



17 September 2010

Mr Neville Henderson  
Chair, Reliability Panel  
Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Lodged online @ [www.aemc.gov.au](http://www.aemc.gov.au)

Dear Mr Henderson,

## **Review of Reliability and Emergency Reserve Trader**

### Introduction

Loy Yang Marketing Management Company (LYMMCo) welcomes the opportunity to make a submission in response to the Reliability Panel's Review of Reliability and Emergency Reserve Trader (RERT).

LYMMCo operates as the arm's length agent for Loy Yang Power, performing the energy trading functions and managing National Electricity Market regulatory and market development activities for Loy Yang Power.

Loy Yang Power is the largest single privately-owned generator in the National Electricity Market (operating the Loy Yang A power station) and the supplier of coal to both the Loy Yang A and Loy Yang B stations.

In total, LYMMCo trades in excess of 2,200 MW which represents around one third of Victoria's electricity needs.

### Discussion

The Panel raised a range of issues concerning the operation of the RERT in its present form and three specific questions. Our response is framed around those three questions as set out below.

**Question 1: The Reliability Settings have been set at levels that are expected to encourage sufficient investment in new capacity. Do stakeholders consider that the residual risk of insufficient capacity being available in the future is high enough to retain a form of reliability safety net (of similar form to the reserve trader)?**

LYMMCo supports the view expressed previously by the Panel that the reliability settings are set at levels which are sufficient to encourage new investment. Notably, as part of the Reliability Standards and Settings Review, a significant number of participants expressed the view that new investment was not being constrained by the reliability settings.

Nevertheless, there is a view, which LYMMCo does not share, that the RERT forms a useful insurance mechanism in the event of insufficient capacity.

LYMMCo does not support this view and believes the RERT is a cumbersome tool that lacks transparency and is unlikely to be effective in the event of serious shortfalls. For example, shortfalls arising from climate change policies are better handled within the context of those policies (for example the assistance package to generators was previously designed on the basis that it would not reduce available capacity from retiring generators).

In any case, the types of shortfall that are being considered are within the scope of events which the NEM is expected to experience. The unserved energy target of 0.002% ensures that unexpected load shedding is likely to occur from time to time; however, the NEM performance to date has bettered the unserved energy target and minimised load shedding arising from lack of capacity.

If there is a view that the current unserved energy measure or manner in which the need for investment is signalled in the NEM is not appropriate - despite numerous recent reviews suggesting otherwise - then those questions should be considered in their own right and not addressed indirectly via the continuation of the RERT. (This sentiment was expressed by the AEMC as part of the Congestion Management Review, where it was provided that the "Reserve Trader is a form of market for capacity" and if needed more extensively then it might be necessary to review other forms of capacity market and therefore not retain the RERT.)

Likewise, if the view is that demand side options need to be further incentivised, then creating a sub-market at a price in excess of the reliability settings, would seem uneconomic and unjustifiable, and the AEMC would be better placed investigating options to increase the role of demand in the primary market.

Hence, given the history of the RERT and the previous reserve trader, and the NEM's success to date, the primary reason for the RERT would appear to be governance and not market performance or economic efficiency. On that basis, LYMMCo continues to support the removal of the RERT.

**Question 2: If a form of reliability safety net is required, do stakeholders consider that the current short, medium and long-notice forms of the RERT are effective?**

The case for the RERT has not been made. However, as a form of insurance the RERT is not effective as it is not clear that the RERT is capable of dealing with the type of shortfall it appears some parties within the governance framework are concerned with, i.e. catastrophic risks, or the risk of enduring undersupply to households and businesses that have specific supply expectations, nor does it operate transparently and in proportion to the risk at hand.

It is these issues of transparency which strengthen the concern that the RERT is not appropriate. At present it is difficult to clearly examine the extent to which the RERT distorts the market. However, if the concern that the RERT disincentivises some participants from joining the primary market is fundamentally correct then its continuation is clearly problematic. Conversely, if evidence indicates that few parties seek to engage in the RERT process and it therefore does not disincentivise primary market participation this suggests that the RERT is of little real value and is merely a governance anachronism which generates uncertainty. Either way the case for the RERT is not supportable.

Importantly, there is little, if any, incentive for generators to not make capacity available where it can bid into the market; as times of high prices are invariably periods where cost recovery, for long-run costs, can be achieved. The notion that generators are withholding capacity given existing reliability settings and the RERT has a role to play to overcome this is incorrect, and reflects a fundamental misunderstanding of generator business models and the importance of getting supply to the market at all times especially during periods of high demand.

More importantly, the RERT ineffectively focuses on supply, by allowing it to be valued at a price beyond which it is currently valued across the market, when the bulk of outages that effect consumers and businesses arise in the supply chain through transmission and distribution. Hence, a more effective policy would be to mitigate the risk of loss through the distribution and transmission systems.

As for the need for a "safety net" or "insurance"; AEMO has the power to issue directions to market customers and generators. This includes load shedding or demand response, the most likely outcome given the near certain absence of generator capacity at times of high demand (where those generators will already be bidding into the market). In these circumstances, load shedding will occur in accordance with information provided by the jurisdictional system security coordinator (with appropriate compensation). This safety net appears appropriate and provides an opportunity for jurisdictions to consider the sensitivities of load shedding within an individual region (which can be further refined by those jurisdictions if desired) without removing the incentive for load to operate in the market of its own accord.

**Question 3: Do stakeholders consider that the current expiry date for the RERT is appropriate and, if not, what is the most appropriate date?**

As LYMMCo does not believe the RERT is a necessary feature of the NEM we endorse its expiry on 30 June 2012 although we would not oppose a change in advance of that date.

## Conclusion

LYMMCo supports the Panel's ongoing work in this area and encourages the Panel to recommend the discontinuation of the RERT given its limited usefulness to date, the likely distortionary impacts and the ongoing difficulties its present for market participants.

Should the Panel determine otherwise, we would support an appropriate cost benefit analysis, and an identification of the circumstances in which the Panel believes the RERT would make a contribution to ongoing reliability in the NEM.

If you have queries in relation to this submission please do not hesitate to contact me on (03) 9612 2236 or email: [jamie\\_lowe@lymmco.com.au](mailto:jamie_lowe@lymmco.com.au).

Yours faithfully,



Jamie Lowe  
**Manager, Regulation and Market Development**