Dr Kerry Schott
Chair, Energy Security Board
By email: info@esb.org.au

12 June 2020

Dear Dr Schott,

Interim reliability measures – reliability reserve: consultation on draft rules

ENGIE Australia & New Zealand appreciates the opportunity to respond to the Energy Security Board (ESB) in relation to the consultation on the draft rules to implement the reliability reserve.

The ENGIE Group is a global energy operator in the businesses of electricity, natural gas and energy services. In Australia, ENGIE has interests in generation, renewable energy development, and energy services. ENGIE also owns Simply Energy which provides electricity and gas to more than 720,000 retail customer accounts across Victoria, South Australia, New South Wales, Queensland, and Western Australia.

The trade-off between reliability and cost

It is axiomatic that an increase in the reliability of any system will come at a higher cost. This is especially evident in the case of electricity supply given its capital-intensive nature. There is an existing periodic process under the aegis of the Reliability Panel to review the reliability settings of the wholesale market, which represents robust governance arrangements. The most recent of these reviews, following analysis and stakeholder input, concluded that no changes were necessary at the time.

Since that time, it seems that community expectations have become apparent that are not met by the current settings, hence the determination by COAG Energy Council to introduce these interim reliability measures. The Council sits at the apex of the National Energy Market (NEM) governance arrangements, which accordingly affords them the ability to make such direct policy decisions, especially on matters such as reliability that entail a nuanced trade-off rather than being amenable simply to technical analysis.

Nonetheless, repeated incursions into existing, robust governance arrangements will increasingly undermine stakeholder confidence in the overall governance framework. It would be beneficial if the ESB and the Energy Council (or any successor in the new intergovernmental arrangements) reaffirmed the importance of the existing Reliability Panel process for future reliability assessments. To this end, there would be value in aligning the timing of the Australia Energy Regulator's next review of the Value of Customer Reliability (VCR) with the Reliability Panel Review so that the Panel and other stakeholders can be informed by the most up to date assessment of VCR.

A separate reserve is not the most efficient way to achieve reliability

ENGIE is pleased to note that the ESB's consultants, ACIL Allen point out in their report that "lifting the market price cap to a level consistent with the value that consumers place on reliability [i.e. in the order of $40-45,000/MWh]…is the most economically efficient approach as it allows the market to naturally clear based on price". This is a point that ENGIE has previously made over many years.

Whilst a tripling of the market price cap may not happen overnight, and may be unappealing to some, it is important that policymakers are not unduly seduced by the apparent benefits to consumers of segregating the provision of reliability to control overall energy costs. If policymakers had the ability to accurately "slice and dice" resources up into a set of segregated markets that each paid just enough to secure the next tranche of resources, then there would be no need for a market at all. Given they do not, each segmentation introduces an additional distortion into the market and reduces the efficiency of resource allocation over the long term.

Concerns that useful resources to support reliability such as demand response (DR) may be more effectively procured through a reserve contract approach than the market should be addressed by the ongoing reform process that is seeking to make the wholesale market more attractive to DR: five minute settlement, the expected introduction of a wholesale demand response mechanism (DRM) and the proposed eventual move to a two-sided market. These changes will further weaken the rationale for having a separate procurement mechanism such as the RERT and strengthen the case for targeting reliability outcomes through other reliability settings such as the market price cap and the cumulative price threshold.

The interim nature of the reserve rules

Given the distortions inherent in a separate reserve mechanism, ENGIE appreciates that the ESB has signalled that it intends the reserve to be a temporary measure with an end date of 2024/25 on the basis that the ESB's post-2025 market design review process will lead to the implementation of a more enduring solution to reliability concerns. ENGIE supports this approach and agrees that clause 11.xxx.13 is an important element of the new Rule.

