



12 June 2020

Dr Kerry Schott AO
Independent Chair
Energy Security Board

Submitted via email: info@esb.org.au

Dear Dr Schott

Stanwell Response to Consultation on Interim Reliability Measures Draft Rules – Reliability Reserve

Stanwell appreciates the opportunity to provide feedback on the Energy Security Board's (ESB) consultation paper on the interim reliability measures draft rules – reliability reserve.

Stanwell notes the timeframe to assess and respond to this consultation paper was constrained, particularly considering the impacts that COVID-19 is having on staffing and working arrangements of industry participants.

This submission contains the views of Stanwell Corporation Limited in relation to the interim reliability measures information provided to date and should not be construed as being indicative or representative of Queensland Government policy.

1. Introduction

All energy users, businesses and households, need to be confident that the power system can reliably generate and deliver electricity to meet their demand.

However, the costs of increasing reliability rise considerably as the reliability standard moves towards the unachievable target of zero Unserved Energy (USE). Any action aimed at reducing expected USE below the level preferred by energy users will increase costs without a commensurate increase in benefits to energy users.

Stanwell maintains that security, rather than system reliability, is the key challenge currently facing network operators and therefore energy users. As the Reliability Panel noted in 2018 Final Report, *"since 2007/08 only 0.23 per cent of supply interruptions (in terms of GWh) were the result of reliability events"*¹. While this figure increased to 1.9 per cent of in 2018/19, reliability events continue to account for a small share of total supply interruptions².

¹ www.aemc.gov.au/sites/default/files/2018-04/Reliability%20Panel%20Final%20Report.pdf, p5

² www.aemc.gov.au/data/annual-market-performance-review-2020/sources-of-supply-interruptions-in-the-nem-2008-09-to-2018-19

Stanwell is concerned with the governance of the process to date and the changes to the reliability standard, multi-year reliability reserve contracts and the delinking of the T-3 trigger from the T-1 trigger under the Retailer Reliability Obligation (RRO).

In the event these changes proceed, Stanwell requests transparent reporting on the procurement costs associated with the interim reliability measures. This will ensure the costs incurred to meet a reliability standard tighter than that recommended by the Reliability Panel are visible to all stakeholders.

2. Governance

This current consultation process is industry's first opportunity to provide feedback on the proposed changes to the reliability standard and operation of the RRO agreed at the March 2020 Council of Australian Governments (COAG) Energy Council (EC) meeting.

Stanwell is concerned that these changes undermine a number of recent processes focused on energy reliability and security in which consultation was broad and transparent, including:

- The Reliability Panel's 2018 review of the reliability standard settings;
- The Australian Energy Market Commission's (AEMC) final determination on Enhancement to the Reliability and Emergency Reserve Trader, which did not allow multi-year reserve contracting because it would "*likely create significant distortions to market participants' incentives to invest*"³; and
- The RRO, which commenced on 1 July 2019, particularly the RRO development process and the Australian Energy Regulator's (AER) ongoing consultation on the final RRO guidelines.

Stakeholders committed resources to participating in these recent reviews and rule change processes, engaging with market bodies, attending workshops and one-on-one meetings, and preparing submissions. Undertaking another review and changing both the reliability standard and the RRO means those resources and effort were wasted. This is a significant burden on industry, especially given the sizeable number of regulatory reviews and rule change processes currently underway, and stakeholders having to prioritise which they will participate in due to resource and capacity constraints.

3. Tightening the Reliability Standard

The ESB's reliability standard review follows two previous reviews in the past two years, both of which found the current reliability standard settings were appropriate:

- In its four-yearly reliability standard settings review published in April 2018, The Reliability Panel found that "*[t]he current reliability standard and settings are, in our view, achieving their purpose and are likely to continue to so do throughout the review period [i.e. 1 July 2020 to 30 June 2024]*"⁴; and

³ www.aemc.gov.au/sites/default/files/2019-05/Final%20Determination.pdf, p135

⁴ www.aemc.gov.au/sites/default/files/2018-04/Reliability%20Panel%20Final%20Report.pdf, piii

