



31 May 2018

Sarah-Jane Derby
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Ms Derby

RE: Reinstatement of the long notice Reliability and Emergency Reserve Trader (ERC 0238)

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) consultation paper on the reinstatement of the long notice Reliability and Emergency Reserve Trader (RERT).

About ERM Power

ERM Power is an Australian energy company operating electricity sales, generation and energy solutions businesses. The Company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load¹, with operations in every state and the Australian Capital Territory. A growing range of energy solutions products and services are being delivered, including lighting and energy efficiency software and data analytics, to the Company's existing and new customer base. ERM Power also sells electricity in several markets in the United States. The Company operates 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland.

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General comments

The issue of whether or not to make the rule change is a vexed one, particularly with regards to how urgent it may be. We appreciate the concern that the Australian Energy Market Operator (AEMO) has expressed about system reliability and security for the upcoming 2018-19 summer. This rule change also comes against the backdrop of the development of the National Energy Guarantee, a policy which could substantially change how retailers and generators respond to reliability concerns in the National Electricity Market (NEM).

ERM Power understands that the AEMC is unable to wait until the National Energy Guarantee is agreed to and design steps are being taken. Nonetheless, we encourage all parties involved in this process including the AEMC, AEMO and the Energy Security Board to ensure that work on these overlapping issues is coordinated. Indeed, the reinstatement of the long-notice RERT may be necessary as part of the Procurer of Last Resort mechanism under the National Energy Guarantee. We consider that it would be better to consider this rule change as part of the development of that policy rather than as a standalone issue.

¹ Based on ERM Power analysis of latest published financial information.

That said, we understand that as the AEMC is required to consider AEMO's rule change proposal in isolation, and as such our comments on the rule change are made in that context.

Reliability in the 2018-19 summer

AEMO has proposed this expedited rule change on the basis that in their view there is a small risk (less than one in ten) that the level of unserved energy may exceed the reliability standard for the 2018-19 summer. Recent work performed for the AEMC's Reliability Panel indicates that the reliability standard will not be breached in the near term.² On the other hand, the most up-to-date MTPASA projections, using new probabilistic modelling, do indicate that the reliability standard could be breached in South Australia in 2019 under extreme demand and high generator failure conditions.

ERM Power has a number of concerns with these forecasts which call into question whether there is a genuine risk. While AEMO's headline figure sees the reliability standard being breached, delving deeper into the data suggests that this is unlikely to be the case. The generation availability which underpins this fails to include the 250 MW of diesel generation that the SA Government has installed, which is to be used in the event of a risk to system reliability. We also understand that the full capability of the Hornsdale Power Reserve may not be factored into generation availability either.

In addition, we note that AEMO will have 190 MW of demand response available should the RERT be required thanks to a joint Australian Renewable Energy Agency (ARENA) and AEMO trial. This is in addition to the 250 MW of emergency diesel generation and 70 MW reserved Hornsdale battery response available in South Australia which is currently not bid in the Projected Assessment of System Adequacy (PASA) timeframes and therefore not included in AEMO's reliability assessment. This demand response and additional generation capability was available to AEMO in the 2017-18 summer. These measures effectively act much like the long-notice RERT in practice as AEMO knows it will have access to 520 MW of unscheduled response as part of the RERT if it is needed in 2018-19. This will surely assist AEMO should more up-to-date projections suggest that there is a reliability issue for the upcoming summer.

Finally, there is nothing to prevent AEMO from discussing arrangements and settling terms and conditions including pricing with potential RERT providers well in advance of the medium-notice RERT period of 10 weeks in advance of a potential reliability issue. The absence of the long-notice RERT simply means that AEMO is unable to sign formal contracts for the provision of RERT more than 10 weeks in advance of a projected reliability or security issue. AEMO could conduct a process whereby they enter into discussions with potential RERT providers or even develop a standard form of contract to be taken to and agreed with providers before signing contracts 10 weeks out from the projected reliability shortage. This would allow AEMO to wait until there is a better understanding of conditions that can influence demand and supply such as updated forecasts of expected weather conditions and changes to forecast plant outages.

Given all of these factors, ERM Power does not consider that there is a clear case to justify reinstating the long-notice RERT at this time.

