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Australian Energy Regulator
GPO Box 520
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Submitted by email to RRO@aer.gov.au

For consultation - Draft Interim Qualifying Contracts and Firmness Guideline

Snowy Hydro Limited welcomes the opportunity to comment on matters raised in the Consultation Paper from the Australian Energy Regulator (the AER) on the Draft Interim Qualifying Contracts and Firmness Guideline.

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.

With the energy industry's investment focus shifting to a combination of firm lower emissions gas generation and renewables more than 3,000 megawatts of firm generation exited the market in Australia over the last few years. For an electricity system to work properly and contribute to reliability there needs to be sufficient dispatchable and flexible capacity that can operate continuously on a sustained period of time.

Snowy Hydro supports the principles proposed by the AER's Draft Interim Qualifying Contracts and Firmness Guideline. We understand that if the Retailer Reliability Obligation (RRO) is triggered, "firmness" of contracts used for compliance will take into account the firmness factor applied to each contract considering characteristics such as strike price, the variability and profile of volume settled under the contract and the likelihood of the contract providing cover to the buyer during the reliability gap. There are however a range of issues and comments Snowy Hydro would like to raise. These include:

- The Rules and Guidelines should be flexible in their assessment of qualifying contracts.
- The principles should not stifle contracting innovation and the ability for market participants to dynamically manage their portfolio to reduce costs for customers, including accessing interregional generation and other derivatives to meet their obligations.
- The standard option approach is welcome however in the interim the option for bespoke firmness methodologies approved by an Independent Auditor should also be provided to continue to encourage innovation and allow participants to test the approach.
- The AERs criteria in calculating the firmness factor for internal hedge should serve as a guide for vertically integrated businesses and not serve as a mandatory requirement on participants. An additional layer of mandatory reporting will be onerous on businesses and add further costs.
- There should be certainty or provisions in the rules which would ensure that once firmness factor has been approved for a technology it will not change significantly for the life of the contract.

- Audits will provide assurance to the AER that reported positions are realistic and include only qualifying contracts that meet a period of peak demand. However in requiring an additional audit on firmness calculations of bespoke contracts the process will add to the costs of the RRO.
- Those appointed to the AER's Auditors Panel must have sufficient experience and expertise in energy derivatives and energy contracts to carry out the functions of an Independent Auditor. Given the complexity of the market it is important that the auditor understands how the market operates and understand the market rules.
- The arrangements in the rules which require demand response to be registered in AEMO's Demand Side Participation Information Portal (DSPIP) and that the liable entity must take into consideration any factors which limit the ability for the contract to be used during a one-in-two year peak demand event during the reliability gap period is welcomed.

Firmness methodology

Snowy Hydro supports the firmness principles described in the Rules. The principles for the firmness adjustment of contracts will be critical in the operation of the RRO. It is for that reason we welcome the criteria set out by the Rules in reflecting three types of risk:

- *Price risk – whether the contract limits a liable entity's exposure to a high spot prices during the reliability gap period*
- *Volume/shape risk – whether the contract sets a fixed volume of electricity, is variable (such as being tied to the output of a generator or, the performance of an interconnector), or varies based on the time of day*
- *Contract limitations – whether the qualifying contract contains other terms that limit the coverage from spot price volatility (such as a contract that has a maximum payout limit or a contract that only triggers when certain weather conditions occur).¹*

The firmness of qualifiable contracts is central to the effectiveness of the RRO. Hence we note the importance of qualifiable contracts recognising the quality and duration of the supply and/or demand response source. Snowy Hydro's preference is that there is an appropriate duration criteria where the source can meet a period of peak demand for 4 continuous hours. The source must have a high level of reliability such that it can be relied on to start-up and supply energy.

Standard Options

The AER considers that any standard option valuation approach could be used to adjust the firmness of qualifying contracts. With the option delta providing a reasonable approximation of the likelihood of the contract being in place during the reliability gap period, and the measure of the contract's firmness. Snowy Hydro supports this standard approach however believes the option for bespoke firmness methodologies approved by an Independent Auditor should also be provided in the interim guidelines as with the non-standard qualifying contracts.

The bespoke methodology would enhance innovation for market participants. In the interim guideline it is important to provide enough options for participants to provide different methodologies. The option should be left with the market participant to decide whether they

¹ Australian Energy Regulatory, 2019, "For consultation - Draft Interim Qualifying Contracts and Firmness Guideline Retailer Reliability Obligation", pp16

undertake a bespoke methodology and require an auditor or follow the standard approach avoiding the need for an auditor.

Interregional contracts

Snowy Hydro understand the AER's guidance for developing a bespoke firmness methodology for interregional contracts. The Rules and Guidelines however should be flexible in their assessment of qualifying contracts. Overly prescriptive criteria could have a material impact on the way in which participants seek to meet their RRO obligations, which could have resulting impacts on the structure of investment in the NEM and the operation of the NEM financial market.

