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Government of South Australia

Department of Mining and Energy

Submitted by email: RRO@sa.gov.au

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

AGL Energy (**AGL**) welcomes the opportunity to make a submission in response to the South Australian Department of Energy and Mining's Consultation on the Proposed Operation of the Retailer Reliability Obligation (**RRO**) Rule Changes in South Australia (**Consultation Paper**).

AGL is one of Australia's largest integrated energy companies and the largest ASX listed owner, operator and developer of renewable generation. Our diverse power generation portfolio includes base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources. AGL is also a significant retailer of energy, providing energy solutions to around 3.5 million customers throughout eastern Australia.

In addition, AGL is continually innovating our suite of distributed energy services and solutions for customers of all sizes. These behind-the-meter energy solutions involve new and emerging technologies such as energy storage, electric vehicles, solar PV systems, digital meters, and home energy management services delivered through digital applications.

Proposed amendments to the Retailer Reliability Obligation

Prior to the October 2018 COAG Energy Council meeting, the Energy Security Board (**ESB**) consulted on draft exposure legislation to form the reliability component of the National Energy Guarantee as well as alternate pre-conditions options to trigger the obligation.¹ In December 2018, the South Australian Government also consulted on a proposed Reliability Instrument, which would effectively allow the South Australian Minister to trigger the retailer reliability obligation (**RRO**) with only 15 months' notice.²

AGL continues to have the same concerns regarding the proposed amendments as we have expressed in our previous submissions on this issue. These concerns have also been echoed in submissions from a range of other stakeholders, including market participants, business representatives, and consumer representatives, which have also suggested that the proposed SA Reliability Instrument is not required and may in fact detract from the operation of the broader RRO.

We do not consider the changes proposed by the Draft Bill to be an improvement on the original design of the RRO and do not consider that the Government has made a case as to why the proposed derogation would improve reliability and help put downward pressure on prices for electricity in South Australia. Therefore, we would recommend that the SA derogations not be exercised until the Minister and the Government have fully understood the implications of following that course of the action, which would

¹ See AGL's response to the proposed alternate pre-conditions for the reliability obligation, available here: <https://thehub.agl.com.au/articles/2018/09/submission-in-response-to-the-neg-reliability-requirement-pre-condition-options-paper>

² See , for example, AGL's response to this consultation is available here: <https://thehub.agl.com.au/articles/2018/12/submission-in-response-to-the-sa-governments-proposed-reliability-instrument>



require the RRO to first be finalised and further analysis on the impact of earlier notice period to be assessed. In the interim, we consider that there are a number of existing mechanisms that can be utilised to adequately maintain power system reliability over the next three years.

Impact of Ministerial discretion

Reducing the lead time of the T-3 reliability instrument and decreasing the certainty over the conditions at which it will apply seems to be in contradiction to the design of the RRO, which necessitates predictability of application and a sufficient lead time for retailers to react to a shortfall by sourcing firm contracts.

One of the key benefits of the RRO is that its application would be foreseeable and would therefore establish a degree of investment certainty for participants. This certainty over time was expected to drive greater investment in the optimal supply mix to meet wholesale market objectives and lower prices for customers.

While the Consultation Paper does not seek further views on the ability of the SA Minister to make a T-15 month reliability instrument, we note that the existence of this Ministerial power without clear guidance on the parameters under which that power may be exercised will add additional risk for market participants, reducing the value of investment certainty. We therefore make a general comment that derogations from the national Rules framework should be avoided unless absolutely necessary and also exercised cautiously.

Impact of short notice periods

If the Ministerial power was used to trigger the RRO with less than three years notice, there would be substantial concerns with liable entities' ability to comply with the obligations under such a short timeframe, and an increased risk of distortionary market impacts as a result of the market intervention.

For example, a T-15 month instrument as proposed by the Draft Bill would require retailers to not only seek out and establish hedge cover but also provide evidence of this sufficient firm cover within the three month period between the T-15 month determination and the T-1 year compliance deadline. There would be a very limited ability for retailers and large customers to restructure electricity supply contracts in advance of the trigger, leading to a serious risk of adverse consequences as obligations for participants crystallise without adequate notice.

These adverse consequences and difficulties in achieving compliance may occur even if sufficient qualifying contracts to meet the terms of the RRO are technically available in the market. However, if they are not (i.e. there is a shortage of firm contracts in accordance with the RRO firmness specifications), it is also not plausible that lowest-cost new generation, demand response, or other contracts that could be used to show compliance with the RRO would be able to be negotiated by retailers and energy users within such a short period.

Sourcing existing contracts in accordance with an as-yet-unknown process to determine firmness factors, submitting these for assessment to an independent auditor, revising and updating those positions, and finally providing them to a regulator is likely to take much longer than three months. Development of new generation under the same constraints would be even more challenging.

While extending the contract position day and reporting day timeframes as proposed in the Consultation Paper may provide more time for participants to understand and meet their compliance obligations, the timeframe between the T-15 trigger and any forecast Reliability Gap remains much too short.

