19/06/2019

Mr Paula Conboy
Chair
The Australian Energy Regulator (AER)
GPO Box 520
Melbourne, VIC 3001

Via electronic lodgement

To Paula Conboy,

Retailer Reliability Obligation

Thank you for this opportunity, to provide feedback to the Australian Energy Regulator (AER) on the Draft Interim Guidelines for the Retailer Reliability Obligation (RRO).

Mondo is an energy infrastructure and service company. We strongly support a sustainable and renewable energy future. However, Mondo equally recognises the market's current dependence on firm synchronous generation and the need to manage the transition to renewables in a way that protects customers and reliability.

We note that the energy-only market design of the National Electricity Market (NEM) encourages new generation capacity and supports reliability through high energy prices, which occur when generation is scarce. The risk of these high price events are typically managed through generation ownership and forward contracts, that is 'hedging', and the cost of these is passed through to customers. We understand that the intention of the RRO is to provide additional incentives that encourage Retailers to purchase more energy cover.

The implementation of the RRO will involve some additional costs for all parties and the potential for unintended consequences that may undermine existing market mechanisms. However, we are confident that well designed guidelines can avoid these outcomes and as such, support the AER's efforts.

Draft Interim Qualifying Contracts and Firmness Guideline

Mondo strongly supports the AER's development of an Interim Qualifying Contracts and Firmness Guideline, especially with regard to non-standard qualifying contracts. The RRO rule change requires liable entities to independently develop 'bespoke methodologies' with regard to non-standard qualifying contracts. We note that this process is likely to result in higher compliance costs for non-standard contracts. With regard to costs, the Qualifying Contracts and Firmness Guideline will play a crucial role in keeping costs down by focusing the efforts of the liable entities while they are developing default methodologies. These Guidelines will provide greater benefit to liable entities if they are regularly updated to provide advice on particular contract types as auditors approve new methodologies.

Given the private nature of bespoke methodologies and their approval, there is a risk that different auditors can interpret 'firmness' differently, resulting in inconsistent application of the Guidelines. We encourage the AER to explore practical mechanisms for auditors to share their approaches and for the AER to review and update the guideline accordingly.

Definition of Firmness

The development of any methodology for estimating 'firmness' will be based on a definition of 'firmness' itself. The current draft guideline appears to provide the following definition of firmness:

> *"The likelihood of the qualifying contract providing cover to the liable entity during the gap trading intervals (including the extent to which the contract endures for the reliability gap period)."*

A key concept in the above is the meaning of 'cover'. We note that 'cover' could take on a variety of meanings including ranging from the absolute avoidance of negative outcomes, to a reduction in the probability or magnitude of a negative outcome. We propose that the later and broader definition of 'cover' is more appropriate as it allows for the full value of more complex contracts and emerging technologies to be realised.

The definition of firmness may also be enhanced to better align it with the underlying drivers of the RRO, that being the potential for a region wide generation shortfall. Currently, the Firmness Principles are silent with regard to the market conditions under which 'firmness' should be considered. Updating this to focus on just the scenarios where a shortfall is forecast to occur would provide a measure of firmness that better reflects the intent of the RRO and rewards technologies which address the needs of the NEM.

Relationships between volume, price and contract firmness

The guidelines appear to define the firmness factor as a probability ('likelihood') which is the product of three firmness factors relating to volume, price and contractual arrangements. We note that if 'firmness' is a probability then this definition will be correct where the three firmness factors are independent. Where these factors are not independent a more sophisticated statistical approach would be needed.

The following hypothetical examples provide an illustration of the complications that arise where factors are not independent:

- **A solar PPA** provides 'cover' in the form of a fixed price for the volume of electricity associated with a particular generator. The volume generated varies, with more electricity generated when the sun is shining. The PPA price does not vary, however the spot price, against which the PPA provides cover does vary. If the spot price tends to be higher when the weather is sunny, then the PPA will provide

more volumetric cover during high price events, which is when the liable entity needs cover. In this scenario, a simple consideration of PPA volume and price separately would not recognise this additional cover provided by increasing PPA volume during high spot prices.

- **An option** provides a buyer with the right to purchase a firm hedge contract at an agreed time and price prior to the contract period. If the market forecasts high spot prices, due to a shortage of generation, then the buyer is likely to exercise the option resulting in a firm contract. However, if the market forecasts low prices then buyer will not exercise the option, resulting in no cover. Considering just the contract aspect of the option, the firmness would be the probability that the option is exercised. However, this ignores the added value that the option provides by providing cover when the liable entity most needs it, that is when spot prices are forecast to be high. In contrast, a contract which randomly provided cover with a given probability would clearly provide less overall protection from high prices.

Individual Contract or Portfolio Approaches

We note that the general intent of the guidelines appears to be to allocate a firm MW value to each contract so that the Net Contract Position is the simple sum of 'Firmness adjusted MWs'. This approach is simple, however it does overlook relationships between contracts. For example, in the case of a load following swap, the guidelines, quite reasonably, determine the firmness factor to be 1. However, this result is only apparent if the load following swap is considered in conjunction with the Retailer's load liabilities. This is, in reality, a common sense portfolio approach, albeit with a very small portfolio.

We would support the AER in further developing the guidelines to allow for methodologies that evaluate firmness across 2 or more contracts, as a portfolio.

Draft Interim Forecasting Best Practice Guideline

The Reliability Forecast will fulfil a critical role in identifying the timing and magnitude of forecast breaches of the 'reliability standard' and in providing support for the issue of Reliability Instruments. The forecast may also enhance the overall efficacy and efficiency of the RRO, if the forecast contains the right information. Two opportunities to achieve this are:

- Including information on shortfall scenarios and associated conditions
- Identifying the minimum reliability gap period.

Shortfall Scenarios & associated conditions

Certain bespoke firmness methodologies may need to reference the market and weather conditions which are likely to be present during a shortfall event. The Reliability Forecast should ideally include a description of the scenarios under which the largest amounts of unserved energy (USE) are expected, and provide probability weightings for each. Each scenario may include a list of conditions relevant to calculating the firmness of common contract types. This approach will ensure liable entities are able to use a common set of assumptions to calculate firmness under bespoke methodologies.

Identifying the minimum reliability gap period

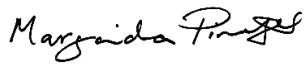
The RRO allows for a Reliability Instrument to identify Gap Trading Intervals. If applied broadly, the Gap Trading Intervals could apply continuously over a term of many months. This broad approach would blunt

incentives provided by the RRO by requiring liable entities to have 'cover' even when a Reliability Standard breach is not forecast, materially impacting contract firmness. For example, a solar PPA may provide somewhat firm generation during daytime hours on hot days, but a much lower level of firmness when evaluated on a 24 hour basis across all days.[1] Consequently, solar firmness will be much higher if the Gap Trading Intervals are defined narrowly, say from 11am to 8pm (Dec-Feb) than it would be if they were simply defined as Dec to Jan.

We believe there is a clear advantage in setting *Gap Trading Intervals* narrowly. The guidelines may facilitate this by requiring the Forecast to identify the minimum set of trading intervals which need to be 'covered' to achieve the Reliability Standard.

Please feel free to contact Daniel Brass, our Market Insights Lead, (daniel.brass@mondo.com.au, ph:04 88135557) if you have any questions in relation to this submission.

Regards,



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Manager Policy and Insights

[1] This results from solar generation being zero overnight and lower on overcast and rainy days.