Nonetheless, stakeholders may have some scepticism that this sunset date will be adhered to. The reliability safety net put in place at market start was extended on three occasions with the expiry date moving from 30 June 2003 to 30 June 2008. It was then replaced by a version of the current RERT, which was scheduled to sunset in 2012. A subsequent rule change extended it by four years (when the proponent, the Reliability Panel had only requested a one-year extension). Finally, a rule change proposal by COAG energy council for another three years (or seven years after the original sunset date) resulted in the RERT being retained indefinitely.

This process of repeated extension of instruments that were designed and intended as temporary stopgaps is a clear illustration of the challenging environment for private capital in the NEM over the last decade or so. A key measure of the success of the post-2025 market design review will be that it restores investment confidence to a level such that policymakers are confident in allowing the reliability reserve to sunset.

Limitation on multi-year contracting and oversight of reserves procurement

Rule 11.xxx.4 appears to suggest that AEMO may procure multi-year contracts for reserves up to the amount to the highest interim reliability exceedance (i.e. reliability gap) for the three years. This appears unlikely to be in customers' interests if one of the three years has a much higher interim reliability exceedance than the other two years. It would be preferable to restrict this volume to the amount required to address the interim reliability exceedance in at least two of the three years.

More broadly, the new reliability standard and the ability to procure multi-year contracts are likely to result an overall higher cost of the reliability reserve than the current RERT. The proposed introduction of a wholesale DRM may result in some resources entering the market and no longer being eligible for reserve contracts, which may also push up the cost per MWh (though other things being equal should also reduce the volume required).

These trends increase the risk that AEMO will inadvertently spend more than necessary in procuring the resources it considers necessary to meet the reserve. Accordingly, in order to maintain market confidence in AEMO, it is increasingly important that there is some independent oversight of AEMO's procurement on an annual basis, rather than waiting until July 2023. This would include reviewing information that may otherwise be considered confidential and so would not be available to the broader market through AEMO's RERT quarterly reports. Either AER or AEMC could potentially carry out this review.

Amending the Retailer Reliability Obligation

The other arm of the reliability reforms is the proposal to remove the requirement for a T-3 instrument for the Retailer Reliability Obligation (RRO). This means that an RRO can be called for the first time for a given period at T-1, or only 12 months out from the compliance date. This has a number of consequences.

Given that T-1 is when retailers (or other liable entities) have to share their contract position with the AER, if this was the only change to the RRO, then retailers would have no time to achieve compliance. The only way to ensure compliance then would be to seek to be permanently compliant. This would be inconsistent with the original purpose of the RRO.

According to the COAG Energy Council website, the RRO "will provide an incentive for market participants to invest in the right technologies in regions where it is needed, to support reliability"[1]. The point of the T-3 trigger was to signal to the market where investment in technologies to support reliability was needed with adequate notice for that investment to take place. The removal of the requirement for a T-3 trigger undermines this signal. The market would not have any prior notice of the specific regions and periods for which the reliability gap is forecast to occur. This means the market would be unable to use targeted, bespoke contracts to address the gap, which could be more efficient approach than purely relying on standardised contracts.

[1] http://www.coagenergycouncil.gov.au/priorities/reliability

Moreover, the Market Liquidity Obligation (MLO) does not work under this scenario. This is designed to operate between a T-3 trigger and a T-1 trigger, across the timeframes when retailers will typically be building up their hedge book for the period T.

To address the first issue the contract position date would need to be moved forward to allow time for the market to solve for the specific reliability gap. Products may need to be designed, parties will need to reconsider their overall contract position in the light of the T-1 trigger and the forecasts that occasioned the trigger, the market will need to be tested and negotiations will need to be carried out. With this in mind, a minimum of three months seems appropriate.

The MLO will be of considerably less relevance in such a period, and ENGIE suggests that the administratively simplest approach would be to scrap it. However, we are open to discussing other options with the ESB and other industry participants. For example, use of the MLO only in circumstances where liquidity concerns have been identified by the Australian Energy Regulator.

Should you have any queries in relation to this submission please do not hesitate to contact me on, telephone, (03) 9617 8415.

Yours sincerely,

Jamie Lowe
Head of Regulation