

Our Ref: 15919549
Contact Officer: Alistair Pellen
Contact Phone: 08 8213 3470
Date: 20 November 2023

Ms Anna Collyer
Chair – Australian Energy Market Commission
PO Box A2449
Sydney South, NSW, 1235

Dear Ms Collyer,

Review of the operation of the Retailer Reliability Obligation (RRO) – draft report 2023

The Australian Energy Regulator (**AER**) welcomes the opportunity to comment on the draft report by the Australian Energy Market Commission (**AEMC**) on the *Review of the operation of the Retailer Reliability Obligation*. The AER thanks the AEMC for the level of engagement it has provided the AER to date, to allow the AER's experience in implementing the current RRO framework to inform the AEMC's policy development.

The AER's detailed comments on each of the AEMC's draft recommendations are set out in the attachment to this letter. We support many of the draft recommendations.

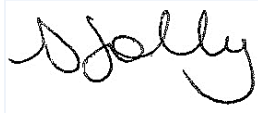
We note the AEMC is proposing to move the contract position day from T-1 to T to resolve a number of limitations it has identified with the current framework, including:

- liable entities not being able to contract with projects commissioned between T-1 and T;
- liable entities not knowing their expected demand at T-1, which may lead to over or under contracting; and
- audit and compliance costs that may be considered unnecessary if a forecast reliability gap does not occur.

The AER considers this proposed change will impact the incentives that policy makers originally sought to create through the introduction of the contract position day at T-1, being to promote sufficient contracting by participants well in advance of a forecast reliability gap. Earlier and longer contracting is needed to underpin investment in physical generation and storage assets in areas of the network where supply is needed. As this proposal has the potential to alter the overall impact of the RRO framework, we consider the AEMC's draft recommendation 1 extends beyond the scope of the current review, which is to review the operational aspects of the RRO. We expand on this in the attachment.

We thank the AEMC for the opportunity to submit on this process and look forward to continuing to work with the AEMC on its review of the RRO. If you have any questions about the AER's submission, please contact Alistair Pellen on (08) 8213 3470.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'S Jolly', enclosed within a thin black rectangular border.

Stephanie Jolly
A/Executive General Manager
Consumer Policy and Markets
Australian Energy Regulator

ATTACHMENT

Draft recommendation 1: Move the T-1 Net Contract Position (NCP) compliance date to T

The AEMC is proposing to move the contract position day from T-1 to T. This means that liable entities would have until the commencement of a reliability gap (at T) to finalise their contracting of firm generation, rather than have their megawatt position locked in one year in advance (at T-1). Liable entities would then only be required to report on their net contract position (**NCP**) if a reliability gap actualises.

The AER does not support moving the contract position day from T-1 to T. The T-3 instrument is intended to drive investment decisions in physical capacity and demand side response in areas where supply is needed ahead of the relevant forecast reliability gap period. The T-1 instrument then aims to crystallise the need for contracting and incentivises liable entities to be prepared *well ahead of* the forecast gap period. Earlier and longer contracting is needed to underpin investment in physical generation and storage assets in areas of the network where supply is needed. Moving the contract position day to T would impact this incentive for early contracting by removing the requirement for participants to finalise their contracts well in advance of the forecast reliability gap.

As the AEMC notes in its draft report, given the AER has only recently made its first T-1 reliability instrument, there is limited data and experience to determine the overall policy efficacy of the framework. The outcomes of the SA forecast reliability gap in 2024 will influence future investment and contracting behaviour by participants, and participants are still on a learning curve under the framework. We therefore consider it is too early to conclude that changing the contract position day to T is necessary or appropriate.

We note that the scope of the AEMC's current RRO review is to consider the operational aspects of the RRO and not the overall efficiency of the obligation. As this proposal has the potential to impact how the framework meets its original policy intent, we consider the AEMC's draft recommendation extends beyond the scope of the current review.

We note there are a number of other draft recommendations (particularly 4, 11 and 12) where the AEMC assumes that draft recommendation 1 will sufficiently address or prevent the underlying issue. We suggest that the AEMC consider how these draft recommendations might change should draft recommendation 1 not be carried through to the final report. In particular, we note below under Draft recommendation 13, our view that the opt-in cut-off date moves commensurate with any change made to the contract position day. This is to ensure sufficient notice for large energy users to opt-in to manage their own RRO obligations and, in turn, allow retailers to understand what large customers are doing as retailers prepare their own contracting for a gap period.

