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Australian Energy Market Commission
PO Box A2449
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Submitted online
EPR0090

Dear Ms Collyer

Draft Report – Review of Interim Reliability Measure

This letter and attachment constitute AEMO's submission to the consultation Draft Report, published 9 March, for the Review of the Interim Reliability Measure (IRM).

AEMO welcomes the opportunity to provide feedback on the Draft Report and supports the recommendation to extend the application of the IRM to the RRO to 1 July 2028.

AEMO appreciates the opportunity to provide comment on the Draft Report. Feedback is provided in three sections below:

1. The use of the IRM as an interim measure to maintain reliability
2. IRM as a trigger to the RRO is not overly onerous
3. Extension of the IRM to the IRR

With respect to item 3, the Draft Report discussed the value of the IRM as the trigger for the RRO as an efficient proxy risk management tool that provides certainty to the market until a new form of the reliability standard is implemented. AEMO considers that this rationale and certainty also applies to the use of the IRM as the trigger for the IRR. The IRM should be able to be used in 2026 to purchase IRR through multi-year contracts for potential gaps in 2027 and 2028. The IRM should also be able to be used in 2027 to purchase IRR under a single year contract if a gap was identified in 2028. If the IRM and IRR were not extended in the manner described, AEMO considers that this would be inconsistent with the treatment of the IRM as a trigger for the RRO and would decrease the efficiency and flexibility of procuring reserves and create a gap between the 0.006% IRM and the 0.002% reliability standard.

If you have any questions please contact Kevin Ly, GM Reform Development & Insights at kevin.ly@aemo.com.au.

Yours sincerely,

Violette Mouchaileh

Executive General Manager – Reform Delivery

1. The use of the IRM as an interim measure of maintain reliability

AEMO supports extending the application of the IRM as the trigger for the RRO and agrees with the Draft Report that it remains fit-for-purpose as an interim measure as the power system transitions.

In its submission to the 2022 Reliability Standards and Settings Review (RSSR), AEMO agreed that a fundamental shift in the NEM's reliability risk profile will occur over the coming decade and reconfirmed AEMO's desire for reliability at a level of 0.0006% USE.[1]

In 2019, AEMO proposed an improvement to the reliability standard in the 2019 Electricity Statement of Opportunities (ESOO) that ultimately fed into the development and level of the IRM. AEMO also highlighted the limitation of the current reliability standard that using 'expected' values of USE masks high impact low probability ('tail risk') events because USE is averaged across all possible outcomes.[2] At the time, AEMO proposed the following change to the reliability component of the National Electricity Objective:

> "*Ensure there are sufficient dispatchable reserves (MW) available in each region such that USE is forecast to be less than 0.002% of total energy demanded in the region in 9 out of 10 years.*"

Following ESB advice[3] and subsequent rule change found that maintaining reliability to meet levels of a one-in-10-year summer aligned with community expectations and that the development of an IRM of 0.0006% USE would provide net positive benefits and was equivalent to AEMOs original position.

AEMO considers that the likelihood of tail risk outcomes and their impact on maintaining reliability continues to increase as the power system transitions to a high variable renewable energy (VRE) and energy limited system. The Reliability Panel demonstrated this in detail as part of the 2022 RSSR and has now commenced a review of the form of the reliability standard to address tail risk more comprehensively with a new reliability standard.

AEMO acknowledges that the Commission is not seeking to repeat the Panel's work and while the form of the reliability standard and tail risk are not within the scope of this review, AEMO supports the Draft Report's recommendation to extend the application of the IRM until a new form of the standard is in place. AEMO is of the view that the IRM continues to be an appropriate interim risk management tool and an important temporary measure to support the changing nature of reliability risk. The 0.0006% USE standard continues to supplement the reliability standard to meet consumer expectations per its original design.

