



Australian Energy Market Commission

RULE CHANGE

DRAFT RULE DETERMINATION

National Electricity Amendment (Expiry of the Reliability and Emergency Reserve Trader) Rule 2012

Rule Proponent

Reliability Panel

Commissioners

Pierce
Spalding

15 December 2011

JOHN PIERCE

Chairman

For and on behalf of the Australian Energy Market Commission

Inquiries

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

E: aemc@aemc.gov.au

T: (02) 8296 7800

F: (02) 8296 7899

Reference: ERC0132

Citation

AEMC 2012, National Electricity Amendment (Expiry of the Reliability and Emergency Reserve Trader), Rule Determination, 15 December 2011, Sydney.

About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. The AEMC has two principal functions. We make and amend the national electricity and gas rules, and we conduct independent reviews of the energy markets for the MCE.

This work is copyright. The Copyright Act 1968 permits fair dealing for study, research, news reporting, criticism and review. Selected passages, tables or diagrams may be reproduced for such purposes provided acknowledgement of the source is included.

Summary of draft rule determination

The Australian Energy Market Commission (AEMC or Commission) has determined to make a draft rule in response to the Reliability Panel's (the Panel) rule change request regarding the expiry of the Reliability and Emergency Reserve Trader (RERT) and the Panel's requirement to review the RERT a year prior to its expiry.

The RERT is a mechanism under the National Electricity Rules (NER) which is designed to allow the Australian Energy Market Operator (AEMO) to procure additional reserves to ensure reliability and security of supply. The RERT acts as a safety net and is only used in emergency situations where ordinary market mechanisms are unlikely to deliver adequate electricity supply to meet the demand of the market. The RERT has not been exercised to date.

The RERT is currently due to expire on 30 June 2012.

The Panel submitted a rule change request proposing that the expiry of the RERT is postponed for a year to 30 June 2013 and that the obligation on the Panel to review the RERT a year prior to its expiry should be removed. The Commission has decided to postpone the expiry of the RERT for four years to 30 June 2016 and to remove the obligation on the Panel to review the RERT a year prior to its expiry.

Reliability Panel rule change request

On 1 July 2011 the Panel submitted a rule change request to the AEMC to make a rule regarding the RERT. The rule change request consists of two components:

- postponing the expiry of the RERT for one year to 30 June 2013; and
- removing the obligation on the Panel to review the RERT a year prior to its expiry.

The Commission's draft determination

The Commission's draft determination is that it should not make the proposed rule but should instead make a more preferable rule.

The more preferable rule postpones the expiry of the RERT to 30 June 2016, rather than 30 June 2013 as proposed by the Panel.

The Commission has also determined that the requirement placed on the Panel to review the RERT a year prior to its expiry should be removed from the NER. The more preferable rule also provides for the removal of all RERT related provisions from the rules as at 1 July 2016.

Reasons for the Commission's draft determination

The Commission is satisfied that the draft rule meets the rule making test in that it will, or is likely to, contribute to the achievement of the National Electricity Objective

(NEO). Moreover, the Commission is satisfied that the draft rule will, or is likely to, better contribute to the achievement of the NEO than the proposed rule.

The Commission considers that the draft rule meets the NEO by promoting the efficient use of electricity services for the long term interests of consumers with respect to reliability and security of supply.

In its assessment of the proposed rule, and the draft rule, the Commission considered a number of factors including market uncertainty, potential market distortions created by the RERT, and market development and timing issues.

Market uncertainty

The Commission considers that market uncertainty may potentially delay investment in generation capacity for a period of time in some regions of the National Electricity Market (NEM). Uncertainty regarding the introduction of a carbon pricing regime may have potentially delayed investment in the NEM, and it may be a period of time before market participants respond to the new policy settings because generation investment requires substantial lead times for deployment. In addition, there may be ongoing market uncertainty in relation to the impacts of a carbon pricing regime.

The Commission considers that if investment in some NEM regions fails to occur in sufficient time to meet demand, the RERT may be a useful safety net mechanism to allow AEMO to source additional reserves to reduce the risk of load shedding events. The RERT may therefore give consumers greater confidence that they are able to access a reliable and secure supply of electricity, consistent with the reliability standard.

Market distortion

The Commission acknowledges that the RERT may potentially create minor market distortions. However, the Commission does not consider that these potential distortions are significant. In addition, in the Commission's view these possible distortions are outweighed by the benefits of maintaining the RERT.

The RERT may distort the market by creating a secondary market for reserves. However, based on the fact that the RERT has rarely been used in the past it appears unlikely that participants with available reserves would withhold capacity in the expectation of entering into reserve contracts with AEMO in preference to contracting with retailers and other intermediaries in the primary market for reserves. Accordingly, any distortions created by the RERT are likely to be minor.

The Commission considers that, on balance, any minimal market distortions created by the RERT are likely to be outweighed by the benefits the RERT provides in relation to maintaining reliability and security of supply of electricity to consumers.

Market development and implementation issues

The Commission notes that there are substantial policy initiatives currently in development that may have a material impact on reducing the barriers to demand side

participation. Increased demand side participation may provide an additional mechanism for minimising the risk of load shedding events during periods of high demand by increasing the pool of available reserves in the market. This is likely to increase the range of policy tools available to the market to efficiently meet the reliability standard.

It will take a period of time for policy changes associated with demand side participation to be implemented and take effect in the market. This period of time is likely to be more than the one year period contemplated by the Panel in their proposed rule change.

The Commission also notes that the Panel is due to review the reliability standard and settings by April 2014. That review will provide an opportunity for the Panel to assess whether the current reliability settings are likely to deliver sufficient generation investment in light of current and expected future policy settings. Postponing the expiry of the RERT until after that date will allow any recommendations stemming from the Panel's review to be implemented.

The Commission considers that the expiry of the RERT should be postponed for a period of four years. This will allow sufficient time for:

- demand side participation rule changes, and recommendations stemming from reviews, to be implemented;
- any recommendations relating to the Reliability Panel's review of reliability standards and settings, scheduled for completion by April 2014, to be implemented; and
- market uncertainty as a result of the recent changes in policy settings to lessen.

