10 May 2023

Anna Collyer
Chair
Australian Energy Market Commission
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Submitted online at www.aemc.gov.au

Dear Ms Collyer

Review of the operation of the Retailer Reliability Obligation – Consultation Paper

Origin Energy Limited (Origin) welcomes the opportunity to provide comments on the Review of the Retailer Reliability Obligation (RRO) consultation paper (the Paper) by the Australian Energy Market Commission (AEMC).

The review of the RRO is timely given the progression of other reforms and recent experience with the T-1 instrument process in SA. In general, we question whether the RRO can efficiently achieve its primary objective of supporting reliability.

As noted by the AEMC, the RRO commenced with the aim of providing 'stronger incentives for market participants to invest in the right technologies in regions where it is needed, to support reliability in the NEM'.[1] However, a fundamental shortcoming of the RRO and other decentralised capacity mechanisms of this nature is that they provide a relatively indirect (and consequently uncertain) means of facilitating new investment. This was a key reason for progressing the Capacity Investment Scheme (CIS), which is being developed to complement changes to market settings and provide a more direct and certain mechanism for ensuring investment in new firming capacity, with the government targeting the first auction in 2023.

The RRO also requires that retailers enter into contracts to meet their share of a one-in-two year peak demand by the T-1 contract position day. The T-1 contract position day is set one year before the beginning of the reliability gap period and is intended to provide time for market investment in additional capacity, and for reserves to be contracted by the Australian Energy Market Operator (AEMO) if required. However, the utility of this requirement is undermined by two key factors:

- Although liable entities must contract for their expected maximum demand by T-1, there is no corresponding requirement on energy consumers to contract with a retailer by T-1. Given a prudent retailer is unlikely to hedge the load for customers that have not contracted over the reliability gap period by the T-1 contract position day, this inherently limits the effectiveness of the T-1 obligation.
- New developments that do not meet specific criteria at the T-1 stage can still reach commercial operation past the T-1 cut-off date but in time to cover the reliability gap period. The new development may not be contracted for the reliability gap period at T-1 and as such cannot be included in any liable entity's NCP, despite the fact the capacity may ultimately be available to support a retailers load during the reliability gap period.

[1] AEMC, 'Review of the operation of the retailer reliability obligation', 23 March 2023, pg.1.

An outworking of the above is that the current form of the RRO creates a compliance obligation that ultimately provides a materially incorrect view of supply and demand. While the mechanism appropriately provides scope for retailers to account for changes in their customer load after T-1 by submitting an adjusted Net Contract Position (NCP), the fact this adjustment mechanism is required highlights the inherent shortcoming of the mechanism. There is also no commensurate mechanism for adjusting a retailer's contract position after T-1, noting there can be circumstances outside the retailer's control (e.g. reliance on an external capacity providers contracting timeframe) that may have limited their ability to enter the required level of contracts by the contract position day.

Given the above, we do not consider the RRO to be an enduring mechanism for supporting reliability in the NEM, particularly given the progression of the CIS. Although the terms of reference do not cover an assessment of the efficacy of the RRO as a reliability measure, it should be considered by the Reliability Panel concurrently with the reliability settings and other measures as part of the next Reliability Panel Review in 2026.

While the RRO remains in operation, we also recommend simplifying the existing framework by removing the T-1 contract position day and assessing liable entities' NCP during the reliability period rather than one year in advance. The T-1 instrument could still be made a year in advance to give liable entities and their customers notice of the requirement.

This approach would retain the obligation and financial incentives on liable entities to be contracted given exposure to procurer of last resort (PoLR) costs, while simplifying compliance, and overcoming issues related to the T-1 contract position day. It would also minimise unnecessary regulatory burden in many cases where compliance / enforcement is not required because no reliability gap is now forecast, or maximum demand did not meet the one-in-two year peak demand threshold.

Where the T-1 contract position day is retained, we recommend the following changes to the current framework.

- Allow for additional time to submit an adjusted NCP report.
- Ensure new developments can be included in NCP reports.
- Introduce a minimum time between making the T-1 instrument to the contract position day.

Please find more details and discussion of various aspects of the RRO in the attachment and contact Ben Hayward on 03 9067 3403 in the first instance if required.

Yours Sincerely,

S Cole

Shaun Cole
Group Manager, Regulatory Policy

No existing requirement for customers to contract by T-1

Origin's main concern with the operation of the RRO relates to the inconsistency arising from the obligation to be hedged by the T-1 contract position day without a corresponding requirement on customers to contract with a retailer by this date. A retailer who is a liable entity cannot prudently hedge the load for customers who have not contracted by the T-1 contract position day. The risks of over or under contracting are increased for reliability gap periods where supply scarcity and volatile prices are expected.

