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Thursday, 21 November 2019

Kate Degen
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Ms Degen

RE: Victorian jurisdictional derogation – RERT contracting rule change request

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) rule change on a Victorian jurisdictional derogation to Reliability and Emergency Reserve Trader (RERT) contracting.

About ERM Power

ERM Power is an Australian energy company operating electricity sales, generation and energy solutions businesses. The Company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load¹. A growing range of energy solutions products and services are being delivered, including lighting and energy efficiency software and data analytics, to the Company's existing and new customer base. The Company operates 662 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland. www.ermpower.com.au

General comments

ERM Power has been actively involved in recent policy developments involving the RERT, in particular the Enhancement to the RERT rule change process. We supported the AEMC's final determination on the rule change, released in May 2019. We have consistently argued that one of the key risks involved in the RERT is imposing a RERT procurement framework on the National Electricity Market (NEM) which imposes significant costs on consumers for an uncertain benefit. We and others wish to ensure that the RERT framework balances the overall costs of any RERT procurement to the benefit received by consumers, it is unclear to us that the proposed Victorian jurisdictional derogation achieves this objective.

The AEMC's final determination on the Enhancement to the RERT rule change request which sought to impose a framework where the market operator could commit consumers to paying for multi-year RERT contracts on a "just in case" basis was released on May 2019. The AEMC rejected the proposal to allow multi-year contracts on the grounds that while it may lead to cheaper year-on-year costs for emergency reserves, the overall costs on consumers would outweigh the benefits.² We therefore consider the rationale for this rule change is questionable. Ordinarily, the AEMC would not consider a rule change on the same

¹ Based on ERM Power analysis of latest published financial information.

² AEMC, Enhancement to the RERT – Final Determination, May 2019, pp x.



issue within a 12-month period unless there has been a material change in circumstances. We do not consider that this threshold has been reached to warrant re-opening this issue.

There are risks to allowing this rule change to be made: it could prevent some supply resources from registering to go “on market” and based on previous history, we do not consider it certain that it will only be a short-term solution as described by the proponent. The prospect of receiving availability payments as well as the potential for dispatch payments above the market price cap may prove to be generous enough that some supply which would otherwise be planning “on market” investment choosing not to enter the market and instead attempt to negotiate a RERT contract with AEMO for Victoria. As this capacity remains “off-market”, this would also increase wholesale market prices above that which would have otherwise occurred, further increasing costs to consumers. Similarly, the Victorian Government may feel confident that the permanent presence of what is effectively a standing strategic reserve is necessary to manage against the risk of even the smallest potential for unserved energy. It is unclear to us that this would provide a balanced cost vs benefit outcome for consumers.

The Commission noted in the Enhancement to the RERT rule change Final Determination that “load is shed on a rotational basis, the impact felt by each customer, while regrettable, is only felt for a short amount of time. However, the system operator would be affected to a greater extent than each consumer would. The system operator, in managing the entire system, would “feel” the entire event and experience the event through the total amount that needed to be shed, rather than through a rotational basis.”³

In the event of any involuntary load shedding, the respective state government would also “feel” the event in the same way as the system operator. This potentially explains both AEMO’s original proposal and this rule change request which mirrors AEMO’s proposal to establish what is in effect a standing strategic reserve to reduce the potential for involuntary load shedding to close zero, whereas consumers are more focused on the costs incurred for such a change.

As part of the Enhancement to the RERT rule change process, the Commission engaged the Brattle Group to review and report on the reliability standards, setting and reserve contracting framework applicable in overseas power markets. The Brattle Group found that “all four jurisdictions that it examined as part of their review target a reliability standard that is much higher than justified on the basis of the expected economic benefits of avoided outages or procure more resources than that required to meet their reliability standard, or both”.⁴

The Commission noted that “this is expected of a system operator, given the role that it plays in managing the system and the incentives that it faces. The risks associated with not having enough reliability are borne by both consumers and the system operator. However, the costs of procuring more reserves than needed are borne by consumers alone - the system operator does not bear any commercial risk in procuring more”.⁵

These comments applicable to a system operator would equally apply to any jurisdiction. The Commission also noted that “this is why the governance framework for reliability involves independent organisations setting and reviewing the reliability standard, and doing so on behalf of consumers while weighing the costs and benefits of reliability rather than this being undertaken by the system operator”.⁶

³ AEMC, *Enhancement to the RERT – Final Determination*, May 2019, p 71.