Draft recommendation 2: Change the timeframe for AEMO to request a reliability instrument

The AEMC notes that AEMO must publish the reliability gap in an ESOO or ESOO Update no more than 42-months prior to the forecast gap and submit a T-3 request no less than 39-months prior. This gives AEMO only three months to publish a forecast gap and submit a request for a T-3 instrument. We understand the AEMC is suggesting that AEMO should be allowed to publish the reliability gap no more than **48** months prior to the forecast gap, giving it nine months to publish a forecast gap and submit a T-3 instrument request. It considers that this will enable AEMO to effectively cover potential reliability gaps in spring and autumn periods and ensure that AEMO is able to consider new information which may subsequently close a gap.

The AER supports this recommendation. We agree with the AEMC's reasoning that the modified timeframe will reduce unnecessary constraints on when AEMO can request that an instrument be made, especially during shoulder seasons.

Draft recommendation 3: Provide AEMO with a limited power to request the AER removes a T-1 instrument; and Draft recommendation 4: Maintain the AER's existing role

The AER appreciates that the AEMC's draft recommendation 4 is to maintain the AER's existing role in assessing instrument requests. However, we question whether providing AEMO with the power to request that the AER remove a T-1 instrument implies an extension of the AER's role in relation to instrument requests more broadly. In our submission to the AEMC's consultation paper,¹ we recommended that the AER should not be granted the power to amend or revoke a T-1 instrument once made. We consider the current RRO framework, under which a T-1 instrument is not subject to a specific revocation or alteration power, best supports the objective of the RRO to support reliability in the NEM.

We maintain our position that we should not be granted the power to revoke a T-1 instrument when a reliability gap is no longer forecast. The AER considers the RRO would be having the intended impact if an increase in supply and commitment decisions following the making of a T-1 instrument results in AEMO indicating a reliability gap is no longer forecast. We consider revoking a T-1 instrument would be inconsistent with that intention. The prospect of revoking an instrument may encourage liable entities to risk their position and not sufficiently contract in the hope or expectation that an instrument will be revoked.

We recognise the AEMC's caveat that AEMO should only exercise the power to request the AER revoke a T-1 instrument if data in an Electricity Statement of Opportunities (**ESOO**) or ESOO Update shows the reliability standard or interim reliability measure is no longer breached and if AEMO considers that the forecast reliability gap will not reappear before T. However, we note that AEMO assessed the SA 2024 forecast reliability gap in the T-1 instrument as closed in the update to the 2022 ESOO (released February 2023), but subsequently assessed the forecast reliability gap as re-arising in the 2023 ESOO released six months later. This suggests a risk in revoking T-1 instruments based on a forecast at a point in time. It is also unclear what specific criteria AEMO would need to consider (if any) in deciding that a gap will not reappear, and the role the AER would have in determining whether those criteria have been properly applied.

Draft recommendation 5: Amend the Market Liquidity Obligation (MLO) to ten per cent threshold for MLO groups

The AEMC recommends amending the MLO from a 15 per cent threshold for MLO groups to a 10 per cent threshold, which it proposes will ensure that the MLO continues to support market liquidity in South Australia. It notes that outside of the six T-3 MLO windows, overall market liquidity continues to decline while remaining stable in other NEM regions.

The AER supports this recommendation as it will increase the likelihood of there being at least two generator portfolios in each jurisdiction. This is especially important in South Australia, as it will enable the MLO to more effectively address market liquidity gaps.

Draft recommendation 6: Remove the voluntary book build mechanism

The AEMC recommends that the voluntary book build mechanism be removed as it is not being used; its removal will simplify legislation; and all commenting stakeholders agreed to remove it. The AER supports the AEMC's reasoning for removing the voluntary book build mechanism.

¹ [AER submission – AEMC RRO review consultation paper](#), p.2.

Draft recommendation 7: The AER review expanding eligible demand-side management contract types;

Draft recommendation 9: The AER review the Contracts and Firmness Guidelines to expand eligible qualifying contracts; and

Draft recommendation 10: The AER review opportunities to simplify bespoke methodology and audit arrangements

The AEMC's draft recommendations 7, 9 and 10 all advocate for the AER to review its Contracts and Firmness Guidelines to improve the operation of the RRO.

