Consultation on the Proposed Operation of the Retailer Reliability Obligation Rule Changes in South Australia

1- Introduction

At its meeting on Wednesday 19 December 2018, the COAG Energy Council agreed to amendments to the National Electricity Law to give effect to the Retailer Reliability Obligation as well as local amendments to its operation in South Australia.

The *National Electricity (South Australia) (Retailer Reliability Obligation) Amendment Bill 2019* (the Bill), currently progressing through the South Australian Parliament, amends the *National Electricity (South Australia) Act 1996* so that a T-3 reliability instrument could be made by the South Australian Minister if it appears to the Minister, on reasonable grounds, that there is a real risk that for a specified period, supply of electricity to all or part of the South Australian community may be disrupted to a significant degree.

The amendments allow the Australian Energy Market Operator to request and the Australian Energy Regulator to make a T-3 reliability instrument for the same period in which the Minister may make a T-3 reliability instrument.

The Bill also provides a head of power to make Regulations to modify the Rules to ensure the clear and efficient operation of the South Australian Minister's power.

The local amendments were included in the Bill to ensure South Australia can manage its reliability concerns through the transition to the new mechanism.

On 8 March, the Energy Security Board released draft changes to the National Electricity Rules related to the Retailer Reliability Obligation for public consultation. It is expected that the COAG Energy Council will make a decision on the final Rules in time for commencement on 1 July 2019.

As the Rules are yet to be finalised, this consultation paper has been prepared to seek stakeholder feedback on how South Australia may need to amend the application of some Rules in South Australia in relation to a T-3 reliability instrument made by the South Australian Minister.

This consultation paper is not seeking feedback on the ability of the South Australian Minister to make a T-3 reliability instrument or other aspects of the Bill itself.

2- Amendments modifying operation of Retailer Reliability Obligation Rules in South Australia

The Bill provides that a T-3 reliability instrument must be requested by AEMO 3 years before a reliability gap period. This means that if the Bill is passed by mid-year, the first year that AEMO could request a reliability instrument for is 2022.

The Bill provides for the South Australian Minister to make a T-3 reliability instrument for 2020 if the Bill is passed by mid-year. This is because the Bill allows the South Australian Minister to make a reliability instrument 15 months before the start of the reliability gap period for a transitional period.

The transition period applies to the day that occurs 3 years after the day the Bill comes into operation. This means if a reliability instrument is made for a period that commences before this date it can be made with 15 months notice, but if the period commences after this date 3 years notice is required.

Question 1: Do stakeholders consider that any amendments are required to the operation of the Rules for reliability instruments made with 3 years notice?

Question 2: Do stakeholders consider that any amendments are required to the operation of the Rules for reliability instruments made with 15 months notice?

Reliability Instruments

Under the draft Rules, if the South Australian Minister were to make a T-3 reliability instrument with 15 months notice, and the AER were to subsequently make a related T-1 reliability instrument, liable entities would have limited time, approximately 3 months, to finalise their contract positions.

The South Australian Government is considering options to provide liable entities with more time to finalise their contract positions under such circumstances. Options being considered include amending the T-1 compliance dates, that is the contract position day and reporting day, and/or allowing liable entities to amend their net contract position after the contract position day. Adjustment of net contract positions could be provided for by reducing the thresholds prescribed under the Rules which define where an adjustment event has occurred.

Question 3: If the contract position day were to be delayed how much time do stakeholders consider is reasonably required for liable entities to finalise contract positions prior to the start of the reliability gap period?

Question 4: If the contract position day is left unchanged at T-1 what additional flexibility should be allowed for liable entities to amend their contract positions between T-1 and the start of the reliability gap period?

Further, the Bill does not prevent the AER and the South Australian Minister from both making T-3 reliability instruments that cover the same forecast reliability gap period. These could have overlapping or different definitions of the reliability gap period and trading intervals that are subject to compliance. The South Australian Government is also seeking stakeholder's views

on issues that may arise under such circumstances and whether amendments to the operation of the Rules is required.

Question 5: What issues do stakeholders consider could arise if T-3 instruments made by the South Australian Minister and the AER were in operation at the same time?

Question 6: Do stakeholders consider that the Rules should be amended to manage such an occurrence?

Qualifying Contracts and Firmness

Section 14O(1) of the Bill defines the meaning of a qualifying contract as a contract or other arrangement that:

- Is directly related to the purchase or sale, or price for the purchase or sale, of electricity from the wholesale exchange during a stated period; and
- The liable entity entered into to manage its exposure in relation to the volatility of the spot price.

Based on the draft Rules released by the ESB, the Rules will not specifically provide for permitted or excluded contracts. Under the draft Rules (4A.E.1) the AER, in the Contracts and Firmness Guidelines:

- May include guidance for liable entities to determine whether a contract or arrangement is a qualifying contract;
- Must not prescribe other types or arrangements that are taken to be qualifying contracts under section 14O(1)(b) of the National Electricity Law; and
- May specify the types of contracts or other arrangements that are taken to be excluded contracts (and therefore not qualifying contracts) under section 14O(2) of the National Electricity Law.