⁴ Brown et al. (2019) *High-Impact, Low Probability Events and the Framework for Reliability in the National Electricity Market – prepared for the Australian Energy Market Commission*, p v.

⁵ AEMC, *Enhancement to the RERT – Final Determination*, May 2019, p 66.

⁶ Ibid.



We note there are a number of other options for jurisdictions to have more emergency reserves if they consider these are needed, particularly in the short-term without imposing additional costs on consumers. This includes jurisdictions providing funding to emergency reserve providers to sit on, and so be available through the RERT panel, or by participating in emergency reserves themselves, e.g. by purchasing capacity that is then offered into RERT.

We also believe that in considering this rule change request, the Commission should consider its recent draft determination on the Medium-Term Projected Assessment of System Adequacy (MTPASA) rule change. If implemented as drafted, this change will help to provide longer duration signals for the need for more capacity that will negate the need for this Victorian RERT over a three-year period. The draft rule change would extend the MTPASA from two years to three years, providing an increased rolling three-year window on a more granular basis for the need for capacity to be signalled to the market.

Impact of forecasts

We note that the primary motivation for this rule change request is based on one of a number of potential scenarios contained within the 2019 Electricity Statement of Opportunities (ESOO) that showed a forecast breach of the reliability standard in Victoria for 2019-20. However, the assumptions that led to this forecast breach are predicated on a series of outages or supply-limits which may or may not eventuate. AEMO's assumptions for forecast unserved energy (USE) in Victoria in 2019-20 which exceeds the Reliability Standard, is based on a sensitivity case where both Mortlake Unit 2 and Loy Yang A Unit 2 remain unavailable, along with 2 units at the Torrens Island A power station in South Australia not receiving government approval to extend its operations. AEMO assigned an 18 per cent probability that neither the Mortlake nor Loy Yang A unit would be in-service over the entire 2019-20 summer period despite little if any indication this would not be the case and a 100% probability that the South Australian government would withhold approval for an extension of the operation of the additional 2 units at Torrens A. Torrens Island A has now received approval to extend its life and will be available for the coming summer.

As publicly-listed companies, AGL and Origin have duties of disclosure regarding material impacts on risk and company performance. We believe this would include a requirement to disclose a lengthier outage of the Loy Yang A and Mortlake generating units. Further, as market participants, they must report accurately to the MTPASA process or risk facing civil penalties as per clauses 3.7.2 and 3.7.3 of the National Electricity Rules (NER). Given these significant risks, we think it reasonable that AGL and Origin's intentions to return the Loy Yang A and Mortlake units to service in late 2019 to be the most appropriate assumption to make when assessing the supply-demand balance in the NEM over this summer.

The forecast USE scenario also excluded operation of the nine "emergency" diesel generating units currently operated by SA Power Networks on behalf of the South Australian Government which have a rated hot summers day capacity of 216 MW, similar to the additional capacity provided by the additional two Torrens A units. The impact of operation of these generating units would result in a similar reduction of forecast USE in Victoria as that attributed to the ongoing operation of the two Torrens A units. While this capacity is not currently included in the ESOO or MTPASA reliability assessment, operation of these units will transfer to registered participants following the 2019-20 summer period and are expected to further improve future reliability assessments from that time.

With the exception of the single sensitivity scenario for the 2019-20 summer in the Victorian region included in the 2019 ESOO, the ESOO indicates no forecast breach of the Reliability Standard in the Victorian region for the ten-year period covered by the ESOO forecasts.



