



RETAILER RELIABILITY OBLIGATION

Response to ESB Draft Rules Consultation Paper

April 2019

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1. Executive summary

Thank you for the opportunity to provide feedback on the Retailer Reliability Obligation (RRO) detailed in the ESB Draft Rules Consultation Paper (Consultation Paper).

This submission contains the views of Stanwell Corporation Limited in relation to the RRO information provided to date and should not be construed as being indicative of Queensland Government Policy

Stanwell understand that one of the initial drivers of the RRO was to incentivise customers – through their retailer where necessary – to hedge early enough to ensure that adequate physical resources remain in the system or are introduced to meet demand at times of potential market stress. Stanwell is concerned that this intent will not be met through the current RRO design due to the continuing ability for customers to hedge less than one year ahead without penalty as long as they are neither very large nor very small.

The consultation paper suggests the AER choose Market Liquidity Obligation (MLO) participants from the pool of scheduled generators. This does not appear to be resilient to the market transformation currently underway where scheduled generators are increasingly being replaced by semi-scheduled generators. Stanwell suggests all registered generators be considered to some degree and offers suggestions as to how the capacity of semi-scheduled generators could be determined for the purpose of the MLO.

Stanwell agrees with the independent audit of bespoke firmness methodologies approach detailed in the Consultation Paper but considers that once a methodology is set, calculations are a simple application of the methodology to the volume of the contract. Requiring an additional audit on firmness calculations of bespoke contracts will add to the costs of the RRO for no apparent benefit.

Stanwell is concerned with interaction of the extension of RERT to one year and the Retailer Reliability Obligation. After the ESOO is released, the last four months before T-1 are likely to see significant demand for contracts and a possible short squeeze. AEMO participating in the market at this time through tendering activities will increase costs for retailers and large customers obligated under the RRO.

Stanwell welcomes the opportunity to further discuss this submission. Please contact Evan Jones on (07) 3228 4536 or Jennifer Tarr on (07) 3228 4546.

2. Interaction of RRO and Enhancement to the Reliability and Emergency Reserve Trader Draft Rule Determination

The Enhancement to the Reliability and Emergency Reserve Trader Draft Rule Determination¹ (Draft Determination) extends the maximum procurement lead time for emergency reserves from nine to 12 months ahead of an identified shortfall. The justifications for the lengthening of the procurement lead time are that it will broaden the pool of potential RERT providers (potentially reducing costs) and create consistency with the lead time under the draft Retailer Reliability Obligation (RRO).

Stanwell is concerned that the longer procurement lead time will result in AEMO tendering for RERT at the same time as retailers are finalising their contract positions under the RRO (refer Figure 1).

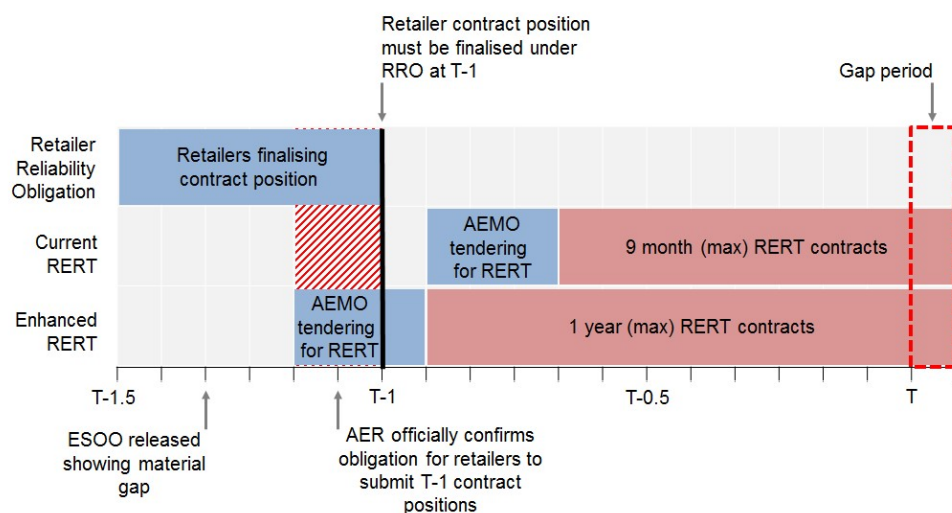


Figure 1: Retailer Reliability Obligation and Enhanced RERT with 12 month procurement lead time

After the ESOO is released, the last four months before T-1 are likely to see significant demand for contracts and a possible short squeeze. AEMO participating

in the market at this time will increase costs for retailers and large customers obligated under the RRO.

