21 June 2019

Peter Adams
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

EnergyAustralia Pty Ltd
ABN 99 086 014 968

Level 33
385 Bourke Street
Melbourne Victoria 3000

Phone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@energyaustralia.com.au
energyaustralia.com.au

Lodged electronically: rro@aer.gov.au

Dear Mr Adams,

AER Draft Interim Contracts & Firmness Guidelines, Retailer Reliability Obligation

EnergyAustralia is one of Australia's largest energy companies with around 2.6 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own, operate and contract an energy generation portfolio across Australia, including coal, gas, battery storage, demand response, solar and wind assets with control of over 4,500MW of installed generation capacity in the National Electricity Market (NEM).

We remain seriously concerned about the compressed timeline for implementation of the Retailer Reliability Obligation (RRO) which creates significant challenges for all participants and market bodies, including the AER. Further, it has been challenging for the industry to get a holistic view of the entire set of guidelines and their interaction with the rules given the varying timelines specified in the rules for both interim and final guidelines, potentially meaning complex issues are overlooked or unresolved.

EnergyAustralia recognises the challenge that the AER has been given under the RRO rules in completing the novel task of determining 'firmness' factors for financial contracts. These Interim Draft (and final) Contract and Firmness Guidelines (the guidelines) will be critical to the success of the RRO and in ensuring the obligation achieves, as far as possible, its desired aims at the lowest cost to the market and customers.

The AER should recognise that there is time, after the draft guidelines come into effect, to refine the details of these guidelines and should endeavour to continue to work with industry to improve them.

Implications of additional SA Government Powers

The ability for the South Australian (SA) Minister to make a T-3 reliability instrument with only 15 months' notice before it takes effect creates additional risk and challenges for all participants. Industry is still yet to see the final regulations that will stipulate how the SA Ministers additional powers will interact with the final RRO rules. There remains the risk that a T-3 could be made by the SA Minister before the interim guidelines are

finalised. As there may only be 3-months between a T-3 and T-1 instrument being made this could create significant challenges for industry as they try and understand their qualifying contract positions. It is imperative that the AER understands and seeks to address these risks that the additional SA Minister powers create.

Default Firmness Methodologies

When developing the final guidelines, firmness factors and methodologies the AER needs to consider the fundamental objective of the RRO which is to incentivise investment in existing and new dispatchable generation, protecting retailers from high prices is just a by-product of the RRO design. We are supportive of the AER applying default firmness methodologies to standard products and this should help minimise cost of compliance with the RRO.

Swap Products

Assigning a firmness factor of one to standard swap products is a sensible approach, we support this.

Cap Products

It is still unclear why the AER has selected 5% of the Market Price Cap (MPC) as a threshold for a then declining firmness factor for cap products. The AER should consider that in fact there may be generation technologies or demand response which have a higher short run marginal cost (SRMC) than 5% of SRMC and therefore a higher strike price would still likely be a legitimate product for the owner of this physical position. We recognise that a cap product with a strike price of very near MPC is not likely to meet the objective of the RRO and therefore should have a lower (near zero) firmness factor but it is not clear why the firmness factor declines in the curve shape chosen. The AER should endeavour to provide more information on this point.

Options

EnergyAustralia is supportive of using the delta value of options to access firmness, delta values are a well understood measure and commonly used metric across the industry. We have some concerns that the current available exchange measures of volatility (at T-1) that the AER requires to be used in the options pricing model to calculate deltas may create undesirable outcomes. Therefore, we suggest that the AER should allow additional third-party measures of volatility (for example, broker curves) as well as considering using a longer volatility calculation period that ends before T-1 to provide clarity on the firmness of options before the contract position date. We suggest that averaging volatility over 2 months from 3 months before a T-1 until 1 month before a T-1 would be sensible.

Bespoke methodologies

We support the AER's approach to bespoke firmness methodologies. Given the myriad of different contractual and product innovations in the NEM it is important that the AER's guidelines continue to allow for these to occur under the RRO. Contracts that meet the objective of the RRO but are not standard contracts should be able to be used to meet the obligation, provided they are adjusted for firmness

Internal Hedges

When considering the firmness factor of internal generation, the AER should not limit the assessment of generator performance to simply backwards looking but should also allow consideration of forward looking generation performance (for example, due to upgrades or additional maintenance) and forecast outage rates to feed into any firmness measure. For example, the AER could allow internal measures of forecast forced outage rates for future business planning purposes to be used in bespoke firmness calculations.

The work that has been presented by the AER on internal generation assumes that all generation in a vertically integrated generator sits in the same liable entity. As previously highlighted this is not always the case and the AER needs to ensure the process to approve internal generation as a qualifying contract does not create further challenges for obligated parties.

Batteries

The reliability gap that is determined at T-1 by AEMO is probabilistic in nature only. It is simply the period (or periods) where there is higher Loss of Load Probability (LoLP) but not necessarily periods where there will actually be any reserve issues. For energy limited plants (or demand response) the AER should allow for some flexibility that participants will dispatch their resources at times when a compliance periods actually applies in real time, and not just assign the output of this energy limited plant based on a forecast (uncertain in nature) at T-1. This is representative of actual practice where market participants, using more accurate short-term forecasts, will seek to dispatch their energy limited plant during periods of higher prices. It is our understanding that AEMO in their reliability modelling in fact apply this 'perfect foresight' principle.

PPA's

The guidelines should not attempt to be too granular when determine variable generations capacity across the gap periods and trading intervals. A daily intraday profile for each month of the gap period should be sufficient. As highlighted above, the reliability gap as determined at T-1 by AEMO is only a forecast more probably period of low reserves. AEMO cannot be certain of the exact conditions that may actually lead to a 1-in-2 demand condition occurring and therefor the AER should not seek to prescribe a trading interval granularity over the entire reliability gap period.

Liable entities and Net Contract Position

The AER should give consideration to the definition of liable entities under the final RRO rules and some of the unintended challenges this could create for market participants and the AER. The RRO stands to be a significant compliance burden and ongoing piece of work for both liable entities in complying with the obligation, but also on the AER in accepting and monitoring submitted Net Contract Positions (NCP), among other things. As it stands retailers (as registered market customers) may be required to submit multiple NCP reports, including complicated internal positions as the final rules do not contemplate the reality of retailers varying structures. EnergyAustralia suggests that the AER (and the rules) should consider allowing liable entities to nominate their liability and reporting requirements to another related entity. This would likely simplify the overall compliance burden on liable entities and reduce associated costs.

Whatever is decided by the AER this needs to be applied consistently across all Liable Entities and associated market participants.

Non-Qualifying Contracts

EnergyAustralia is disappointed that the final rules specify that only non-qualifying contracts that increase an entities exposure to the volatility of the spot price in a region during the gap trading intervals. The one-sided treatment makes little sense and we would suggest that non-qualifying contracts that reduce exposure should be treated symmetrically.

Audit Panel

The AER should allow for Liable Entities to utilise existing relationships with current Auditor (provided meets certain reputable requirements) to minimise cost and further complexity of compliance. We do not agree with the AER's concerns that it may be challenging to find sufficiently qualified people to act in this role.

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

Regards

Sean Ogilvie
Electricity Trading Leader