The Commission considers that postponing the expiry of the RERT is a temporary measure primarily directed at accommodating a period of market uncertainty that may be a result of the transition to a carbon pricing regime. This market uncertainty is expected to have abated by 2016 and the Commission considers that another review of the RERT prior to its expiry is unnecessary. Removing the requirement for the Panel to review the RERT should also provide market participants with greater certainty as to the status of the RERT.

Contents

1	Reliability Panel's rule change request	1
1.1	The rule change request	1
1.2	Rationale for rule change request	1
1.3	Solution proposed in the rule change request.....	1
1.4	Relevant background.....	2
1.5	Commencement of rule making process	5
1.6	Consultation on draft rule determination.....	6
2	Draft rule determination	7
2.1	Commission's draft determination.....	7
2.2	Commission's considerations.....	7
2.3	Commission's power to make the rule	8
2.4	Rule making test.....	8
2.5	More preferable rule	9
3	Commission's reasons.....	11
3.1	Assessment of issues.....	11
3.2	Draft rule	13
3.3	Civil penalties.....	14
4	Commission's assessment approach	15
5	Market uncertainty	17
5.1	Rule proponent's view.....	17
5.2	Stakeholders' views.....	18
5.3	Commission's analysis	20
5.4	Commission's conclusion.....	24
6	Market distortions and costs.....	26
6.1	Rule proponent's view.....	26
6.2	Stakeholders' views.....	27
6.3	Commission's analysis	27

6.4	Commission's conclusion.....	29
7	Market development and implementation issues	31
7.1	Rule proponent's views.....	31
7.2	Stakeholders' views.....	31
7.3	Commission's analysis	32
7.4	Commission's conclusion.....	34
	Abbreviations.....	36
A	Summary of issues raised in submissions	37

1 Reliability Panel's rule change request

1.1 The rule change request

On 1 July 2011 the Reliability Panel (rule proponent) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) to make a rule to regarding the Reliability and Emergency Reserve Trader (RERT). The rule change request consists of two components:

- postponing the expiry date of the RERT for a period of one year to 30 June 2013; and
- removing the obligation on the Reliability Panel to review the RERT a year prior to its expiry.

1.2 Rationale for rule change request

The Reliability Panel (the Panel) considered that the expiry of the RERT should be postponed for a period of one year to 30 June 2013. The Panel's decision to recommend postponing the expiry of the RERT by a period of one year recognised that while the market had performed well in meeting the reliability standard, there were a number of stakeholders that may be impacted by the removal of the RERT.

In terms of market performance, the Panel considered that the market had delivered sufficient generation capacity to achieve reliable and secure supply of electricity, and that the outlook for reliability showed adequate reserves in most regions for a number of years into the future. For this reason, the Panel considered that the RERT was no longer required.

However, the Panel also considered that some participants may be impacted by the removal of the RERT, especially those who work with the demand side. It also considered that postponing the expiry of the RERT for a year would allow additional time for work regarding demand side management to be completed and implemented.

The Panel also considered that if the expiry date of the RERT were postponed, the National Electricity Rules (NER) may be interpreted to mean that the Panel is required to undertake another review of the RERT, to be completed by 30 June 2012. The Panel considered that removing the requirement for the review of the RERT would lead to increased market certainty, which is particularly important for those stakeholders whose core business will be affected by the operation, or expiry, of the RERT.

1.3 Solution proposed in the rule change request

The rule proponent sought to resolve the issues referred to above by amending the expiry date provided for in clause 3.20.1 of the NER from 30 June 2012 to 30 June 2013.

In order to avoid market uncertainty with respect to whether the Panel is required to undertake another review of the RERT a year prior to its expiry, the rule proponent also proposed that clause 3.20.9 in the NER was omitted in its entirety.

1.4 Relevant background

This section briefly describes the arrangements for the RERT, a number of progressive amendments to its scope and operation, and its interaction with other policy settings such as the reliability standard and settings.

1.4.1 Current arrangements

The RERT is a mechanism under the NER which is designed to allow the Australian Energy Market Operator (AEMO) to procure additional reserves to ensure reliability and security of supply. Scope and guidance for procuring additional reserves is provided by the RERT guidelines developed by the Panel,¹ and AEMO's procedure for exercising the RERT.² The NER allow for AEMO to develop guidelines to enable them to contract for reserves according to a range of timeframes:

- at least ten weeks' notice of a reserve shortfall (long-notice RERT);
- between one and ten weeks' notice of a reserve shortfall (medium-notice RERT);
and
- between three hours' and seven days' notice (short-notice RERT).

Under the RERT guidelines AEMO may establish a RERT panel of entities that can be called upon to tender for, and enter into, reserve contracts for the medium-notice RERT and short-notice RERT. The RERT guidelines specify that AEMO should not rely on the RERT Panel when contracting for long-notice RERTs.

AEMO procures additional reserves from a number of parties, who would not otherwise be available to the primary market for reserves, according to the following process:

- parties who have non-market generation capacity make themselves known to AEMO and declare what price those parties wish to be paid to use that capacity;
and
- individuals or groups of consumers declare what remuneration they would seek to reduce their demand in excess of the saving in energy cost.

¹ Clause 3.20.8 of the NER requires the Panel to develop guidelines with respect to the scope and principles to be employed by AEMO when procuring reserve capacity. These are available on the AEMC website.

² Clause 3.20.7 of the NER requires AEMO to develop procedures for exercising the RERT, including the process for selecting participants for the RERT panel. These are available on the AEMO website.

The NER require AEMO to consult on costs and cost-sharing arrangements with affected participating jurisdictions that stand to benefit from additional reserves before entering into a reserve contract, or prior to exercising the short-notice RERT.³ The NER allow AEMO to recover the costs of reserve contracts from market customers, such as retailers.⁴

The Commission understands that the market operator has entered into reserve contracts twice, and in each case has not dispatched additional capacity:

- 31 January 2005 to 4 March 2005 for Victoria and South Australia NEM regions AEMO sought to contract up to 230MW, and contracted for 84MW; and
- 16 January 2006 to 10 March 2006 for Victoria and South Australia NEM regions AEMO sought to contract up to 500MW, and contracted for 375MW.

