10 February 2016

Mr John Pearce
Chairman
Australian Energy Markets Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Pearce

RE: Extension of the Reliability and Emergency Reserve Trader Consultation Paper (Reference: ERC0198)

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Commission's (the Commission) Consultation Paper on the Extension of the Reliability and Emergency Reserve Trader rule change request proposed by the Council of Australian Government Energy Council (COAG-EC, the Proponent).

About ERM Power Limited

ERM Power is an Australian energy company that operates electricity generation and electricity sales businesses. Trading as ERM Business Energy and founded in 1980, we have grown to become the fourth largest electricity retailer in Australia, with operations in every state and the Australian Capital Territory. We are also licensed to sell electricity in several markets in the United States. We have equity interests in 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland, both of which we operate.

General comments

ERM Power does not support an extension of the Reliability and Emergency Reserve Trader (RERT) provision of the National Electricity Rules (NER). Based on any measure and comparison with any other electricity supply system elsewhere in the world, the National Electricity Market (NEM) has exhibited extremely high reliability since its commencement in 1998.

The latest Annual Market Performance Review issued by the Reliability Panel in July 2015 indicates the following with regard to the average performance of each NEM region against the Reliability Standard for the past 10 years. The Reliability Standard is based on a maximum of 0.002% Unserved Energy (USE) in any region based on the 10 year rolling average.

The following table shows the actual 10-year rolling USE for each NEM Region.

Queensland	New South Wales	Victoria	South Australia	Tasmania
0.0000%	0.0000%	0.0004%	0.0003%	0.0000%

While a small amount of USE occurred in Victoria and South Australia in 2008/09, due to extreme weather conditions[1] , unplanned transmission outages and interconnector capacity reductions, over the long term the absolute level of USE in the NEM has been negligible.

The Commission would also be aware that post the 2008/09 summer, 660 MW of thermal generation capacity and 1,780 MW of wind generation capacity in Victoria and South Australia has been added to the power system, while at the same time significant reductions in Victorian and South Australian peak demands have been observed. Furthermore, in the 2015 National Electricity Forecast Report, AEMO forecast additional capacity reductions in these regions in response to industry closures. The operational demand outcomes that occurred during the 2008/09 summer, 10,460 MW in Victoria and 3,408 in South Australia are not forecast to be exceeded by the AEMO demand forecasts until 2023 in Victoria and 2027 in South Australia.

The Consultation Paper indicates that while AEMO and its predecessor NEMMCO entered into RERT contracts with reserve providers on only three occasions, the contracted reserve was never dispatched; however, the Commission should consider that the cost of these reserve procurement decisions was met by retailers and consumers who had no input into the RERT decision making process. Further, whilst these reserve contracts were not activated in Dispatch, had these contracts been activated by AEMO (NEMMCO) then significant additional costs to retailers and consumers would have occurred.

During the previous RERT extension process in 2012, many participants raised concerns with the Commission that as the current RERT sunset date approached participants would yet again see a process to extend the RERT. The Commission considered these valid concerns by participants in regard to a further extension of the RERT in its final determination and went into considerable detail in its conclusion to address participants' concerns. The Commission in the final rule determination removed the then NER provision for any further yearly reviews of the RERT by the Reliability Panel indicating this should address participants' concerns in this regard. Using the Commission's own words from the final paragraph of the Final Determination;

> *Therefore a key component of this rule is removing the RERT review mechanism. If the review mechanism were retained, it would provide a potential avenue for postponing the RERT's expiry again. Removing the requirement for the Panel to review the RERT should provide market participants with greater certainty as to the status of the RERT after 30 June 2016.* ***The Commission considers that the RERT should not be retained beyond its expiry date of 30 June 2016.*** [ERM Power's emphasis]

The interaction of risk management and reliability in the NEM

ERM Power believes that in considering this rule change request, the Commission needs to recognise and consider the strong interaction of risk management and reliability in the NEM. Load serving entities such as retailers, and for large loads sometimes generators, are highly incentivised to ensure sufficient supply, including reserve, is available to meet the expected demand conditions. The financial penalty, due to the high Market Price Cap (MPC) in the NEM, currently $13,800/MWh, for retailers and generators failing to ensure adequate risk management against forecast customer load, and generator availability could result in loss of retained earnings or in the extreme, terminal failure.

