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Government of South Australia

Department of Mining and Energy

Submitted by email: RRO@sa.gov.au

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Consultation on the draft National Electricity (South Australia) (Ministerial Reliability Instrument) Amendment Bill 2019

AGL Energy (**AGL**) welcomes the opportunity to make a submission in response to the South Australian Government's draft *National Electricity (South Australia) (Ministerial Reliability Instrument) Amendment Bill 2019 (Draft Bill)*.

AGL is one of Australia's largest 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, providing energy solutions to around 3.5 million customers throughout eastern Australia.

In addition, AGL is continually innovating our suite of distributed energy services and solutions for customers of all sizes. These behind-the-meter energy solutions involve new and emerging technologies such as energy storage, electric vehicles, solar PV systems, digital meters, and home energy management services delivered through digital applications.

Amendments proposed by the Draft Bill

Prior to the October 2018 COAG Energy Council meeting, the Energy Security Board (**ESB**) consulted on draft exposure legislation to form the National Energy Guarantee¹ (**Guarantee**) as well as alternate pre-conditions options to trigger the reliability requirement². The Draft Bill proposed by the South Australian Government would amend the *National Electricity (South Australia) Act 1996* to enact one of the alternate pre-condition options considered in that previous consultation.

Specifically, it would allow for a T-3 reliability instrument to be made by the South Australian Minister if it appears to the Minister, on reasonable grounds, that there is a real risk that for a specified period supply of electricity to all or part of the South Australian community may be disrupted to a significant degree. It would also allow the Minister to apply the trigger with only 15 months' notice during the first 3 years of the mechanisms' operation.

AGL continues to have the same reservations about the benefits of the proposed amendments as we expressed in our previous submission to the ESB's Reliability Requirement Pre-condition Options Paper. We do not consider the changes proposed by the Draft Bill to be an improvement on the original design of the RRO.

¹ AGL's response to this consultation is available here: <https://thehub.agl.com.au/articles/2018/09/submission-in-response-to-the-energy-security-boards-consultation-on-neg-amendments>

² AGL's response to this consultation is available here: <https://thehub.agl.com.au/articles/2018/09/submission-in-response-to-the-neg-reliability-requirement-pre-condition-options-paper>



Possible impacts from the proposed amendment

Reducing the lead time of the T-3 reliability instrument and decreasing the certainty over the conditions at which it will apply seems to be in contradiction to the design of the RRO, which necessitates predictability of application and a sufficient lead time for retailers to react to a shortfall by entering into firm contracts.

Impact of Ministerial discretion

One of the key benefits of the RRO is that its application would be predictable and would therefore establish a degree of investment certainty for participants. This certainty over time is expected to drive greater investment in the optimal supply mix to meet wholesale market objectives and lower prices for customers.

The ESB's draft design has considered that there may be rare occasions where it is appropriate for AEMO to trigger the RRO without a T-3 determination and forecast reliability gap, although these circumstances are yet to be determined in the Rules.

While we consider that circumstances to require a trigger of the RRO without a T-3 reliability gap would be exceptionally rare, the possible conditions under which a later trigger could occur must still be objective and set out clearly for participants to be able to factor that risk into their operations; for example, by reference to a material change in a reliability gap that had not been previously forecast and including a limit on the timeframe before the compliance period within which a determination can be made. This trade-off between flexibility and certainty must be sufficiently narrow in order not to erode the benefits of certainty for market participants as to how the proposed mechanism will operate.

The Draft Bill does not allow for the same certainty, instead allowing a much greater amount of discretion that is not linked to a predictable metric or calculated forecast but rather to a Ministerial power. In the absence of a material reliability gap, it is unclear what problem the Draft Bill would be trying to resolve if triggered by a Minister, and consequently how retailers would be required to show compliance. It is also not clear if there would be any ability to interrogate or challenge the Minister's determination prior to the obligation being triggered.

The existence of a Ministerial power without clear guidance on the parameters under which that power may be exercised would add additional risk for market participants, reducing the value of investment certainty.

Impact of short notice periods

Where the Ministerial power is used with less than three years notice, there are significant concerns with liable entities' ability to comply, and the possibility of distortionary market impacts as a result of a poorly forecast intervention in the market. For example, a T-15 month instrument as proposed by the Draft Bill would require retailers to not only establish hedge cover but also provide evidence of this sufficient firm cover within the three month period between the T-15 month determination and the T-1 year compliance deadline.

It is not clear if it will be possible to meet this obligation within such a short period of time, even if sufficient qualifying contracts are technically available in the market. If they are not (i.e. there is a shortage of firm contracts in accordance with the RRO specifications), it is implausible that lowest-cost new generation, demand response, or other contracts that may be able to be used to show compliance will be able to be developed and negotiated by retailers and assessed by an independent auditor within three months.

Sourcing contracts in accordance with an as-yet-unknown process to determine firmness factors, submitting these for assessment to an independent auditor, revising and updating those positions, and finally providing them to a regulator is likely to take much longer than three months.



