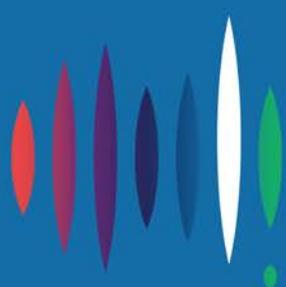
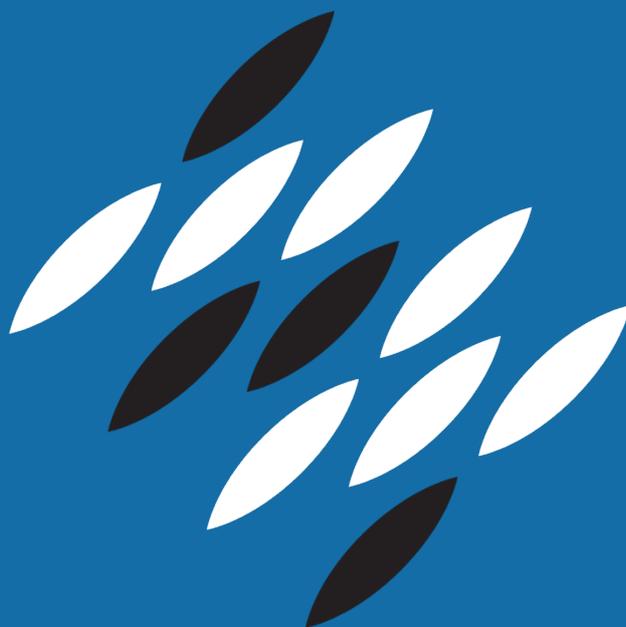


# Submission to the Energy Security Board

Draft Detailed Design Consultation Paper

13 July 2018



**ENERGY  
CONSUMERS  
AUSTRALIA**

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## Version history

| VERSION | DATE         | COMMENTS |
|---------|--------------|----------|
| 1       | 13 July 2018 | Final    |
| 2       |              |          |



Energy Consumers Australia appreciates the opportunity to provide this submission to the Energy Security Board (ESB). Our submission primarily focuses on aspects of the National Energy Guarantee (NEG) in respect of which the ESB has specifically sought feedback and which are likely to impact the long-term interests of consumers. In this submission, Energy Consumers Australia argues that there is need for a laser like focus on affordability in implementing the National Energy Guarantee, so as to contribute to the rebuilding of consumer confidence and trust in the energy sector.

## 1. Overview & summary

*The importance of acting to rebuild the confidence of consumers in the sector and trust in the energy system cannot be overstated.*

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the Council of Australian Governments (COAG) Energy Council in 2015, our objective is to promote the long-term interests of consumers with respect to price, quality, reliability, safety and security of supply.

Energy Consumers Australia appreciates the opportunity to provide this submission to the ESB. Our submission primarily focuses on aspects of the NEG in respect of which the ESB has specifically sought feedback and which are likely to impact the long-term interests of consumers. Energy Consumers Australia has no detailed comments on the emissions reduction requirement. Accordingly, our submission focuses principally on the reliability requirement.

*Through the reliability mechanism, the NEG could incentivise and facilitate adequate investment in dispatchable energy, including importantly through consumer participation in demand response.*

In our view, the importance of acting to rebuild the confidence of consumers in the sector, and trust in the energy system, cannot be overstated. Consumers understand that there is a generation “supply” problem, with the ageing of the coal fired power station fleet, and the need for a minimum amount of dispatchable energy to be available to meet consumer and system needs, in the transition to a lower emissions economy.

In this context the focus of the NEG must be about delivering the transition that focusses on lowest efficient costs and lower bills.

In our view there are two high level aspects of the NEG that go directly to affordability and outcomes for consumers.

Through the reliability mechanism, the NEG could incentivise and facilitate adequate investment in dispatchable energy, including demand response.

However, there must be no opportunity for over-investing in generation assets at the same time as past investment in network assets has resulted in lower capacity utilisation, and spiralling costs for consumers.

In other words, there must be no opportunity for any single part of the system to de-risk its own position at the expense of consumers through added costs.

At the same time, using technology and data, consumers are more willing to be partners in achieving an energy system that contributes to affordability in their communities through incentives or rewards for consumers.

There are many more opportunities for sophisticated demand response measures and programs, than we have seen adopted so far. More can be done to build on the AEMO-ARENA trials over summer and programs such as Power Changers and Summer Saver in Victoria, and Peak Smart in Queensland.