[1] AEMO data indicated the temperatures observed were consistent with a 1% probability of exceedance event.

The Commission acknowledged in the Consultation Paper that the high MPC is in fact the primary reliability setting in the NEM. The MPC was in fact calculated and set by the 2009/10 Reliability Panel review and subsequent 2011 rule change, and has been maintained at this level during subsequent reviews to allow for the efficient provision of additional peaking plant to meet demand when the addition of new supply is required. This high MPC allows for the recovery of sufficient revenue to ensure capital adequacy of this new plant from a very small number of hours of operation in any year. The MPC is also coupled with the Cumulative Price Threshold (CPT) which allows for up to 7.5 hours of Regional Reference Price (RRP) outcomes at the MPC in any seven day rolling period. These market settings combined, more than allow for the capital adequacy to facilitate the entry of new supply.

Retailers and generators facilitate this risk management process through forward hedge contracts. Hedge contract prices are highly transparent and fluctuate based on participants' views of the range of possible future spot prices and the need for load serving entities to manage customer load risk and generators' plant failure risk. Historically, when the demand for contracts has approached the current generation supply level, contract price outcomes have been sufficient to facilitate the entry of new supply, and new supply has arrived in the NEM. The examples of this are numerous. There has been no analysis offered by the Proponent or the Commission to indicate this will not be the case into the future.

The active dispatch of demand response in the NEM

In addition to these market settings and the need for load serving entities to manage the risks associated with customer load which historically has ensured new supply is added when required, demand response is routinely efficiently dispatched into the NEM. Demand response can be dispatched either as a reduction in consumption or the switching on of small capacity standby generation at a customer's facility. ERM Power is currently active in the dispatch of significant demand response into the NEM. ERM Power's submission to the current rule change consultation *Demand Response Mechanism and Ancillary Services Unbundling* clearly identified numerous instances of the routine dispatch of demand response across all regions of the NEM when RRP outcomes identified it was efficient to do so.

While the Commission raises concerns in the RERT Consultation Paper that demand response has not developed as expected in the NEM, ERM Power believes this is a misconception formed primarily due to the decentralised and non-reportable nature of demand response occurring. ERM Power contends that simply because demand response is not centrally dispatched or routinely reported to AEMO, does not equate to a lack of demand response in the NEM. Demand response is alive and well and efficiently dispatched in the NEM.

The negative impact of the RERT on the risk management process

ERM Power believes the Commission needs to very carefully consider the negative implications of any RERT extension with regard to retailers' and generators' risk management process and the additional costs this will impose on consumers. An extension of the RERT has the real potential to lead to the withholding of possible new demand response or delays in the provision of new generation that would be normally facilitated by the risk management process pending the conclusion of any AEMO RERT acquisition process. This will have the effect of reducing the pool of possible risk management alternatives available to load serving entities leading to increase costs as alternative and services are sought.

An extension of the RERT may also lead to possible gaming by existing suppliers via pending closure announcements to access additional funds from consumers to maintain existing facilities, which would have a high probability of remaining available for routine operation anyway, in order to satisfy internal risk management requirements.

The mere potential for any of these scenarios will add costs to the risk management process, the cost of which will ultimately be borne by end consumers. Consumers therefore may be paying for reliable supply threefold;

- Firstly, through the very high MPC and CPT settings justified on the basis these leads to reliable supply outcomes,
- Secondly, paying for the combined costs of RERT contracts acquired by AEMO, which may or may not be dispatched, and
- Thirdly, due to the real negative impact that the RERT extension has on the normal risk management process.

