



Mr John Pierce, Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce,

Re: Expiry of the Reliability and Reserve Tracer (ERC0132)

The NGF and esaa welcome the opportunity to provide our views again on the RERT.

NGF and esaa Position

The NGF and esaa support the abolition of the RERT. They see no reason to extend the RERT by 12 months and believe that it should end on 30 June 2012. They also support the removal of the review provisions.

This rule change is unusual because it has been preceded by an extensive consultation process which was run by the Reliability Panel. The Panel members represent a wide range of energy interests and reached a view about the desirability of the RERT which was that it was not needed. We encourage the AEMC to give due weight to the Reliability Panel process although we recognise that the AEMC has its own statutory obligations irrespective of where a rule proposal emanates.

The NGF and ERAA made joint submissions to the Reliability Panel on 9 February 2010 and 17 September 2010 during their assessment of the RERT. esaa made submission to the Reliability Panel on 17 September 2010, 22 November 2010 and 10 February 2011. This submission builds on the points made in those submissions and is structured around the questions posed by the AEMC.

Question 1

(a) What market distortion is created by the RERT and what evidence is there in support of that position

There are three areas of market distortion which occur with the RERT which are discussed below. They are:

- Distorted Value for Secure Operating State
- Distorted Supply and Demand Signals
- Demand side Signals

Distorted Value for Secure Operating State

The RERT currently creates an inconsistency within the Rules. This inconsistency relates to the implied value of achieving a *secure operating state*.

Rule 3.8.1(c) requires AEMO to establish procedures to relax constraints to resolve infeasible dispatch solutions in order to determine prices. This implicitly accepts that dispatch at times will not comply with security constraints. In other words load shedding will not be used to avoid a risk of load shedding.

This Rule sets a value of achieving a *secure operating state* that is less than the value attributed to load shedding, namely the market price cap.

In contrast, the RERT allows contracted reserves under the RERT to be used to address a power system security event, in other words these reserves may be used to achieve a *secure operating state*.

The primary effect of the RERT is to provide a role for services that could be in the market, but choose not to deal with the difficulties and costs of market entry given revenue available as restricted by the *market price cap*. Thus the application of reserves acquired under the RERT implies a willingness to pay more than the *market price cap*.

The proposed Rule would thus introduce an inconsistency, with the achievement of a *secure operating state* valued in one context at up to the *market price cap*, but under the RERT, valued at above the *market price cap*. This is a symptom of the separate reserve market which is in danger of developing under the RERT provisions.

We note that the most common departures from a *secure operating state* involve a risk that some load shedding will become necessary in the unlikely event that a critical contingency event occurs. Thus from the perspective of the customers, who are faced with the cost of market intervention, the actual value of achieving a *secure operating state* is, in most cases, very much lower than the market price cap.

We submit that a consistent approach to the important issue of system security is required under the National Electricity Objective, and that the AEMC should give consideration to this important issue in its assessment of the abolition of the RERT.

Distorted Supply and Demand Signals

We recognise that there is scope for the more active involvement of small generators and some loads in the NEM. Possible barriers to entry for small generators and demand side participants include compliance and registration costs and high technical requirements. Non-registered participants, although small, may collectively make a reasonable impact at times of high demand and stress in the market.

The AEMC has a clear market design choice. By keeping the RERT, it is continuing to marginalise the activities of these non-active participants into a reserve market. We believe that efforts should be directed at encouraging these participants to take part in the main market, not a separate reserve market.

Additionally, there is a further distortion created at the boundary of supply-demand balance by the presence of the RERT. At the point just before the RERT becomes active, the value of energy that can be accessed by regular market participants is the market price cap; however once the RERT is enabled, participants under the RERT can access a greater price than the market price cap. Thus participation decisions are distorted at the margin, and potential incentives exist to avoid participation in the main market.