In responding to the Draft Detailed Design Consultation Paper, Energy Consumers Australia supports:

- the approach to delivering adequate reliability, in providing clear investment signals, while lowering emissions;
- the design elements that work to improve liquidity, transparency and the effectiveness of competition in retail markets, though we request that further clarity on some of these elements be provided in the subsequent development of the changes to the National Electricity Rules;
- the technology neutrality of the design of the NEG, so that the least emissions intensive, lowest costs and most reliable generation – including demand response - is available in the right place and at the right time.

In this submission, Energy Consumers Australia has provided feedback on the proposed design of the NEG. However, we note that there are a number of complementary reforms that will need to be integrated with the design of the NEG should the COAG Energy Council agree to proceed with its implementation on 10<sup>th</sup> August 2018. We look forward to the opportunity to engage in the process for developing the NEG legislative and regulatory reform package.

## 2. Promotion of the long-term interests of consumers

The primary objective of the Australian Energy Market Agreement is ‘**promotion of the long-term interests of consumers** with regard to the price, quality and reliability of electricity and gas services.’<sup>1</sup>

Another limb of the objective is “the establishment of a framework for further reform to ... address greenhouse emissions from the energy sector, in light of the concerns about climate change and the need for a stable long-term framework for investment in energy supplies.”

The primary objective has been reflected in the lens that Energy Consumers Australia applies to the analysis of the NEG, which is the long-term interests of consumers. This forms the core of the energy regulatory framework. Specifically, the long-term interests of consumers are explicitly referred to in the National Electricity Objective (NEO), the National Gas Objective (NGO) and the National Energy Retail Objective (NERO) – collectively, the “energy objectives”. It is also reflected in the constitution of Energy Consumers Australia.

The primary requirement for the promotion of the long-term interests of consumers is economic efficiency; that current and future consumers pay no more than is necessary for the quality and reliability of services they need.

The policy to achieve efficiency has been to separate natural monopoly elements from potentially competitive elements, and allowing competition in the latter.

In particular, the promotion of the long-term interests of consumers requires the following.

- **Competition:** It is not sufficient to merely permit competition. Markets need to be effectively competitive to guarantee consumers pay no more than they need to. This requires, among other things, market liquidity and low barriers to entry that will encourage innovation and the provision of lower costs or better products and services for consumers.
- **Costs:** Where costs are not constrained by competition alone, they must be constrained to be as low as possible since these costs will eventually be recovered through consumer prices in the long-term.
- **Confidence:** Consumers need to have confidence in the market to engage in it and thereby provide the dynamic through which competition achieves low cost outcomes. A core requirement of this is transparency including that relevant information must be available and accessible.
- **Equity:** Provision must be made for vulnerable and disadvantaged consumers to continue to access essential energy services.

*The primary requirement for the promotion of the long-term interests of consumers is economic efficiency; that current and future consumers pay no more than is necessary for the quality and reliability of services they need.*

<sup>1</sup> COAG 2013 *Australian Energy Market Agreement*

[http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Australian%20Energy%20Market%20Agreement%20-%20Dec%202013\\_1.pdf](http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Australian%20Energy%20Market%20Agreement%20-%20Dec%202013_1.pdf)

## 3. Responses to key draft design elements

### Architecture of the NEG – integration of energy and emissions

The NEG is designed to integrate energy and emissions policy in a way that incentivises new investment in low emissions technologies while allowing the electricity system to continue to operate reliably.

*The NEG is likely to provide a firm basis for efficient, long-term investment and decision-making by sector participants.*

In Energy Consumers Australia's view, the integrated approach towards both energy and emissions under the NEG for the first time ensures coherence at a national level between energy and emissions policy. This reduces the risk of unintended consequences associated with regulating each area separately. Further, we consider that the NEG is likely to provide a firm basis for efficient, long-term investment and decision-making by sector participants.

In relation to the emissions mechanism, Energy Consumers Australia recognises that the draft design has responded to issues raised by stakeholders in consultation with the ESB.

In particular, by ensuring the emissions mechanism works completely separately from existing price risk management contracting (which will largely also represent reliability mechanism contracting), it does not threaten existing market liquidity or transparency.

In our view, the registry approach is relatively simple, and the process to initially place all generation in an unallocated pool is sound and low-cost. If the intensity target is not binding in a year, then participants need do nothing further – all will be allocated the compliant residual pool intensity.

The proposal to publish the unallocated generator volumes regularly over the course of each year is a good transparency measure, which will assist retailers in knowing where to look for emissions contracts should they need them.

