

17 October 2017

Mr B Noone
Project Leader
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Via email to Ben.Noone@aemc.gov.au

Dear Mr Noone

**Aurora Energy submission to AEMC Five Minute Settlements Draft Determination
(Reference: ERC0201)**

Aurora Energy appreciates the opportunity to provide a submission to the Australian Energy Market Commission's (AEMC) Five Minute Settlement Draft Determination ("Draft Determination"). Aurora Energy is retailer for 279,636 Tasmanian residential and business customers. Aurora Energy's core focus is to generate value for its customers and the broader Tasmanian community. It is this objective in mind that Aurora Energy does not support the five minute settlement rule change ("Rule change") as proposed in the Draft Determination.

Aurora Energy acknowledges that the AEMC has responded to a range of stakeholder feedback provided to its Directions Paper in the Draft Determination. However, it is Aurora Energy's view that the AEMC has failed to adequately address feedback with regards to a number of key issues, and as such, we would like to reiterate and extend its feedback on the following issues:

- The inadequacy of the proposed three year seven month transition period;
- The impact of other market reforms already taking place across the National Electricity Market (NEM);
- The impact of the Rule change on forward wholesale contract markets; and
- The apparent lack of a cost-benefit analysis undertaken in determining the merits of the Rule change.

Inadequacy of the Proposed Transition Period

Aurora Energy believes that the Draft Determination fails to provide sufficient time for market participants to implement the required system and process changes. The Draft Determination stipulates that the Australian Electricity Market Operator (AEMO) must have completed its amendments to “relevant market procedures, methodologies and guidelines” by 1 December 2020. These AEMO changes form the basis for market participants’ to assess the changes required to their own system and processes, and begin their own respective implementation program. Under the proposed timing of the Rule change, market participants’ must therefore complete their own implementation in the remaining seven months prior 1 July 2021. This is a grossly inadequate time period for market participants to implement the changes required by the Rule change.

Along with other market participants, Aurora Energy is in the final stages of implementing the Power of Choice rule change. The implementation of Power of Choice has been undertaken concurrently with AEMO procedure development, with procedures effectively able to be changed through to the commencement date. This has considerably increased the risk of the implementation for all parties, resulting in higher costs and lack of readiness for market participants (as evidenced by the publicly available readiness reporting undertaken). If this risk is to be avoided with respect to the transition to five minute settlements, the proposed seven month implementation timeframe for market participants should be extended to, at a minimum, twelve months.

Further, Aurora Energy is of the view that the three year and seven month transition period has failed to appropriately consider the lead time required to appropriately manage wholesale market risk faced by retailers.

Retailers require sufficient levels of customer data at a five minute level on which to make contracting decisions to manage forward market risk. In order to provide price certainty for customers, retailers will generally purchase wholesale forward contracts for periods up to three year in advance. Inherent in executing contracts that settle at a five minute level is the requirement to have sufficient load forecasts at a five minute level when forward contracts are executed. Such forecasts require, at a minimum, six to twelve months historical data at a five minute level to support appropriate electricity purchasing risk management. In order to facilitate this outcome, there will be at least a further six month lead time required for market participants to reconfigure and/or replace an adequate amount of existing meters (requiring a site visit in most cases) and invest in systems and processes to store and manage the additional five minute meter data.

The proposed three year and seven month transition period only considers the three year forward contract term, and does not adequately consider the additional six to twelve months of five minute settled data necessary to inform wholesale energy purchasing (and associated lead time). The absence of adequate five minute settled data will very likely result in the application of load risk premiums and therefore additional wholesale costs being passed to customers.

Therefore, it is Aurora Energy's view that both the overall transition period and the implementation timeframe for market participants should be extended by at least twelve months. This would result in a transition that best manages participant risk and avoid any cost increase associated with these risks.

The Impact of Other Market Reforms

The general objective of the Rule change is to promote efficient outcomes in the NEM, however it is unclear how this reform will operate in conjunction with other market reform initiatives currently being canvassed in the energy sector. At this time of market uncertainty, Aurora Energy asserts that the introduction of this Rule change further exacerbates risk for market participation.

The range of current review processes underway by AEMC and AEMO are summarised in section 5.2.2 of the Draft Determination. These review processes, including the AEMC Reliability Frameworks Review, are likely to lead to fundamental structural change in the NEM within the transition period proposed in this Rule change. Importantly, this would result in a corresponding change to how market participants manage wholesale risk and may mean that the imperative for five minute settlements is materially reduced.

By way of example, one likely structural reform of the NEM is the introduction of some sort of capacity-based market. Should this occur, the wholesale strategies adopted by market participants to manage electricity purchasing risk would change. Depending on the form of a capacity market, a market participant may focus efforts to manage market risk through capacity rather than conventional baseload contracts. Should such an outcome prevail, the investment made by market participants to implement five minute settlements could become redundant to a large extent.