1.4.2 Previous changes to the reserve trader provisions in the NER

Since the commencement of the National Electricity Market (NEM), the market operator has had the power to contract for additional reserves. Over time, the original reserve trader provision has been reviewed and subsequent amendments introduced that have postponed its expiry date, as well as changed its scope and operation. The table below briefly outlines these amendments.

Amendments to the reserve trader provisions since the commencement of the NEM

Year	Amendment
December 2005	Reliability Panel submitted a rule change proposal to postpone the expiry of the reserve trader provisions in the NER until June 2008. The rule change was made with minor amendments and allowed the reserve trader to continue while the Reliability Panel completed its Comprehensive Reliability Review (CRR).
December 2007	The CRR recommended a number of amendments to the reserve trader provision which led to the adoption of the RERT in the NER the following year. ⁵
June 2008	RERT adopted in the NER following recommendations stemming from CRR. Amendments directed at increasing flexibility in the way that AEMO can contract for reserves and minimising any potential impact of market distortions created by the continuation of the RERT. The review also recommended postponing the expiry of the RERT to 30 June 2012, and including a requirement for the Reliability Panel to review the RERT a year prior to its expiry. ⁶

³ See clause 3.20.3 of the NER.

⁴ See clauses 3.20.3(c) and 3.15.9(e) of the NER.

⁵ See Australian Energy Market Commission, *Comprehensive Reliability Review*, final report, AEMC, 21 December 2007, Sydney.

⁶ See Australian Energy Market Commission, *National Electricity Amendment (NEM Reliability Setting: Information, Safety Net and Directions) Rule 2008*, AEMC, 26 June 2008, Sydney.

Year	Amendment
October 2009	Reliability Panel proposes rule change to allow AEMO to contract for reserves at short notice. RERT amended to allow for AEMO to contract for reserves under a range of timeframes. ⁷
April 2011	Reliability Panel completes review of RERT, as required by the NER and in accordance with terms of reference set by the AEMC. ⁸

1.4.3 Reliability standards and settings

The reliability settings are the key mechanisms for balancing supply and demand in the wholesale market over time. The reliability settings include the Market Price Cap (MPC), the Cumulative Price Threshold (CPT), and the market floor price. The reliability settings are set at a level intended to deliver capacity to meet the reliability standard of 0.002 per cent unserved energy⁹ with the aim of avoiding unmanageable risks for market participants.¹⁰

The level of the MPC, currently set at \$12,500, is crucial because it provides the key signal for supply and demand-side investment and usage. For example, if the MPC is set too high, market participants (retailers, other customers, and generators) can be exposed to very large financial risks. However, if it is set too low, there may be insufficient incentives to invest in new generation capacity and demand-side response to meet the reliability standard.

The CPT is an explicit risk management mechanism designed to limit participants' exposure to protracted stress in the wholesale spot market. If the sum of the spot price (\$/MWh) in the previous 336 trading intervals¹¹ exceeds the CPT, or if the sum of the ancillary services price (\$/MWh) in the previous 2,016 dispatch intervals¹² exceeds six times the CPT, then an Administered Price Period (APP) is declared. During the APP, if the spot price calculated normally exceeds the Administered Price Cap (APC), the price is set at the APC. Similarly, if, during the APP, the spot price is less than the Administered Floor Price (AFP), the price is set at the AFP.¹³

⁷ See Australian Energy Market Commission, *National Electricity Amendment (Improved RERT Flexibility and Short-notice Reserve Contracts) Rule 2009*, AEMC, 15 October 2009, Sydney.

⁸ See Australian Energy Market Commission, *Review of the Reliability and Emergency Reserve Trader*, final report, AEMC, 21 April 2011, Sydney.

⁹ The reliability standard is an output-based measure expressed in terms of 'maximum permissible unserved energy'. It effectively is an expression of the maximum allowable level of electricity at risk of not being supplied to consumers in any region.

¹⁰ Australian Energy Market Commission, *Reliability Panel Review of the Reliability and Emergency Reserve Trader*, final report, April 2011, Sydney.

¹¹ This is the equivalent to a consecutive seven day period.

¹² This is the equivalent to a consecutive seven day period.

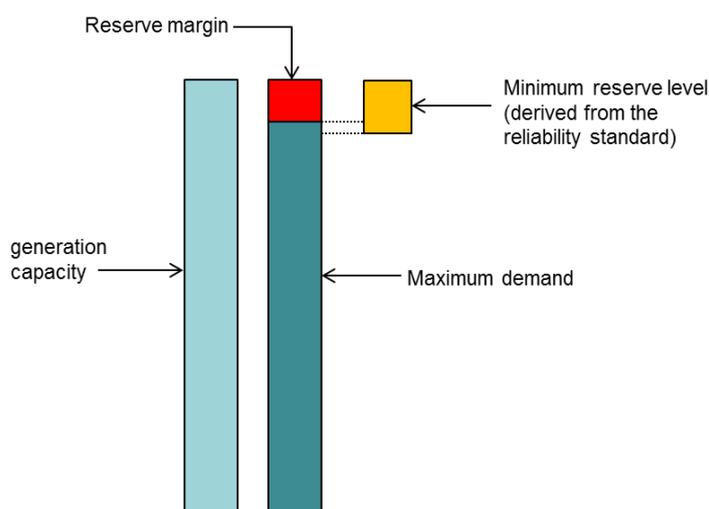
¹³ See clause 3.14.2 (d)(1) and 3.14.2(d)(2) of the NER.

The interaction between the reliability standard and reserve capacity is illustrated in Figure 1.1 below. The reserve margin is the level of generation capacity available less the maximum demand (calculated according to ten per cent probability of exceedance) for a NEM region. The minimum reserve margin is essentially a translation of the reserve margin that is required to meet the reliability standard.¹⁴

Reserve margins shrink when conditions of supply-demand balance tighten. Factors which may cause the supply-demand balance to tighten include insufficient investment in generation capacity, extreme weather conditions such as drought, and unplanned outages. As reserve capacity shrinks relative to the minimum reserve level, there is a risk that the reliability standard may not be achieved.