In terms of other forecasts of reliability, the MTPASA is based on the most recent weekly update of forecast supply including a derating for unplanned generating unit outages and high temperature for all days in the summer period. Regional demand shows no breach of the reliability standard over the next two years, and the rolling weekly updates have shown no forecast breach since January 2019. From a perspective of delivering a reliability benefit to consumers, it is therefore unclear to ERM Power on what basis this rule change is needed.

ERM Power notes that in the weekly MTPASA reliability assessments, AEMO regularly forecasts the potential for a significant level of involuntary load shedding (ILS) under 50% POE demand forecast conditions. In the end of May 2019 update, AEMO forecast ILS of up to 290 MW under some forecast scenarios for the Victorian region during June 2019 under 50% POE demand conditions. At the end of July, MTPASA's 50% POE forecasts for Victoria projected ILS of around 150 MW of USE in August, going up to as much as 650MW at the extreme end and indicated a possibility of more in September. None of this USE eventuated. Similarly, ILS of up to 650 MW was also forecast for the NSW region in June 2019, again under 50% POE demand conditions. No ILS occurred and in fact there were no Lack of Reserve conditions declared in any region during June 2019. This is under the lower 50% POE conditions, with the 10% POE forecasting even higher amounts of ILS. Examples of AEMO published data regarding the potential for ILS on a regional basis in any month covered by the MTPASA is set out in Appendix A.

ERM Power also supports the Energy Users Association of Australia's (EUAA) comments in their submission on the conservative nature of AEMO's forecasts. As the EUAA highlights, AEMO's forecasts contain a number of conservative assumptions that lead to a tighter supply-demand balance. These include an overly-pessimistic view of generator outages, under forecasting of demand response, and scaling up of historical demand levels to the 10% demand forecast, despite the fact the 10% POE forecast demand has never been exceeded in Victoria.

The Victorian Government argues that making the rule change would allow for enough reserves to be procured to allow for the Retailer Reliability Obligation (RRO) to be in full effect. We have taken this to mean that due to the nature of the T-3 and T-1 trigger process, no gap period could have been declared for either the 2019-20, 2020-21 or 2021-22 summers, so the Victorian Government is choosing to focus on this period. However, as discussed above, no forecast breach of the reliability standard was identified for the 2020-21 or 2021-22 period in the 2019 ES00, therefore in our view any focus regarding what the RRO may or may not have delivered is immaterial. Additionally, the Victorian Government points to the closure of the Liddell Power Station as another risk to manage as part of this rule change. Liddell Power Station is scheduled to close after the 2022-23 summer period according to the most recent update provided by the station's owner, AGL. In considering any future risk to be managed, it should be noted that the closure of Liddell was included in the 2019 ES00 forecasts.

The RRO should create an incentive for more generation to be available in Victoria following the closure of Liddell in 2023 should this requirement be identified. Any potential breach of the reliability standard will be signalled in the 2020 Electricity Statement of Opportunities (ES00) and if required will lead to a T-3 gap period declaration for the 2023-24 summer. The market will then essentially need to find more capacity and contract sufficiently to try to 'fill' the gap or face the risk of additional costs associated with the RERT and any RRO shortfall penalty. ERM Power is confident that if a potential T-3 reliability gap is declared a market response will be forthcoming, as the costs to the market of not responding would exceed the costs of any response.

Victoria will also see a number of supply-side developments in the next few years which may serve to solve any reliability concerns. Generation facilities like the Stockyard Hill and Moorabool wind farms are due to come online over the next 12 months with more to follow. In addition, July 2022 should see the beginning of the Wholesale Demand Response Mechanism which will allow large users to be scheduled and paid like



generators to reduce demand. Part of the reasoning for this rule change is that it will also help to address any future reliability concerns.