Customers exposed to the market price could be from one of two cohorts

- customers on a pool-exposed contract who will need to purchase qualifying contracts or move to a fixed price contract with their retailer, or
- customers who have yet to enter into a contract for the reliability gap period.

For pool-exposed customers, terms in the contract can require the customer to take an action such as enter into qualifying contracts by the contract position date. This allows the retailer to purchase contracts from the market while limiting price exposure.

For customers who are on a contract which expires before the reliability gap period but after T-1, there is no contract to enforce. A retailer cannot require an existing customer to re-contract for the reliability gap period before T-1.

Retailers will also avoid purchasing contracts against an uncertain customer load and price. Retailers may intend to recontract their existing customers at a time beyond T-1 but they cannot know the intention of their customers and would be taking on exposure to contract price movements. A retailer wishing to avoid this exposure could only do so by not recontracting their existing customers, noting new customers can sometimes be accounted for through an adjusted NCP report.

The existing RRO regulations therefore lead to a situation where

- customers may be forced to change retailer due to a technicality, and
- the benefits of requiring liable entities to hedge by T-1 are not realised as many customers' load would not be counted towards any liable entity's expected demand at T-1.

Customers value flexibility in the how they contract. They come to market at a time that suits their business requirements. Origin also finds flexible hedging products to be popular with business customers which allow them to lock in prices at a pace and timing that suits them. Customers will naturally seek pricing as the end of their contract approaches, this will often fall after the contract position day for a reliability gap period.

If we accept that many customers will not be under contract with a retailer by T-1 for the reliability gap period, and their load not counted towards 'expected demand' at T-1, then the T-1 contract position day loses its significance and provides an incorrect view of supply and demand. Therefore, the AEMC should consider assessing liable entities' actual contract position for any compliance TI in the reliability gap period rather than the contracted position at T-1. This would provide a true view of liable entities' contract position and allow for reduced complexity and compliance work while retaining the incentives of the Procurer of Last Resort (PoLR) costs and the obligation to be contracted to a one-in-two year peak demand.

The T-1 instrument could still be made a year in advance to give liable entities and their customers notice. However, if the contract position is taken from the reliability gap period rather than the T-1, compliance work can be saved in many cases where it is not required because no reliability gap is now forecast, or maximum demand did not meet the one-in-two year peak demand threshold.

Expected maximum demand

Liable entities must submit an ‘expected maximum demand’ forecast as part of their NCP report. This is not used to assess compliance with the RRO as a liable entity’s contract position is assessed against its actual market share of a one-in-two year peak demand. Rather, the expected maximum demand forecast is used to determine the additional contracts which can be included in any adjusted NCP report which is submitted.

The expected maximum demand is defined in the Australian Energy Regulator’s (AER) interim contracts and firmness guidelines as ”the liable entity’s likely share of the system one-in-two year peak demand during the forecast reliability gap period”. This definition is problematic given the nature of customer contracting discussed in the previous section. ‘Likely’ market share is difficult to ascertain when the contracting intentions of existing customers cannot be known.

Furthermore, the definition is not necessarily congruent with section 9.3 of the Interim Contracts and Firmness Guideline and the National Electricity Rules (NER) section 4A.E.7(b). Here, the regulations only contemplate the existing NMIs of a Financially Responsible Market Participant (FRMP) rather than customers likely to be contracted.

This is problematic, as a liable entity would not consider a customer who has indicated intent to change retailer as ‘likely’ and would not include their load in ‘expected maximum demand’. However, this would show up as a reduction in connection points for which the liable entity is financially responsible and negatively impact the liable entity’s ability to submit an adjusted NCP report.

As in the previous section, we suggest that the AEMC removes this inconsistency by moving away from the T-1 contract position day and assessing a retailer’s contract position at the time of any compliance TI. This would remove the need for an ‘expected maximum demand‘ forecast or the need for an adjusted NCP report.

Adjusted NCP report timing

An adjusted NCP report can be submitted to include additional contracts to meet a higher expected demand due to becoming the FRMP for new NMIs following the T-1 contract position day. This must be submitted by the beginning of the reliability gap period.

