AGL Energy Limited
ABN: 74 115 061 375
Level 24, 200 George St
Sydney NSW 2000
Locked Bag 1837
St Leonards NSW 2065
t: 02 9921 2999
f: 02 9921 2552
agl.com.au

Mr John Pierce

Australian Energy Market Commission

PO Box A2449

Sydney South, NSW 1235

31 January 2020

Submission to Victorian Jurisdictional Derogation – RERT contracting (ERC0283)

AGL Energy (**AGL**) welcomes the opportunity to comment on the Australian Energy Market Commission's (**AEMC**) draft determination on the Victorian Jurisdictional Derogation to the Reliability and Emergency Reserve Trader (**RERT**) contracting arrangements.

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 a significant retailer of energy 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. The RERT is a last resort intervention that is available to AEMO when market signals fail.

AGL understands the Victorian Government's concerns that are sought to be addressed with the proposed derogation. AGL considers that upcoming market reforms and mechanisms are likely to address these government concerns through existing policy developments such as the Retailer Reliability Obligation (RRO) and the Energy Security Board's (ESB) post-2025 review.

Specific comments on the draft rule

As noted above, we understand the Victorian Government's concern regarding the importance of addressing reliability risks sooner than previously, particularly given key regulatory frameworks such as the Retail Reliability Obligation and the Demand Response Mechanism reforms are yet to have an impact on reliability shortfalls for several more years. We note that AEMO has not forecast a reliability shortfall in Victoria after 2019-20.

We agree with AEMO and the Victorian Government that there may be notable benefits arising from multi-year contracts 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, as the AEMC has discussed not only in this draft rule but also in the Enhanced RERT rule change, these benefits need to be considered in the context of the significant negative impacts multi-year RERT contracting may also pose to the market, and ultimately to customers through higher wholesale energy supply costs. We therefore strongly agree with the AEMC that these risks must be strictly managed, particularly measures to prevent over procurement of emergency reserves, avoiding indirect costs such as market inefficiencies, and preserving the RRO framework.

The measures proposed by the AEMC go some way to mitigating these risks.

Along with applying elements of the Enhanced RERT rule change to multi-year RERT, we note the AEMC has proposed three key measures to manage these risks

1. Consistent with the Enhanced RERT rule change, the trigger for procuring the RERT contract is the forecast breach of the reliability standard for the first year. Subsequent years of the contract apply a lower threshold requirement where the contract is “reasonably necessary to ensure reliability of supply in the Victorian region.”,
2. The multi-year contract may remain only as long as is necessary, and no more than three years. Furthermore, the Derogation will only remain in place up until 2023, and
3. AEMO has additional reporting obligations for multi-year RERT procurement.

Firstly, we are supportive of the derogation ceasing in July 2023, instead of June 2025 as proposed in the rule change request. We remain cautious of the potentially distortive impacts of multi-year RERT contracts and consider that making the length of the derogation as short as possible will help to minimise any distortive effect on the market. As mentioned above, the transitional reliability issues currently of concern in Victoria will be addressed in the coming years through policy developments such as the RRO and the broader ESB post-2025 review.

Secondly, we consider the other measures are a step in the right direction, but the draft rule should be further adjusted to better align the draft rule with the AEMC’s policy rationale and its intended purpose. Our suggested changes are outlined below.

When should multi-year RERT be contracted?

AGL’s preference is that multi-year contracting should only occur where there are successive years of an identified low reserve condition (unserved energy). The draft rule allows AEMO to enter multi-year Victorian contracts where the second and third years of the contract are “reasonably necessary to ensure reliability of supply in the Victorian region.”

To ensure RERT is contracted at the right level, the requirement must remain closely tied to the Reliability Standard. The “reliability of supply” requirement is too broad to achieve this and therefore fails to effectively mitigate the risk of over-procurement. Should the AEMC consider the procurement threshold should be lower after the first year, as a minimum, AEMO should be reasonably satisfied that there is a material factor (not captured in the reliability forecasts) that poses a heightened risk that the reliability standard is not being met.

Preserving the RRO framework

The RRO was developed by the ESB as a key mechanism focussed on addressing reliability shortfalls by facilitating an in-market response.

As outlined in the draft determination, the RRO will not be able to address the reliability shortfalls until the 2023-24 summer peak period and beyond. We note that a proposed benefit of this rule change is therefore providing additional assurance that any reliability shortfalls are met prior to the commencement of this date.

In the draft determination the AEMC noted that the ability of AEMO to enter into multi-year contracts should end prior to the time at which, were the RRO to be triggered, retailers would be required to enter into contracts to meet their share of expected system peak demand. Otherwise, the time-frame would overlap with the obligations and incentives market participants face under the RRO.

Whilst we agree with this assessment, the AEMC has proposed in the draft rule to allow AEMO to enter into multi-year RERT contracts up until June 2023, resulting in the contracts potentially being in place up until June 2026.

The proposed rule therefore potentially does not prevent the issues outlined by the AEMC for several years. We therefore propose in the event the RRO is triggered, AEMO cannot procure RERT for the reliability gap more than 12 months in advance. This express exclusion will preserve the RRO framework without unnecessarily limiting AEMO's ability to procure multi-year RERT up until 2023.

Minimising market distortion

A key benefit of the multi-year RERT contracting is the potential reduction in RERT costs. This is because the yearly 'availability' costs will reduce as these costs are, in some cases, largely the sunk upfront costs of installation and connection of the RERT asset.

Just as there are RERT providers that face this cost structure, there are also potential RERT providers that face low availability costs. Given the risks outlined above, we propose these types of RERT providers are not contracted for more than the standard RERT period of 12 months. In other words, AEMO should not be able to enter into a multi-year RERT contract when there is no material saving in costs.

This will mean these suppliers annually face the choice of entering RERT contracts or entering a market arrangement. This optionality will be particularly important when the Demand Response Mechanism is implemented in the near future.

We consider these further measures will enable AEMO to activate longer term RERT contracts in circumstances only when it is absolutely necessary 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.

State by state approach

We also note the preference that there be a national approach to energy policy. While jurisdictional derogations can be valuable in that they allow the Rules to take into account the specific circumstances of a single state, it generally adds complexity to the market operation and increases the regulatory burden on energy market bodies and on market participants.

Further, whilst the proposed derogation is focused on addressing reliability concerns in Victoria, the distortionary impact will not be contained within this jurisdiction. These distortionary impacts will often flow through to other NEM jurisdictions, further degrading market signals and potentially further undermining long term reliability across the NEM. In turn, this may drive the need for further regulatory interventions.

If you have any queries about this submission, please contact me on (03) 8633 6758 or CStreets@agl.com.au.

Yours sincerely,

Chris Streets

Senior Manager Wholesale Markets Regulation