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Dear Mr Adams,

AER Draft Interim Market Liquidity Obligation Guideline, 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 thank the AER for running the consultation and appreciate the limited time given to the AER to develop several guidelines, including these, that will be critical to the operation of the Retailer Reliability Obligation (RRO).

EnergyAustralia remains seriously concerned about the compressed timeline for implementation of the RRO which creates significant challenges for all participants and market bodies. Further, it is 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. To complicate matters further the Energy Security Board (ESB) has now released final rules (the final rules) to give effect to the RRO[1] but current AER consultation is based on previous draft rules (the draft rules). While we appreciate this is somewhat out of the AER's control, all industry bodies should give consideration to how to better improve this co-ordination.

We consider that there continues to be no justification for any compulsory market making obligation in the NEM as it enjoys fairly high levels of liquidity in all regions, with the exception of South Australia which faces a number of structural issues inhibiting greater liquidity[2]. Further, the existence of the Market Liquidity Obligation (MLO) will be a disincentive on larger customers to change their current behaviour as they will always assume the liquidity obligation can be relied upon when the market has hit an

[1] http://www.coagenergycouncil.gov.au/publications/retailer-reliability-obligation-rules
[2] For more detail see page 3, EnergyAustralia's submission to the AEMC market making consultation, https://www.aemc.gov.au/sites/default/files/2019-02/Rule%20Change%20SubmissionERC0249%20-%20Energy%20Australia%20-%2020190207.pdf

investment shortfall - potentially decreasing the incentive for new supply. The MLO could therefore act against the intent of the RRO.

We are disappointed that the ESB is not willing to consider the MLO as a backstop should no other formal market making arrangement be operating in a region between T-3 and T-1[3]. We continue to have the view that a voluntary market making scheme is more rational, will improve transparency and price discovery and will send the right signals for new investment. Notwithstanding the above, EnergyAustralia notes that the ESB's final rules appear to have taken into account some stakeholder concerns around the MLO but consider that there are still significant issues that need to be addressed.

Performing a liquidity obligation

EnergyAustralia is concerned how the volume limit rules treat the 'buy' side of any bid-offer spread required under the MLO. Any volume measure to track if an obligated party is satisfying a liquidity obligation should treat buys and sells indifferently as both legs are required for the process of price discovery and contribute equally to any measure of liquidity. We have serious concerns that the final rules do not allow for this and may in fact place obligated parties in a situation where even though they have transacted significant volume within a liquidity trading window/period they still have not met their obligation under the rules. Consider the example below:

- An obligated party places a bid to buy 5MW and an offer to sell 5MW (bid-offer spread) at the required MLO spread on an approved MLO exchange.

- The obligated party's bid of 5MW is accepted (i.e. they buy 5MW) which satisfies their obligation for that liquidity trading period.

- As it stands under the final rules the 5MW (buy) is not included in any volume limits (the 1.25% quarterly limit or the 10% for the liquidity period) and actually reduces the aggregate amount counted towards the volume limits.

- Therefore, in theory the obligated party could continue to have their bid's accepted (that is they buy contracts) for all required trading sessions for the entire liquidity period (~ 2 years) while never actually satisfying the prescribed volume limits of the liquidity obligation.

If this scenario materialised (even in part), it will expose obligated parties to exploitation from those not obligated to provide a Bid/Offer spread under the MLO. It is our strong view that any market making liquidity obligation should treat both buys and sells equally as both are essential to the process of price discovery and increased liquidity.

We would encourage the AER to provide examples in their final interim guideline to ensure that obligated parties are all interpreting their requirements under the MLO in the same way. As it stands, there is a lack of clarity in both the rules and guidelines around what is explicitly required to meet an MLO obligation.

[3] Examples of formalised market making arrangement could include the ASX's market making incentive scheme or the tender for market making responsibilities currently being considered by the AEMC in their rule change consultation process.

MLO Qualifying Contracts

EnergyAustralia considers that MLO products should also expressly include financial and calendar year contracts. Including these products would likely improve the reliability of the NEM as it encourages generation to be available to the market across a longer period (not just the gap period) while also allowing peaking plant to recover their fixed costs over a longer period. Only allowing monthly or quarterly products does not align with the intended aim of the RRO to provide certainty to suppliers to invest in new or existing plant.