The draft Rules set out principles that guide how firmness factors are determined. The draft Rules currently propose that the AER Contracts and Firmness Guidelines will set out a range of default methodologies for determining the firmness factor of standard contracts. Liable entities that use default methodologies to calculate the firmness of their contracts can submit their net contract position reports to the AER without engaging an independent auditor.

The draft Rules currently require entities using bespoke methodologies (approved or not) to engage an independent auditor to confirm that the bespoke methodology developed is appropriate having regard to the firmness principles (if not pre-approved) and has been correctly applied to calculating firmness for the net contract position.

Under the draft Rules (11.115.6), the AER must make and publish interim Contracts and Firmness Guidelines by 31 August 2019 to apply until the Contracts and Firmness Guidelines are made and published.

There is the potential, should the Bill pass and the Act be commenced by proclamation on 1 July 2019, that the interim Contracts and Firmness Guidelines will not be published by the time the South Australian Minister makes a T-3 reliability instrument.

Where this occurs, the South Australian Government is considering an alternative approach where liable entities would be able to engage auditors, pre approved by the South Australian Government, to review firmness methodologies for their contracts. Firmness methodologies would need to be consistent with the firmness principles established in the Rules. The auditor would then provide a report to the AER that the methodology used is in line with the principles set out by the AER. This approach is similar to the potential alternative approach to firmness methodologies being considered by the ESB.

The South Australian Government is also considering how firmness factors set under any alternative approach, prior to the interim Contracts and Firmness Guidelines being made, would apply under the national Rules.

Question 7: Do stakeholders consider that there needs to be an alternative approach in South Australia for a reliability instrument made with 15 months notice if the AER has not yet made its interim Contracts and Firmness Guidelines?

Question 8: Do stakeholders agree with the approach proposed to manage such circumstances, or are there alternative approaches that should be considered?

Market Liquidity Obligation (MLO)

The draft Rules provide that obligated parties (Section 6.5.2) must commence market making under the MLO within five business days after a T-3 Reliability Instrument is made by the AER in that region (provided that there are at least two corporate groups which exceed the 15 per cent market share threshold in that region). When the AER receives a T-3 Reliability Instrument Request from AEMO, it will provide obligated parties with advance notice that the MLO could be triggered. This should provide obligated parties with 2 months prior notice of the liquidity period commencing.

The Bill provides for the South Australian Minister to make a T-3 reliability instrument without the approval of the AER. As such, current drafting of the Rules would still require the liquidity period to commence 5 business days after the T-3 reliability instrument takes effect. However, there will be no requirement for the AER to provide obligated parties with advance notice that the MLO could be triggered.

The South Australian amendments to the Bill provide the Minister with the ability to make a T-3 instrument, in the transition, with 15 months' notice. Under such circumstances it may not be practical to provide the same prior notice to obligated parties.

South Australia is considering amending the operation of the Rules in South Australia such that the Minister must use best endeavours to inform obligated parties as soon as practical that the Minister is considering making a T-3 reliability instrument under the South Australian provisions. Failure of the Minister to provide prior notice to obligated parties will not delay the commencement of the relevant liquidity period.

Question 9: Noting the circumstance the South Australian Minister may make a T-3 reliability instrument, do stakeholders consider a requirement to notify obligated parties as soon as practical appropriate?

Question 10: Do stakeholders have views on the most appropriate mechanism for the Minister to communicate the intention to make reliability instrument to obligated parties? For example, formal written communication, intent published on Departmental website, media announcement.

The draft Rules propose that the MLO will only require obligated parties to make contracts available for the period of the forecast reliability gap where there are at least two corporate groups in that region which exceed the 15 per cent market share threshold for the last two consecutive quarters (on average) in that region (each corporate group, being a 'MLO group').

The Rules include a complex range of tests and calculations for identifying obligated parties.

Given the likely time required to determine the appropriate grouping, in consultation with relevant stakeholders, the ESB is considering whether an alternative 'deeming' approach should apply for the first two years of the Obligation (1 July 2019 to 1 July 2021). This would be implemented by:

- Including a list of deemed MLO generators into the transitional Rules
- Providing the AER with an ability to alter the list of MLO generators
- Deferring application of the MLO generator definition in the Rules until 1 July 2021.

The deeming approach would allow for adjustments if there are changes within the two year deeming period.

Given the complexities of draft Rules and the possibility of the South Australian Minister making a reliability instrument soon after commencement, South Australia is considering suitable approaches for determining liable generators during the transition.

Should the ESB decide to undertake the deeming approach for the first two year period, and include a list in the transitional Rules, this should be sufficient for operation of the MLO should the South Australian Minister make T-3 reliability instrument.

Should the ESB not take this approach, South Australia is considering nominating liable generators in regulations for the transition period. This would be done in consultation with the AER and AEMO and assessment would be undertaken in a manner similar to that proposed in the ESB's alternative approach.

Question 11: Do stakeholders agree that the ESB's alternative approach to determining liable parties in the first two years would be sufficient for early operation of MLO in South Australia?