Taking all the factors as discussed above into consideration, the case for justifying multi-year contracts on the basis that this would deliver a net benefit to consumers is weak. All told, the weight of evidence suggests that the likelihood of reliability concerns over the short term to medium term is not significant and no more than the level of risk historically faced and as such, this rule change is unnecessary. While the rule change may act to reduce any perceived risks for the Victorian Government and the market operator, it is consumers in Victoria that will ultimately carry the costs of implementing what is in effect a standing strategic reserve. It is unclear to ERM Power that consumers believe this increased cost is necessary or warranted.

We accept that the AEMC may view this issue differently, and consequently, the comments that follow are based not on ERM Power's support for the rule change. Rather, if the AEMC does decide to make the rule change, several revisions should be made to ensure that this does not distort the market over the long term.

Improving implementation

We consider that the end date for the derogation is too far away, given the Victorian Government points to this being a short-term solution in the rule change request. The rule change request sets a sunset clause for 30 June 2025. Yet it would allow contracts to extend to 30 June 2028. We believe this does not reflect a short-term solution, particularly given the scope of what the Victorian Government is seeking to target – the period around the closure of Liddell and the early years of the RRO. Furthermore, given the history of the RERT, in that an original sunset clause was delayed on a number of occasions and then removed altogether to entrench the RERT as a permanent feature, we have little confidence that this date will not be extended.

In our view, any multi-year contracts struck for the RERT should end by 30 June 2025. This would provide the possibility of RERT contract extending for approximately two years after the closure of Liddell Power Station. Rather than for a five-year period following the Liddell closure date that the rule change request would allow. In this way, three-year contracts could be signed up to 30 June 2022. Until 30 June 2023, two-year contracts could be signed, and following that RERT contracts should be limited to the current short-, medium-, and long-notice format.

We also suggest that if the AEMC does make the rule, then it should lead to additional changes for AEMO's forecasting process. Under current arrangements the supply contracted under a multi-year RERT contract would not be factored into the ESOO or other reliability forecasts. However, the contracted reserve capacity would be available at times of low reserve condition. Therefore, sufficient capacity could be available to ensure no breach of the reliability standard but contracted under a multi-year RERT contract, but because AEMO does not have to factor these reserves into its reliability forecasts, a T-1 gap period may still be declared under the RRO as a result of the Victorian Government's multi-year contracting. Generation or other supply side infrastructure that would otherwise have 'closed' the reliability gap could be incentivised by a multi-year RERT capacity contract to sit outside the market with consumers facing higher costs to meet any reliability gap, and retailers and some large users at risk of penalties if they are determined to be under-contracted. Retailers may also find it difficult or extremely costly to secure sufficient contracts for RRO compliance given a substantial volume of potential options could be locked out of the market in a multi-year reserve contract with AEMO.

Conclusion

ERM Power does not support this rule change on the grounds that it will impose increased costs on customers for little clear benefit. Earlier this year, the AEMC dismissed the notion of multi-year contracts as part of the final determination on the Enhancement to the RERT rule change on the basis that the increased costs for consumers would outweigh any potential benefits. While the proponent may receive a perceived



political benefit for moving the potential for any load shedding closer to zero, it is consumers in Victoria that will ultimately carry the costs of implementing the proposed change. In addition, we consider the Victorian Government has been motivated to submit this rule change request by a highly pessimistic sensitivity contained within the 2019 ESOO for the 2019-20 summer period. We have concerns that AEMO's forecasts of potential unserved energy for this scenario in the ESOO are based on extremely conservative assumptions that were not discussed at any time with AEMO's Forecasting Reference Group as an input assumption in preparing the ESOO and are out of step with the most up-to-date information provided in the MTPASA.

Nonetheless, if the AEMC does decide to make this rule change, there are several steps it can take to minimise the costs and risks to consumers and the wider energy sector. Any supply secured through a multi-year contract should be included in AEMO's future ESOO reliability assessments to ensure that a T-3 or T-1 gap period does not arise despite adequate supply being available. Finally, the proposed end date of 30 June 2025 should apply to the end date of contracts rather than allow three-year contracts to be signed up until this date. The rule change proponent argues that this should be a short-term solution; allowing this derogation to effectively apply until 2028, is not, in our view a short-term solution, and runs the risk of further rule changes to extend the end date.

