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AGL Response to Consultation on the Interim Reliability Measure

AGL Energy (**AGL**) welcomes the opportunity to comment on the Energy Security Board's (**ESB**) consultation on an Interim Reliability Measure in the NEM.

AGL Energy Limited (AGL) is one of Australia's leading 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 an energy retailer and provides energy solutions to over 3.5 million customers in New South Wales, Victoria, Queensland, Western Australia, and South Australia.

AGL is cognisant of the changing dynamics of the NEM, particularly with the increasing penetration of renewables and transitional concerns with reliability. We are supportive of establishing market signals to drive the investment required to support the reliability of the NEM into the future, which is the focus of the ESB's post-2025 market design work program.

To ensure reliability ahead of 2025, the COAG Energy Council has agreed to an interim reliability measure that builds on the existing Reliability and Emergency Reserve Trader (RERT) scheme and will mean that unserved energy does not exceed 0.0006% in any region. ESB has provided a draft rule for consultation.

COAG Energy Council has also agreed that this new standard would be applied to the Retailer Reliability Obligation (RRO), and that the T-1 instrument would be decoupled from the T-3 instrument. While the ESB will consult on draft Law and Rule changes in the coming months, it is seeking initial comments on whether it should consider any consequential changes.

Regarding the process to reach these decisions, AGL is disappointed that this has occurred without public consultation. The ESB's modelling and conclusions have not been worked through with industry or other stakeholders and subject to independent scrutiny.

While the interim reliability measure is a transitionary approach while a post-2025 NEM is being considered (and follows recent consideration under the Victorian derogation from the RERT rule change) the changes to the RRO are not transitionary and represent quite a significant change to its operation. We hold concerns that the full impacts of the RRO proposal have not been thoroughly investigated or considered by industry and other customer stakeholders and suggest that the ESB undertake wider consultation on impacts ahead of drafting the package of Law and Rule changes. In particular, there is a need to investigate the potential for unanticipated consequences on market operation and price.

This submission does not focus on the merits of the new reliability standard and other changes as these are being more thoroughly considered by the ESB as a part of its post-2025 market design program, but instead on the mechanics of the proposal and further considerations for ESB.

Interim reliability measure

AGL considers that there may be some benefits of multi-year contracting such as creating a greater pool of potential suppliers with more diverse system capabilities, along with potentially lower cost solutions when the contract is required for multiple years.

However, these benefits need to be considered in the context of the impacts multi-year RERT contracting may also pose to the market, and ultimately to customers through possible impacts on other market participants and wholesale markets. These risks must be carefully managed, particularly measures to prevent over procurement of emergency reserves, avoiding indirect costs such as market inefficiencies, and preserving the RRO framework.

The requirements set out in the draft rule address some of these concerns. For example, we are supportive of the requirements that:

- A multi-year contract can only be entered if that would be more cost effective than entering successive single year contracts to address the breaches.
- The reserves must be out-of-market.
- There is consultation with jurisdictions on the maximum costs involved.
- AEMO provides quarterly reporting on reserve contracting.
- The Interim Reliability Measure would cease with contracts running no later than summer 2024/25.

Cost effectiveness of multi-year contracts

In addition to the requirement that a multi-year contract can only be entered if that would be more cost effective than entering successive single year contracts, we suggest that AEMO should only enter into a multi-year contract with a provider when there is a material saving in costs compared to a shorter contract with that provider. For example, some providers have large upfront costs or need longer term assurance of revenue flows, which means that it is more cost effective to spread the contract across multiple years. Other providers have low availability costs and there is no substantial additional cost saving from entering a multi-year contract. These providers should be encouraged to consider each year whether they should enter a market arrangement, such as participating in the demand response mechanism.

This approach will help to minimise market distortions and encourage providers to actively consider whether to participate directly in the NEM or in the RERT. It will enable AEMO to activate longer term RERT contracts in circumstances when it is cost effective to do so and in turn ensure the contracts are suitably targeted to meet the policy rationale, minimise market distortions, and to address the reliability standard

Interactions with the RRO

According to the proposed changes to the RRO, it may be possible for the AER to make a T-1 instrument as early as 2021/22 for a forecast breach the following Summer. As the Interim Reliability Measure may have contracts running until 2024/25, there are several years of overlap where a forecast breach may be driving both retailer contracting and AEMO reserve contracting.

AGL proposes that in the event the RRO is triggered, AEMO should be cautious about procuring reserves for that reliability gap before the RRO contract position date, to give retailers every opportunity to secure contracts and to minimise the risk of unnecessary procurement. AEMO's decision around reserve procurement and volumes should then be based on the most up to date information.