Demand Side Signals

We note that the AEMC finalised its Review into Demand-side Participation in the NEM some time ago (December 2009). AEMO has also reviewed the Small Generator Framework Design looking at the technical requirements for registering and metering non-scheduled generators. We believe that efforts should be made to overcome any inefficient hurdles to market entry directly not indirectly through other regulatory measures. Sharper and more accurate supply and demand signals would encourage participants to enter into commercial contracts that have the secondary effect of improving NEM efficiency.

(b) What are the benefits of retaining the RERT, does the RERT in its current form provide a safety net benefit?

RERT has not contributed to System Security

The RERT (and previously the Reserve Trader) has not increased the actual supply reliability in 10 years, making a case that its continuation is required rather doubtful. Although AEMO has contracted load under the Reserve Trader provisions, it has never been dispatched. Despite the lack of use of the Reserve Trader, the market has consistently done better than the reliability target of 0.002% of unserved energy.

The Reliability Panel observes that there is ongoing uncertainty regarding the external regulatory policies such as the Australian Government proposed introduction of a price on carbon. We note that in November 2009, the AEMC wrote to the Department of Climate Change¹ expressing limited concerns over possible reserve shortfalls as a result of the implementation of the RET and CPRS:

“... the AEMC strongly supports the principles of allowing energy markets to operate without distortion as the primary means of protecting the interests of customers in the long term in respect of reliability, security and price. ... The AEMC has recently completed an extensive review of energy market frameworks, and their ability to support efficient transition in the light of CPRS and expanded Renewable Energy Target. Importantly, while we identified a small number of incremental improvements, our broad finding was that current frameworks are capable of supporting an efficient transition.”

Reliability Standard Comfortably Exceeded

The real test of the need to retain or remove the RERT mechanism is to look at the projections for the demand-supply balance over the short to medium term. AEMO's latest Power System Adequacy Report indicates that all regions will be well below the USE standard of 0.002% for the next two years.² The overall performance of the NEM is expected to be more than an order of magnitude better than the standard for those two years. By this time the MPC will have increased further under the recent rule change to index the MPC annually. What is even more remarkable is that even under a scenario with the removal of 1000MW from the NEM, the level of USE forecast for the NEM is materially the same for the two years with only Queensland exceeding the reliability standard in 2012-13.

We also note that AEMO in their recently released Power System Adequacy statement indicate that they will not be invoking the RERT for the 2011-12 summer.

¹ AEMC letter to Martin Parkinson, DCC 23 November 2009

² AEMO Power System Adequacy Report 2011 page

AEMO also have very extensive powers to direct participants when system security is at risk. These powers can be used to address shortfalls as a last resort and have the potential to have a much greater impact than a RERT at the time of the problem.

Question 2

(a) Are stakeholders of the view that it is necessary to extend the expiry date of the RERT to 30 June 2013?

(b) If so why?

Having reached the view that the RERT should be discontinued, there needs to be a strong reason to retain it beyond the current expiry date. The Reliability Panel voiced two reasons for retaining the RERT for one additional year. These are:

- Some stakeholders have a core business affected by the RERT
- Ongoing work in relation to demand side

Stakeholders with Core Business affected by RERT

In its final report, the Panel notes:

The Panel recognises that there are stakeholders, particularly those who work with the demand side, whose core business may be affected by the expiration of the RERT.

RERT has been so limited on its impact on the market that it seems implausible that the impact on any business could be very great. None of the submissions made this point directly. If the RERT were to affect the core activity of a business, it would be expected that they would make a submission to retain the RERT, let alone extend it for 12 months. We do not consider this a sound reason for extension as there is no evidence to support it.

Ongoing work in relation to demand side

The second reason given by the Panel was in relation to ongoing work in demand side. AEMC have commenced the third stage of the Demand Side Participation review with the release of an Issues Paper on 26 August 2011. This process is just beginning, has a very broad reference and has now moved more into the consumer area as shown by its name, *Power of Choice - Giving Consumers Options in the way they Use Electricity*, and a quote from the Information Sheet:

This review is about identifying opportunities for consumers to make informed choices about the way they use electricity.³

This means that it is now much less relevant to the wholesale market and the RERT. This second reason is consequently no longer a reason for transition measures.