Where AEMO forecasts that there may be insufficient reserve capacity to meet maximum demand, it may choose to enter into a reserve contract under the RERT provision to minimise the risk of load shedding events.

Figure 1.1 Interaction of reliability standard with reserve capacity



1.5 Commencement of rule making process

The Panel requested that the proposed rule change be 'fast-tracked' under section 96A of the National Electricity Law (NEL) on the basis that the Panel, an electricity market body, had made the rule change request and had already consulted with the public on the nature and content of the rule change request.¹⁵

The Commission may fast track a rule change proposal if it is of the opinion that the consultation was adequate having regard to the nature and content of the rule change

¹⁴ AEMO uses time sequential monte carlo simulation of the operation of the NEM to determine the minimum reserve levels that would be expected to deliver unserved energy that is no worse than 0.002 per cent in each region over the medium to long-term. See Australian Energy Market Commission, *Review of the Operational Arrangements for the Reliability Standard*, final report, 21 December 2009, Sydney, p.10.

¹⁵ Section 96A(1)(a) of the NEL.

proposal and the kind of consultation conducted by the electricity market regulatory body.

The Commission considered that the Panel had consulted extensively with the public on the nature and content of the rule change proposal. However, the Commission also considered that there remained significantly divergent views amongst stakeholders as to whether the RERT should expire in 2012. In addition to this, the Panel's rule change proposal submission coincided with an announcement by the Australian Government on carbon pricing legislation. The Commission considered that carbon pricing legislation represented a substantial change in policy settings that warranted using the standard rule making process (which provides for two rounds of consultation).

Therefore the Commission considered that the rule change request should not be fast tracked under section 96A of the NEL.

On 8 September 2011, the Commission published a notice under section 95 of the NEL advising of its intention to commence the rule making process and the first round of consultation in respect of the rule change request. A consultation paper prepared by AEMC staff identifying specific issues and questions for consultation was also published with the rule change request. Submissions closed on 13 October 2011.

The Commission received five submissions on the rule change request as part of the first round of consultation. They are available on the AEMC website.¹⁶ A summary of the issues raised in submissions and the Commission's response to each issue is contained in Appendix A.

1.6 Consultation on draft rule determination

In accordance with the notice published under section 99 of the NEL, the Commission invites submissions on this draft rule determination, including the draft rule, by Thursday 2 February 2012.

In accordance with section 101(1a) of the NEL, any person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than 22 December 2011.

Submissions and requests for a hearing should quote project number "ERC0132" and may be lodged online at www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

¹⁶ www.aemc.gov.au

2 Draft rule determination

2.1 Commission's draft determination

In accordance with section 99 of the NEL the Commission has made this draft rule determination in relation to the rule proposed by the Panel.

The Commission's draft determination is that it should not make the proposed rule but should instead make a more preferable rule.¹⁷ The more preferable rule incorporates components of the Panel's rule change request including postponing the expiry date of the RERT and removing the Panel review of the RERT.

Rather than postponing the expiry of the RERT for a period of one year from 30 June 2012 to 30 June 2013, the proposed more preferable rule postpones the expiry of the RERT for a period of four years to 30 June 2016.

The draft determination also provides for the removal of all RERT related provisions from the NER as at 1 July 2016.

The Commission's reasons for making this draft rule determination are set out in section 3.1.

A draft of the proposed rule that the Commission proposes to be made (draft rule) is attached to and published with this draft rule determination. The draft rule is a more preferable rule. Its key features are described in section 3.2.

2.2 Commission's considerations

In assessing the rule change request the Commission considered:

- the Commission's powers under the NEL to make the rule;
- the rule change request;
- the fact that there is no relevant Ministerial Council on Energy (MCE) Statement of Policy Principles;¹⁸
- submissions received in response to the consultation paper;

¹⁷ Under section 91A of the NEL the AEMC may make a Rule that is different (including materially different) from a market initiated proposed Rule (a more preferable Rule) if the AEMC is satisfied that having regard to the issue or issues that were raised by the market initiated proposed Rule (to which the more preferable Rule relates), the more preferable Rule will or is likely to better contribute to the achievement of the national electricity objective.

¹⁸ Under section 33 of the NEL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. Note that the MCE has now been amalgamated into the Standing Council on Energy and Resources.

- rule changes and reviews currently under consideration by the Commission in relation to demand side participation;
- the introduction of carbon pricing legislation; and
- the Commission’s analysis as to the ways in which the proposed rule and the draft rule will, or is likely to, contribute to the National Electricity Objective (NEO).

2.3 Commission’s power to make the rule

The Commission is satisfied that the draft rule falls within the subject matter about which the Commission may make rules. The draft rule falls within section 34 of the NEL and schedule 1 to the NEL.

The draft rule falls within the subject matters set out in section 34(1)(a)(ii) of the NEL as it relates to the operation of the national electricity system for the purposes of the safety, security and reliability of that system.

The draft rule also falls under the following subject matter under Schedule 1 of the NEL, namely reviews by on or behalf of the Reliability Panel (item 33(b) of Schedule 1 of the NEL).

2.4 Rule making test

Under section 88(1) of the NEL the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the NEO. The Commission must apply this decision making framework.

The NEO is set out in section 7 of the NEL as follows:

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity;
and
- (b) the reliability, safety and security of the national electricity system.”

The Commission considers that for this rule change request the relevant aspects of the NEO are the promotion of the efficient use of electricity services for the long term interests of consumers with respect to reliability and security of supply.¹⁹

¹⁹ Under section 88(2), for the purposes of section 88(1) the AEMC may give such weight to any aspect of the NEO as it considers appropriate in all the circumstances, having regard to any relevant MCE Statement of Policy Principles.

The Commission is satisfied that the draft rule will, or is likely to, contribute to the achievement of the reliable and secure supply of electricity where, in light of recent market uncertainty, there is a risk that investment in generation capacity may not be deployed in sufficient time to meet demand requirements in some NEM regions, consistent with the reliability standard.