### Impact of the NEG on competition

*The design of the NEG safeguards competition through the mechanisms underlying both the emissions reduction and reliability requirements.*

Energy Consumers Australia supports the intent of the NEG not to undermine competition and, potentially, to safeguard competition through mechanisms underlying both the emissions reduction and reliability requirements. These mechanisms have been outlined in the Consultation Paper and associated Technical Working Papers published by the ESB.

Energy Consumers Australia supports the delivery of NEG policy through competitive markets. Transparent, liquid markets provide clear price signals in relation to energy supply, reliability of supply and emissions performance. Competitively-driven investments based on those price signals helps to ensure that risk is borne by sector participants, not consumers or taxpayers, and investment is likely to be least-cost and in the long-term interests of consumers.

*The NEG provides clear support for continuing innovation in areas such as demand response participation, financial solutions to firm up renewables supply into the contract markets, and the role of emerging storage assets.*

We support strong limits on the carry forward of over-achievement under the emissions reduction requirement, to ensure that there is sufficient opportunity for all participants to secure adequate contracts. This measure will act to safeguard competition. Further the limited allowance for under-achievement in a particular year will make sure that participants are not forced into failure to comply because of a temporary shortfall.

Energy Consumers Australia supports the threshold exemption of the first 50,000 MWh of customers load from the emissions mechanism, as also likely to safeguard competition.

While we are supportive of the concept of a Market Liquidity Obligation, as a possible mechanism to increase competition through access to tradeable contracts, we are less clear about the practicality of this obligation, and the implications for costs to consumers.

On the other hand, we support the adoption of the trade repository, and the reporting approach, and consider that the benefits for transparency of contracting, and downward pressure on prices, could potentially be large.

In our view, the voluntary book-build is an unnecessary element of the draft design package, and could be withdrawn with little consequence for the impacts on competition.

### **Technological neutrality**

Energy Consumers Australia welcomes the technology-neutral nature of the NEG's reliability requirement, which means that both demand and supply-side resources can be used to meet the reliability requirement.

By allowing demand-side resources to compete with supply through generation, the NEG helps to ensure that the supply-demand balance is achieved efficiently.

In our view the design of the NEG is forward-looking in its principles-based approach to defining reliability contracts. It provides clear support for continuing innovation in areas such as demand response participation, financial solutions to firm up renewables supply into the contract markets, and the role of emerging storage assets.

### **Refinements of NEG design**

Energy Consumers Australia has considered the draft design elements of the reliability mechanism in the NEG as described in the Consultation Paper and associated Technical Working Papers. We have provided feedback, and have sought clarification, in some cases, to inform the NEG process when it proceeds to implementation.

## 4. Comments on the reliability mechanism

### Forecasting the reliability requirement

According to the Consultation Paper, AEMO will forecast 10 years in advance whether the reliability standard is likely to be met (or not) using the Electricity Statement of Opportunities (ESOO).<sup>2</sup> More specifically, AEMO will be required to forecast unserved energy (USE) as the basis for assessing reliability in each NEM region for the next ten years.<sup>3</sup>

Forecasting by AEMO clearly plays a critical role in ensuring that the NEG's reliability requirement is met at the lowest possible cost. Credible and robust forecasts about the balance of demand and supply over time, and the extent of any reliability gap, will be fundamental to enabling liable entities to predict the scale and scope of their potential reliability obligations and their liability well in advance. Further, credible and robust forecasts will be needed so that liable entities are able to make efficient decisions on the basis of their potential reliability obligations.

### Methodology for forecasting

Energy Consumers Australia understands that AEMO will be required to assess ES00 forecasts against best practice guidelines produced by the Australian Energy Regulator (AER) and consult with stakeholders on the forecast methodology.<sup>4</sup>

We support the transparency and monitoring approach, including the importance of continuous improvement, described in the Consultation Paper.

In our view, the most important element in the requirements for AEMO in undertaking its ES00 forecasts is that they will be required to:

*“make sufficient information available so that ES00 forecasts are reproducible (or close to) by an independent reviewer or forecaster.”*

Our interpretation of this requirement is that the methodology to be used in the ES00 should be well established, publicly available and transparent, as well as making available the data inputs into the forecasting models. This practice is rare in Australia, but is a feature of Ofgem in conducting its regulatory oversight functions in the United Kingdom. In Australia, AEMO worked closely with industry in establishing a common methodology for connection point forecasting.