Regional Demand Forecasts

As outlined in the AEMC's Reliability Frameworks Review Directions Paper, AEMO's forecasts have for some time demonstrated a tendency to overestimate demand, thus indicating a greater potential for

² EY, 'Reliability Standards and Setting Review 2018 – Modelling Report for the AEMC Reliability Panel', April 2018, p29.

supply shortages than occurs in reality. This is not a new concern having been identified as early as 2010.³ While AEMO's forecasts have not worsened over time, they have not improved either and the tendency to overestimate demand by significant values is clear. As such, we believe that there is a risk that by procuring long-notice RERT, there will be a greater risk of incurring unnecessary costs which inevitably get passed on to all consumers. ERM Power considers that the medium-notice RERT is a sufficient safety net which allows AEMO to wait until more up to date information is available before committing to procure RERT whilst still allowing sufficient time to do so.

In addition, the recent change to the calculation of required reserve levels based on AEMO's Forecasting Uncertainty Measure (FUM) has the potential to result in increased activation of the RERT in the ST PASA and Pre-Dispatch timeframes where an actual reserve shortfall at Dispatch may not exist at additional costs to consumers. AEMO's Summer 2017/18 Operation Review indicates that had the FUM been operational during the summer period, additional activation of RERT contracts would have occurred resulting in further increased costs to consumers⁴, it is worth noting however, that during all these periods based on actual demand outcomes no threat to supply reliability actually occurred, in all instances there were only perceived threats based on AEMO's demand forecasts.

Furthermore, the new deterministic MT PASA process whilst using 1,600 historical demand traces has all these demand traces scaled up to meet either the 10 or 50% POE forecasts which both suffer from the aforementioned over forecasting bias. As such this process is very conservative in methodology and tends to overstate the potential for USE which further overstates the need for the long-notice RERT. It is also worth noting that these 10 and 50% POE forecasts are not routinely updated to take into account the most recent prevailing weather forecast information.

AEMO argues that the reinstatement of the long-notice RERT could better enable the market to deliver additional capacity and enhance competition, thereby lowering costs for consumers. While we agree that in theory the possibility of AEMO signing RERT contracts up to 9 months before a reliability event may lead to lower costs of procurement, this is uncertain and ignores the fact that AEMO may still lock in unnecessary costs. According to AEMO's 'Summer 2017-18 Operations Review report', the availability payments for the RERT in 2017-18 totalled \$26.29 million.⁵ We would be cautious about any mechanism that would lock in these costs without waiting for more data to determine if they are genuinely needed.

Even with low availability payments and higher dispatch costs, this could disincentivise generation or demand response from participating in the market over the long term. Given that the NEM is an energy-only market, high wholesale prices act as the incentive for peaking generators to remain available in the market for those few times a year when prices are high and they may be valuable. Yet, if some new entrants, or potentially existing participants believed they may be able to access a source of revenue higher than the market price cap if dispatched, they may be more willing to remain off-market and participate in the RERT even with low or no availability payments in exchange for the higher reward if dispatched.

³ NGF Submission Page 14 – AEMC Review of the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events

⁴ AEMO, 'Summer 2017-18 Operations Review Report' May 2018, p 34

⁵ AEMO, 'Summer 2017-18 Operations Review Report' May 2018, p 33

Potential distortionary impacts of the RERT

During the rule change process to remove the original Long Notice RERT provisions the Commission and submissions to the rule change process clearly identified the potential distortionary impacts on the efficient functioning of the market if the procurement process was activated early. We submit that nothing has changed with regards to the NEM that would lead to this view requiring change. The current RERT process does not set limits with regards to the maximum value AEMO may pay for a RERT contract when compared to the value participants can receive for participating in the NEM dispatch process.

Arguably this has distorted the market for demand response by setting expectations with regards to the value of demand response well above the value which would be economically efficient to access the same response within the current market settings. We do not believe this is an efficient outcome for the NEM.

Increasing the availability of demand response for RERT

In our submission to the AEMC's Reliability Frameworks Review, ERM Power has proposed a modification of the existing RERT rules that could enable additional demand response to be quickly and efficiently made available for the RERT if required.