Please contact me if you would like to discuss this submission further.

Yours sincerely,

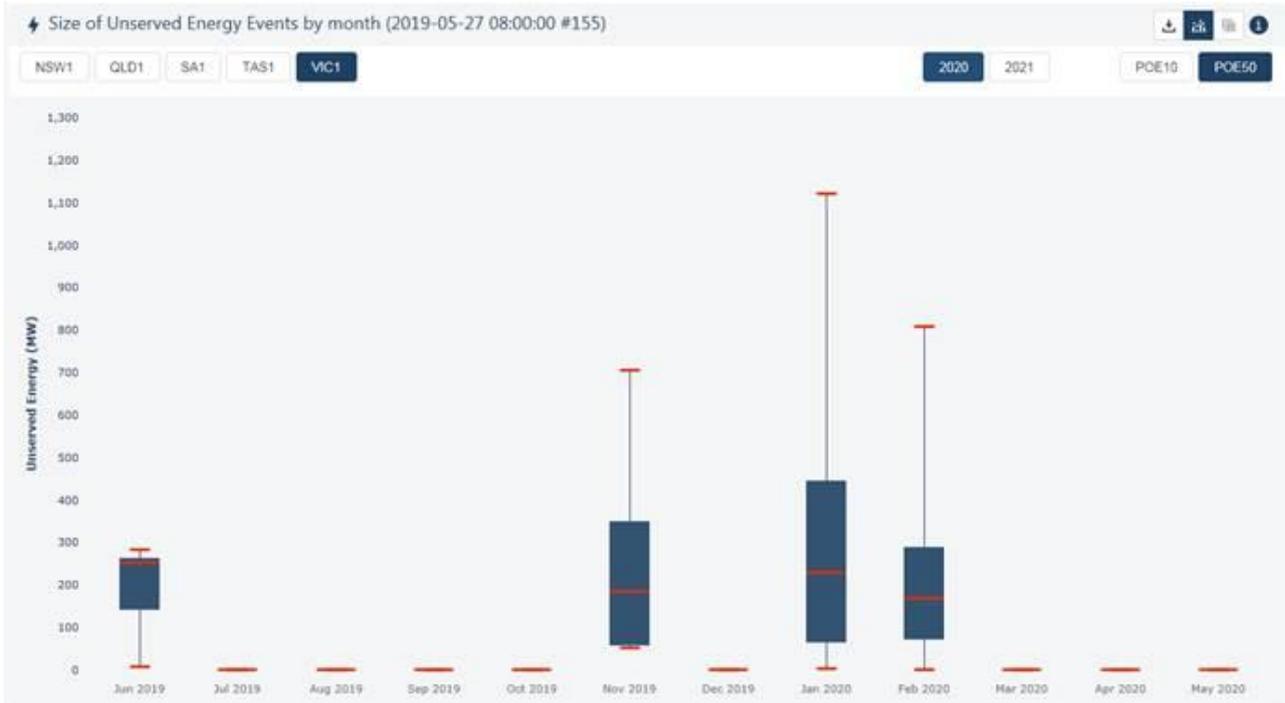
[signed]