What it means in practice, is that the forecasting approach in the development of the ES00 can be shared, and collaboratively developed in advance of it being used to produce actual forecasts. This may require new approaches to consultation than expanding the existing Forecasting Reference Group, which we consider is unlikely to be fit-for-purpose.

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<sup>2</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), p. 6.

<sup>3</sup> ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 14.

<sup>4</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), p. 35. ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 9.

In our view, this will provide confidence that the actual forecasts are credible and robust, over time. We would encourage the ESB, and AEMO, to consider adopting this practice in relation to forecasting the reliability gap.

AER best practice guidelines could play an important role in assisting AEMO to achieve credible, robust forecasts. The guidelines themselves could require periodic review to ensure that they reflect best practice forecasting methods.

**Issue:** The NEG is dependent on the use of well regarded, robust and reliable forecasts.

**Recommendation:** AEMO should work with stakeholders, and in particular liable entities, in the development of a common methodology for forecasts in the ESOO.

#### Timing for updating forecasts

The ESB has proposed that AEMO will update reliability forecasts annually or more frequently if there is a material change to the supply-demand outlook.<sup>5</sup> In addition, AEMO will be required to undertake a 6 monthly ESOO update following a decision to trigger the reliability obligation, with little advance notice, at year T-3 (3 years from forecast reliability gap) – that is, where there is a significant change in ESOO outcomes from year to year.<sup>6</sup>

Energy Consumers Australia supports the inclusion of a general time-frame for updating reliability forecasts (i.e. annually as a matter of course and 6 monthly following the trigger of the reliability obligation). However, there could be value in also having an overarching obligation on AEMO to update the reliability forecasts if, and when, any change to supply and demand could materially affect USE forecasts in the short, medium and longer terms.

The basis upon which this overarching obligation is activated should be clearly identified and defined in the regulatory framework. For example, if the requirement to update the reliability forecasts is to be based on a “material” change in the supply-demand outlook, this term will need to be clearly defined and guidance may be required in relation to how the term should be interpreted in practice by AEMO.

Energy Consumers Australia considers that frequent changes in reliability forecasts that could result from such an approach would not create undue uncertainty nor deter investment provided the changes are based on new information and derived from a robust and transparent forecasting process by AEMO. Assuming that these pre-conditions are met, updates in the reliability forecasts, as and when needed, will help drive efficient decision-making by relevant stakeholders, particularly liable entities.

<sup>5</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), pp. 6 & 35.

<sup>6</sup> ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 20.

**Issue:** Reliability forecasts should be as current as possible. Frequent changes in reliability forecasts would not create undue uncertainty nor deter investment provided the changes are based on new information and derived from a robust and transparent forecasting process by AEMO.

**Recommendation:** General time-frames for updating reliability forecasts should be supplemented with an overarching obligation on AEMO to update the reliability forecasts if and when any change to supply and demand will or may affect USE in the short, medium and longer terms. The basis upon which this overarching obligation is activated should be clearly identified and defined in the regulatory framework.

#### Contextual information

AEMO will be required to prepare USE forecasts as the basis for assessing reliability in each NEM region for the next ten years. To support liable entities to make informed decisions about the implications of the reliability requirement under the NEG, AEMO will also be required to produce additional descriptive information to provide further context to support USE forecasts, including:<sup>7</sup>

- an indication of the additional capacity required to “close” the reliability gap by reducing unserved energy to an acceptable level;
- the pipeline of potential generation projects over the forecast period, along with progress of their development;
- likely time of occurrence of the shortfall, such as season and time of day;
- duration of the expected shortfall; and
- indicative examples of conditions under which unserved energy is occurring.

Energy Consumers Australia supports the publication by AEMO of contextual information together with the USE forecasts, which will certainly assist liable entities to make more informed and efficient decisions.

Energy Consumers Australia recommends that the list of contextual information to be produced by AEMO be described in the regulatory framework inclusively (rather than exclusively) to enable additional contextual information to be included in AEMO forecasts, if necessary.

This inclusive and flexible approach to the description of contextual information by AEMO will help to ensure that the information is as useful as possible for liable entities and accommodates future developments that might affect the level of USE forecasts.

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<sup>7</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), p. 35. ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), pp. 7 and 11.

**Issue:** Contextual information to interpret USE forecasts should be described broadly, so as to adequately support liable entities to make informed and efficient decisions in relation to their potential reliability obligations.

**Recommendation:** The list of contextual information to be produced by AEMO should be described in the regulatory framework inclusively rather than exclusively.

