

12 June 2020

Energy Security Board  
Level 26, 1 Bligh St  
Sydney NSW 2000

Submitted by email to [info@esb.org.au](mailto:info@esb.org.au)

### **Consultation on Draft Interim Reliability Reserve Rules**

Snowy Hydro Limited welcomes the opportunity to comment on matters raised in the Energy Security Board Consultation on Draft Interim Reliability Reserve Rules.

Snowy Hydro understands the challenges AEMO faces in managing energy supply. However we believe the multi-year out of market capacity reserve approach counters having electricity markets as providers would see the out of market capacity reserve as a lower risk alternative to participating in the market as a result increasing costs to consumers. The NEM has some form of regulatory mechanism that has allowed AEMO to contract for emergency reserves along with numerous other intervention mechanisms such as Directions and Instructions which could be utilised in cases of genuine market shortfall.

The Reliability and Emergency Reserve Trader (RERT), the current out of market reserve, is a function conferred on AEMO to maintain power system reliability and system security using reserve contracts. RERT in the Short-Notice or Medium-Notice RERT are currently appropriate tools which allows AEMO to purchase reserves 7 days and 10 weeks respectively from the anticipated shortfall, providing an appropriate trade-off for maintaining sufficient levels of unserved energy in the NEM. There is a recognition that there is a trade-off with cost per unit of the Short-Notice RERT and Medium-Notice RERT being more expensive than a multi-year out of market capacity reserve.

Recent reforms and rule changes in the market have provided initiatives aimed at increasing participation in the market and transparency of information with market participants heavily involved in the process. The Retailer Reliability Obligation (RRO), through extensive consultation, seeks a market response to a forecast supply shortfall while the Australian Energy Market Commission (AEMC) and the Australian Energy Regulator (AER) also pursue increased transparency in forward markets. The out of market capacity reserve mechanism is instead non market based and suffers a complete lack of transparency in both the tendering phase and also the cost of using the service, which is ultimately borne by customers.

The existing market design can be relied upon to support reliability in the long-term with the NEM. The Retailer Reliability Obligation (RRO) and Enhanced RERT design was robustly consulted and should remain the default unless there are demonstrably more efficient options. Should the Draft Interim Reliability Reserve Rules proceed however Snowy Hydro has the following comments following the Consultation Paper:

- AEMO is essentially planning to run the system at a higher level of reliability and do this using out of market resources.
- Changing the reliability standard and the market settings instead would mean that the desired NEM reliability would be achieved via market processes rather than via off market transactions with AEMO.
- It is sensible to replace the Victorian Jurisdictional Derogation final rule for multi-year contracting of RERT by a NEM wide approach.

- The RRO design was robustly consulted and should remain the default unless there are demonstrably more efficient options.

Any new RERT measures and triggers must include greater transparency, to improve the ability of retailers to explain the costs and benefits of emergency reserves to consumers and the industry more broadly. This will allow for efficient investment and operational decisions in response and will improve general market confidence in the RERT process because the market would have greater understanding of the reasons and conditions that required the procurement of the RERT. This could be undertaken through enhanced information by providing quarterly RERT reporting with forward and backward looking elements, reporting shortly after RERT dispatch and methodology reporting. Such changes will increase the frequency of information and provide timely information for market participants to prepare for costs associated with the RERT.

### **Reliability Standard**

Reliability in the NEM is largely driven through market participants responding to financial incentives and information provided about the need for resources. The NEM is an energy-only market. Under this structure, peaking generators such as Snowy Hydro, and others, regularly invest large amounts of capital to ensure they are available during times of scarcity. They do everything possible, at their own cost and own risk, to ensure they are ready to generate during the relatively few periods when demand cannot be met by other types of market generation. It is therefore important that there are robust market structures in place and accurate information available to underpin investment, retirement and operational decisions.

Through the out of market reserve, AEMO is essentially planning to run the NEM at a higher level and do this using off market resources. The Reliability Panel has established the most appropriate level for the Reliability Standard and associated market settings.

A higher level of reliability may be desirable in the NEM but this should be achieved by changing the reliability standard and the reliability settings to match the standard. This would mean that the desired NEM reliability would be achieved via market processes rather than via off market transactions with AEMO.

There needs to be a consistent framework for reliability, market price cap, value of customer reliability and use of the RERT. The reliability settings of targeted levels of unserved energy and the market price cap should be used as the primary investment signals for additional supply.

