduced demand across key periods (and invested in required control systems or other equipment to do this), the current recovery process does not reward the assistance provided to reduce system demand.

While recognising that the cost of ensuring the reliability of the system should be paid by all customers, ideally the recovery process needs to recover costs from participants that were benefitting (i.e. using energy) from the reserve at the time it was activated. The recovery of activation payments and pre-activation payments should be recovered on a usage (megawatt hour) basis across the periods where the reserves were activated (or pre-activated). Recovery of availability payments cannot be recovered in this manner and should continue to be recovered as they are now.

8. Conclusion

While we recognise that at times there will be a requirement for reserves in the NEM any design of a reserve mechanism should first and foremost encourage generation and demand response to participate in the market. Procuring and activating the RERT should be used only as a last resort intervention by AEMO and at the latest time possible.

There is no indication that the reliability standard is not fit for purpose to be used as the procurement trigger or that consumers are willing to pay for a tighter standard. If the AEMC finds that the current standard is insufficient then this should be reviewed by the Reliability Panel. We should not be introducing a new way of triggering the RERT.

While longer reserve contract periods may reduce the overall cost of reserves in the long term, we do not support an increase in contract periods as this does not preserve correct signals for a market solution. We also see that improvements can be made to the transparency of the RERT process as well as the cost recovery methodology.

If you would like to discuss this submission, please contact Andrew Godfrey on 03 8628 1630 or Andrew.Godfrey@energyaustralia.com.au.

Regards

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