### Consultation with stakeholders

The ESB has indicated that AEMO will be required to consult with stakeholders on a range of matters associated with the application and administration of the reliability requirement, including:<sup>8</sup>

- the forecast methodology;
- how best to present material on the AEMO website so that information is easily accessible and interpretable, and report back to stakeholders;
- defining performance metrics and consider back-casting of the ESOO forecasts as part of the performance monitoring; and
- the proposed improvement program.

AEMO will be required to develop a formal consultation process using published guidelines, which will be used as the basis for consultation.<sup>9</sup>

It is also proposed that consultation regarding the forecasting methodology will occur through an enhanced and expanded model of the Forecasting Reference Group (FRG) which meets monthly. Energy Consumers Australia understands that the FRG will include representatives from industry, government and consumer groups and the “independent entity” and will be updated with AEMO’s analysis and test assumptions and methodology before the forecasts are publicly released.<sup>10</sup>

The success of the NEG is critically dependent on the use of credible, robust and reliable forecasts and the stakeholder consultation process proposed by the ESB could assist in achieving this.

In Energy Consumers Australia’s view, the robustness of AEMO’s forecast could be further enhanced if consultation is extended beyond the forecast methodology to forecast outcomes – specifically, AEMO’s USE forecasts and the specific reliability gap.

We note that there may be a need to provide additional support, including resourcing, to facilitate advocates’ participation in this process.

<sup>8</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), p. 35. ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 9.

<sup>9</sup> ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 12.

<sup>10</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), p. 35. ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 9.

Energy Consumers Australia accepts that there may be challenges associated with involving stakeholders (particularly, liable entities) in the substantive exercise of forecasting, including the risk of gaming forecasting outcomes to serve individual interests. (This could largely be overcome by establishing a common, shared methodology in advance, rather than collaborating on the actual forecasts themselves.)

Nevertheless, given the significant impact that AEMO's forecast may have on liable entities and counter-parties with whom liable entities might contract, consultation may help foster a more collaborative approach towards forecasting.

Moreover, stakeholders may have valid and relevant insights into an actual or potential reliability gap that could materially affect the outcome of AEMO's forecasts.

**Issue:** The robustness of AEMO's forecast could be enhanced if consultation is extended beyond the forecast methodology to forecast outcomes – specifically, AEMO's forecasts of USE and the specific reliability gap.

**Recommendation:** AEMO should be required to consult widely with stakeholders (particularly, liable entities) on forecasting approaches such as a common methodology and outcomes – specifically, AEMO's USE forecasts and any reliability gap.

#### Performance monitoring and evaluation

Energy Consumers Australia understands that to provide further confidence in the forecasts used as the basis for the reliability requirement, AEMO's forecast performance will be monitored and published at least on an annual basis. The resulting reports and data will be used to help inform and provide justification for a continuous improvement program that AEMO will be required to implement.<sup>11</sup>

The improvement program will be made available to interested stakeholders and would consist of a list of proposed improvements, estimated impact on forecast performance and deliverable dates. A summary will be published in each subsequent ESOO. The program will capture improvements covering data and information, input assumptions and changes to methodology and processes.<sup>12</sup>

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<sup>11</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), p. 35. ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 13.

<sup>12</sup> ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 13.

Energy Consumers Australia supports the framework for performance monitoring and evaluation proposed by the ESB for forecasting by AEMO. In order to ensure that the performance monitoring and evaluation process is undertaken in a robust and meaningful way, Energy Consumers Australia recommends that the results of the performance monitoring and evaluation process, including the proposed incorporation of the results of that process into future forecasting by AEMO, are reviewed by an external consultant that is suitably qualified.

**Issue:** The performance monitoring and evaluation process must be undertaken by AEMO in a robust and meaningful way.

**Recommendation:** The results of the performance monitoring and evaluation process, including the proposed incorporation of the results of that process into future forecasting by AEMO, should be reviewed by an external consultant that is suitably qualified.

### Defining and calculating the reliability gap

According to the Consultation Paper, AEMO will forecast whether the reliability standard is likely to be met (or not) and will identify the size of any “gap” in the supply/demand response.<sup>13</sup>

Energy Consumers Australia considers that AEMO’s USE forecasts and identification of any reliability gap need to be described in a way that is useful and relevant for relevant stakeholders, particularly liable entities.

More specifically, there must be a specific and clear description of the risk faced by liable entities (including narrow periods where reliability is likely to be compromised) to allow fit-for-purpose contracts and associated responses to any shortfall in reliability requirements to be established. The description of the gap should also be clearly and explicitly linked to the basis upon which the reliability obligation can be triggered by AEMO.

