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Australian Energy Market Commission
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Victorian Jurisdictional Derogation – Reliability and Emergency Reserve Trader (RERT) Contracting Consultation paper

Snowy Hydro Limited welcomes the opportunity to comment on matters raised in the Consultation Paper from the Australian Energy Market Commission (the Commission) on the Victorian Jurisdictional Derogation – RERT Contracting.

Snowy Hydro Limited is a producer, supplier, trader and retailer of energy in the National Electricity Market ('NEM') and a leading provider of risk management financial hedge contracts. We are an integrated energy company with more than 5,500 megawatts (MW) of generating capacity. We are one of Australia's largest renewable generators, the third largest generator by capacity and the fourth largest retailer in the NEM through our award-winning retail energy companies - Red Energy and Lumo Energy.

Snowy Hydro understand the challenges AEMO faces in managing energy supply however we believe the multi-year RERT approach counters having electricity markets as providers would see the RERT as a long-term, lower risk alternative to participating in the market as a result increasing costs to consumers. Victoria has some form of regulatory mechanism that has allowed AEMO to contract for emergency reserves along with numerous other intervention mechanisms such as Directions and Instructions which could be utilised in cases of genuine market shortfall.

RERT in the Short-Notice or Medium-Notice RERT are appropriate tools which allows AEMO to purchase reserves 7 days and 10 weeks respectively from the anticipated shortfall providing the appropriate trade-off for maintaining sufficient levels of unserved energy in the NEM. There is a recognition that there is a trade-off with cost per unit of the Short-Notice RERT and Medium-Notice RERT being more expensive than a multi-year RERT.

A multi-year RERT is fundamentally contrary to the design of the NEM. The RERT was intended as a last resort mechanism, to deal with instances of genuine market failure, and should be rarely used. Snowy Hydro therefore strongly oppose the proposed Victorian jurisdictional derogation to RERT contracting rule change. There is only one market in the NEM and all regulatory settings should be calibrated to incentivise participation in the market. A multi-year RERT is a defacto capacity market in all but name, and would be accompanied all the drawbacks associated with that market structure. The rule change is, therefore, a radical proposal which will fundamentally undermine the market in the short and long run. The ultimate goal should be to encourage participation in the NEM and investment directly into dispatchable energy to meet peak demand. Increasing reliance on the RERT will be likely to produce a less secure market, the opposite of its intended result, and discourage investment in the NEM.

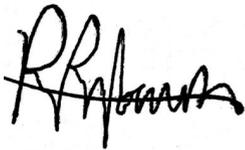
The proposed rule change will lead to costly unintended consequences disrupting the market. Snowy Hydro's detailed concerns are as follows:

- Less than 12 months ago the Commission considered the similar Enhanced RERT rule change. The Commission took significant steps in addressing the concerns raised by market participants which all risk being completely undermined less than 1 year later.
- The RERT rule which is specific to one jurisdiction would cause material complications for AEMO's management of power system operations and market participants across regions with different RERT arrangements across jurisdictions.
- If generators are denied an opportunity to earn an adequate return on their investment, they will have no choice but to reduce their level of investment. As a consequence, the multi-year RERT will crowd out the investment and AEMO will need to continually grow its shadow fleet to fill the gap.
- The direct and indirect costs imposed on market participants, and ultimately end consumers, have been and will be high.
- An alternative market incentivising generation out of the NEM would increase reliability risks and increase the cost to consumers. The energy transition in Victoria will be undertaken in the NEM and not through a separate market.

With the upheaval and structural change already under way in the NEM, this is an inopportune time to be implementing such a radical proposal. Generators are already grappling with the shift to five minute settlement. The multi-year RERT represents narrow thinking which trades long term, effective policy for temporary expedients. We urge evidence-based solutions which provide a stable investment framework, low prices and a secure system of energy supply.

Snowy Hydro appreciates the opportunity to respond to the Consultation paper and any questions about this submission should be addressed to me by e-mail to panos.priftakis@snowyhydro.com.au.