If the current 9 month procurement lead time for RERT is maintained, retailers will be able to finalise their position by T-1, then AEMO will have at least three months to negotiate long-notice RERT contracts with out-of-market resources. This will also minimise the trade-offs some potential RERT providers will have to make in determining whether to provide in-market energy services or out-of-market RERT services.

3. Forecasting the reliability requirement

Given the critical role AEMO's forecasts will play in triggering the RRO and in influencing how retailers should hedge, Stanwell supports the proposed improvements to the AEMO forecasts. Although not yet developed, Stanwell is hopeful that the AER's Forecasting Best Practice Guideline will provide confidence to market participants as to the quality and transparency of the reliability forecasts.

Stanwell also supports the broadening of AEMO's information requests to cover proposed new generation capacity and operational assumptions for existing generation capacity from Registered Participants. This will improve the quality and breadth of the inputs to AEMO's Electricity Statement of Opportunities (ESOO) forecasts.

4. Triggering the reliability obligation

Preparing an Instrument Request

Stanwell supports the balance the Consultation Paper strikes between the flexibility provided to AEMO in how it defines a T-3 reliability gap period and adjusts for unforeseen changes in the forecast over time and the certainty for liable entities that AEMO must only make a T-1 Reliability Instrument Request that relates to a previous T-3 Reliability Instrument.

Stanwell supports the new approach that the gap periods defined in the T-1 Reliability Instrument must be a subset of the gap periods defined in the T-3 Reliability Instrument. This provides certainty to market participants that they are entering into contracts that cover the period of compliance.

Timeframes for requesting and making reliability instruments

The Consultation Paper asks whether the notice of closure of a generator should be extended from 3 years to up to 4 years. Stanwell does not believe this is warranted as the 3 year notice of closure rule change also requires generators to submit their expected closure date regardless of how far away it is. This means generators that

¹ www.aemc.gov.au/sites/default/files/2019-02/Draft%20determination.pdf

are expected to close in four years will already be incorporated into AEMO's forecast with this closure date.

Three year notice of closure is also consistent with the Independent Review into the Future Security of the National Electricity Market (Finkel) recommendation². It was believed that three years balanced the difficulties faced by generators in predicting closure dates with a period that gave the market ample time to invest in new generation capacity. Also, given the three year notice of closure rule allows exemptions, in these circumstances nothing can prevent the possibility of a surprise generation plant closure being announced after T-3.

5. Opt-in Customers

Opt-in Customer threshold for Large Customers

Stanwell agrees that the Opt-in Customer threshold for large customers should be set higher than 100 MWh in order to minimise the burden for the AER and retailers in dealing with opt-in requests. In reality customers of 100MWh are unlikely to have the desire or expertise to deal in the financial products required for compliance. Stanwell agrees that the threshold for large customers should be increased to at least 8,760 MWh/year (equivalent to a 1 MW flat load).

Opt-in Cut-off Day

Stanwell supports the Opt-in Cut-off Day being 18 months after the T-3 Reliability Instrument is effective, as this gives retailers six months' notice of the opt-in load of its customers before the Contract Position Day (T-1).

To ensure retailers have certainty about the demand they will need to contract to cover in the event the obligation is triggered, retailers will need access to the opt-in register. Retailers will use the register to confirm the opt-in status of energy users when quoting for new contracts and managing their retail books.