The description of the reliability gap could include:

- the “shape” of the gap in each settlement interval for each day during the gap period, including a distinction between working and non-working days (when demand circumstances are quite different); and
- “frequency” of the gap, indicating what percentage of days in the quarter are forecast to experience the conditions.

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<sup>13</sup> ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 20.  
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Such information is likely to reveal the extent to which the reliability gap needs to be met by longer-term dispatchable assets (i.e. to cover a gap that is forecast to persist for much of a day and/or for many days in the quarter) versus shorter-term assets (i.e. to cover critical peaks of short duration and/or rare occurrence).

Alternatively, such information may indicate that the threat to reliability is relatively short-term – for example, the specific circumstances leading to a gap might be late afternoons and early evening on a hot summer weekday, following several days of hot weather during which air-conditioning has been used extensively. In this scenario, the lowest-cost contract for a retailer might be something very specific – such as a 5-hour option backed by demand-response or a battery.

This outcome would ensure the contracts represent only the necessary capacity to close the gap, and no more. More specifically, an appropriate description of the reliability gap would allow retailers and their contracting counterparties to properly evaluate the requirements to meet reliability, and the lowest-cost means of doing so. A regulatory requirement to specifically and clearly identify the reliability gap will also impose discipline on AEMO in the forecasting process and, thereby, help to avoid unnecessary over-investment in capacity that could result from overestimates of the reliability gap.

Finally, the process of substantive consultation with stakeholders on forecast outcomes may serve as a more direct advance warning mechanism for liable entities and incentivise them to take voluntary action to avoid the reliability obligation being triggered by AEMO.

**Issue:** Absence of specific and clear information about the reliability gap could compromise the ability of the NEG to deliver efficient, low cost generation and demand responses that are in the long-term interests of consumers.

**Recommendation:** AEMO should be required to identify the reliability gap specifically and clearly to allow fit-for-purpose contracts and associated responses to be established. The description of the gap should also be clearly and explicitly linked to the basis upon which the reliability obligation can be triggered by AEMO.

### Materiality of the reliability gap

Our understanding is that where AEMO has identified a reliability gap in its ESOO forecast three years in advance of the period in which the gap is forecast, it will need to form a view on whether the gap is sufficiently “material” to trigger the reliability obligation under the NEG.

If the reliability gap is considered to be material, AEMO must request the AER, as the independent entity, to approve the request to trigger the reliability requirement and, if this approval occurs, the trigger will be operative. In practical terms, liable entities will need to enter into qualifying contracts and may be required to demonstrate future compliance unless the reliability gap closes. The AER must assess whether the identification of a material gap is consistent with the assessment framework and is reasonable, based on all the available information.<sup>14</sup>

The regulatory framework will set out a transparent framework to allow AEMO and the AER to determine the materiality of a reliability gap and will specify<sup>15</sup>:

- the timing of the materiality assessment.
- prescriptive requirements which must be adhered to as part of the materiality assessment.
- a requirement that AEMO must publish a guideline, as part of the annual ESOO development consultation process, outlining how it will determine materiality.
- how a material gap, and decision to trigger the reliability obligation, is communicated to market participants.

#### Decision-making framework

The ESB has indicated that the assessment of materiality will be based on objective criteria with some structured discretion.<sup>16</sup>

Energy Consumers Australia recognises that determining whether a reliability gap is “material” is a complex exercise, which involves balancing the risk of unserved energy against the cost of filling the reliability gap.

The approach to determining whether or not a reliability gap is material will also involve consideration of the need to provide certainty and predictability to affected parties while accommodating changing market conditions and possible future responses to reliability shortfalls that may emerge. On this basis, Energy Consumers Australia supports a flexible decision-making framework to establish the materiality of a reliability gap.

To ensure coherence of the reliability framework, Energy Consumers Australia recommends that the criteria used to assess materiality of a reliability gap are linked to the factors that are used to describe the reliability gap in the ESOO.

Moreover, clarity is required regarding how these criteria will be applied and balanced in practice by AEMO. This clarification could be reflected in AEMO’s guidelines outlining how it will determine materiality. If so, this aspect of the guidelines should be the subject of consultation with interested stakeholders to ensure that the balancing process is robust.

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<sup>14</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), pp. 6, 36 - 37.

<sup>15</sup> ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 18.

<sup>16</sup> ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 17.