Yours sincerely,



Panos Priftakis
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Snowy Hydro

Enhanced RERT rule change

On 2 May 2019 the Commission made a final rule to the reliability and emergency reserve trader (RERT) so that AEMO had the flexibility to effectively protect the reliability of the national electricity market while minimising costs to consumers. The substantive features of the final rule have not yet been actioned¹.

During the Enhanced RERT consultation the Commission addressed concerns from the market distortions caused from the RERT. The Commission noted that resources that are incentivised to participate in the RERT instead of the primary NEM are distorting incentives to participate in the market which will impact the entry and exit of suppliers in the NEM.² The proposal correctly acknowledged that the RERT is an emergency reserve that should only be used as a last resort mechanism in cases of genuine market failure ensuring that it does not undermine the market it is actually trying to protect. Further to this it highlighted that inappropriate use of the RERT imposes significant costs on consumers as it carries both direct and indirect costs in the NEM and by encouraging the reserve providers to move from the RERT into the market, the Commission correctly highlighted that reliability is delivered at a lower cost to consumers.

The Commission under the Enhanced RERT took significant steps in addressing the concerns raised by market participants which all risk being completely undermined less than 1 year later. Snowy Hydro therefore strongly believes that since the proposed rule change is so similar to what has been proposed previously, the Commission should not be considering the proposed rule change until the rule has completely commenced.

State Derogation

Snowy Hydro does not support specific jurisdiction RERT rules. Jurisdictional RERTs would lead to significant uncertainty for market participants in Victoria and complications for AEMO's management of power system operations across regions with different RERT arrangements. In an interconnected NEM, it is inefficient that possible future challenges facing the market need be managed at a jurisdictional level. Victoria and South Australia alone are strongly linked and often are exposed to similar climatic conditions however if we start heading down the path of jurisdictional rules this will complicate the market and provide further market uncertainty.

The NEM has largely served us well and consistently met its objective of reliable power even through the significant transformation and policy instability over time, it is therefore important we don't overcomplicate and separate the NEM with numerous jurisdictional rule changes. The Consultation Paper correctly notes that *"the RERT forms part of the broader reliability framework for the NEM, comprising market mechanisms and incentives, the reliability standard and reliability settings, the provision of information to the market and intervention mechanisms. In addition, the reliability framework was recently supplemented by the Retailer Reliability Obligation (RRO) that was put in place on 1 July 2019."*³ This should not be complicated through numerous jurisdictional rules.

Impact on investments

Procuring reserves too far in advance of a projected shortfall will likely result in market distortions on both the supply side and demand side. Snowy Hydro is significantly concerned with the comment that the *"RERT is not delivering sufficient reserves to support reliability during the energy transition in*

¹ AEMC, Victorian jurisdictional derogation – RERT contracting, Consultation paper, 24 October 2019

² AEMC, Enhancement to the Reliability and Emergency Reserve Trader, Draft rule determination, 7 February 2019, pp 127

³ AEMC, Victorian jurisdictional derogation – RERT contracting, Consultation paper, 24 October 2019

Victoria and allowing for multi-year contracting of up to three years would help to attract greater volumes of reserve capacity generation”. The ultimate goal should be to encourage participation in the NEM and investment directly into dispatchable energy to meet peak demand, increasing reliance on the RERT will not provide the lowest cost option. The energy transition in Victoria will be undertaken in the NEM and not through a separate market.

As mentioned, the RERT would deprive peaking generation from earning a return on investment. The RERT tends to be dispatched during periods of volatility, depriving peaking plant of earning scarcity pricing for making themselves available during these periods. This reduces the number of participants operating in the ‘energy only’ market. Over time, the quality of the NEM’s generation fleet will decline, compromising its ability to respond to future market events. In short, the system becomes less secure.

If generators are denied an opportunity to earn an adequate return on their investment, they will have no choice but to reduce their level of investment. As a consequence, multiyear RERT will crowd out the private sector, and AEMO will need to continually grow its shadow fleet to fill the gap.