- The reliability standard was also considered as part of the Enhancement to the Reliability and Emergency Reserve Trader rule change. In the final determination published in May 2019, the AEMC concluded “[t]here is no change to the reliability standard as part of this final rule. Questions about the reliability standard and what it should be are dealt with by the Reliability Panel as part of its regular review, which considers the reliability standard in the context of the broader reliability framework. That review is separate from the consideration of the tools that the system operator has to maintain reliability, such as the RERT [Reliability and Emergency Reserve Trader].”⁵

The AER also recently found the Value of Customer Reliability (VCR) has not materially changed in recent years. In its final report released in December 2019, the AER found “that while there are some differences between 2014 and 2019 in VCR values for residential and business customers, in general VCR values are similar between the two years”⁶.

Given the conclusions of those recent reviews and rule change process, Stanwell would be keen to understand what additional evidence has come to light that warranted another review and informed the recommendation to tighten the reliability standard. Stanwell is particularly interested in the basis of the assertion that community expectations that electricity supply will remain reliable during a “1 in 10” year summer, as stated in the COAG EC Terms of Reference.

Any investment to increase generation capacity (either through refurbishing existing units, returning mothballed units to service or building new plant) in an attempt to decrease USE to a level below what is valued by energy users would be inefficient. Regardless of whether the interim reliability standard is met through investment in additional generation capacity or out-of-market interventions, costs to energy users will increase.

4. Interim Reliability Reserve draft rules

With respect to the Interim Reliability Reserve draft rules presented as part of this consultation, Stanwell provides the following comments:

- 11.xxx.6: In order to make the cost of the tightening of the interim reliability standard explicit, all reporting should detail what RERT procurement is related to the reliability standard and what additional volume is related to the interim reliability standard. This will make explicit to all stakeholders the cost or efficacy of the change compared to what the Reliability Panel said was efficient.
- In addition to multi-year reserve contracts, further consideration should be given to whether interim reliability reserve costs could be reduced by procuring multi-region reserve contracts that simultaneously address interim reliability exceedances across multiple regions, with costs shared appropriately across regions on a user-pays basis.
- Similarly, there should be an expectation that out-of-market resources be made in-market resources where feasible. This will reduce the distortions of out-of-market procurement on the energy market.

⁵ www.aemc.gov.au/sites/default/files/2019-05/Final%20Determination.pdf, pii

⁶ www.aer.gov.au/system/files/AER%20-%20Values%20of%20Customer%20Reliability%20Review%20-%20Final%20Report%20-%20December%202019.pdf, p3

5. Out-of-market procurement

Expanding the Victorian Jurisdictional Derogation final rule for multi-year contracting of RERT to the National Electricity Market has created market incentives in the opposite direction to market design.

Out-of-market procurement has the potential to cause distortions in the energy market, including the withdrawal of generation capacity from the market, dampen investment signals in capacity to participate in the market, inefficient risk allocation, and unpredictable reliability reserve costs⁷.

Stanwell maintains that in-market solutions are more transparent and efficient than out-of-market solutions.

6. Delinking the Retailer Reliability Obligation T-3 Trigger from the T-1 Trigger

Stanwell has significant concerns with the proposed change to the RRO trigger. Delinking the requirement for a T-3 trigger to enable a T-1 trigger fundamentally undermines the intent of the RRO. It was originally envisaged that the supply side of the market would be given time to address an identified material reliability gap, as detailed in the Market Making Requirements in the NEM consultation paper:

“Signaling [sic] the material gap at T-3 allows the market sufficient time to respond by investing in new capacity that reduces or even closes the gap.”⁸

In delinking the T-3 trigger, the market may not get this opportunity to address an expected material reliability gap prior to AEMO undertaking non-market interventions (e.g. RERT).