We also suggest that more nuanced approach be considered to the interaction between these measures. For example, previously procured volumes of interim reliability reserve should be included in calculating whether a shortfall would occur and reduce the likelihood that the RRO will be triggered. This would avoid a situation where AEMO procures reserves under a three year contract and in the third year the RRO is triggered unnecessarily. This is duplicative and would lead to excessive and unnecessary costs on the market. This as well as other interactions with the market and other measures should be investigated further by ESB in consultation with industry.

Retailer Reliability Obligation

The ESB is seeking feedback on areas where further consideration may be needed to support the implementation of the agreed changes to the RRO.

While the proposed changes sound simple, the implications represent a large shift in the operation of the RRO which needs to be carefully thought through and not just addressed via technical rule change consultation. De-coupling a T-1 instrument from a prior T-3 instrument means that retailers will not have advanced warning for a "bare" T-1 instrument and the obligation to report their contract positions. Under existing rules around T-1 compliance, retailers may have as little as three weeks' notice between a bare T-1 instrument being made and the contract position day, although the ESOO (published a few months prior) would indicate whether there are forecast breaches.

The outcome of the proposed change is that retailers will need to continually consider their contractual exposure to meet their forecast one in two year peak demand by the contract position date. Those that do not may face the risk of exposure to additional RERT costs through the Procurer of Last Resort (POLR), as well as AER penalties, should there be an unexpected shortfall.

While large retailers often undertake a level of contracting as general practice, demand from C&I loads is less predictable due to the timing of negotiating contracts. This was discussed at length in previous consultation on the RRO and was an important factor in the current design. The new proposal could interact with these arrangements and if not addressed properly could create greater risk and uncertainty for both the retailer and large customer, and hence difficult-to-predict interactions with the contract market.

Further to this AGL has identified the following suggestions, but we strongly suggest that ESB conduct further consultation specifically on RRO before the package of Law and Rule changes are drafted. In particular, there should be further analysis of the potential implications for contract liquidity and ultimately consumer prices, alongside uncertain effects on reliability, that warrant close consideration.

Greater information and notice of T-1 gaps

Ideally AEMO would provide more regular forecasting (including in the event of a material change to the market). Any level of increased frequency of reporting would help to guide retailers, as much as is reasonably possible, as to the possibility of a bare T-1 instrument.

AEMO could also be required to provide more granular information about the forecast reliability gaps in each ESOO for years below T-3 (eg the dates and trading intervals in which the gap would apply). This would help minimise the risk of retailers being surprised by a shortfall.

Adjusting the contract position day

The contract position date for a bare T-1 instrument should be moved forward as close as possible to T-0, to give retailers acceptable time to finalise their contracting positions and with the most up to date information on expected demand (such as large customer contracts).

While the closer to T-0 the better, a suggestion might be to have the contract position day three months before T-0 and the reporting date could be one month before T-0.

Adjusting the MLO

AGL is concerned with any suggestions that the MLO might apply following a bare T-1 instrument. The MLO imposes cost and an increased level of risk on MLO participants, which escalates as the gap period approaches.

While we consider there to be a strong case to move the contract position day forward, the MLO should not also be adjusted and these two milestones should be decoupled. We note that the general market practice is to complete hedging for a coming Q1 well in advance, not to leave contracting to the last quarter of the year. An MLO would be particularly risky for MLO participants if it applies any later than T-0.5.

Interactions with RERT

Bringing the contract position date forward is supported, however may exacerbate issues of overlap with the RERT and the new interim reliability measure. There is a greater risk that AEMO RERT procurement may be competing with retailers trying to finalise their positions.

There is also a heightened risk that AEMO procures long notice RERT that is not needed because retailers will continue to be contracting throughout that year.

AGL notes that this risk could be mitigated by the requirement that AEMO take these potential interactions with the RRO into account when deciding whether to enter a RERT contract. We suggest that these decisions be scrutinised though AEMO's reporting process. Alternatively, more consideration could be given to the way the new RRO trigger arrangements interact with the interim measure.

Interaction between the RRO and Post-2025 NEM Design

AGL notes that one of the issues being considered by the ESBs in the post-2025 NEM design is the adequacy of market incentives and investment. As part of that process (and depending on the outcomes) the ESB should be considering whether existing policies like the RRO are the optimal way to drive resource adequacy incentives. We look forward to further engagement with the ESB on the post-2025 NEM design.

If you have any queries about this submission, please contact Jenessa Rabone on (02) 9921 2323 or JRabone@agl.com.au.

Yours sincerely,

Barry Sterland

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