

INTRODUCTION

National Electricity Amendment (Victorian Jurisdictional Derogation – RERT Contracting) Rule – ERC0283

The Energy Users Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing and materials processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and expect to see all parts of the energy supply chain making their contribution to the National Electricity Objective.

Our members are highly exposed to movements in both gas and electricity prices and have been under increasing stress due to escalating energy costs. These increased costs are either absorbed by the business, making it more difficult to maintain existing levels of employment or passed through to consumers in the form of increases in the prices paid for many everyday items.

In previous submissions the EUAA argued against the RERT Contracting rule change being expedited and also against the rule change itself. It is perhaps worth noting that, despite the claim by the Victorian Government¹:

“Given implications for reliability during summer 2019-20, this rule change request relates to a matter that, if not made as a matter of urgency, will result in an inability to contract sufficient RERT reserve capacity over the peak summer demand period in 2019-20 which will imminently prejudice or threaten the reliability of the national electricity system as it operates in Victoria. Pursuant to sections 87 and 96(1) of the National Electricity Law (NEL), Victoria seeks that the AEMC assess this rule change request in an expedited manner as an urgent rule.”

that AEMO was able to secure what it, in consultation with the Victorian Government, considered was sufficient RERT for 2019-20.

The EUAA appreciates the substantial analysis undertaken by the AEMC as part of its considerations on this matter. We believe that the Draft Rule addresses many of the concerns we expressed in our initial submission on the need to optimise direct and indirect costs. This will be achieved through greater constraints on contracting than was requested and significantly improved transparency around AEMO’s actions as they apply an expanded suite of provisions from the final enhancement to the RERT rule change.

Nevertheless, we still see potentially significant residual risks to consumers.

For example, the Commission concludes in its discussion on indirect costs that, given AEMO cannot enter into a long notice RERT unless there is a declaration of an LRC based on USE forecasts, then (p.68):

“These constraints would still operate in relation to multi-year contracts. Therefore, the Commission considers that concerns about increased indirect costs from the derogation are minimised due to these changes. In addition, the draft rule still preserves the use of the RERT as a last resort during times of market failure, and so is not contrary to the design of the market as suggested by some stakeholders.”

Yet the Commission acknowledges that AEMO only has to demonstrated the trigger is required in year 1. The Draft rule may reduce the risks, but it does not necessarily minimise the risk that costs will be optimised.

¹ Victorian Government Rule Change Request 7th October 2019 pp. 3-4

The argument of the EUAA and some other stakeholders is that the more you take reserves out of the market (where costs are capped at the MPC) to go into RERT (where costs are not capped by the MPC), the more likely there will be market failure and hence the more likely RERT will be required. In this way, it could be argued that the Victorian proposal increases the chances of market failure happening and requiring RERT while also creating a potential for overpaying for resources that would have been in market in any event. We are not opposed to RERT being used as a safety net to address market failure – just that it is less likely to occur – and costs to consumers will be lower – when indirect costs are minimised.

We are also concerned that consumers are being asked to pay an insurance premium – in the form of guaranteed payments under multi-year contracting – on the basis of a year 1 forecast only. We understand that the hope is that if there is USE demonstrated in years 2 and 3 (even if it is not forecast now), the overall cost will be cheaper than yearly procurement. However, if RERT is not required in either or both of years 2 and 3, or, if required, can be procured at a lower cost on an annual basis in years 2 and 3, then costs will not be lower from multi-year procurement.

In 2019. that – and currently in MT PASA – there is no forecast of USE in Victoria for the next two years. Now the response will be that “things can change and we should be prepared”. However, for a variety of reasons (including forecasting errors), we have seen before that things can change both ways – not just move from no USE to some USE.

Consumers need to have a high level of ex ante and ex post transparency to have confidence they are buying an efficient policy and not wasting their money in years 2 and 3 of a contract that was not required. A level of ex ante transparency should be provided by the AER Best Practice Forecasting Guideline that applies to the ESOO. Although even that did not prevent AEMO in the 2019 ESOO from forecasting USE in Victoria in 2019-20 on the basis of assumptions of the return to service of Loy Yang 2 and Mortlake plus availability of Torrens Island in South Australia. Unfortunately, these assumptions were not consulted on, contrary to the provisions of the Guideline.

Here we propose two measures to address these residual risks - one ex ante and one ex post:

1. the term of the derogation and contract length – we propose a change that would mean the multi-year RERT contracts would not overlap with the RRO
2. the need for transparency – we propose an independent review of AEMO’s performance to be undertaken by the AER

1. Term of derogation and contract length

The Information Sheet says:

“It is important to note that the RRO does not take effect unless triggered three years in advance of a forecast shortfall. The RRO is yet to be triggered and the earliest it could next take effect in Victoria is for the summer of 2023-24, following an assessment by AEMO in the 2020 Electricity Statement of Opportunities (ESOO).”

The draft rule specifies that the derogation be in place for approximately three years, rather than five as proposed by the Victorian Government, and end on 30 June 2023.