**Issue:** It is important to ensure that the decision-making framework for triggering the reliability obligation is consistent with the framework for identifying and describing any reliability gap in the lead up to activating the trigger.

**Recommendation:** The criteria used to assess materiality of a reliability gap should be linked to the factors that are used to describe the reliability gap in the ES00. Moreover, clarity is required regarding how these criteria will be applied and balanced in practice by AEMO. To the extent that AEMO's guidelines deal with this balancing process, they should be the subject of consultation with interested stakeholders to ensure that the balancing process is robust.

#### Triggering the reliability obligation

Our understanding from the Consultation Paper is that the reliability obligation will be triggered if three years from a relevant period (T-3), a material gap continues to exist or a new material gap emerges then.<sup>17</sup>

Energy Consumers Australia questions whether three years is the appropriate time frame for determining whether the reliability obligation should be triggered. The AER review should be sufficient to flag that there exists a reliability gap.

The longer the period between the trigger point and the reliability gap, the greater the risk that un-needed investment in capacity or demand response occurs. And, accordingly, the greater the risk of consumers facing higher costs than are necessary, earlier than necessary. The shorter the period, the lower the risk of over-investment but there is a risk that urgent, expensive measures to address a material reliability gap will need to be ultimately employed by AEMO – specifically, through the Reliability Emergency Reserve Trader (RERT) mechanism.

Overall, Energy Consumers Australia considers that the risks and costs for consumers warrants removing the T-3 step from the process for triggering the reliability obligation. In this regard, Energy Consumers Australia notes that the industry is currently investing in capacity of its own accord and in the absence of the reliability requirement.

Other policy adjustments, such as the 3-year requirement to provide notice of closure, are also likely to help incentivise investment in new capacity.

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<sup>17</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), p. 6.

### Independent review mechanism

The ESB has proposed that the AER act as the independent entity to provide a check on a request by AEMO to trigger the reliability obligation.<sup>18</sup> If approval is given by the AER, the reliability obligation is effectively triggered. The AER would be empowered to perform the following functions in this context:<sup>19</sup>

- confirm or refuse to confirm that AEMO's request to trigger the reliability obligation three years out (T-3), including that the identification of a material reliability gap, is reasonable and adequate based on the available information.
- Participate in consultative stages of the development of forecasting methodologies and processes of AEMO.
- If a material reliability gap persists one year out, the AER will activate the requirement for liable entities to provide details of qualifying contracts. Concurrently, AEMO will commence procurement of resources to address the remaining gap.

Energy Consumers Australia supports the selection of the AER as the independent entity to review a decision by AEMO to trigger the reliability obligation, on the basis that the AER will be appropriately resourced to perform this function.

The ESB has indicated that the AER's own assessment process, as the independent entity, should be formalised and published in a guideline to give stakeholders confidence in the reliability obligation and any decision to trigger.

The guideline will outline issues the AER will consider in its review, including adherence by AEMO to any applicable consultation requirements in developing its recommendation.<sup>20</sup> The ESB has also flagged various models for review by the AER, including conducting ongoing parallel monitoring; full merit assessment of AEMO's decision making; or reviewing AEMO information based on enhanced transparency of the ESOC processes.<sup>21</sup>

**Issue:** Review by the AER of a decision by AEMO to trigger the reliability obligation should add value to the reliability framework.

**Recommendation:** The model for assessment and review by the AER of a decision by AEMO to trigger the reliability obligation should, at a minimum, require the AER to undertake its review in a timely manner, avoid unnecessary duplication of costs and efforts, and add value to the reliability framework.

<sup>18</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), pp. 6 and 37.

<sup>19</sup> ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 24.

<sup>20</sup> ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 25.

<sup>21</sup> ESB, Technical Working Paper – Forecasting the Reliability Requirement (June 2018), p. 23.

While Energy Consumers Australia does not have a position on the specific model for assessment and review to be adopted by the AER when reviewing a decision by AEMO to trigger the reliability obligation, the model should, at a minimum, require the AER to undertake its review in a timely manner, avoid unnecessary duplication of costs and efforts and add value to the reliability framework.

### Liabile entities

Given the intention that the reliability mechanism is designed to provide incentives to improve reliability, there is a sound basis for including large customers as liable entities, well as retailers.

In our view, any exclusion of large customers risks increasing the costs of the system where retailers will be forced to charge a premium when they face uncertainty about the future load of these customers. In this context, we support an opt out of the reliability obligation for large customers rather than opt-in.