The ESB should consider the recommendations from their consulting report if there are any changes to the reliability standard through the post 2025 market design. The ACIL Allen Consulting report notes that if there is a need for a tighter reliability standard through the current NEM market arrangements then this can be achieved through changes to the market settings. This approach as the paper notes is the *“most economically efficient approach as it allows the market to naturally clear based on price”*.<sup>1</sup>

To date the reliability standard has essentially been met. The reliability standard of 0.02 percent unserved energy has provided an appropriate balance between providing a reasonable level of reliability without significantly increasing costs to consumers in providing a higher target.

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<sup>1</sup> ACIL Allen Consulting, 2020, “Reliability Standard: Economic Analysis to Support”



## **Multi-year out of market capacity reserve**

A multi-year out of market capacity reserve is fundamentally contrary to the design of the NEM. Any out of market capacity reserve should be intended as a last resort mechanism, to deal with instances of genuine market failure, and should be rarely used. Snowy Hydro therefore strongly oppose the contract terms of up to 3 years. There is only one market in the NEM and all regulatory settings should be calibrated to incentivise participation in the market.

A multi-year out of market capacity reserve is a defacto capacity market in all but name, and would be accompanied by all the drawbacks associated with that market structure. The rule change is, therefore, a radical proposal which will fundamentally undermine the market in the short and long run. The ultimate goal should be to encourage participation in the NEM and investment directly into dispatchable energy to meet peak demand. Increasing reliance on the out of market reserves will be likely to produce a less secure market, the opposite of its intended result, and discourage investment in the NEM.

## **State Derogation**

Snowy Hydro believes it is sensible to replace the Victorian Jurisdictional Derogation final rule for multi-year contracting of RERT by a NEM wide approach. Jurisdictional RERTs can lead to significant uncertainty for market participants in Victoria and complications for AEMO's management of power system operations across regions with different RERT arrangements. In an interconnected NEM, it is inefficient that possible future challenges facing the market need be managed at a jurisdictional level.

The NEM has largely served us well and consistently met its objective of reliable power even through the significant transformation over time, it is therefore important we don't overcomplicate and separate the NEM with numerous jurisdictional rule changes. The AEMC in the recent Victorian RERT consultation correctly noted that *"the RERT forms part of the broader reliability framework for the NEM, comprising market mechanisms and incentives, the reliability standard and reliability settings, the provision of information to the market and intervention mechanisms. In addition, the reliability framework was recently supplemented by the Retailer Reliability Obligation (RRO) that was put in place on 1 July 2019."*<sup>2</sup> This should not be complicated through numerous jurisdictional rules.

## **Retailer Reliability Obligation (RRO)**

The RRO is an important policy to achieving a reliable energy market. These policy objectives can be achieved through building on the existing strengths of the market. Snowy Hydro supports retaining a trigger period of 3 years for retailers to meet a forecast reliability gap which will allow for more current and complete information. If retailers do not meet the requirement by the compliance date, the last resort function will be triggered by Australian Energy Market Operator (AEMO) 1 year before the forecasted reliability gap.

The RRO design was robustly consulted and should remain the default unless there are demonstrably more efficient options. For that reason that we do not support revisions to the Retailer Reliability Obligation (RRO) by removing the T-3 trigger. The change would be a significant market distortion which will:

- cause the uncertainty for the sector.

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<sup>2</sup> AEMC, Victorian jurisdictional derogation – RERT contracting, Consultation paper, 24 October 2019

- create significant regulatory risk for retail businesses, an outworking of which may be inefficient levels of contracting and additional costs for consumers.
- lead to retailers inefficiently investing and contracting to address risks which may never materialise.
- retailers not having sufficient time to procure the additional capacity needed.

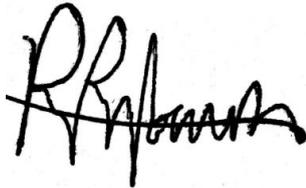
The NEM has largely served us well and consistently met its objective of reliable power even through the significant transformation and policy instability which has occurred over time.

### **About the Snowy Hydro Group**

Snowy Hydro Limited is a producer, supplier, trader and retailer of energy in the National Electricity Market (NEM) and a leading provider of risk management financial hedge contracts. We are an integrated energy company with more than 5,500 megawatts (MW) of generating capacity. We are one of Australia's largest renewable generators, the third largest generator by capacity and the fourth largest retailer in the NEM through our award-winning retail energy companies - Red Energy and Lumo Energy. Collectively, they retail gas and electricity in South Australia, Victoria, New South Wales, Queensland and the ACT to over 1 million customers.

Snowy Hydro appreciates the opportunity to respond to the Energy Security Board Consultation on Draft Interim Reliability Reserve Rules and any questions about this submission should be addressed to [panos.priftakis@snowyhydro.com.au](mailto:panos.priftakis@snowyhydro.com.au).

Yours sincerely,



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