The AEMC's rationale for each of these recommendations is as follows:

- **Draft recommendation 7** – the AEMC suggests that expanding eligible demand-side management contract types is likely to increase the pool of eligible contracts, reduce costs and regulatory burden. We acknowledge the AEMC's draft recommendation and appreciate the AEMC's recognition that double counting must be guarded against.
- **Draft recommendation 9** - AEMC's recommendation that the AER review its Interim Contracts and Firmness Guidelines to consider expanding eligibility of qualifying contracts with a firmness of 1 to include caps above five per cent of the Market Price Cap (**MPC**) to increase the pool of eligible contracts and reduce costs. We provide further details below on our approach to reviewing the appropriate methodology for caps, as set out in the Guidelines.
- **Draft recommendation 10** – the AER should review opportunities to simplify bespoke firmness methodologies in the Contracts and Firmness Guidelines in light of stakeholder feedback that arrangements for power purchase agreements and load following hedges are too complex. We agree with the AEMC's observation that any changes to simplify arrangements would need to be balanced against the importance of ensuring that contracts are firm.

The AER's Contracts and Firmness Guidelines have been in interim form since 2019. Next year we aim to commence a holistic review of these guidelines before finalising them – this will include reviewing demand-side management contract types, eligibility of qualifying contracts with a firmness of 1, and opportunities to simplify bespoke firmness methodologies. We consider this approach is consistent with the intent of the AEMC's abovementioned draft recommendations.

Approach to determining appropriate methodology for caps

In relation to draft recommendation 9, the AER's Interim Contracts and Firmness Guidelines currently provide for caps with a strike price:²

- of up to 5% of MPC to have a firmness factor of 1 where no other contract limitations are present; and
- greater than 5% of MPC to have a firmness factor based on the formula $(1/0.952^2) \times (1 - \text{strike price}/\text{MPC})^2$.

² AER, Interim Contracts and Firmness Guidelines, p.22.

The AER took a pragmatic, consultative approach when considering the appropriate default firmness methodology for caps in the Interim Contracts and Firmness Guidelines. As noted in the Guidelines:³

The decision to set the cap threshold at five per cent of MPC instead of at \$300 to mimic the current standard cap strike price was made in consultation with market participants. Using the five per cent threshold allows the methodology to move in relation to movements in MPC and allows room for innovation within the contracting space as new firming technologies emerge. The electricity market is undergoing numerous changes including increased generation from renewable sources, the introduction of new technologies such as batteries and an upcoming change to five-minute settlement. Developments in the market may have an impact on the future/forward markets and how cap contracts are traded and used by participants.

Consistent with our position in the Guidelines, we will consult through our abovementioned review of the Guidelines on whether our firmness methodology for caps is still appropriate or whether developments in the market mean this should be amended.

Draft recommendation 8: AEMO review expanding timeframes for the demand portal being open

The AER supports increasing the duration and/or regularity of AEMO's Demand Side Participation Information Portal (**DSPIP**) being open. This will provide increased opportunities for liable entities to register demand response contracts so they can be used as RRO qualifying contracts. While parties should be entering into contracts from T-3, the T-1 instrument solidifies obligations and some parties may only become aware of the utility of demand response within their portfolio when they are reviewing and refining the portfolio shortly before contract position day. Some liable entities were not able to register demand response contracts in the DSPIP for the SA 2024 T-1 Instrument as it was not open between the T-1 instrument being declared and the contract position day.

Draft recommendation 11: Maintain the timeframes for advice on PoLR costs

The AER has no concerns with the AEMC's draft recommendation to maintain the timeframes for advice on PoLR costs.

Draft recommendation 12: Maintain the existing role of market customers as liable entities

The AER supports maintaining the existing role of market customers as liable entities and recognises that the AEMC intends to amend the liable entity criteria so that Integrated Resource Providers will be treated consistently with how the load of market customers is treated.⁴

Draft recommendation 13: Maintain the existing opt-in mechanism

The opt-in cut-off date should move commensurate with any change the AEMC decides to make to the contract position day, to retain the opt-in cut-off date at six months before the contract position day. This will allow for large energy users to opt-in to manage their own RRO obligations closer to a gap period, while still providing affected retailers notice to

³ AER, Interim Contracts and Firmness Guidelines, p.21.

⁴ AEMC, [Final Determination](#) – Integrating energy storage systems into the NEM, p. 67.

incorporate any necessary changes to their own NCPs due to large energy users contracting for their own load.

Draft recommendation 14: The AER to review options to simplify compliance arrangements through guidelines

We acknowledge the AEMC's draft recommendation that the AER review options to simplify compliance arrangements through guidelines. We will consider how to efficiently consult with stakeholders on these arrangements.