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Dr Kerry Schott
Chair
Energy Security Board

Dear Dr Schott

RE: Material Reliability Gap Definition and Communication

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Energy Security Board's (ESB) material reliability gap definition and communication consultation paper relating to the Retailer Reliability Obligation (RRO).

About ERM Power

ERM Power is an Australian energy company operating electricity sales, generation and energy solutions businesses. The Company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load¹, with operations in every state and the Australian Capital Territory. A growing range of energy solutions products and services are being delivered, including lighting and energy efficiency software and data analytics, to the Company's existing and new customer base. The Company operates 662 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland.
www.ermpower.com.au

Metric to assess a gap period

ERM Power has previously suggested linking the gap period to the existing reliability standard. The reliability standard is a well-understood metric largely supported by market participants. The standard is set by the AEMC's Reliability Panel, which comprised of industry and consumer representatives offering a wide spectrum of views with regards to setting the reliability standard. We believe the current methodology used and the approach taken in which the Reliability Panel formally engages with all interested parties provides a robust, transparent and independent economic assessment of the costs and benefits of the reliability standard.

The reliability standard is based on an economic assessment that the cost of seeking to achieve closer to 100% reliability from wholesale supply in the planning domain would result in excessive costs to consumers. We believe that the ESB must acknowledge this in deciding on a metric for determining whether a gap period should be triggered. For these reasons we firmly believe that the reliability standard should be a key metric used in establishing whether to trigger a gap period under the RRO.

ERM Power believes it is helpful at this point to consider how AEMO's forecasts of unserved energy (USE) are prepared. AEMO currently assesses its forecasts as part of the Electricity Statement of Opportunities (ESOO) against the reliability standard to determine whether a low reserve condition exists. However, AEMO's forecasts contain a range of biases that tends to overstate the likelihood and volume of unserved energy. For example, AEMO calculates the probability weighted average USE based on a weighted value derived only from the 10%

¹ Based on ERM Power analysis of latest published financial information.



POE (one-in-ten year) and 50% POE (one-in-two year) forecast demand scenarios. Currently, the calculation is based on a weighting of 30% applied to the 10% POE forecast and 70% applied to the 50% POE forecast with no consideration of demand forecasts below the 50% POE. ERM Power contends that this methodology leads to an additional level of conservative bias in AEMO's calculations, which is likely to overestimate the probability and weighted amount of USE. Our submission to the Australian Energy Market Commission's Enhanced Reliability and Emergency Reserve Trader rule change option paper contains a more detailed discussion of these issues. We encourage the ESB to read that submission as an addendum to our submission to this consultation paper.

Consequently, ERM Power considers that a less conservative approach needs to be taken and that the proposed Metric B – where a buffer is applied to the reliability standard, is the most appropriate approach in that gap periods will only be declared when a genuine risk to supply exists.

Defining a material reliability gap period

ERM Power is strongly supportive of the ESB's preliminary position that the gap period is locked in at T-3 with changes only allowed to trading intervals within the specified gap period. We believe that this structure will support enhanced contracting as well as investment in additional capacity such as demand response and battery storage.

A well-defined and narrow gap period is far better suited to incentivising different various technologies to be available in the right places at the right times to target the specific periods of concern. It allows storage technologies like pumped storage or batteries to be fully available as well as guiding demand response providers of the times to be ready for dispatch. Large users who have opted-in may also be able to structure their business operations to shift demand to other times of the day.

By establishing the maximum bounds of the gap period(s) three years in advance, consumers, retailers and generators will be able to begin considering how best to meet the gap period using a range of options from investments in generation or demand response, or more specific hedging arrangements. It could also assist gas-fired generators to arrange access to gas pipelines at specific times.

Level of discretion provided to AER

We agree that the AER should have discretion to reject a gap period even if AEMO's forecasts suggest a gap period could be triggered. The principles and criteria that the ESB has set out in the consultation paper are a good starting point for the AER to consider when deciding whether to accept a gap period.

The declaration of a gap period is likely to lead to an increase in costs as retailers contract at higher levels than if a gap period had not been declared. To the extent that these costs will be higher than any benefit to consumers from increased reliability, it may not be beneficial to consumers to declare a gap period.

There may also be cases where AEMO has requested a reliability gap that is too broad in nature and does not adequately target the specific trading intervals where reliability is genuinely at risk. In such a case, ERM Power argues it should be reasonable for the AER to be able to narrow (but not expand) a proposed gap period if it believes this is more beneficial to consumers. As discussed above, a targeted gap period provides incentives for investment in both supply- and demand-side solutions to manage the risk of a genuine reliability gap.

Updating forecasts and providing information to participants

ERM Power broadly agrees with the ESB's proposed position that AEMO must provide a minimum of three months' notice before a request for a T-3 trigger. This will give liable entities some ability to begin managing the risk of compliance early. In the case of a T-1 trigger, however, we are concerned that the three months' minimum notice for AEMO combined with a two-month maximum for the AER to provide its decision could lead to a very short period in which liable entities will be able to finalise their contract positions before the T-1 period begins. Such a restricted timeframe is likely to see a spike in contract prices as contract sellers seek to take advantage of the high demand for contracts during a limited period. The AER may also be limited in its ability to conduct a genuine



consultation period given such time constraints. As such, we recommend that AEMO should be required to give the AER a minimum of six months' notice before requesting a T-1 period. We acknowledge that a balance must be struck between giving sufficient notice to market participants and allowing for the most up-to-date forecasts to be used. In our view, a six month notice period for AEMO along with an adequate review period for the AER, balances the ability of liable entities to procure contracts in a timely fashion and is likely to allow for consideration of the most up-to-date medium term projected assessment of system adequacy (MT-PASA) and ESOO forecasts.

Given the importance of using up-to-date forecasts to inform the decision to declare a gap period, we consider that there is merit in requiring more frequent updates of forecasts once a T-3 period has been declared; every three months would appear to be a reasonable starting point. This could be more accomplished more easily if the medium term projected assessment of system adequacy (MT-PASA) period were extended to 3 years, as the ESB raises as an option in the consultation paper. Extending the MT-PASA to three years would align it with the three-year notice of closure requirement for generators as well as provide monthly indicators of expected USE for the entirety of a T-3 gap period. We believe that this would be a relatively simple and inexpensive reform that would enhance liable entities' ability to plan investment and manage compliance obligations for a gap period.

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

Yours sincerely,

[signed]

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