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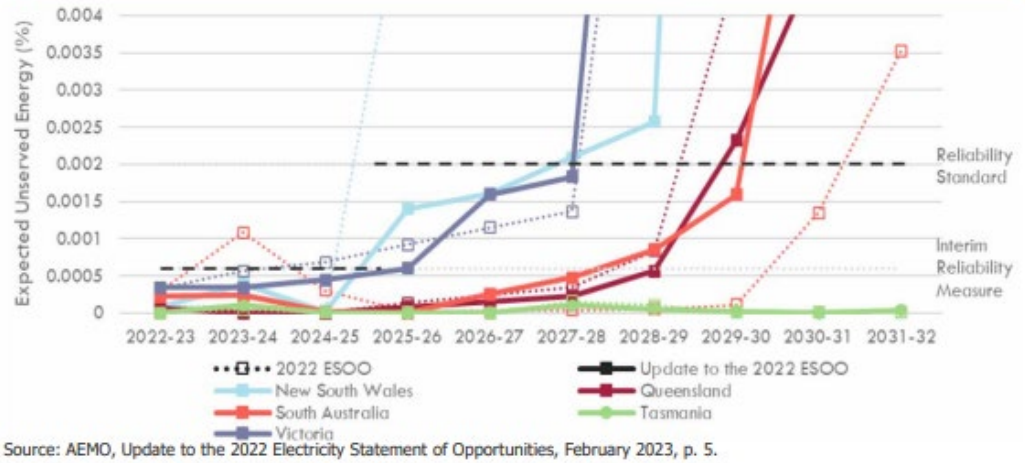
[1] AEMO Submission to Reliability Standards and Settings Review Issues Paper - https://www.aemc.gov.au/sites/default/files/2022-03/1%20Australian%20Energy%20Market%20Operator.pdf

[2] AEMO 2019 Electricity Statement of Opportunities - https://aemo.com.au/-/media/files/electricity/nem/planning_and_forecasting/nem_esoo/2019/2019-electricity-statement-of-opportunities.pdf?la=en

[3] ESB – Interim Reliability Measures – RRO Trigger: https://web.archive.org.au/awa/20210603165453mp_/https://energyministers.gov.au/sites/prod.energycouncil/files/publications/documents/ESB%20Consultation%20Paper%20on%20Draft%20Rules%20Interim%20Reliabity%20Measures%20-%20RRO%20Trigger%209%20September%202020.pdf

Figure 2.1: **Reliability and indicative reliability forecast, all regions, 2022-23 to 2031-32**



Source: AEMO, Update to the 2022 Electricity Statement of Opportunities, February 2023, p. 5.

Current ESOO forecasts identify gaps over the period 2025-26 to 2027-28, in New South Wales and Victoria which sit between the 0.0006% USE IRM trigger for the RRO and the 0.002% USE reliability standard that would be used to trigger to the RRO if the IRM is not extended. AEMO considers that the continued use of the IRM as the trigger for the RRO appropriately signals an upcoming need for investment in firm generation at the level that aligns with community expectations of reliable electricity supply during a one-in-10-year summer, at lowest cost to the market.

AEMO also recognises the upcoming review of the form of the reliability standard will likely change the role and function of the IRM and therefore agrees that the extension to the IRM should only be until such date that the new standard is implemented (expected 1 July 2028).

2. IRM as a trigger to the RRO is not overly onerous

The IRM is used to trigger the Retailer Reliability Obligation (RRO), but it does not place an obligation on market participants to contract to the 0.0006% USE level. Under the RRO obligation and guidelines, if a gap is identified at T-1 and a *reliability instrument* is created, liable entities must only enter sufficient contracts to cover their share of one-in-two-year peak demand.

The Draft Report (page 5) correctly states that in the 2022 ESOO Update, AEMO advised in order to maintain a level of dispatchable generation to meet relevant standards, 'firm capacity solutions such as electricity storage are needed, particularly long duration storage solutions.'[4] AEMO is of the view that retaining the IRM as the trigger for the RRO provides appropriate signals for when further investments in firm generation are required, but does not impose overly onerous obligations or costs on liable entities as they are only required to contract to cover their share of one-in-two-year peak demand.

AEMO supports extending the application of the IRM to the RRO and believes that the IRM as the RRO trigger is an important mechanism that supports efficient investment in firm capacity by appropriately balancing customer expectations with costs and burden to the market.

[4] Update to the 2022 Electricity Statement of Opportunities - https://aemo.com.au/-/media/files/electricity/nem/planning_and_forecasting/nem_esoo/2023/february-2023-update-to-the-2022-esoo.pdf?la=en&hash=1AED91846C35DE3DE0BFC071A2228EAD

3. Application of the IRM to the IRR

Under clause 11.128.12 of the NER, the AEMC is required to review the IRM and any other matter the Commission believes is relevant to AEMO's procurement of the IRR. The Terms of Reference (ToR) of this review state that given 'the decision by Ministers to extend the application of the IRR', the scope of the review is limited to the application of the IRM as the trigger for the RRO to 1 July 2028. This decision is referred to in the Draft Report (page 2) as: "AEMO can now enter multi-year contracts triggered by the IRM beyond mid-2025. In practice, this extends the IRR by three years to March 2028."