The long notice RERT is a form of moral hazard. A situation where economic actors make inefficient decisions because they are able to avoid costs associated with their conduct. In the case of the RERT, AEMO implements costly intervention measures on the basis they are paid for by market customers. This risk of moral hazard is that investors undertake projects without adequately assessing the externalities created by the RERT resulting in inefficient investment decisions.

In addition, the Victorian Government has not provided any basis for a number of its assertions in its rule change request. In particular, it claims, without providing any supporting evidence, that “indications are that maximum market availability for demand-side contracts has been materially reached” and “small-scale generation contracts are potentially available, but require greater certainty to be able to cost-effectively recoup their investment within the term of the contract.”⁴ These assertions need to be substantiated before they can be accepted as a basis for implementing the proposed rule change.

RERT multi-year contracts

RERT in the Short-Notice or Medium-Notice RERT are appropriate tools which allows AEMO to purchase reserves 7 days and 10 weeks respectively from the anticipated shortfall providing the appropriate trade-off for maintaining sufficient levels of unserved energy in the NEM. There is a recognition that there is a trade-off with cost per unit of the Short-Notice RERT and Medium-Notice RERT being more expensive than a multi-year RERT.

A longer-term market will also have the side-effect of AEMO contracting to satisfy inaccurate forecasts, given accuracy deteriorates as predictions of conditions become further into the future. The implications are that implementing a rule change which allows for RERT to be contracted for longer periods may expose consumers to the unnecessary costs of superfluous RERT.

Snowy Hydro believe the costs outweigh the benefits when increasing the procurement lead time to multi-year from one year. Deciding the point in time to trigger the RERT involves a trade-off between the accuracy and completeness of the information available at that point in time. However we believe the 12 month process is more than sufficient with the Long Notice RERT already not being functionally efficient and as result:

⁴ The Honourable Lily D'Ambrosio MP, *Victorian jurisdictional derogation – RERT contracting, rule change request*, p6.

- the cost of off-market reserves is higher than it should be;
- the triggering of the procurement process has deterred or crowded out market responses;
- the revenue structure of the RERT incentivises both off-market supply and demand response.
- the forecasting of demand to trigger the RERT process has been overly conservative.

As a result of these highlighted inefficiencies it would be problematic to extend the RERT to anything greater than 12 months. Addressing the forecasting issues is of greater importance and is fundamental to the operation of the RERT before any proposal to extend the lead time. The contracting duration for the RERT has been extended from 9 to 12 months. Although unwelcome, this is significantly less than the multiple years which would have impacted future investment further.

Benefits for the long-term interests of consumers

The direct and indirect costs imposed on market participants, and ultimately end consumers, have been high. Using the RERT more frequently has been associated with higher costs. Grattan Institute noted that the 2017-18 summer costs were fairly modest in aggregate, at about \$6 per household per unit, however of expected consumption not supplied it cost about \$57,000 per megawatt-hour. This as noted by the Grattan paper is more than 60 per cent higher than AEMO's estimate of the value of customer reliability, and four times the market price cap in that year⁵. Under the Enhanced RERT rule change the Commission addressed affordability concerns as a key issue for all consumers.

The RERT reverses the normal risk allocation, from proponents spending their own money to a market operator with no risk capital at stake. AEMO is assured of recovering its investments from energy consumers, and so does not exercise the discipline of a proponent risking its own capital. Unsurprisingly, the costs of the RERT have been extreme.

In summary, the RERT is a distortive mechanism which imposes significant costs on consumers and the industry. It does little to achieve its aims and in fact draws attention away from the real issues of lack of competition and inadequate transmission. An efficient NEM energy-only market will provide long-term cost reductions to all consumers. We don't want an alternative market incentivising generation out of the NEM which would increase reliability risks and increase the cost to consumers.

⁵ Grattan Institute, 2019, "Keep calm and carry on - Managing electricity reliability", << <https://grattan.edu.au/wp-content/uploads/2019/02/914-Keep-calm-and-carry-on.pdf> >>