MLO Spreads

EnergyAustralia supports the changes to the bid-offer spreads from the draft rules to the final rules. As previously highlighted in our submission to the RRO draft rule consultation it was unclear as to why there had been a change since earlier workshops[4]. However, the final rules and guidelines are unclear as to how the bid-offer spread is to be calculated. We consider the spread should be measured relative to the offer and we encourage the AER to clarify this in their final interim guidelines.

MLO Exemptions

The final rules provide a limited set of circumstance where an obligated party is not required to perform their MLO obligations[5]. We consider that the AER MLO Guidelines should also provide for exemptions from performing a liquidity obligation if an obligated party reasonably considers that they are at risk of breaching any law, regulation or rule. For example, this would cover:

- An obligated party who is in receipt of any unpublished information that could reasonably be considered price sensitive, and may put them at risk of breaching insider trading rules under the MLO, for example:
    - a party is in negotiations for a significant transaction that is non-public; or
    - a party is aware of a significant fuel supply or plant-related issue.
- An obligated party who has reasonable grounds to suspect that they may be at risk of self-dealing.

Due to the short consultation timeframe provided for the draft RRO rules and guidelines we have not completed a full assessment, but we have concerns that there could in fact be competition law issues relating to the operation and implementation of the MLO. Likewise, given the potential for future law changes, for example the Treasury Laws Amendment (Prohibiting Energy Market Misconduct)[6] could be reintroduced, any current obligations should allow for exemptions to ensure that any MLO remains workable in the future.

[4] http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/EnergyAustralia%20Response%20to%20National%20Electricity%20Rules%20Amendments%20-%20Retailer%20Reliability%20Obligation.pdf

[5] Final Rules, 4A.G.21

[6] https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6256

We note that the ASX's Market Making Incentive Scheme allows for a number of exemptions ("Permitted Circumstances"); one of which provides exemptions for a Market Maker (MM) if "entering into a Contract in that Product during the Market Making Session will cause the MM to breach an applicable law". We encourage the AER to model any changes off these exemptions.

Deeming MLO Generators and Groups

We note that the final rules allow for deeming of MLO Generators and Groups until the 30th June 2021[7]. This approach is acceptable provided there is an avenue for obligated parties to dispute deemed units prior and during an MLO liquidity period. Given that at the time of publishing the AER's Draft Interim MLO Guidelines the ESB had not finalised their decision on the deeming of units there is little information in the draft guidelines as to how the AER will deal with this. We would encourage the AER to provide further clarity to stakeholders around how any adjustment to the deemed list of MLO generators and groups in the final rules will be made.

The final rules include a list of deemed generators for the MLO and EnergyAustralia notes that this list includes battery energy storage systems. It is our view that for similar reasons to excluding variable renewable generation (inability to support sold swap or cap position) that developing technologies, such as batteries, should be excluded from the MLO at this point. Any inclusions may in fact act as a barrier to obligated parties investing in additional developing technologies. We would encourage the AER to consider this point further in the development of the final guidelines.

Generator capacity and closures

The final rules allow for exemption from the liquidity obligated if the generating units closure date is earlier than the start of the forecast gap period[8]. EnergyAustralia supports this change from the draft rules. Similar to how the final rules deal with generator closures, the AER should give consideration in its guidelines to allow adjustments and/or exemptions to MLO requirements due to unplanned plant shutdowns or issues that may impact the availability of generation during the liquidity period.

EnergyAustralia considers that using registered capacity to determine volume limits for obligation parties is not reflective of the actual ability for a generator to 'defend' during a reliability gap period. The ESB in their RRO final rules package cover document correctly identify this concern and that other measures such as summer capacity provided to AEMO might be a better measure to be used[9]. We are concerned that the ESB appears to have dismissed their own argument for a different measure of capacity due to the fact that it may introduce some minor additional administrative burden on the AER. Given that generators maximum capacities can vary greatly from season to season and the likelihood that any reliability gap will occur in the summer period when generators are most de-rated, we consider that an alternative measure (such as summer capacity) should be used. Further, registered capacity is not reflective of the generation for which a party receives payment at the Regional Reference Node (RRN) due to auxiliary loads

[7] Final Rules, 11.116.12

[8] Under NER 2.10.1(a)(2), the final rules extend the generator closure notice from 3 years to 3.5 years

[9] http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Retailer%20Reliability%20Obligation%20-%20Cover%20Paper_1.pdf

and transmission losses. While not previously raised this should be considered when determining what volume of contracts a generator can 'defend'.

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

Sarah Ogilvie
Industry Regulation Leader