The draft rule will promote efficiency in the use of electricity services for the following reasons:

- The combined effect of market uncertainty with respect to the impacts of carbon pricing and deployment of renewable energy generation on wholesale electricity prices may potentially dampen investment signals for generation capacity in some NEM regions. Maintaining the RERT provides a safety net for consumers if investment in generation capacity is not sufficient to meet forecast maximum demand in some NEM regions, consistent with the reliability standard.
- It is unlikely that the continuation of the RERT will create a material market distortion. Based on the fact that the RERT has rarely been used in the past it appears very unlikely that participants with available reserves would withhold capacity in the expectation of entering into reserve contracts with AEMO in preference to contracting with retailers and other intermediaries in the primary market for reserves. On balance, any minimal market distortions created by the RERT are likely to be outweighed by the benefits of maintaining reliability and security of supply of electricity to consumers and ensuring that the risk of load shedding events are minimised.

The Commission also considered that the requirement placed on the Panel to review the RERT a year prior to its expiry should be removed. The Commission considers that postponing the expiry of the RERT is a temporary measure primarily directed at accommodating a period of market uncertainty that may be a result of the transition to a carbon pricing regime. This market uncertainty is expected to have abated by 2016 and the Commission considers that another review of the RERT prior to its expiry is unnecessary. Removing the requirement for the Panel to review the RERT should also provide market participants with greater certainty as to the status of the RERT.

Under section 91(8) of the NEL, the Commission may only make a rule that has effect with respect to an adoptive jurisdiction if it is satisfied that the proposed rule is compatible with the proper performance of the AEMO's declared network functions. The draft rule is compatible with AEMO's declared network functions because it has no impact on rules relating to AEMO's declared network functions or transmission network services providers in general.

2.5 More preferable rule

Under section 91A of the NEL, the Commission may make a rule that is different (including materially different) from a market initiated rule (a more preferable rule) if the AEMC is satisfied that, having regard to the issues that were raised by the market

initiated proposed rule (to which the more preferable rule relates), the more preferable rule will, or is likely to better contribute to the achievement of the NEO.

The proposed more preferable rule incorporates the two key elements of the proposed rule which are that the expiry of the RERT should be postponed, and that the requirement placed on the Panel to review the RERT a year prior to its expiry should be removed from the NER.

Having regard to the issues raised by the rule proposed in the rule change request, the Commission is satisfied that the draft rule will, or is likely to, better contribute to the NEO than the proposed rule for the following reason:

- The draft rule will more effectively promote the efficient use of electricity services than the proposed rule because market participants may need a period of time to respond to new policy settings such as carbon pricing legislation. If investment in generation is delayed as a result of this uncertainty there is a risk of not meeting the reliability standard in some regions. Therefore to support the achievement of the reliable and secure supply of electricity to consumers, and minimise the risk of load shedding events, it is prudent to postpone the expiry of the RERT for a period of four years instead of one year.

3 Commission's reasons

The Commission has considered the rule change request by the Panel, and assessed the issues that it raises. For the reasons set out below and in the following chapters, the Commission has determined that a more preferable rule be made, rather than the proposed rule.

3.1 Assessment of issues

In assessing the key components of the rule change request, namely the expiry date of the RERT and the requirement placed on the Panel to review the RERT a year prior to its expiry, the Commission considered the extent to which:

- recent periods of market uncertainty may impact on the deployment of generation capacity and the availability of demand side responses in some NEM regions;
- the continuation of the RERT may contribute to market distortions; and
- external policy settings, and current issues under consideration by the Commission, may require a period of time to be implemented, or for market participants to respond.

The Commission's assessment and determination on each of these matters is summarised below.

Market uncertainty

The Commission considers that market uncertainty may potentially delay investment in generation capacity in some NEM regions. The Commission notes that uncertainty regarding the introduction of a carbon pricing regime may have potentially delayed investment in the NEM, and it may be a period of time before market participants respond to the new policy settings. This is because generation investment requires substantial lead times for deployment. In addition, there may be ongoing market uncertainty in relation to the impacts of a carbon pricing regime, such as the transition from a fixed price on carbon to an emissions trading scheme where the price of carbon permits is determined by a market mechanism.

This view is supported by the Investment Reference Group, which reported to the Commonwealth Minister for Resources and Energy on the impact of carbon pricing uncertainty. The Investment Reference Group noted that:²⁰

“There is a concern that policy uncertainty could lead to a reduction or delay in investment and, coupled with the time required to make investments, may see reserve level requirements breached.”

²⁰ Investment Reference Group Report, *A Report to the Commonwealth Minister for Resources and Energy*, April 2011, p. 27.

The Commission notes that AEMO's 2011 Power System Adequacy (PSA) report forecasts sufficient reserve capacity and energy adequacy up to 30 June 2013, and AEMO noted that it is unlikely to enter into long-notice RERT contracts in that period. However, AEMO's 2011 Electricity Statement of Opportunities (ESOO) report has brought forward some of its forecast reserve shortfalls from the previous report, and forecasts that several regions in the NEM may experience reserve shortfalls in 2013- 14 or 2014- 15.²¹

In addition, a recent report from the Bureau of Resources and Energy Economics (BREE) indicates a decline in the number of projects moving through to the completion stage in recent years.²² The Commission considers that if investment is delayed in some NEM regions there is an increased risk that generation capacity will not be deployed in adequate time to meet forecast reserve shortfalls.

Market distortion and costs

The Commission has considered whether the RERT may potentially create a market distortion, and agrees that the RERT may create a minor market distortion. However, the Commission considers that the impact of these potential market distortions are not likely to be significant and are outweighed by the benefits of maintaining the RERT for a period of time, especially while market uncertainty may persist.

The Commission notes that AEMO has only entered into reserve contracts twice, and in each case, chose not to dispatch additional capacity available under the contracts. Given the very infrequent use of the RERT it is very unlikely that participants would avoid the primary market for reserves in preference to potentially contracting with AEMO.

Maintaining the RERT for a defined period is likely to provide benefit to consumers in terms of the reliable and secure supply of electricity. The RERT provides a mechanism to ensure that the risk of load shedding events are minimised and should give a greater degree of confidence to consumers that they are able to access a reliable and secure supply of electricity, consistent with the reliability standard.