Opt-in Register

Instead of a separate AER opt-in register being set up, consideration could be given to enhancing AEMO's Market Settlement and Transfer Solution (MSATS) system which is already accessible to retailers and contains information on customers. One potential option could be to add an MSATS table containing a "reliability responsible market participant" for each identified gap period.

6. Qualifying contracts and net contract position

Firmness methodologies

Stanwell agrees with the independent audit of bespoke firmness methodologies approach detailed in the Consultation Paper, as it will support innovation in contracting options for liable entities. Allowing for the entity to choose from a list of AER-approved auditors is consistent with current environmental schemes including the NSW Energy Savings Scheme (ESS) and Victorian Energy Efficiency Target Scheme (VEET). Stanwell supports the proposal that the audit be binding on the AER.

Once a methodology is set, calculations are a simple application of the methodology to the volume of the contract, regardless of whether the contract is bespoke or standardised. Requiring an additional audit on firmness calculations of bespoke contracts will add to the costs of the RRO for no apparent benefit. The AER has opportunities under the NEL to ask for further information and conduct compliance checks if it suspects audited methodologies have been incorrectly applied.

Stanwell suggests that liable entities should have the choice as to whether they get their bespoke methodologies audited before or after the gap period if it has been confirmed that actual demand has exceeded the one-in-two year forecast peak demand. This approach is illustrated in the decision tree below (Figure 2).

² www.energy.gov.au/sites/default/files/independent-review-future-nem-blueprint-for-the-future-2017.pdf

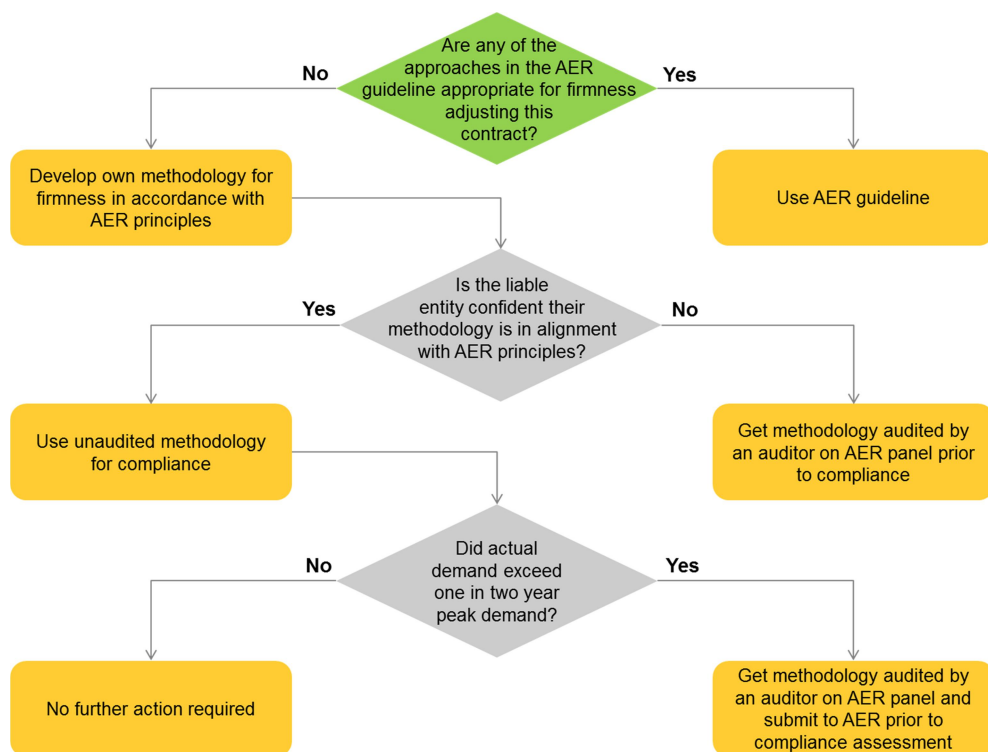


Figure 2: Firmness methodologies decision tree

This approach reduces the cost impact of the scheme because if compliance is ultimately not required the expense of the audit is saved. If a post-gap methodology audit finds the entity has overstated the firmness of a contract, then their net contract position should be reduced appropriately, increasing the likelihood of compliance penalties. This is a manageable risk that some liable entities are likely to prefer in order to save on the upfront cost of an ultimately unnecessary audit.