Further, under the proposal to extend the RERT by one year, any new demand side resources that were 'unlocked' by any current demand side reform would only be able to access the RERT for one additional year. To the extent that those resources are viable participants in the NEM in their own right, access to the RERT would be not required. (Indeed, in such cases the RERT could be considered a superfluous subsidy given that RERT payments are not constrained by the market price cap that applies to the rest of the market.) Conversely, if newly emerging resources stimulated by the demand side review require the RERT to be viable, the one year extension of the RERT will do little to underpin their long-term involvement in the market.

³ <http://www.aemc.gov.au/Market-Reviews/Open/Stage-3-Demand-Side-Participation-Review-Facilitating-consumer-choices-and-energy-efficiency.html> Information Sheet on Issues paper

A more fundamental consequence, however, of the Panel's juxtaposition of the RERT with ongoing work to facilitate demand side participation is the risk that it reconceptualises the RERT from a mechanism to support reliability to a tool to support demand side participation i.e. a subsidy scheme. Modifying *ex post* the rationale for an existing policy is poor policy practice and in this case, raises the risk of entrenching a link between the removal of the RERT and particular outcomes with respect to demand side participation. It is conceivable that this could result in a situation where a failure of demand side resources to materialise could be used to justify preservation of the RERT. As the purpose of the RERT is to enhance reliability, and not to entice a class of energy resource into the market, these processes do not provide a compelling reason to prolong an unwarranted policy distortion.

There being no valid reason for extending the RERT, we propose that it should be terminated at the current sunset date, namely 30 June 2012.

Question 3

(a) *does the proposed legislation have any impacts relevant to the existence of the RERT?*

(b) *If so, what are they?*

The proposed Clean Energy Future legislation will have no impact on the desirability of maintaining the RERT.

The Federal Government is aware of the need to maintain system security and has implemented several measures to ensure security is maintained through the transition to lower emissions supply.

These measures include:

- Involvement of AEMO in decisions around Contract for Closure
- Energy Security Fund / Generator Assistance (Clean Energy Bill)
- Loans to Generators (Clean Energy Bill)
- Energy Security Council

Notwithstanding our more general concerns with these measures (as outlined in various submissions to the Government), all of these measures will have a much greater impact on security than the small amounts of capacity that might be made available through the RERT.

Further, it is observed that if policy makers are of the view that the RERT offers protection against 'major' power system events, such as the short notice closure of a large brown coal plant, it should be noted that the size of such an event would likely dwarf the ability of the RERT to respond. As noted by the AEMC in its *Climate Change Review*, the RERT was not designed for either large amounts of capacity or frequent use. On the other hand, if climate change policies precipitate 'minor' generation incidents, it is not clear, on the face of it, why such incidents would be any different to the 'business-as-usual' type occurrences the existing reliability framework has been designed to withstand and successfully accommodating since market start without deployment of the RERT.

Removal of the RERT will increase the achievement of the NEO

The AEMC is required to assess a proposed rule in relation to its impact on the achievement of the NEO. We submit that there are several factors which would contribute to the better achievement of the NEO by terminating the RERT.

More efficient market – having a single market is more efficient than separating out some load and generation into a separate market. It also allows this generation and load to take part in the market all the time and not only when the RERT is active.

Removes inefficient costs from customers – Removal of the RERT will remove the costs of the RERT which has been borne by customers. These costs amount to several million dollars for which customers have received no benefit.

Removes a Rules Inconsistency – The RERT has introduced an inconsistency in the valuation of achieving a secure operating state which would be removed if the RERT were removed (see section 1.3).

If you have enquiries on the attached submission, please call David Bowker on (03)6230 5775.

Yours sincerely



Malcolm Roberts
Executive Director



Clare Savage
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18 October 2011