Market development and implementation issues

The Commission notes that there are substantial policy initiatives currently in development that may have a material impact on reducing the barriers to demand side participation. This should result in attracting additional capacity to the primary market for reserves. These include:

- Distribution Network Planning and Expansion Framework proposed rule change;

²¹ AEMO forecasts reserve capacity deficits for Queensland in 2013-14, and for Victoria and South Australia for 2014-15. See Australian Energy Market Operator, *2011 Electricity Statement of Opportunities*, p. 18 and pp. 24- 27.

²² See Australian Bureau of Resources and Energy Economics, *Major electricity generation projects*, November 2011.

- Inclusion of Embedded Generation Research into the Demand Management Incentive Scheme proposed rule change;
- Efficiency Benefit Sharing Scheme and Demand Management Expenditure by Transmission Businesses proposed rule change; and
- Demand Side Participation Stage 3 market review (Power of Choice).

In addition, new arrangements governing the connection of distributed generation are due to commence in the NER in July 2012 as part of the National Energy Customer Framework reform package.

The Commission considers that it will take a period of time for these policy changes to be implemented in the NER, which will be more than the one year period contemplated by the Panel in their proposed rule change.

The Commission considers that postponing the expiry of the RERT by a period of four years will provide an adequate period of time for:

- rule changes, new arrangements for distributed generation and recommendations stemming from various reviews to take effect;
- any recommendations relating to the Reliability Panel's review of reliability standards and settings, due to be completed by April 2014, to be implemented; and
- the impacts of market uncertainty on investment in generation capacity to lessen.

The Commission considers that postponing the expiry of the RERT is a temporary measure primarily directed at accommodating a period of market uncertainty that may be a result of the transition to a carbon pricing regime. This market uncertainty is expected to have abated by 2016 and the Commission considers that another review of the RERT prior to its expiry is unnecessary. Removing the requirement for the Panel to review the RERT should also provide market participants with greater certainty as to the status of the RERT.

3.2 Draft rule

The draft rule postpones the expiry of the RERT by a period of four years from 30 June 2012 to 30 June 2016. This effectively also extends the operation of all other provisions in the NER associated with the continuation of the RERT.

The draft rule omits clause 3.20.9 in its entirety, which placed a requirement on the Panel to review the RERT a year prior to its expiry.

Also contained in the draft rule are a number of amendments that will have effect after the expiry of the RERT on 30 June 2016. These amendments are directed at removing references to the RERT in the NER and are included to improve the quality of the NER in terms of accuracy and consistency.

Clause 3.15.9 has been omitted as most of the provisions of that clause relate to settlement of amounts payable or receivable by AEMO under reserve contracts. Those parts of clause 3.15.9 (paragraphs (b)(2)(i) and (h) of the current clause) that relate to settlement of amounts determined to be payable by AEMO by the independent expert under clause 3.12.3 have been moved to new clause 3.15.10C(b1) (with minor amendments).

A new transitional provision has been inserted into Chapter 11 of the NER to clarify that settlement of amounts payable or receivable by AEMO under reserve contracts up until 30 June 2016 will be settled in accordance with existing clause 3.15.9.

The draft rule has been published simultaneously with this draft determination.

3.3 Civil penalties

The draft Rule will omit a clause of the Rules (clause 3.15.9(f)) that is classified as a civil penalty provision under the National Electricity (South Australia) Regulations. The AEMC will notify the MCE²³ of the removal of this provision. The draft Rule does not propose that any provisions that are not currently civil penalty provision be classified as such.

²³ Note that the MCE has now been amalgamated into the Standing Council on Energy and Resources.

4 Commission's assessment approach

This section briefly outlines the Commission's approach to assessing the rule change request in accordance with the requirements set out in the NEL. The same assessment framework has been used to assess the more preferable rule which was developed by the Commission.

In assessing any rule change request, the Commission must have regard to the extent to which the rule will, or is likely to, contribute to the achievement of the NEO. In making this assessment, the Commission may give such weight to any aspect of the NEO as it considers appropriate.

In assessing this rule change request, the Commission has identified the most relevant aspects of the NEO as being the promotion of the efficient use of electricity services for the long term interests of consumers with respect to reliability and security of supply. In coming to its draft determination the Commission sought to satisfy the objective of promoting the reliable and secure supply of electricity to consumers by minimising the risk of load shedding events in any NEM region, and giving greater confidence to consumers that the reliability standard will be met.

In assessing the rule change request and the draft rule, the Commission considered the following issues:

- *Market uncertainty* – the extent to which recent periods of investment uncertainty may impact on the deployment of additional generation capacity in some NEM regions:
 - Where market signals are dulled or investment decisions are delayed due to changes in policy settings there is potentially a risk that generation capacity and the availability of demand side responses may not be deployed in adequate time to meet the maximum demand in some NEM regions, consistent with the reliability standard.
- *Market distortion* – the extent to which the continuation of the RERT may contribute to market distortions:
 - The RERT may create a potential secondary market for reserves, which is not subject to the MPC, by incentivising some participants to enter into reserve contracts with AEMO rather than retailers and other intermediaries in the primary market. The likelihood and materiality of this potential market distortion should be weighed against the benefit of ensuring the reliable and secure supply of electricity and minimising the risk of load shedding events.
- *Market development and implementation issues* – the extent to which external policy settings, and current issues under consideration by the Commission, may require a period of time to be implemented, or for market participants to respond:

- Market reviews and rule changes directed at reducing barriers to demand side participation are currently being progressed by the Commission and will require a period of time before they are implemented and acted upon.
- The Reliability Panel is due to complete its next review of reliability standards and settings by April 2014, which includes an assessment of the appropriate level for the MPC.
- Market uncertainty as a result of changes in policy settings, including carbon pricing legislation, is expected to lessen by 2016.

5 Market uncertainty

The Commission has considered a number of factors that may potentially contribute to market uncertainty and therefore a period of delayed investment decisions for some NEM regions. These include:

- the impacts of carbon pricing legislation, including periods of policy uncertainty leading to its implementation; and
- the impact of renewable energy generation on wholesale prices which may dampen investment signals for generation capacity in some NEM regions.