This approach also allows for bespoke contracting arrangements to be made all the way up to the contract date, subject to the retailer accepting the risk that an ex-post audit may create compliance penalties. Restricting this ability may restrict customer access to non-standard products.

Maintaining net contract position

Stanwell supports the proposal that entities do not have to maintain their net contract position and are entitled to trade out of their T-1 position. A requirement to maintain a net contract position would have risked liquidity and other issues.

Now that there is no requirement to maintain a net contract position, it should not be necessary to notify that AER when a retailer adjusts their contract position down, only up. For example if a retailer lost load (of whatever size), it should be able to sell the associated contracts, reducing its net contract position, without notifying the AER. This did not appear to be the case in the online RRO timeline example. Stanwell suggests clarifying this in the final rules

Adjustments to Net Contract Position for Marginal Loss Factors

The draft Rules allow liable entities to adjust their Net Contract Position if the load of large customers changes after T-1 by more than 1 per cent. In recent years the influx of new generation capacity and changes in network demand have seen Marginal Loss Factors (MLFs) being very volatile. Changes in load Marginal Loss Factors routinely exceed 1 per cent, with some changing more than 5 per cent.

As the RRO compliance load is calculated at node and annual MLFs are published after T-1, liable entities could be affected by large increases in their load after they have submitted their net contract position. Given the magnitude of the possible increases, Stanwell suggests that liable entities be permitted to adjust their Net Contract Position to accommodate for the impact of changes of MLFs.

Using net contract position as base for adjustments

The consultation paper suggests using the net contract position as the base for determining whether a threshold increase has occurred. This is problematic as it does not account for the different approaches retailers take to the timing of hedging new load.

Some retailers may purchase hedges in excess of their current requirement in order to leave room in their book for acquiring new load. They then face the risk of acquiring new load in excess of this contract position but below the 1 per cent threshold for adjusting their Net Contract Position, leaving part of this new load exposed to compliance penalties even though it is protected from high spot prices.

Stanwell suggests that when reporting their net contract position, retailers also provide their forecast load at node as well as their average forecast MLFs. This at-node load could then be used as the basis for later load or MLF adjustments.

Reporting non-qualifying contracts

The Consultation Paper states that if the liable entity “has non-qualifying contracts which have the effect of increasing the liable entity’s exposure to the spot price, these contracts and their impact must also be reported to the AER”. It is not clear why a contract altering an entity’s exposure to spot prices would be deemed a non-qualifying contract by the AER, but be relevant to the entity’s compliance position.

The examples of non-qualifying contracts canvassed previously include weather derivatives and business interruption insurance. While these types of contract arguably decreases an entities exposure to high spot prices in specific circumstances, it was indicated that it would be non-qualifying as the seller (insurer) is unlikely to invest in dispatchable generation in order to back the contract. Similarly, a liable entity selling weather derivatives is no less likely to invest in dispatchable generation than if it had not sold such a non-qualifying contract. It seems counterproductive to penalise an entity for holding a contract which has been deemed to be irrelevant to the task at hand.

7. Market Liquidity Obligation

Identifying obligated parties

The Consultation Paper states that the MLO will apply to scheduled generators whose generation (based on the registered capacity of all scheduled generation units in the region) exceeds 15%. Selecting only scheduled generators does not appear to be resilient to the changes that are currently occurring in the market, particularly scheduled generation being replaced by semi-scheduled generation.

Stanwell understands that the ability of semi-scheduled generators to provide significant volumes of swaps and caps is currently limited, but they can provide reduced volumes and other hedging products (e.g. power purchase agreements). Further, continued cost reductions in energy storage technologies are expected to increase the dispatchability of new technologies in the future while not necessarily creating conditions for formal scheduling of such plant.