ERM Power's retail business (ERM Business Energy) has one of the most successful demand response programs in the NEM, spread across all interconnected states and territories. As such we are well placed to comment on how to better facilitate demand response in the NEM.

At present, demand response may only participate in the RERT if it is not already participating in the market through existing arrangements. The rationale for this requirement is to ensure that RERT contracting is associated with genuinely new supply that would not otherwise be provided through the market in response to high spot prices. However because of the competing aims of AEMO and retailers or third parties in dispatching demand response, there may be more demand response able to assist AEMO in the event of a potential reliability issue under the right conditions.

This is because retailers dispatch demand response in response to projection of wholesale prices, whereas demand response will be dispatched for the RERT in response to a forecast of possible lack of supply. While it should be expected that at times of lower system reserves, where Lack of Reserve notices have been issued by the market operator there would be high wholesale market prices, this has historically not always been the case and was not primarily the case in the 2017-18 summer when AEMO twice dispatched relatively small amounts of demand response for system reliability purposes. At these times wholesale prices generally did not approach the market price cap which would be expected at times of a tight supply-demand balance. As such, there may have been low cost and short notice retailer-led demand response available at these times that were unable to participate as part of the RERT because it is classified as on-market.

Consequently, we consider that there is a case to change the RERT rules to allow for on-market demand response to be used for the RERT if it would not otherwise be dispatched. One such way to achieve this could be to allow retailers and third party aggregators with demand response the opportunity to on-sell their demand response to AEMO as part of the RERT. This may be particularly effective in the Short Notice RERT timeframe. This would provide AEMO with an option to access significant volumes of additional demand response at a time closer to dispatch when the uncertainty of its actual need is reduced and at lower costs than typical RERT contracts. In situations where the retailer or third party is not dispatching, or intending to dispatch the demand response, AEMO could dispatch this for the RERT. We submit this would be a good first step to efficiently unlock additional demand response prior to the 2018-19 summer period.

Reinstating the long-notice RERT

While we do not support AEMO's rule change in its current form, if the Commission concludes the long notice RERT should be re-instated, ERM Power considers this should be achieved by reinstating the original long-notice RERT provisions in the Reliability and Emergency Reserve Trader (RERT) Guidelines rather than amending the current medium notice RERT provisions from 10 weeks to 9 months. Both the long-notice and medium-notice RERT provisions should remain as separate standalone provisions.

Under section 5.3.1 of the consultation paper, the AEMC discusses transitional requirements if the rule is made. In this case, we suggest that these transitional requirements mirror the guidelines and procedures that were in effect immediately prior to the latest update to remove the long notice RERT provisions with two suggested change as set out below. These original guideline and procedures have previously been consulted on and would avoid requiring the Reliability Panel and AEMO to review guidelines and procedures.

Should the Commission determine that the long notice RERT be re-instated, then we recommend an additional provision in the RERT Guidelines to only allow the procurement of long-notice RERT contracts to remove any forecast level of unserved energy (USE) to meet the current 50% POE regional forecasts of system demand, this will reduce the costs to consumers of AEMO procuring long-notice RERT to meet higher level demand forecasts that have a much lower probability of occurring.

Also, when assessing the need to enter into RERT contracts the Guideline allows considerable discretion to AEMO by allowing AEMO to take into account "any other information that AEMO considers relevant". We believe in the interests of transparency and to reduce the potential for market distortions this should be changed to "any other publically notified information that AEMO considers relevant". This change would allow the market to respond where possible to any change in information prior to AEMO commencing the RERT procurement process.

Conclusion

ERM Power sees that there may be a need for a provision similar to the long-notice RERT to be reinstated as part of the Procurer of Last Resort Mechanism in the National Energy Guarantee. As such, we would prefer that this rule change be considered alongside the Guarantee rather than in isolation. However, we acknowledge that the AEMC is unable to do this. As such, given the evidence available to the market at this stage, ERM Power considers that there is not clear justification for the reinstatement of the long-notice RERT at this time.

We also contend that AEMO may be able to enhance the amount of demand response it has access to under the current RERT arrangements by allowing retailers or third party aggregators to on-sell their demand response to AEMO.

Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

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