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Appendix A

MTPASA – 27 May 2019, Victoria, P50

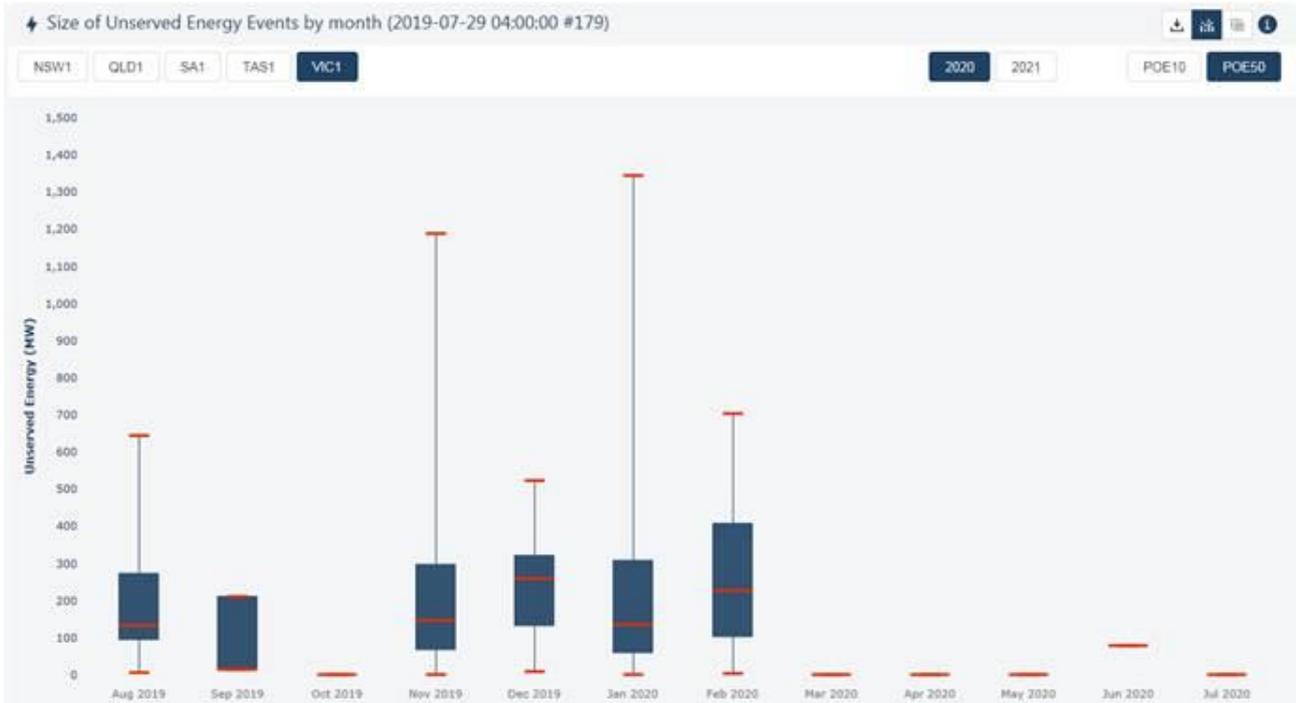


MTPASA – 27 May 2019, New South Wales, P50