However, if the Draft Bill does proceed in its current form, liable parties will need to be commercially prepared for that eventuality. As a result, the existence of the 15-month trigger could affect the ongoing contracting behaviour of retailers even in the absence of any reliability gap, creating incentives to enter into firm contracts even where there is no supply shortfall.

While this may indeed incentivise the market for firm contracts, the financial impact of having all liable entities hedged to a POE50 basis in the absence of a forecast shortfall would need to be looked at in more detail, as imposing directions on contracting behaviour in this manner could lead to losses in portfolio management efficiency and come at expense to customers for an uncertain benefit.

Continued development of the RRO

We note that in addition to considering the Draft Bill, we are also currently responding to initial consultation on the settings under which the RRO would operate. A number of critical conditions under which the RRO will operate are anticipated to be the subject of future Rules consultations, initial discussion papers for which have only recently been published.³

Elements such as the calculation of firmness factors, the definition of a material reliability gap, and how reserves are procured may impact the way the RRO operates. For example, the extent to which hedge arrangements are required to be supported by generation physically located within a particular NEM region may impact the extent to which the RRO will support the investment in or the retention of dispatchable generation in that region. These elements are yet to be determined and therefore the potential impacts of the RRO on the SA market are not yet clear.

Until these conditions have been determined, it is difficult to predict the impact of the RRO with any certainty and further understand the impact of derogations or alternate conditions from that central design.

Changing dynamics in the South Australian market

AGL is acutely aware of the factors that may influence the dynamics of gas and electricity markets in South Australia over the coming decade. The interaction between increasing variable renewable energy, new interconnection, gas availability, and closure of gas plant could feasibly lead to adverse unserved energy outcomes and system strength issues under certain conditions. The dependencies between these factors have been stated by a number of sources including AEMO's ES00 and ElectraNet's study to facilitate South Australia's energy transformation⁴, which led to the proposed development of the NSW-SA interconnector.

For example, the market benefits assessment for the proposed SA-NSW interconnector was predicated on a reduction in wholesale market costs in SA due largely to an expected exit of gas plant and reduction in associated fuel costs. As a result, the SA market would become heavily reliant on interconnectors to assure reliability and less firm contracts would be available in the SA market. The potential exit of dispatchable plant would also have implications for regional system security and hedge market liquidity, which were concerns that were raised in responses to ElectraNet's proposal.

This may point to a need to further support the levels of firm generation located in SA through a market mechanism such as the RRO. However, it should be recognised that there are particular needs of the SA market which the RRO is not designed or intended to address, such as system strength requirements, and that expanding the operation of RRO may not assist in meeting these objectives while also having adverse impacts on the operation of the wholesale market.

³ See <http://www.coagenergycouncil.gov.au/publications/consultation-retailer-reliability-obligation-detailed-design-issues>

⁴ See <https://www.electranet.com.au/projects/south-australian-energy-transformation/>



As currently designed, the RRO requires liable entities to enter contracts which enable them to evidence cover for particular forecast peak demand periods. However, these periods do not necessarily coincide with periods where directions are called upon to maintain system strength. Other mechanisms to more directly incentivise and reward system strength services may therefore be more appropriate and effective in meeting this objective.

Similarly, addressing short-term reliability concerns at the lowest cost, might be best achieved through utilisation of the RERT, which is currently being reviewed and enhanced by the AER. The RERT takes into account forecast capacity shortfalls and seeks to obtain sufficient reserves to meet those requirements at lowest cost.

Next Steps

AGL remains committed to supporting policy that provides clear long-term investment signals for the electricity sector. We look forward to engaging further with the SA Government to discuss market reform that could maintain system security and reliability in South Australia at the lowest cost to customers.

At this stage, we do not consider that Ministerial power to impose a reliability obligation that is still very much under development will support this aim, and instead, in the short term could lead to adverse outcomes in terms of hedge market liquidity and costs to SA market participants and customers. The mechanism may also not contribute to resolving current concerns regarding SA system strength.

Despite our stated concerns regarding the particular amendments to the RRO proposed to apply in South Australia, we acknowledge that a well-formed RRO may be a useful component of the solution to maintain the reliability of SA's electricity system by providing some additional contracting incentive to ensure sufficient capacity is available during periods of forecast shortfalls. However, its impact in terms of underpinning longer-term investment and meeting affordability and security objectives will need to be monitored to understand whether it meets the expectations of policy-makers.

We look forward to working closely with the SA Government to meet these aims in a way that provides the most certainty for investors and lowest cost for customers over the long-term.

Should you have any questions in relation to this submission, please contact Aleks Smits, Manager Policy & Research on 03 8633 7146, or myself on 03 8633 7252.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Eleanor McCracken-Hewson', with a long horizontal stroke extending to the right.

Eleanor McCracken-Hewson

Senior Manager Policy, Research & Stakeholder Engagement, AGL Energy