Delinking the T-3 trigger also means the RRO can be triggered without a Market Liquidity Obligation (MLO) or book build period, meaning retailers could not access the risk mitigation offered by these mechanisms. As detailed in the AER’s Interim Market Liquidity Obligation Interim Guidelines final determination:

“The MLO is a market making requirement designed to facilitate transparency and liquidity in the trading of electricity futures contracts relating to a forecast reliability gap. The MLO operates between T-3 and T-1 when the RRO is triggered and provides a source of qualifying contracts for liable entities to purchase to help meet their RRO contracting requirements.”⁹

One way to address retailer uncertainty about whether the RRO will be triggered without a T-3 trigger would be for the MLO to apply at all times. In its submission to the Market Making Requirements consultation paper, Stanwell suggested:

“Rather than having the MLO apply only in response to reliability or liquidity needs, Stanwell suggests that new entrant retailers would benefit from a MLO that applies at all times, in all regions... Stanwell agrees with the statement in section 2.4.2 of the Consultation Paper that an on-again, off-again MLO cycle

⁷ www.aemc.gov.au/sites/default/files/2019-02/Draft%20determination.pdf, pp117-118

⁸

www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Market%20Making%20Requirements%20in%20the%20NEM%20Consultation%20Paper.pdf, p7

⁹ www.aer.gov.au/system/files/AER%20-%20Final%20Determination%20-%20Interim%20Market%20Liquidity%20Obligation%20Guidelines%20-%20August%202019.pdf, p1

would not address the underlying causes of the lack of liquidity and the resulting disruption may have a detrimental effect on contract prices in a region.¹⁰

With the delinking of the requirement for a T-3 trigger, this would provide contract market liquidity for retailers and customers in the period between the Electricity Statement of Opportunity (ESOO) forecast being released and the formal declaration of a T-1 event.

However, this would not address the potential for changes in AEMO's forecasts triggering the RRO at T-1. The sole reliance on AEMO forecasts for determining whether a material reliability gap is expected affects retailers' risk management and contracting strategies. While the RRO requires Market Customers (mainly retailers) to hedge their portion of the "1 in 2" year peak demand forecast (referred to as 50 per cent probability of exceedance or 50PoE) the "gap" is likely to occur primarily in relation to AEMO's 10PoE forecasts.

These forecasts can be volatile. For example, there was a marked increase in Queensland's forecast maximum demand between the 2018 ES00 and the 2019 ES00, driven in part by AEMO changing the methodology¹¹.

While there is currently no forecast USE for Queensland, an equivalent change to the USE methodology could affect a region with some expected USE (particularly those close to breaching the reliability standard). This would impact the RRO T-1 trigger and the level of hedging required by retailers to avoid POLR costs and non-compliance penalties under the RRO.

Had the 2018 ES00 been marginal for Queensland (say, 0.0005 per cent), the 2019 ES00 would likely have breached the new interim standard. Taking 2021 as an example, even if retailers had contracted their share of forecast P50 demand of 8,513 MW from the 2018 ES00, they would have had to purchase additional contracts at short notice to reach the same share of Queensland's maximum demand of 9,406 MW in the 2019 ES00. This volume of contracts sought would be in addition to the contracts required for customers who would have been expecting to contract after the T-1 date given no material reliability gap had been identified in the 2018 ES00.

Stanwell notes the delinking of the T-3 trigger will be the subject of ESB consultation. Stanwell encourages the ESB and COAG EC to consider these issues prior to releasing their consultation paper.

¹⁰

www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Stanwell%20response%20to%20Market%20Making%20Requirements%20in%20the%20NEM%20Consultation%20Paper.pdf, pp2-3

¹¹ www.aemo.com.au/-/media/Files/Electricity/NEM/Planning_and_Forecasting/NEM_ES00/2019/Electricity-Demand-Forecasting-Methodology-Information-Paper.pdf, pp10-11

7. Conclusion

The changes to the reliability standard, out-of-market procurement incentives and RRO undermine or overrule the outcomes of previous recent reviews and rule changes, and do not address the 97 per cent of supply interruptions that are not related to reliability events.

Stanwell is particularly concerned with the delinking of the T-3 trigger from the T-1 trigger, less than one year after the RRO came into effect, and the incentivisation of out-of-market resources in apparent preference to in-market resources.

In targeting a level of USE below what may be valued by consumers, the costs of the proposed interim reliability measures would exceed the benefits to energy users of increased reliability.

Stanwell welcomes the opportunity to further discuss this submission. Please contact Evan Jones on (07) 3228 4536.

Yours sincerely



Ian Chapman
Manager Market Policy and Regulatory Strategy