AEMO agrees that the 2022 Ministerial decision provided an indication to industry of the continued need for reserves to meet the 0.0006% USE standard, however AEMO considers it is important to clarify that the 2022 Ministerial decision did not extend the expiry date of the IRR but rather allowed multi-year IRR contracts to be extended to 2028 if entered prior to 2025[5]. Clause 11.128.2 of the NER assigns the IRR an expiry date of 31 March 2025. At the time, the 2022 Ministerial decision did not specifically extend the expiry date to the allow the entering of IRR contracts after March 2025 as it sought to align with the commencement of a long-term reliability measure (such as a capacity market) in 2025 and to not over-procure reserves.[6]

While AEMO considers it appropriate to reference the 2022 Ministerial decision, AEMO recommends the AEMC provide clarification that this review is not seeking to extend the IRR or allow for the entering of IRR contracts, triggered by the IRM, after 2025, and that this is something that has been not explicitly enabled by the Ministerial decision.

Under the current framework, if the entering of IRR contracts is not extended post 2025, the process for the procurement of reserves would revert to the long-notice RERT framework, for which the trigger is a forecast exceedance of the 0.002% USE reliability standard, with only single year contracting.

AEMO is of the view that reverting to the long-notice RERT process and trigger, does not align with the 2022 RSSR identified need to consider tail risk and the discussion included in the Draft Report within the context of the application of the IRM to the RRO.

If the IRR (NER 11.128) expires on 31 March 2025, IRR contracts for reserves that cover the period 2025 to 2028 would have to be entered into prior to 31 March 2025. The maximum period multi-year contracts may cover is three years, and they are only permitted when there is a forecast breach of the IRM trigger in at least two of the three years, including the first year. Therefore, for IRR contracts to cover any period post 2025, a reliability gap must have been identified for financial year 2025-26.

AEMO believes this requirement limits its ability to efficiently contract for reserves in a system where uncertainty and risk are increasing. The increasing scale and pace of change across the NEM requires a reserve mechanism that can efficiently respond to changing forecast market conditions. If we were to get to 2025 and there was no forecast reliability gap identified for the 2025-28 period, it is increasingly likely that one may emerge closer to the date. If the IRR and the IRM trigger were extended the IRM could be used in 2026 to purchase IRR through multi-year contracts for potential gaps in 2027 and 2028. The IRM could also be used in 2027 to purchase IRR under a single year contract if a gap was identified in 2028. Alternatively, if the

[5] Multi-year contracts have a maximum of three years

[6] ESB Decision Paper – Interim Reliability Reserve, page 12 - https://www.datocms-assets.com/32572/1666757503-attachment-b-esb-decision-paper-interim-reliability-reserves-recommendation-final.pdf

IRM and IRR were not extended, AEMO considers that this would decrease the efficiency and flexibility of procuring reserves and creates a gap between the 0.006% IRM and the 0.002% reliability standard.

As discussed in Section 1 above, AEMO considers that the 0.0006% USE metrics continues to align with consumer expectations of reliability meeting a one-in-ten-year summer. The 2022 RSSR also identified that due to the increasing risk of low-probability, high impact events, average 0.002% USE no longer reflects the distribution of risk within the system. AEMO is of the view that reverting to the 0.002% USE reliability standard as the trigger for the procurement of longer-term reserves does not align with the identified and increasing need to protect consumers from changing reliability risk. The Draft Report also discussed the value of the IRM as the trigger for the RRO as an efficient proxy risk management tool that provides certainty to the market until a new form of the reliability standard is implemented. AEMO considers that this rationale and certainty also applies to the use of the IRM as the trigger for the IRR.

Given the new form of the reliability standard is expected to be in place by 1 July 2028, AEMO recognises there is no need to allow IRR contracts to be extended post 2028.

To confirm, AEMO supports the Commission's decision to align the scope of this review with the 2022 Ministerial decision to extend IRR multi-year contracts to March 2028 but recommends that further clarification on the extension of the entering of IRR contracts after 1 July 2025 is provided.