Stanwell proposes that MLO obligated parties are chosen based on registered generation capacity but with all categories of generation considered (i.e. scheduled, semi-scheduled and non-scheduled). The registered generation capacity of each generator should then be adjusted for each plant’s ability to reduce exposure to spot market prices. There are a couple of ways capacity could be adjusted, including:

- Using the average capacity factors generated from AEMO’s forecasts. These capacity factors are likely to relate to historic performance and take

into consideration the energy constraint information provided by generators through the Energy Adequacy Assessment Projection (EAAP). The EAAP resource gives AEMO visibility of fuel constraints such as gas and water shortages that will impact future capacity factors; or

- Allowing each generator to provide a self-assessment of their likely capacity factor. This would be based on their knowledge of their own fuel supply, constraints, maintenance issues etc. This approach could be identical to firmness adjusting qualifying contracts and use the same AER guideline as reference. To add credibility to the self-assessment the proposed methodology for determining the capacity factors could be endorsed by an auditor (or the AER).

When selecting MLO obligated parties, the AER should also take into account 3 year notice of closure announcements. Closures are relevant whether they occur during the T-3 to T-1 window or soon after T as obligated parties will not be able to make a market in products for periods that they will no longer be generating.

Information reporting to AER

The Consultation Paper states that the AER will calculate generation market shares at least once every quarter. New and existing generators will be required to provide information to the AER on generating units under their influence and control, and on the corporate grouping to which they (or the person that holds their trading rights, if a third party) belong.

Stanwell suggests this information be provided to the AER once at the start of the RRO, then updated as necessary (i.e. when control of generation dispatch of a unit changes, or a unit enters the market or is retired). This is preferable to an approach which requires generators to provide quarterly confirmation to the AER that their portfolios have not changed. This approach increases the compliance burden for generators without an offsetting benefit to the AER or the market.

MLO requirements

Regarding the specification of the MLO components:

Platform: Stanwell endorses the approach taken by the ESB in initially approving the ASX but allowing for the possible entry of new exchanges. We note however that liquidity is likely to be enhanced if all market makers are participating on the same exchange.

Products: The identified products of base, peak and cap futures are appropriate and Stanwell appreciates the flexibility offered by the ESB for participants to select the products that best suit their portfolio.

Size of bids and offers: Stanwell supports the ESB's proposed requirement for MLO participants to make spreads which allow 1 MW lot trades to occur.

Market making trading hours: Stanwell supports the proposed two trading sessions per day.

Bid/offer spread: Stanwell supports the ESB's suggestions, combining a percentage based spread with a backstop of \$1 per MWh for low price contracts

Stanwell considers that the basis of the percentage calculation should be made explicit in advance – that is, if a bid of \$X is placed an offer no greater than 1.03\$X would be required.

Daily net sales limit: The proposed 5 MW per session in New South Wales, Queensland and Victoria, and 2 MW per session in South Australia is appropriate.

Quarterly net sales limit: The proposed 1.25% of the obligated party's registered scheduled generation capacity is appropriate.

Total net sales limit: The proposed 10% of the obligated party's registered scheduled generation capacity is appropriate. Stanwell understands this to mean per contract duration (i.e. inclusive of traded volumes of both cap and swap over that duration) over the 2 year period of the MLO (T-3 to T-1).

Interaction with voluntary market making

The proposed MLO should allow voluntary schemes to count towards MLO compliance. Contract market liquidity will be enhanced if the platform, products and time period overlap with existing schemes. Also the obligation to participate in a compulsory scheme should be deemed met if the participant is already participating in a voluntary scheme that meets the criteria of the MLO.

Stanwell suggests the ESB give consideration to a transitional arrangement whereby a voluntary scheme can be used to meet an MLO triggered by the 2019 ESoO even if the bid/offer spread requirements do not entirely align, given the narrow implementation time available between the design being finalised and the MLO potentially being triggered.

