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21st March 2019

Submitted online to: <https://www.aemc.gov.au/rule-changes/enhancement-reliability-and-emergency-reserve-trader>

Dear Ms Derby,

Enhancement to the Reliability and Emergency Reserve Trader
Reference: ERC0237

The Australian Energy Council (the “**AEC**”) welcomes the opportunity to make a submission in response to the Australian Energy Market Commission’s (“**AEMC**’s”) *Enhancement to the Reliability and Emergency Reserve Trader (“**RERT**”) Rule Change Draft Determination*.

The Energy Council is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to over ten million homes and businesses, and are major investors in renewable energy generation.

Introduction

The Draft Determination is extremely wide-ranging in its approach and represents the most thorough review ever conducted of the RERT or its predecessor, the Reserve Trader.

The AEC supports most aspects the Draft Determination which it considers to represent a significantly improved rule with respect to both the proposal and *status quo*. This is unsurprising as the AEMC conducted excellent background research, including useful international comparison via the Brattle Group report, and successfully applied a sound assessment framework to the proposal. Its decisions were supported by thorough consultation, including the use of a Technical Working Group which included AEC members and its secretariat.

As stated in our earlier submission, the AEC strongly supports the Reliability Standard, as determined by the Reliability Panel, to be the over-arching reliability objective for the National Electricity Market (“**NEM**”). It is an appropriate trade-off between reliability and cost, and at the same time provides stability around which the market may invest.

Whilst *High Impact Low Probability* (“**HILP**”) and risk-aversion concepts are relevant to NEM *security*, they are not relevant to *reliability* because reliability shortfalls result only in controlled rotational load-shedding. Progressively increasing levels of Unserved Energy (“**USE**”) imply a progressive increase in customer inconvenience, appropriately measured by the product of USE and the Value of Customer Reliability (“**VCR**”). Assuming *security* can be maintained, there is no linkage between forecast *reliability* and the risk of a catastrophic event, which is equally probable at times of high reliability. This observation was confirmed by the Brattle Group report.

Discussion

Reliance on the Reliability Standard

The AEC strongly supports the form and level of the existing Reliability Standard and the retention of responsibility for setting it with the Reliability Panel. The AEC had serious concerns that the proposed rule would permit the RERT to deviate from the Standard, diminishing its significance and transferring responsibility for determining the on-going economic level of reliability to the market operator.

The AEC previously recommended that the Reliability Panel should provide additional guidance to AEMO in how to interpret the Reliability Standard when considering timeframes below one year. There remains a widespread misconception that short-term interventions target zero USE. This has never been the case and would be mathematically impossible. Confusion arises from the use of deterministic tools to assist quick online decision making which apply, at the final stage of their calculation, a reserve margin. However this reserve margin is itself derived from an economic trade off of USE versus cost. The trade-off can be determined through mathematical assessment such as the Forecast Uncertainty Measure (“FUM”) in the Short-term PASA, or it can be derived from rules of thumb based around a reasonable number of credible contingencies.

In the case of the Short-term PASA tool which is used to invoke short-term RERT, the trade-off is encapsulated in the confidence level of the FUM. AEMO is presently applying the following percentages in different lead times. 98% implies that the chance of at least some load shedding is no more than 2%¹.

Table 1 Confidence levels for determination of FUM values

Region(s)	Forecasting Horizon (Hrs)	Confidence level
All	0.5 to 15	98%
All	15.5 to 18	97%
All	18.5 to 21	96%
All	21.5 to 72	95%

It is not mathematically straightforward to convert a long-term standard into short-term parameters such as the confidence level above, and there is some concern as to whether the levels being used are consistent with economic trade-offs behind the annual reliability standard. It seems unreasonable to expect the market operator alone to perform this difficult conversion and inconsistent with the existing governance of the reliability standard.

The AEC’s earlier submissions recommended the Reliability Panel determine how the reliability standard should be interpreted in shorter-term forecasts. We consider it remains open to the AEMC in the final determination of this rule change to recommend that the Reliability Panel should issue guidelines to AEMO on how to interpret the reliability standard in forecasts below one year. This seems consistent with the proposed guidelines on payment structure.