Question 12: Should South Australia be required to nominate liable generators in regulations, what considerations do stakeholders consider should be taken into account when determining liable generators?

Currently the draft Rules define a number of events, the earlier of which of these occur will end the liquidity period. This includes the liquidity period ending on the T-1 cut off day for the relevant forecast reliability gap.

The South Australian Minister has the ability, for period commencing prior to the relevant day, to make a T-3 reliability instrument 15 months out. The Bill defines the T-1 cut-off day for a forecast reliability gap as the day that is 1 year before the day the forecast reliability gap period for the forecast reliability gap starts. This means the MLO may only be in operation for 3 months.

Further, the AER may inform obligated parties that the MLO is no longer required where a T-3 instrument is issued, but no related T-1 instrument is made within the timeframe required by the Rules, or where there are less than two corporate groups in a region which exceed the 15 percent market share threshold for the last two consecutive quarters (on average) in that region.

Given the South Australian Minister's ability to make a T-3 reliability instrument in a compressed timeframe, to maintain liquidity and avoid activation of the MLO for very short periods, South Australia is considering extending the operation of the MLO for a fixed period.

Where the South Australian Minister makes a T-3 reliability instrument with less than 3 years notice, the MLO would commence on issuing of the T-3 reliability instrument and cease on the date the liability period commences.

The South Australian Government is considering whether volume limits prescribed in the Rules would continue to apply as prescribed in South Australia.

South Australia is also considering whether other events listed under 4A.G.16(d) of the draft Rules would apply in South Australia prior to the relevant day.

Question 13: Are stakeholders aware of any issues that should be considered in relation to the MLO operating for a fixed period under the circumstances described above?

Question 14: Do stakeholders consider there need to be adjustments to the volume limits as prescribed in the draft Rules if the above approach is adopted?

Question 15: Do stakeholders consider that the other events listed in the Rules as ending the liquidity period should continue to apply in South Australia prior to the relevant day?

Opt-in Cut Off Day

The draft Rules provide that the Opt-in Cut-off Day is 18 months after the T-3 reliability instrument is effective, or the next possible business day. Ordinarily, this will give retailers around six months' notice of the opt-in load of its customers before the Contract Position Day, and time to adjust its contract position accordingly.

The draft Rules require the AER to establish an opt-in register within 30 business days of a T-3 reliability instrument being published. However, as a transitional measure, the AER will not establish an opt-in register until the AER's Opt-in Guidelines are in place (which must be before 30 June 2020). As a result, if a T-3 reliability instrument is issued before 30 June 2020, eligible large customers will not be able to opt-in until this time.

Further, applications for the Prescribed Opt-in Customer category must be received by no later than 40 business days before the Opt-in Cut-off Day.

Following the issuing of the AER's Opt-in Guidelines there will be a period of time where the South Australian Minister may make a T-3 reliability instrument 15 months out from the start of the relevant period, and the Opt-in Cut-off Day will apply. Given the compressed time frames associated with the Minister's T-3 reliability instrument the current timelines for opting in will not be appropriate.

To manage this, South Australia is considering that for T-3 reliability instruments made by the South Australian Minister with less than 3 years notice, an amended opt-in process would apply. Broadly, the process following the South Australian Minister making a T-3 reliability instrument would involve:

- The AER establishing an Opt-in register;
- Limited to large opt-in customers that meet a defined threshold;
- Large customers wishing to opt-in must opt in for the entire load at a connection point; and
- Applications to opt-in would be made to the South Australian Minister for Energy who would approve the large customer becoming an opt-in customer and included in the AER's register.

It is important to note that the Minister for Energy would be assessing that a large customer properly understands its obligations under the RRO and not undertaking a formal assessment of the business' financial position or risks associated with becoming large opt-in customers.

Question 16: Do stakeholders consider the above proposal sufficient to provide for large customers to opt-in where a T-3 reliability instrument is made before the relevant day?

Question 17: Do stakeholders have a view on an appropriate large customer threshold for application under such circumstances, noting the ESB is also currently considering potential large opt-in customer thresholds?

Other Issues

The issues and proposed approaches covered above have been identified as a high priority by the South Australian Government, in consultation with market bodies. However, the Department would also be interested in stakeholders' views on any other issues, particularly related to a reliability instrument made by the South Australian Minister with less than 3 years notice.

It should also be noted that this paper has been prepared on the draft Rules, and further local changes in South Australia may be required if there are significant changes to the final Rules approved by the COAG Energy Council.

Question 18: Do stakeholders have any further amendments to the Rules that may be necessary to facilitate operation of the South Australian amendments prior to the relevant day?

3- Consultation timetable.

The Department for Energy and Mining invites comments from interested parties on the drafting of the bill and questions set out in this paper by close of business Thursday 16 May 2019. Late submissions will not be accepted. Feedback received will inform the preparation of Regulations to amend the operation of the Retailer Reliability Obligation Rules in South Australia.

Submissions can be lodged by emailing them to RRO@sa.gov.au.

All submissions will be published on the Department for Energy and Mining's website, unless indicated as confidential.