This gives AEMO flexibility to enter into multi-year contracts up until such time the RRO could next address reliability issues, which is for the summer of 2023-24. The ability of AEMO to enter into multi-year contracts would end prior to the time at which, were the RRO to be triggered for 2023-24, retailers would be required to enter into contracts to meet their share of expected system peak demand. Otherwise, the RERT multi-year procurement timeframe would overlap with the obligations and incentives market participants face under the RRO.”

We are not sure that the Draft Rule achieves this. It seems that AEMO can enter RERT contracts of up to three years duration (providing it meets the conditions in the draft rule) at any time up to and including 30th June 2023. So, in theory the last of these contracts would end on 30th June 2026 – well after the RRO can be triggered. If this is a correct interpretation of the Draft Rule then AEMO could be competing with retailers to meet their RRO obligations, with both seeking to secure the same reserves.

Given that retailers will be willing to pay up to the MPC (which is passed on to consumers) but AEMO is willing to pay up to VCR (which is also passed on to consumers) then it might limit the bucket of reserves that is available “in-market” for RRO.

We would suggest an alternative approach eliminate the potential for AEMO and retailers competing for reserves:

- If the 2020 ESOO shows a RERT requirement in 2020-21 and a T-3 shortfall (confirmed by the AER) then,
 - AEMO is able to enter RERT contracts of up to 3 years duration (2020-21, 2021-22 and 2022-23)
 - Retailers are able to procure reserves to meet their 2023-24 obligation
- If the 2021 ESOO shows a RERT requirement in 2021-22 and a T-3 shortfall (confirmed by the AER) then,
 - AEMO is able to enter RERT contracts of up to 2 years duration (2021-22 and 2022-23)
 - Retailers would be able to meet their 2023-24 and 2024-25 obligations without having to compete with AEMO
- If the 2022 ESOO shows a RERT requirement in 2022-23 and a T-3 shortfall (confirmed by the AER) then,
 - AEMO is able to enter RERT contracts covering up to 1 year (2022-23)
 - Retailers would be able to meet their 2023-24, 2024-25 and 2025-26 obligations without having to compete with AEMO

So, the derogation allows AEMO to enter any long term RERT contract as long as the contract ends on or before 30th June 2023. This would be the case even if AEMO’s 2020 ESOO did not declare a T-3 shortfall. This achieves the aim in the quote above of eliminating the overlap. It also means that AEMO cannot enter into 3-year RERT contracts where the first year indicates USE but there is no extant T-3 shortfall.

2. Transparency

The Draft Rules provisions for increased transparency are welcome. But we wonder if they go far enough. Historically, in the EUAA’s experience, AEMO has resisted increased transparency around RERT costs, claiming confidentiality². AEMO resisted AEMC proposals for increased information disclosure as part of the Enhanced RERT rule change³. AEMO has not taken up our suggestion to provide additional RERT information for 2019-20 ahead of the AEMC rule change timetable.

There is always a balance between transparency and confidentiality, but we think it needs to be biased to the former when consumers are being asked to pick up the bill.

For example, the Commission (p.69) refers to confidential information provided by AEMO that supports the view that:

“...the type of resource providers that would become more cost competitive if multi-year contracts were offered under the RERT would be unlikely to participate in the market because they would be largely supply-side.”

Intuitively there is reason to believe that there would be greater competition for multi-year contracts and this would lower annual availability costs. Yet, while the Commission provides for increased transparency around the whole process, it was not able to share the information provided by AEMO to support this view.

² [See our submission to the AEMC on the Enhanced RERT review](#)

³ [See AEMO submission to the AEMC on the Enhanced RERT review](#)

The importance of transparency around the tender process was emphasised in the AER's submission that is quoted in the Draft Determination (p.55):

"The AER also said that if the derogation proposal was to be progressed, it would support consideration of measures that would ensure multi-year tender process and its outcomes are transparent to the market in order to achieve optimal pricing outcomes and value for money for consumers."

While we support the Draft's proposed application of the Enhanced RERT provisions, plus additional ones in the Draft⁴, which come into effect on 26th March 2020, to reduce the likelihood of inefficient and unnecessary RERT, we need to have confidence that AEMO is actually following those provisions. Ideally the level of disclosure should enable market participants to undertake their own analysis of the results and be able to judge if AEMO has achieved its objective of efficient RERT procurement to meet the NEO and in particular to meeting the Commissions Assessment Framework – promoting reliability in the power system, minimising market distortions and minimising direct costs.

However, we recognise that that confidentiality constraints are likely to mean that market participants will not have sufficient information. For this reason, we recommend consideration of the AER undertaking a review, on an annual basis, of AEMO's RERT procurement process to ensure it meets the stated objectives. This is similar to the role the AER plays in many other areas of market governance e.g. reviewing AEMO's conclusions on whether the RRO should be triggered.

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

Sincerely,



Andrew Richards
Chief Executive Officer

⁴ As set out on pp59-60 in the Draft Determination