In its assessment of market uncertainty, the Commission considered the extent to which maintaining the RERT provides a safety net for consumers if investment in generation capacity is insufficient to meet the reliability standard in some NEM regions.

5.1 Rule proponent's view

In its rule change request, the Panel considered whether the RERT should expire in light of current investment uncertainty, which was due to several years of uncertainty in relation to the introduction of carbon pricing policies. In its assessment the Panel referred to AEMO's 2010 ESOO (which forecasts supply and demand scenarios in each region of the NEM), and also data from the Australian Bureau of Agriculture and Resources Economics on the deployment of new generation capacity in the NEM.²⁴

The Panel also noted the concerns of some stakeholders who considered that investment uncertainty is becoming an increasingly significant issue.

The Panel observed that:²⁵

“the outlook for reliability shows that the majority of the NEM regions are expected to have sufficient reserves up to 2015/16. Since 2009, there have been eight new major generation projects completed, with a combined registered capacity of approximately 2 305MW and as of the end of October 2010, there were twelve projects at an advanced stage of development with a total capacity of 1 768MW.”

The Panel concluded that sufficient capacity has been delivered to the market, and that generally the performance of the market has been sufficient to ensure the security and reliability of electricity supply.²⁶

24 AEMO, 2010 *Electricity Statement of Opportunities*, pp.148- 154; Australian Bureau of Agriculture and Resource Economics - Bureau of Rural Sciences, *Electricity Generation: Major development projects - October 2010*.

25 Reliability Panel rule change proposal, p.17.

26 Reliability Panel rule change proposal, p.17.

However, in its overall assessment the Panel determined that the expiry of the RERT should be postponed for a period of one year from 30 June 2012 to 30 June 2013. This was to provide adequate notice of change to stakeholders, particularly those on the demand side whose core business may be impacted by the expiry of the RERT.

5.2 Stakeholders' views

Submissions received in response to the consultation paper presented two clearly divergent views as to the ability of the market to deliver sufficient capacity in some or all NEM regions in order to achieve reliable and secure supply of electricity. The issues that stakeholders responded to are categorised according to:

- managing the transition to a carbon pricing regime;
- investment lags in generation capacity; and
- reliability performance of the NEM.

Managing the transition to a carbon pricing regime

In the consultation paper stakeholders were asked whether, in their view, proposed carbon pricing legislation had any impacts relevant to the existence of the RERT.

Typically, generators and retailers viewed that there were numerous and adequate policies currently being pursued that would support the removal of high carbon emitting, large-scale base load generation from the NEM.²⁷ Stakeholders noted that the removal of such generation plants from the NEM is to occur in consultation with AEMO, who is "required to make an assessment of any potential closure on system security and the compensation arrangements in the legislation have specific provisions regarding energy security".²⁸

On that basis, these stakeholders argued that the RERT was not an adequate policy tool to attract enough capacity to fill the gap caused by the departure of large-scale base load plant as a result of the introduction of a price on carbon.²⁹

Other stakeholders considered that even if carbon pricing legislation did precipitate some minor incident, that it should not be "any different to the 'business as usual' types of occurrences that the existing framework has been designed to withstand and successfully accommodated since market start without deployment of the RERT".³⁰

²⁷ Private Generators Group, consultation paper submission (representing the interests of AGL Energy, Alinta Energy, Energy Brix, InterGen, International Power GDF-Suez, LYMMCo and TRUenergy), p. 3; NGF/esaa, consultation paper submission, p. 5.

²⁸ Private Generators Group, consultation paper submission, p. 4.

²⁹ TRUenergy, consultation paper submission, p. 3.

³⁰ NGF/esaa, consultation paper submission, p. 5.

Investment lags in generation capacity

Jurisdictional governments that provided submissions were of the view that carbon pricing legislation, amongst other policy settings, was a contributing factor as a cause for lags in investment in generation capacity in some NEM regions.

The Victorian Department of Primary Industries (DPI) observed that the impacts of market uncertainty on generation investment were already apparent across the NEM. According to DPI, AEMO's 2011 ESOO identified approximately 1,280MW of committed generation across the NEM, yet 1,000MW of new generation is required to meet AEMO's forecast load growth. DPI noted that of the new committed generation, approximately 588MW is wind generation which makes a limited contribution to meeting peak demand.³¹

Similarly, the South Australian Department for Transport, Energy and Infrastructure (DTEI) similarly argued that market uncertainty had created investment lags. DTEI observed that while South Australia will require an additional 46MW of new generation or demand-side investment by 2014/15, AEMO's 2011 South Australian Supply and Demand Outlook observed that generation investment in that state had slowed.³²

Reliability performance of the NEM

In considering the impacts of market uncertainty on investment decisions, stakeholders also considered the market's performance in meeting reliability standards.

Typically, retailers and generators argued that the RERT should expire given AEMO's recent assessment in its 2011 PSA report. AEMO considered the supply and demand outlooks for all NEM regions, in conjunction its energy adequacy assessment, to determine that over the next two years all regions of the NEM will meet the reliability standard.³³

DPI and DTEI formed a contrary view as to the NEM's ability to meet the reliability standard, and argued that the proposal by the Panel to allow the RERT to expire on 30 June 2013 was based on the NEM's historical performance and failed to take into account the challenges faced by the NEM in the future.³⁴

Moreover, both DPI and DTEI were concerned that the current reliability settings, and in particular the MPC, were not sufficient to attract investment in Victoria and South Australia. DTEI argued that because of the substantial amounts of installed wind

³¹ Victorian Department of Primary Industries, consultation paper submission, p. 3.

³² South Australian Department for Transport, Energy and Infrastructure, consultation paper submission, p. 3. Note that a recent portfolio change in the South Australian Government has led to a name change, and this department is now the Department for Manufacturing, Innovation, Trade, Resources and Energy.

³³ NGF/esaa, consultation paper submission, p. 3.