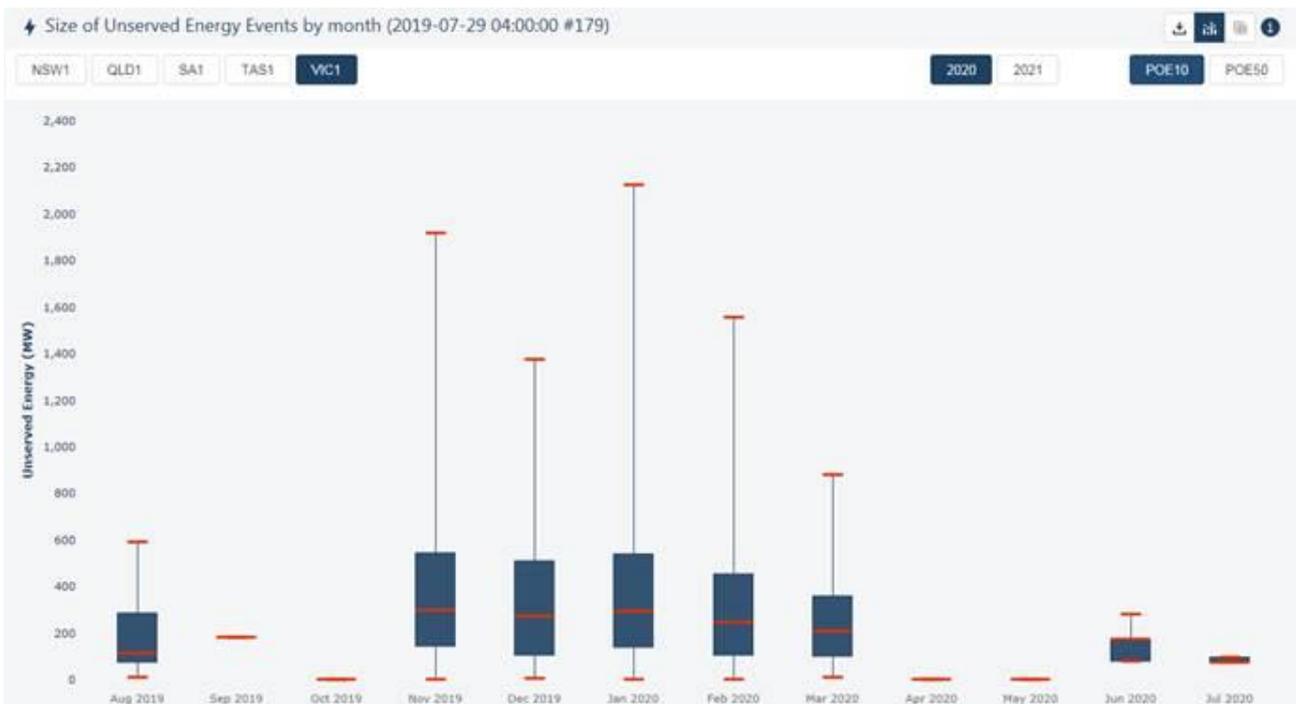




MTPASA – 29 July 2019, Victoria, P50



MTPASA – 29 July 2019, Victoria, P10

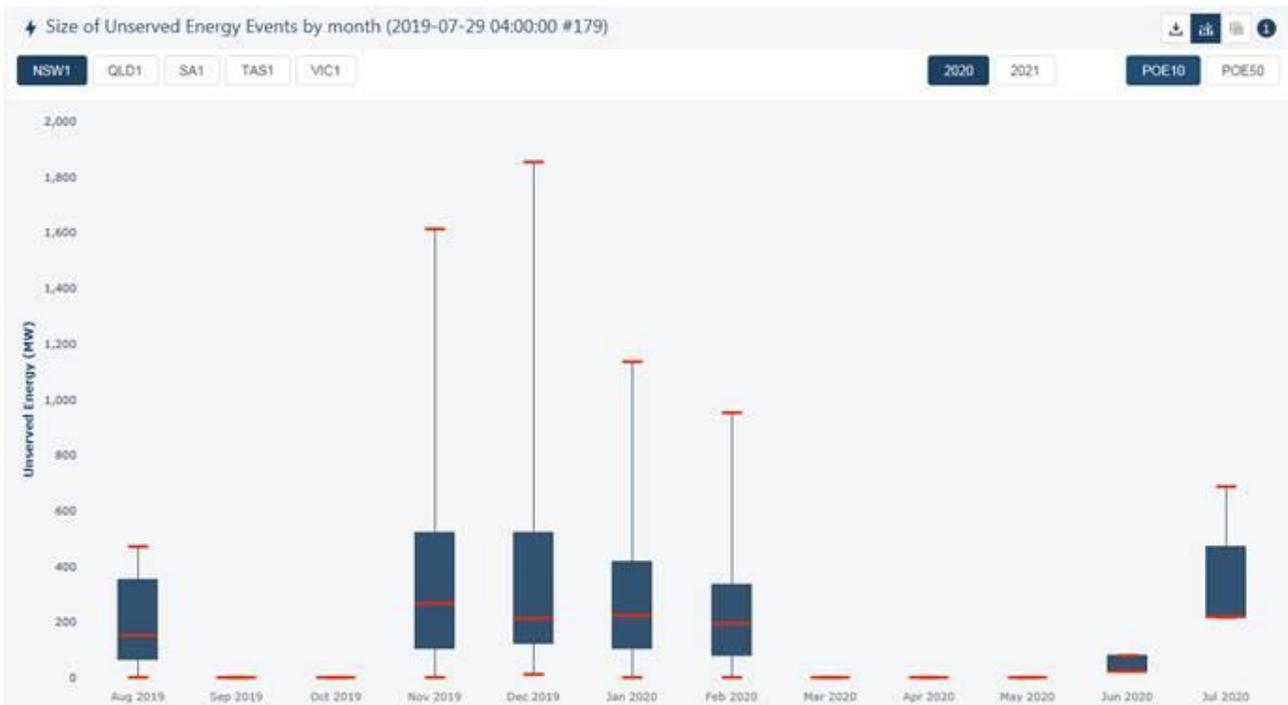




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