The timing of current forecast reliability gaps will require adjusted NCP reports to be submitted by December or January. December is also a time when many businesses contract for the following year as their contract approaches its end date and hence a time when a retailer may be acquiring many new customers. We therefore might expect an adjusted NCP report to be required and submitted even while contracting for the reliability gap period is ongoing, which is likely to give rise to unnecessary regulatory burden.

Removing the T-1 contracting requirement would overcome this issue, since there would be no resultant need for an adjusted NCP report under such a framework. However, where that broader change isn’t adopted, we recommend allowing submissions to be provided up to three months after the last day of the reliability gap period. This would provide additional time for preparation and assurance of the adjusted NCP report. This would not undermine the compliance process, noting the AER’s assessment would not take place until AEMO provides final meter read data after 40 weeks.

New developments

New developments can reach commercial operation past the T-1 cut-off date but in time to cover the reliability gap period. To be included currently in a liable entities NCP, projects may have a Power

Purchase Agreement (PPA) or other offtake agreement in place by T-1, or they may be owned by a liable entity in which case no contract is required. There should be exceptions for projects which do not meet either of these criteria to enable their output to be valued under the RRO. If physical plant can demonstrate that their output was not contracted on the contract position day but subsequently contracts with a liable entity, the liable entity should be able to submit an adjusted NCP report which includes this additional contract irrespective of changes to expected demand.

Approach to firmness methodologies

Default firmness methodologies are published for standard qualifying contracts. For non-standard qualifying contracts, a bespoke methodology must be developed and approved by an auditor.

Origin considers there is merit in the AER publishing default firmness methodologies that cover a broader array of qualifying contract types. This could include PPAs, options, insurance, inter-regional products, generators, and batteries. These additional default methodologies should provide sufficient details as to how firmness is calculated such that an auditor’s report is not required. Liable entities would still be provided with flexibility to opt for a bespoke firmness methodology where it could be justified.

This approach would give more certainty around the firmness adjusted MW provided by a contract at the time of contracting. It would also help to clarify the AER’s interpretation of the rules and the Interim Contracts and Firmness Guidelines to liable entities and auditors. This would streamline the development of auditor reports and reduce the risks of a misunderstanding between the AER and liable entities being uncovered following the reliability gap period.

Minimum time between making the T-1 to the contract position day

Market exposed customers have expressed a preference to hedge only when there is certainty of a T-1 instrument. It is possible under the existing regulations for the time between the AER making a T-1 instrument and the contract position day to be only a number of weeks, which may even cover the holiday period. This provides insufficient time for liable entities to efficiently respond to changes in contract terms that can be triggered by the making of the T-1 instrument.

Our preferred solution of removing the T-1 requirement would address this issue. If this is not pursued, a minimum time should be set between making a T-1 instrument and the contract position day even if this extends the contract position day beyond the T-1 cut-off date. This period should be forty business days to allow sufficient time for additional contracting and to address clauses in contracts triggered by the AER making the instrument.

Opt-in mechanism

Our customers have generally expressed a preference that Origin manage their RRO obligations. Feedback from customers is that the penalties are high, and the regulations are complicated. We have found this even with sophisticated customers with existing hedges. The AEMC should consider a reduction in the maximum penalties that could apply to opt-in customers as well as two additional options outlined below based on customer feedback and interactions to date.

Currently third-party hedging agreements held by a customer must be renegotiated to include the retailer as a party to the agreement and in turn, allow the hedges to be included in the retailer’s NCP, which requires legal resources and creates additional complexity for both parties. We suggest that the opt-in mechanism be repurposed to allow customers to register contracts with the AER which would contribute to the NCP of their retailer. This might take a similar form to an NCP report but would need to be approved by the AER ahead of time so that the liable entity has confidence in their position. This enables customers to utilise their own contracts while leaving the compliance and penalty risk with the retailer.

Feedback from customers also suggests that certainty around compliance is needed to encourage uptake of the existing opt-in mechanism. This could be achieved by allowing customers to provide an audited demand forecast along with the NCP, and use the forecast rather than actual demand. For opt-in customers, allowing for an increased role of the auditor to also prepare the NCP and bespoke methodologies might reduce complexity and facilitate greater utilisation of the mechanism.

Market Liquidity Obligation

The voluntary market maker arrangements of the ASX provide a better mechanism for support liquidity than the Market Liquidity Obligation which adds limited value due to its narrow scope and required compliance work. Origin is a market maker on the ASX, and we suggest that incentives to participate in this more comprehensive scheme could be increased by exempting those parties that participate in the voluntary market making arrangements from the MLO.