Snowy Hydro understands as a liable entity must record and be able to provide to the AER documents developed by the generation and retail arms of the business providing evidence of the following:

- The total generation capacity of the liable entity
- The proportion of total generation capacity reserved for internal hedging
- The calculation of the firmness factor in accordance with the guidance.
- The firmness adjusted internal hedge position.

These principles should however not stifle contracting innovation and the ability for market participants to dynamically manage their portfolio to reduce costs for customers, including accessing interregional generation and other derivatives to meet their obligations. Retailers should be able to manage their exposure to the wholesale market in an efficient and lowest-cost manner, rather than be subject to additional contracting requirements that will become a costly and inefficient burden. It is however important that liable entities must firmness adjust an internal hedge to reflect how likely they are to meet the gap.

Further to this, the AER note a minimum that liable entities must consider when calculating the firmness factor for internal hedges:

1. *Recent historical performance of the generator. Historical data must be recent (within 3 years) and correspond to the same time of year and trading intervals as the reliability gap period.*
2. *Any planned outages forecast for the reliability gap period. A planned outage of a generating unit would reduce the firmness factor to 0 for any gap trading intervals coinciding with the planned outage.*
3. *Planned upgrades to the generating units. If upgrades have recently been done or are planned before the reliability gap period and are consistent with AEMO's committed criteria, this adjustment may result in a higher forecast generation level than historical data would suggest.*
4. *Any fuel considerations. For a hydro plant this would include modelling of dam storage levels and any impact this would have on the capacity of the plant during the reliability gap period.²*

The above criteria can serve as a guide for vertically integrated businesses however it should not serve as a mandatory requirement on participants. An additional layer of mandatory reporting will be onerous on businesses and add further costs as we work through the numerous reform changes

² Australian Energy Regulatory, 2019, "For consultation - Draft Interim Qualifying Contracts and Firmness Guideline Retailer Reliability Obligation", pp 36-38

progressively being implemented. A significant amount of the information requested above is already available to AEMO and the AER.

It is important that principles should ensure that contracting innovation is not stagnated and market participants remain free to develop arrangements to satisfy the RRO and operate in the market.

Firmness contracts

Snowy Hydro would welcome some certainty or a provisions in the rules which would ensure that once firmness factor has been approved for a technology it will not change significantly for the life of the contract. Without the certainty, market participants will continue to face ongoing regulatory risks of frequently having to revisit contracts which would impact. Snowy Hydro therefore welcomes the rules allowing the firmness factor to apply to the life of the bespoke contract.

Auditor

Snowy Hydro understands that the AER in assessing compliance with the RRO will undertake an external auditor's assessment of the liable entities' qualifiable contracts. This approach will provide assurance to the AER that reported positions are realistic and include only qualifying contracts that meet a period of peak demand. However in requiring an additional audit on firmness calculations of bespoke contracts the process will add to the costs of the RRO.

The AER is required to establish an Auditors Panel. Snowy Hydro agrees that those appointed to the Auditors Panel must have sufficient experience and expertise in energy derivatives and energy contracts to carry out the functions of an Independent Auditor. Given the complexity of the market it is important that the auditor understands how the market operates and understand the market rules.


Demand response products

Demand response is likely to play an increasingly important role in the future of the National Electricity Market (NEM) improving through technological advancements. It is therefore important that the rules clearly assess the flexibility and duration of demand response if it is to accommodate the increasing penetration of variable renewable generation.

Snowy Hydro supports the arrangements in the rules which require demand response to be registered in AEMO's Demand Side Participation Information Portal (DSPIP) and that the liable entity must take into consideration any factors which limit the ability for the contract to be used during a one-in-two year peak demand event during the reliability gap period which include:

- *How much control the liable entity has when curtailing load.*
- *If the customer providing the demand response has full discretion whether to provide the demand response, the firmness factor would be low.*
- *Maximum duration load can be curtailed for an event or total duration load can be curtailed over a contract period. How long the load takes to respond to a curtail notice. Number of times a load can be curtailed over the contract period.³*

³ Australian Energy Regulatory, 2019, "For consultation - Draft Interim Qualifying Contracts and Firmness Guideline Retailer Reliability Obligation"



The flexibility, duration and performance is the most important for the reliability and security of the NEM. There is a significant difference in firmness and flexibility on small and large scale demand response and the above questions will assist in making sure demand response can provide the service it has promised to provide. The comprehensive registration process and assessment of baseline methodologies will provide more certainty in the firmness of demand response.

Further to this, if the firmness methodology for internally hedged generation requires significant historical information then this should also apply for demand response on the performance of the load. It is important that there is a technology neutral approach.

Snowy Hydro appreciates the opportunity to respond to the Consultation Paper. Any questions about this submission should be addressed to Panos Priftakis, Regulation Manager, by e-mail to panos.priftakis@snowyhydro.com.au.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K Ly', with a long horizontal stroke underneath.

Kevin Ly
Head of Wholesale Regulation
Snowy Hydro