The ESB asks whether the MLO should only be triggered where sufficient voluntary market-making is not already occurring in the region. Stanwell suggests not introducing a subjective element to the scheme and that the MLO be triggered regardless of liquidity. If liquidity is healthy obligated parties are likely to already be making markets in the products the subject of the scheme. If they are already acting in this manner then there are minimal additional compliance obligations from triggering the MLO.

Reporting and compliance

The Consultation Paper states that "The AER's MLO Guideline must set out reporting requirements of obligated parties, including, frequency, content, format and timing". Under the MLO, obligated parties are required to create a spread on specified products for the period of the reliability gap. Reviewing trading data only shows when an obligated party has traded, not when they were maintaining a spread.

Stanwell is anxious to avoid a requirement on entities to maintain a log of every price put up or pulled down as this would significantly add to the costs of the scheme. Stanwell supports the suggested requirement on authorised exchanges to share relevant information with the AER for the purpose of compliance. This approach appears to best balance the need to ensure compliance with the costs of proving compliance.

Safeguards

The consultation paper suggests that the obligated party is not required to comply with the MLO when there are trading halts imposed on the company either by law or by the exchange. This safeguard appears to be adequate to remove participants from the obligation to make a market when they are in possession of potentially market sensitive inside information.

8. Voluntary book build

Stanwell had understood the book build to be voluntary, both on participants and on AEMO. The consultation paper appears to suggest that the book build is compulsory for AEMO to run. Stanwell suggests this should be reconsidered and AEMO instead be given the *option* to run the book build.

It would be pointless and distortionary for AEMO to run a book build if it observed another player running an equivalent book build process or if its market sounding revealed no interest from sellers or buyers in an AEMO-run book build.

Alternatively AEMO could call for expressions of interest then only run the book build if it determined there was an adequate level of buying and selling interest.

9. Compliance

Assessment of Regional Demand

To calculate the actual demand for a region, the Consultation Paper states that “the demand data published by AEMO will be adjusted to reflect what would have occurred, had AEMO not intervened in the market through directions, RERT or load shedding”.

Stanwell agrees that calculating and publishing regional demand in close to real time will enable liable entities to manage their load when demand is high during reliability gap periods. However Stanwell considers it acceptable for AEMO to use its *best estimate* of the impact of its actions on the market, rather than having to use only what it has *actually requested* from RERT providers or networks.

For example, AEMO knew immediately when it directed load shedding in South Australia on 28 September 2016 that the Distribution Network Service Provider shed more load than AEMO had requested. Had the RRO been operational during that event, AEMO could have made adjustments to account for the actual volume shed, rather than the requested volume shed.

Liable Entity's share of peak demand forecast

Stanwell notes that the ESB has chosen to use a single scaling factor for the entire gap period rather than a scaling factor for each trading interval in the gap period. Stanwell understands that this scaling factor is calculated based on a single maximum demand from AEMO's forecast and a single maximum actual demand observed during the gap periods.

Stanwell has assessed this approach and considers it acceptable. Changing the scaling factor for each trading interval both introduces complexity and shape risk. Shape risk is more difficult to understand and hedge for than the potential exposure of the maximum demand.

10. Procurer of Last Resort

Refunding RERT costs

One of the issues with assessing compliance and apportioning PLOR costs is that it occurs more than 30 weeks after the reliability gap ends and after actual RERT costs have been paid. During this time customers may have changed retailers and retailers may have merged or gone out of business. It may be very difficult and administratively expensive to refund customers their RERT costs via retailers.

Stanwell does not consider that creating a mechanism to fund future RERT costs would be an efficient use of customer funds.

Pass through of POLR costs

The ESB is also interested in whether non-compliant retailers should be able to pass-through their POLR costs. If there was a restriction on passing through POLR costs, it is unclear how this would work in practice. Usually fines and penalties would add to the cost base for an entity making them less competitive in the future.

Pass-through may also be appropriate where a penalty is directly related to a difference between terms agreed between the customer and the retailer and the actual consumption during the relevant periods.