Aurora Energy does not consider it prudent to progress with this Rule change at this time of considerable market uncertainty. Aurora Energy believes that the AEMC should defer finalisation of this Rule change to ensure that its introduction can be considered with the outcomes of other market reform review processes.

Impact on Forward Contract Markets

Aurora Energy does not agree with the AEMC's assertion within the Draft Determination that "there is unlikely to be a significant increase in cap contract prices from five minute settlement". The Rule change will result in a material shortfall of generation that can defend a five minute cap contract as acknowledged in the Energy Edge consultant report associated with the AEMC's Direction Paper. While the Draft Determination notes a range of alternative sources for five minute cap contracts, it is Aurora Energy's view that these are untested and therefore the AEMC's assertion relating to the impact on cap contract prices is speculative.

The Draft Determination presented historical analysis that concluded that there is likely to only be a moderate increase to the cost of a typical retail contract portfolio (section 4.3). This analysis by the AEMC is based on the intrinsic value of cap contracts to a theoretical contract portfolio, however Aurora Energy believes this underestimates the total costs to the portfolio, and in turn customers, as a result of a likely increase in cap and swap contract prices.

A relevant example is the impact of the closure of Hazelwood Power Station on the Victorian cap and swap contract prices. On 30 June 2016, the Quarter 1 2018 Victorian cap contract price was \$9.50. Following the withdrawal of capacity associated with the Hazelwood Power Station on 26 September 2017, the Quarter 1 2018 Victorian cap contract price had increased to \$35.25. This represents a 262% increase in cap contract prices due to the closure of Hazelwood Power Station. In the same period, the Quarter 1 2018 Victorian swap contract price increased by 156%. This example of increased costs due to the withdrawal of capacity is much higher than the theoretically modelled increase in contract portfolio costs included in the Draft Determination.

The recent withdrawal of Hazelwood Power Station's capacity in Victoria highlights the high risk of increasing cap and swap contract prices, and in turn, hedging costs for retailers. The proposed introduction of five minute settlements will have a major impact on the commercial viability of current peaking generators in the NEM, which currently meet peak electricity demand over a 30-minute trading period. Aurora Energy expects that the shortfall of peaking generation sources that will be able to defend a five minute cap contract will result in an increase to both cap and swap contract prices and higher wholesale electricity prices being passed through to customers.

Lack of Cost-Benefit Analysis

The AEMC is considering the Rule change at a time of significant uncertainty in the electricity sector. As is well documented, the transition of the market towards low emission generation sources presents a major challenge for system reliability and electricity affordability. This has led to a number of market review processes and continued volatility in wholesale electricity prices. These market conditions serve only to increase costs and heighten risk to market participants, which are ultimately passed on to electricity customers through higher electricity prices.

In the near-term, Aurora Energy is preparing for commencement of the Power of Choice rule change. The Power of Choice rule change has resulted in a major investment by Aurora Energy and other Tasmanian market participants that will lead to higher on-going costs in the energy sector, without a commensurate benefit for Tasmanian electricity customers in the short to medium term. The implementation has also diverted Aurora Energy's limited resources from delivering on other important customer priorities.

Like Power of Choice, the estimated implementation and on-going cost increases associated with this proposed Rule change are material for Tasmanian customers. In its submission to the AEMC Five Minute Settlements Directions Paper, Aurora Energy suggested that a detailed cost-benefit analysis be performed to support the proposed Rule change. Aurora Energy acknowledges that the views of stakeholders were considered in the development of the Draft Determination, however it notes that a robust cost-benefit has not been completed. Aurora Energy does not support the AEMC's justification of considering the additional costs of the Rule change directly against the total revenue of the NEM. In its absence, it is Aurora Energy's firm view that the costs and risks of this Rule change will significantly outweigh the supposed benefits.

Summary

While Aurora Energy supports the broader objectives of an efficient market transition to lower-emission sources of electricity generation, it considers that the costs and risks associated with this Rule change can be minimised by deferring its implementation. The commencement of the Rule change should consider the following:

- From an implementation perspective, the Rule change (including transition period) should provide market participants sufficient time for implementation following finalisation of AEMO procedures and sufficient five minute settled data to support forecast and purchase of five minute settled contracts; and
- From a market reform perspective, the Rule change should allow sufficient time for other market reform initiatives to be understood and facilitate a holistic approach to market reform.

At a minimum, Aurora Energy requests that the Rule change commencement be deferred by twelve months to ensure implementation risks can be best managed. However, in order to avoid unnecessary costs being passed through to electricity customers, Aurora Energy request that the Rule change commencement be reconsidered within the context of the wider market reform agenda.

If you have any queries in relation to this submission, please contact Hayden Moore, Regulatory and Policy Manager on 6237 3119 or via email: hayden.moore@auroraenergy.com.au.

Yours sincerely



Rebecca Kardos
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