**Issue:** The challenge to reliability of the system is driven by the uncertainty of lumpy loads of large commercial and industrial customers for retailers, and the associated challenges those retailers face in contracting long-term for dispatchable supply.

**Recommendation:** The model for assessment and review by the AER of a decision by AEMO to trigger the reliability obligation should, at a minimum, require the AER to undertake its review in a timely manner, avoid unnecessary duplication of costs and efforts. and add value to the reliability framework.

### Qualifying contracts

Under the proposed design, we understand that if the reliability obligation is triggered, liable entities will be required to enter into sufficient qualifying contracts (including demand response) to cover their share of system peak demand at the time of the reliability gap.<sup>22</sup>

If a sufficient gap persists at T-1 (one year before the relevant reliability gap), liable entities will be required to aggregate all qualifying contracts and submit net contract positions to the AER.<sup>23</sup>

To provide assurance to the AER that liable entities have adopted a reasonable and widely accepted approach to measuring the firmness of the various contracts entered into to meet the reliability requirement, they will be required to submit an independent auditor's report confirming the appropriateness of the methodology adopted.<sup>24</sup>

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<sup>22</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), p. 7.

<sup>23</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), p. 39.

<sup>24</sup> ESB, Draft Detailed Design Consultation Paper (15 June 2018), p. 39.

Energy Consumers Australia supports the flexible approach to qualification of contracts to meet the reliability requirement.

Energy Consumers Australia considers that the principles-based approach proposed by the ESB is forward-looking and will accommodate future developments in contracting to firm up variable renewables, bring forward greater demand response, and support limited-capacity storage assets such as batteries.

This flexible approach, which avoids undue prescription, will help deliver the lowest-cost solutions that are in the long-term interests of consumers.

Energy Consumers Australia also supports the approach of allowing self-assessment of retailers' reliability positions.

In designing the details of how the contract qualification requirements will be implemented – specifically, the requirement imposed on liable entities to submit net contract positions to the AER and to submit an independent auditor's report on the methodology to assess contract firmness – Energy Consumers Australia recommends that consideration be given to the processes and costs associated with contract qualification as these costs are likely to be passed through to consumers. The processes should be as simple as possible and should avoid unnecessary work and effort on the part of liable entities, while at the same time providing sufficient information to the AER.

**Issue:** The processes and costs associated with contract qualification are likely to be passed through to consumers.

**Recommendation:** The contract qualification processes should be as simple as possible and should avoid unnecessary work and effort on the part of liable entities, while at the same time providing sufficient information to the AER.

## 5. Concluding remarks

As was observed by the Australian Competition and Consumer Commission in the Final Report of its Retail Electricity Pricing Inquiry released this week, “high prices and bills have placed enormous strain on household budgets and business viability”.

While there are many causes of the current problems in the electricity market, the failure to settle the policy framework for integrating emissions and energy policy has been a significant driver of uncertainty and increases in electricity costs.

In this context, adoption of the NEG is critical to delivering targeted progress towards lower emissions through renewable energy sources, while maintaining an energy system that consumers can depend upon.

The NEG must also deliver the transition to a lower emissions economy in a way that lowers bills.

As past experience has demonstrated, there is a risk of over-correction, so that concerns with the potential for the system to be less reliable result in excessive investment in assets. If this were to emerge, it would further add to the burden on households and businesses.

In every decision, including in relation to the design of the NEG, affordability must act as a constraint.

So that not one more dollar is invested than is needed, one day earlier than necessary.

There could also be a risk that multiple mechanisms – the reliability obligation, the Reliability and Emergency Reserve Trader mechanism, Procurer of Last Resort, wholesale demand response mechanisms, network business demand response measures etc - that target the system security and reliability problems in different ways, could interact in unforeseen ways or duplicate effort and costs. The costs of such inefficiency would be ultimately borne by consumers, both in damaged confidence and in higher bills than would otherwise be the case.

Consumers are willing to be partners in maintaining system security and reliability.

Consumers want their confidence and trust in the energy system restored, so that they can live comfortably and their businesses are profitable and competitive.

Energy Australia commends the work undertaken by the ESB in advancing the design of the NEG to this stage, with the aim of improving the affordability outcomes for consumers. We hope that the comments that have been provided to the ESB in this submission are of assistance in finalising the detailed design of the NEG, to be taken forward for consideration by the COAG Energy Council in August. If the ESB has any questions on this submission, please contact Lynne Gallagher on 02 9920 5516 or [lynne.gallagher@energyconsumersaustralia.com.au](mailto:lynne.gallagher@energyconsumersaustralia.com.au).

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