Procurement Trigger

The AEC strongly supports the improvements proposed to Rules 3.20.3 (f) and (k) to restrict the use of RERT only to that which is reasonably necessary to meet the reliability standard. The AEC is concerned that RERT may have previously been used beyond this level, implying poor value for customers and running contrary to the assumed governance of the Reliability Panel to determine the acceptable level of reliability.

Governance of Trigger

The draft rule clarifies the intended procurement volume without prescribing AEMO’s interpretation or introducing oversight from another party. Considering the rules’ generally low level of prescription on RERT operationalisation, on balance the AEC considers the AEMC’s approach is appropriate.

Whilst the draft rule clearly improves guidance to AEMO regarding procurement volumes, it could operate with more confidence if the existing Rule 3.20.3(c) requirement for AEMO to consult with jurisdictions on the volume was removed, or diminished to an advisory function. With respect to the commentary in pages 89-91 supporting retention of the provision:

- The discussion has not engaged with the key concern: a scenario where a jurisdiction desires a more conservative approach than the NEM’s reliability standard and uses this provision to pressure AEMO into doing so.

¹ http://www.aemo.com.au/-/media/Files/Stakeholder_Consultation/Consultations/Electricity_Consultations/2017/Reserve-Level/LOR-Reserve-Level-Declaration-Guidelines-Final-V10.docx Appendix B

- Box 12 appears to welcome jurisdictions using the provision to influence AEMO's selection of reserve contracts. However this would undermine AEMO's independence, exactly highlighting the risks that the provision creates. Such intervention by a jurisdiction would undermine confidence in the process for both the market and RERT providers.
- Page 91 describes a number of actual jurisdictional actions taken to improve reliability, however their relevance to the obligation is unclear: these would equally have occurred without this provision.
- The discussion also suggests jurisdictional consultation is necessary to determine cost sharing. The AEC suggests however this should be determined entirely independently by AEMO without inviting influence from jurisdictions who naturally seek to minimise their individual cost shares. Rule 3.20.3(c) increases the risk of AEMO's judgement being pressured, or potentially disputed.

Use of RERT for System Security

The AEC supports the draft determination clarifications for the use of RERT for Power System Security. RERT is a *reliability* intervention and RERT reserves should only be acquired for meeting the reliability standard. Other mechanisms exist for procuring services to manage *security*, such as ancillary services markets. The existing wording creates a risk of confusion about how security services are expected to be obtained. Note that the concern is theoretical: the AEC does not suspect that RERT reserves have actually been procured for security services to date.

Having engaged RERT reserves for reliability, should a critical security issue arise that requires an AEMO intervention, dispatching RERT providers should remain an option to maintain security, along with other forms of intervention such as direction and Rule 4.8.9 instruction.

Transparency

The AEC supports the proposed improved transparency requirements regarding information to include in the RERT report under Rule 3.20.6(d) with the various quarterly reporting requirements and the requirement for AEMO to detail the forecasts that indicated RERT intervention was required.

In addition, the AEC suggests it would be valuable for AEMO's quarterly and post-dispatch/activation reports to include information on the reserves technology types dispatched in each region. Providing this additional data will assist market participants and potential RERT participants make investment decisions with regard to maintaining existing plant, and commissioning new plant.

Procurement Lead Time

The AEC strongly opposed AEMO's proposals for multi-year contracting due to the risks of distorting normal market investment processes, and supports the draft determination's rejection of this.

The appropriate contracting lead time is problematic to assess. The Energy Council is aware that short lead times will facilitate plant participating in the RERT process thereby improving the outcome for consumers. Conversely, a short lead time will not provide the necessary signals to encourage market solutions to forecast shortfalls, and spur new plant being built.

On that basis we do not agree with extending the contracting lead-time from 9 to 12 months. Furthermore, the draft determination has argued this is necessary to make the RERT lead-time consistent with the proposed Retailer Reliability Obligation (RRO) Provider of Last Resort (POLR). On the contrary, the AEC considers it may put the RERT into direct conflict with it.