Qualifying Contracts and Firmness

We note that in addition to considering the Draft Bill, we are still responding to consultations on the initial settings for the RRO at a NEM-wide level. A number of critical conditions under which the RRO will operate

remain the subject of future consultations, such as the AER's Contracts and Firmness Guideline that has not yet been published and will not be finalised until 2020.³

Elements such as the calculation of firmness factors materially impact the way the RRO operates. For example, the extent to which hedge arrangements are required to be supported by generation physically located within a particular NEM region may impact the extent to which the RRO will support the investment in or the retention of dispatchable generation in that region. These elements will only be determined after the release of the 2019 ESOO, providing market participants with no time to consider the potential impacts of the RRO on the SA contract market.

Until these conditions have been determined, it is very difficult to predict the uncertain impact of the RRO and therefore recommend any structure for derogations or alternate conditions from that central design.

While an audit framework could in the interim provide some assurance that participants are making genuine attempts to meet the intention of the RRO, such a framework would need to allow for significant flexibility in how participants chose to meet their obligations, given the extremely constrained time to prepare for compliance with new obligations, and the absence of clear direction from central authorities on how particular contracts should be treated.

For example, as currently designed, firmness principles may not assign much weight to electricity sourced from other NEM regions, due to the structure of existing interregional hedging products. In South Australia, however, where a significant proportion of generation is likely to come from the interconnector, this may make compliance with the RRO problematic if there is a shortage of local firm contracts available to show compliance with the proposed obligations.

We are therefore concerned that there may be shortage of contracts to show compliance with the RRO due to an insufficient lead time to develop appropriate guidelines, despite there not actually being a significant shortage of energy in the market.

These are key issues that the Minister will need to assess when determining whether to trigger the RRO with only 15 months' notice for participants. In our view, instead of proposing to use a mechanism that has not yet been fully developed, addressing short-term reliability concerns at the lowest cost might be best achieved through utilisation of the RERT. The RERT takes into account forecast capacity shortfalls and seeks to obtain sufficient reserves to meet those requirements at lowest cost through established processes and procedures.

Beyond the RERT, the SA Government also has broad powers under *the Emergency Management (Electricity Supply Emergencies) Amendment Act 2017*, which allows the Minister to give broad directions regarding the operation of the electricity market in response to a declaration by the Minister of an electricity supply emergency in South Australia.

Market Liquidity Obligation

The utilisation of the market liquidity obligation (**MLO**) on such a short timeframe is unlikely to provide any significant benefit. Following analysis and stakeholder feedback, the ESB in its Final Rules package proposed MLO settings that would operate over a two year period from T-3 to T-1. Compressing the proposed MLO period to one quarter (i.e. T-15 months to T-1) would further reduce any of the claimed benefits associated with the ESB's MLO design.

³ The AEMO Forecasting Best Practice Guideline will only see an interim guideline published 30 September 2019, and the as yet unreleased AER Contracts and Firmness Guideline will only have an interim guideline to be published 31 August 2019. These guidelines materially impact the operation of the RRO but are still under initial development and will only be finalised after the publication of AEMO's 2019 ESOO.



The final structure of the MLO has been predicated on its application 3 years from the reliability gap, with the MLO ceasing operation prior to the contract position day. We therefore do not consider that the MLO should apply if a trigger is called within 15 months as the very significant administrative overheads and compliance burden on MLO Groups is unlikely to provide a commensurate benefit during this short time.

However, if the MLO does apply, we consider it should apply on the same terms as designed by the ESB. If any changes are made, we consider that a separate consultation should consider alternate proposals in more detail, on the basis of further analysis and justification for positions that are inconsistent with either the ESB's decisions and the conditions of the voluntary ASX market making scheme.

Multiple compliance obligations

The Draft Bill should prevent the AER and the South Australian Minister from both making T-3 reliability instruments that cover the same forecast reliability gap period and impose conflicting obligations on liable entities. It would be a regulatory failure if participants were subject to different compliance obligations for the same activity during the same period. In our view, such a conflict may be open to legislative challenge, creating even greater uncertainty for liable entities.

Next Steps

AGL remains committed to supporting policy that provides clear long-term investment signals for the electricity sector. We look forward to engaging further with the SA Government to discuss market reform that could maintain system security and reliability in South Australia at the lowest cost to customers.

At this stage, we do not consider that Ministerial power to impose a reliability obligation that is still very much under development will support this aim, and instead, in the short term could lead to adverse outcomes in terms of hedge market liquidity and costs to SA market participants and customers. The mechanism may also not contribute to resolving current concerns regarding SA system strength.

We look forward to working further with the SA Government however to address any reliability concerns in a way that provides the most certainty for investors and lowest cost for customers over the long-term.

Should you have any questions in relation to this submission, please contact Aleks Smits, Manager Policy & Research on 03 8633 7146, or myself on 03 8633 7252.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Eleanor McCracken-Hewson', written over a horizontal line.

Eleanor McCracken-Hewson

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