The distortionary impact of the RERT on regional reference price outcomes and generator dispatch

The RERT if activated in dispatch activates the generally referred to as 'what if pricing' outcomes (see Pricing in the event of intervention by AEMO - Clause 3.9.3 of the NER). This has the effect of increasing spot prices and also impacts the amount of generation that would have otherwise been normally dispatched into the NEM, as some of this generation is displaced by generation or demand response dispatched due to the RERT contract being dispatched by AEMO. This has the potential to impact the total revenue received by an individual generator and the inability of a generator(s) to meet hedge contract levels. This may lead to a reduction in supply offered to the NEM as part of the normal risk management process by a generator(s) if they believe there is a risk of the undue dispatch of RERT contracts by AEMO.

Changes in generation mix

The Proponent and the Commission cite the forecast changes in generation mix as a reason for the extension of the RERT. The Consultation Paper cites the closing of Northern Power Station in South Australia as being of major concern. ERM Power believes that as part of their risk management process, load serving entities have already considered the forecast closure of Northern and the required characterises of replacement supply. This includes a need for more suitable demand matched generation which also takes into account the intermittent output of wind generation, or alternatively, the dispatch of additional demand management. ERM Power believes this will most likely lead to the provision of additional small distributed generation or fast-start open-cycle gas turbines in South Australia when they are required to meet forecast customer load.

The Commission cites concerns in the Consultation Paper with the current AEMO Medium Term Projected Assessment of System Adequacy (MTPASA) outcomes for the South Australian region for the 2016/17 summer period, yet highlights that these same outcomes are not observed in the 2015 ESOO or the December 2015 Energy Adequacy Assessment Projection (EAAP) update. ERM Power believes the Commission should discuss further with AEMO the specifically tailored input assumptions into the MTPASA process; in particular interconnector limits and assigned wind generation output, to better understand why this discrepancy in outcomes between three AEMO published reports is occurring.

ERM Power draws the Commission's attention to AEMO statements in the December 2015 EAAP update[2];

> *Applying MRL in the MTPASA assists to identify potential reserve shortfalls in the NEM. However, given the approximate nature of the MTPASA process, AEMO applies probabilistic studies such as EAAP to confirm the LRC findings of MTPASA before intervening in response to projected shortfalls.*
>
> *Since Alinta Energy's October 2015 announcement about the withdrawal of the Northern and Playford B power stations, MTPASA has been projecting LRC in South Australia over summer 2016 – 17.*
>
> *The EAAP analysis indicates that these LRCs in South Australia are not expected to result in reliability standard breaches in the next two years.*

Based on these AEMO statements, ERM Power believes the Commission should consider the weighting applied to the MTPASA outcomes in their considerations with regard to reasons for any extension of the RERT.

In conclusion, the NEM has provided a highly reliable supply of electricity to consumers since its commencement in 1998. The NEM supports efficient risk management processes that have resulted in the provision of new generation generally ahead of schedule to not only meet customer needs, but also supply sufficient reserves to ensure that credible contingency events can be met without interruption of supply to consumers.

The RERT has a negative impact on these NEM risk management processes and leads to increased costs that will ultimately be borne by consumers.

No actual analysis indicating a credible reliability issue in the future has been supplied by the Proponent to justify why the RERT should be extended past 30 June 2016. AEMO's latest public reports indicate that the reliability standard is not expected to be breached in any region prior to 2019/20. This allows more than sufficient time for the NEM risk management process to facilitate the entry of new generation as and when it is required.

While AEMO (NEMMCO) has tendered for and implemented RERT contracts on three occasions, at additional costs to consumers, these contracts were not required to meet reliable supply to consumers.

The above information demonstrates that an extension of the RERT provision of the NER is not required.

Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

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[2] AEMO, *Energy Adequacy Assessment Projection Update*, June 2015, p. 5