

2 November 2023

Australian Energy Market Commission

Submitted online



Dear Sir/ Madam,

## **Review of the Operation of the RRO – Draft Report**

The Australian Financial Markets Association (AFMA) is responding to the Australian Energy Market Commission's (AEMC) Draft Report prepared as part of its review of the operation of the Retailer Reliability Obligation (RRO).

AFMA is the leading industry association promoting efficiency, integrity, and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, carbon, and other specialist markets. Our role is to provide a forum for industry leadership and to advance the interests of the markets and their respective participants. Our membership is comprised of over 125 of Australia's leading financial market participants, including many of the energy firms who participate in the National Electricity Market (NEM).

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### **Key Points**

- **AFMA supports the AEMC's draft recommendations to:**
  - **Expand the scope of standard qualifying contracts**
  - **Give AEMO limited powers to revoke T-1 instruments**
  - **Move the Net Contract Position compliance date to T**
  - **Retire the voluntary book build mechanism**
- **AFMA maintains its belief that the RRO is a fundamentally flawed mechanism and supports a further review to consider the ongoing need for it**

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As stated in our previous submission to this review, AFMA is highly critical of the RRO, we consider that it is a flawed mechanism that is unlikely to contribute meaningfully to system reliability and should be replaced.<sup>1</sup> Despite our reservations about the merits of the RRO, AFMA broadly supports the AEMC's recommendations and considers that they will improve the operation of the RRO.

### **1. Standard qualifying contracts (Draft recommendation 9)**

AFMA supports draft recommendation 9 which recommends that the Australian Energy Regulator (AER) should expand the scope of standard qualifying contracts to include caps with strike prices greater than 5% of

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<sup>1</sup> [https://afma.com.au/getattachment/Policy/Submissions/2023/R01-22-AGD-Privacy-Review-Consultation-\(18\)/R26-23-RRO-Review.pdf?lang=en-AU&ext=.pdf](https://afma.com.au/getattachment/Policy/Submissions/2023/R01-22-AGD-Privacy-Review-Consultation-(18)/R26-23-RRO-Review.pdf?lang=en-AU&ext=.pdf)

the Market Price Cap. As proposed in our previous submission, AFMA considers that 10% of the Market Price Cap would be an appropriate level.

As noted in our previous submission our members have found the process for approving non-standard contracts burdensome and support increasing the number of contracts that are treated as standard. As proposed in our previous submission AFMA considers that demand linked swaptions contracts (that perform as a swap once a demand threshold is exceeded), should be included as standard qualifying contracts. We consider that these contracts should have a firmness factor of 1 when the demand trigger is aligned to the RRO obligation of exceeding the 1 in the 2-year peak demand forecast. We also consider that there is merit in exploring more standardised approaches to the treatment of Power Purchase Agreements (PPA) and Settlement Residue Auction Units (SRA).

## **2. AEMO powers (Draft recommendation 2)**

AFMA supports draft recommendation 2 to give AEMO a limited power to request that the AER cancel a T-1 instrument where an Electricity Statement of Opportunities (ESOO) update identifies that a gap has closed. As noted in our previous submission, AEMO's recent practice of publishing ESOO updates has been problematic for the operation of the RRO as it has resulted in T-1 instruments remaining in place even though AEMO has determined that the gap they are intended to address has closed; we therefore support allowing AEMO to request that a T-1 instrument be revoked where the gap has closed.

As discussed in our previous submission we consider that changes to these provisions need to strike a balance between providing the market with certainty, so that it has time to hedge to comply with the RRO, and not imposing costs on the market when AEMO's latest forecasts do not indicate that there will be a reliability gap. We think the processes for AEMO updating the ESOO and requesting the AER to cancel an instrument and the process for the AER making a decision to revoke an instrument, should be formalised to ensure the final AER decision is made in a timely manner that minimises disruption to the market.

## **3. Market liquidity obligation (Draft recommendation 5)**

AFMA notes that the AEMC is not proposing to make substantial changes to the Market Liquidity Obligation (MLO) at this stage but considers that there may be value in further work looking at liquidity in South Australia.

AFMA considers there is merit in exploring options to expand market making and in looking at the challenges of liquidity in South Australia and is keen to be involved in both pieces of work. However, we want to caution that while market making can play a role in enhancing liquidity, it does not in and of itself create new generating capacity, and that ultimately financial market liquidity depends on investment in physical assets. We therefore suggest that properly designed measures aimed at boosting physical capacity, such as the Capacity Investment Scheme (CIS), are likely to contribute more to financial market liquidity than the MLO.

## **4. Move compliance date to T (Draft recommendation 1)**

AFMA supports moving the Net Contract Position compliance date from T-1 to T. As discussed in your draft report we consider that it better aligns the obligation with retailer's demand and allows contracts from assets completed between T-1 and T to be used to satisfy the obligation.

## 5. Voluntary book build (Draft recommendation 6)

AFMA supports the AEMC's proposal to remove the voluntary book build mechanism as to date, it has not been used and our members consider that it is unlikely to be used in future.

## 6. Further review

In section 1.3 of the report, the AEMC note that policy changes have occurred since the introduction of the RRO and say that it "may be necessary to consider the RRO policy in light of the overlap in these additional policy mechanisms." AFMA supports full consideration of the ongoing need for the RRO given other policy developments, particularly the CIS. Given our concerns about the effectiveness of the RRO and the costs it imposes on the industry, AFMA considers that this review should be done promptly.

### AFMA Recommendations

- i. The AER should designate demand linked swaptions as standard qualifying contracts and consider developing standardised approaches for PPAs and SRAs
- ii. The process for AEMO updating its reliability gap forecasts and the AER making decisions to revoke T-1 instruments should be formalised.
- iii. There should be a review considering the ongoing need for the RRO in light of other policy developments, including the CIS.

AFMA would welcome the opportunity to discuss the draft recommendations. Please contact me on 02 9776 7994 or by email at [lgamble@afma.com.au](mailto:lgamble@afma.com.au).

Yours sincerely



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