This is because the expectation (and recent reality) with AEMO's maximum time horizon is that AEMO will conduct tendering with RERT providers, typically demand-side, several months ahead of the limit. As we noted in our July submission, a 9 month lead-time actually aligns with the RRO's T-1 timing, as AEMO will be able to begin their acquisition shortly after the T-1 gap is declared.

If however a 12 month limit is applied, then it is likely AEMO will be tendering possibly 15 months ahead of T-1. This will place the POLR-RERT into direct competition with retailers who will be attempting to ensure their 50%POE position is fully covered in time for T-1. The intent behind the T-1 mechanism is to encourage retailers to seek market based reserves and resolve the problem so that the POLR is not necessary. A 12 month time-

frame may unintentionally result in the perverse outcome of AEMO crowding out from retailers the exact actions they are intended to undertake under the obligations of the RRO.

Contracting Duration

The AEC supports the proposed clarification.

Out of Market Provisions

The AEC appreciates the draft determination's detailed consideration of the risks of reserves that would otherwise have participated in the market being drawn into the RERT, an area that has caused considerable concern to members. In that regard we support the intent of the proposed Rule 3.20.3 (g) to prohibit the engagement of reserves that have participated in the market up to 12 months prior.

A 12 month prohibition is by its nature quite blunt, and there are likely to emerge cases where the prohibition bars reserves, that, *prima facie*, seem genuinely additional to market reserves. In this outcome the prohibition will appear to have unnecessarily limited AEMO's options.

On the other hand, if we empower AEMO to apply discretion, who have a natural incentive to provide it, then we risk them being drawn into ever greater exemptions. This could result in the new out of market provisions having similar effect as the existing arrangements, with another loss of confidence of the genuine additionally of the RERT.

Whilst recognising there are issues on both sides, on balance the AEC considers the draft determination's proposal is appropriate.

Payment Structure

The AEC believes AEMO should buy only those reserves that prove good value: this means the avoided expected USE times the Value of Customer Reliability (VCR) must be greater than the expected availability and usage costs of the reserve. The calculation will require expert judgement and it seems can only be carried out by AEMO at the time of acquiring reserves.

A guideline from the Reliability Panel on how to perform this calculation provides the right balance of direction versus discretion and is supported.

Cost Recovery

An ideal cost recovery structure attempts to recover the cost of the RERT in a perfectly cost-reflective manner. However the more idealised the structure, the more complex it becomes. The present approach of smearing costs across the settlement weeks in which they were accrued is far from ideal, but was justifiable on simplicity grounds. As the 2017-18 and 2018-19 RERT costs were much higher than historical, it is appropriate to move to a better, if slightly more complex, structure.

Recovering activation costs from the settlement intervals in which they were incurred seems appropriate as consumers will be allocated them roughly in proportion to their share of peak load. Smearing availability costs is potentially unfair on loads who have relatively low proportions of the peak, although as the discussion notes, is arguably less distortionary than other approaches.

On balance, the draft determination's proposed cost recovery structure moves towards a more cost reflective approach without introducing unnecessary complexity and is supported.

Conclusion

In conclusion, the AEC strongly supports the Draft Determination, subject to:

- (a) the rule change limiting the ability of jurisdictions to change the dependence on the reliability standard to assess whether RERT capacity is required; and
- (b) procurement lead time remaining at nine months, in order not to impinge on the ability of market participants to procure the necessary capacity in satisfaction of the Retailer Reliability Obligation.

The AEC also considers the draft determination should recommend the Reliability Panel provide guidance to AEMO on interpreting the Reliability Standards for intervals less than one year.

Any questions about this submission should be addressed to the writer, by e-mail to Ben.Skinner@energycouncil.com.au or by telephone on (03) 9205 3116.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ben Skinner', with a large, stylized flourish at the end.

Ben Skinner
GM, Policy & Research
Australian Energy Council