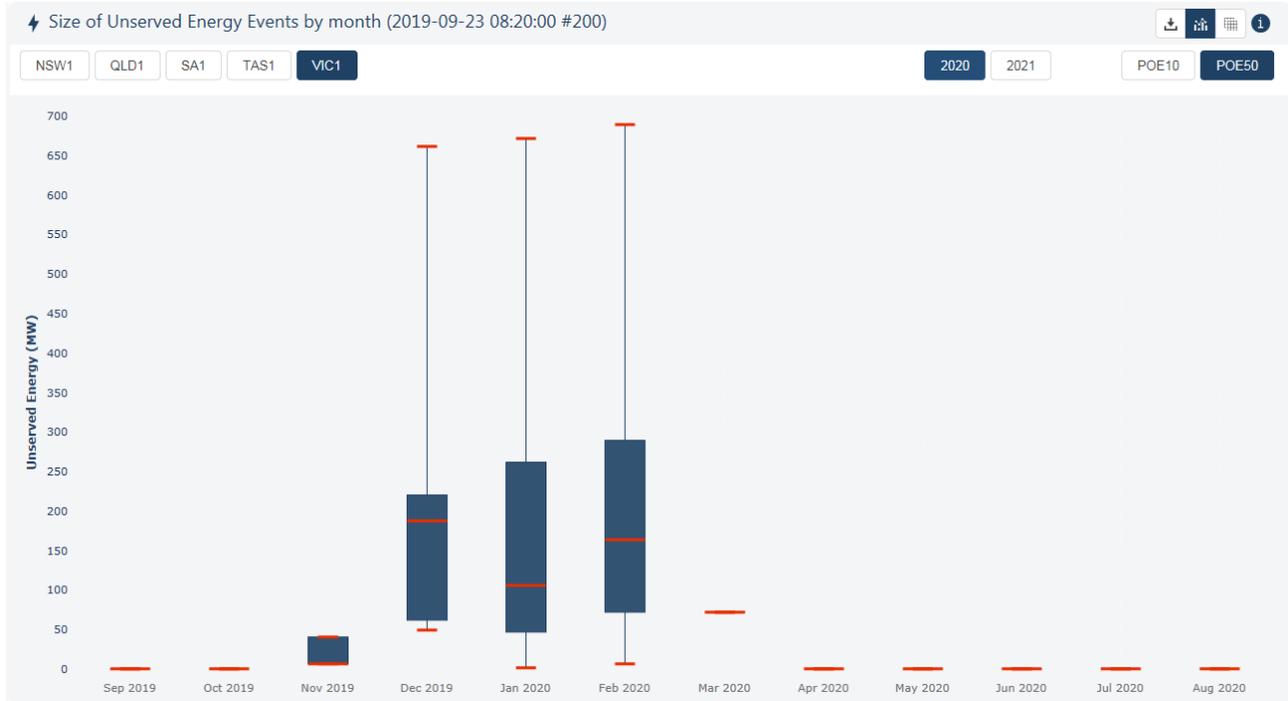


MTPASA – 29 July 2019, New South Wales, P10





MTPASA – 23 September 2019, Victoria, P50



MTPASA – 23 September 2019, Victoria, P50