³⁴ Victorian Department of Primary Industries, consultation paper submission, p. 2; South Australian Department for Transport, Energy and Infrastructure, consultation paper submission, p. 1.

generation in South Australia, which depresses wholesale electricity prices, the MPC needs to be set at a significantly higher level to attract peak generation.³⁵

5.3 Commission's analysis

Managing the transition to a carbon pricing regime

Managing the transition to a carbon pricing regime will result in a change to the mix of generation in the NEM, and the likely eventual exit of high carbon emitting generation. In the near term AEMO notes that changes to the generation mix resulting from the Clean Energy Future Plan are not expected until at least 2015, based on a forecast of medium economic growth.³⁶ Modelling commissioned by the Commonwealth Department of the Treasury indicates that in the longer term the generation mix is likely to change towards renewable generation, with gas-fired generation increasing and traditional coal-fired generation declining. Modelling indicates that renewable energy is expected to grow from 10 per cent of the generation mix today to 40 per cent by 2050.³⁷

The Commission notes that the Australian Government is currently progressing a number of policies directed at managing the transition to a carbon pricing regime. In order to facilitate the eventual exit of high carbon emitting large-scale base load generation, the Australian Government has introduced a Contract for Closure Program. The program is directed minimising the risks associated with the impact that carbon pricing may have on high emitting large-scale base load generation. The program is seeking to negotiate the potential withdrawal of up to 2,000MW of high carbon emitting generation from the NEM.³⁸

The Contract for Closure Program may create a degree of uncertainty in the market until the size and location of generation under consideration for withdrawal is known. This means that until the market has clear information regarding the size and location of the withdrawal of generation from the NEM, market participants may delay investment decisions. Where investment decisions are delayed there is a potential risk that additional generation capacity is not deployed in sufficient time to meet increasing maximum demand, and the reliability standard may not be achieved.

The Contract for Closure Program forms part of a suite of policy measures in the Energy Security Fund aimed at assisting the generation sector's transition to a carbon pricing regime. The Australian Government has also established a generator assistance

³⁵ Modelling commissioned by DTEI indicates that because of South Australia's increased sensitivity to wind generation, it requires a substantially higher MPC for an extreme peak generation plant to be economic in order to achieve the reliability standard of 0.002 per cent unserved energy. See AEMC website: www.aemc.gov.au.

³⁶ AEMO 2011 *Electricity Statement of Opportunities*, Executive Briefing, p. 9.

³⁷ Commonwealth Department of the Treasury, *Strong Growth, Low Pollution: Modelling a carbon price*, update, 2011.

³⁸ See Department of Resources, Energy and Tourism website for Contract for Closure Program Administrative Guidelines: www.ret.gov.au.

program to provide assistance to generators that are strongly affected by carbon pricing legislation. An Energy Security Council has been established which will advise the Commonwealth Department of the Treasury on the generator assistance program.

The Commission agrees with stakeholders that argue the RERT is not a suitable tool to accommodate the withdrawal of substantial amounts of generation capacity from the NEM as a result of climate change policies. Policy mechanisms, such as the Contract for Closures Program and other policies included as part of the Energy Security Fund, are more suited to accommodate the transition to a carbon pricing regime. However, the Commission considers that in the near term, the Contract for Closure Program may create a degree of uncertainty in the market as the size and location of the generators is not known.

Investment in generation capacity

In assessing the rule change request and the draft rule, the Commission considered a number of reports relevant to the issue of investment in generation capacity in the NEM.

AEMO's 2011 ESOO Executive Briefing forecasts the demand and supply outlook for each region over a ten year period and identifies opportunities for potential generation investment or demand side responses which are signalled by low reserve conditions.³⁹

Based on the assumption of medium economic growth, the 2011 ESOO forecasts that:

- Queensland will require additional investment by 2013-14 (this forecast is consistent with the 2010 ESOO); and
- Victoria and South Australia will both require additional generation investment by 2014-15 (this forecast brings forward required investment in generation capacity by a year earlier than that forecast in the 2010 ESOO, and is primarily due to increases in maximum demand projections).

AEMO's 2011 PSA report assesses the electricity supply outlook for the next two years and combines forecasts from the Medium-Term Projected Assessment of System Adequacy and its Energy Adequacy Assessment Projection. Typically, AEMO's decision to enter into a long-notice RERT contract is determined through these assessments.⁴⁰

Based on forecasts in the 2011 PSA report, AEMO observes that the "reserve capacity and energy adequacy assessment found that the power system is expected to have sufficient supply capacity to meet the Reliability Panel's reserve requirements, and at the time of publication, AEMO does not intend to invoke the Reliability and

³⁹ Low reserve conditions do not necessarily indicate that load shedding will occur but that the power system adequacy is falling below long-term system reliability standards.

⁴⁰ The RERT guidelines, prepared by the Reliability Panel, require AEMO to consider the Medium-term Projected Assessment of System Adequacy, but be informed by the Energy Adequacy Assessment Projection.

Emergency Reserve tender process".⁴¹ AEMO's decision to not invoke the RERT relates only to the reporting period of the 2011 PSA report which is from 1 July 2011 to 30 June 2013. AEMO do not comment on use of the RERT in relation to the reserve shortfalls identified in the 2011 ESOO.

The Bureau of Resources and Energy Economics (BREE) provides key information in relation to investment activities in generation capacity according to NEM region, fuel types and the project development investment cycle on an annual basis.⁴² The BREE report, released in November 2011, notes that in the year to October 2011, only two electricity generation projects have been completed in Australia, both of which are wind generation. The report notes that "a number of projects scheduled to be commissioned over the past year were delayed, owing to several factors including difficulties in negotiating fuel inputs and in finalising financing arrangements".⁴³

This represents an overall decline from previous years in the number of completed projects:

- 11 projects were completed in the year to October 2010; and
- 17 projects were completed in the year to October 2009.

Wind generation (41 per cent) and gas generation (37 per cent) form the majority of projects in the advanced stages of development (defined as 'committed' or 'under construction'). However, around 60 per cent of non-renewable projects at the advanced stages of development are located within the NEM.⁴⁴

The graph below illustrates the investment in generation capacity for renewable and non-renewable projects for recent years in Australia.

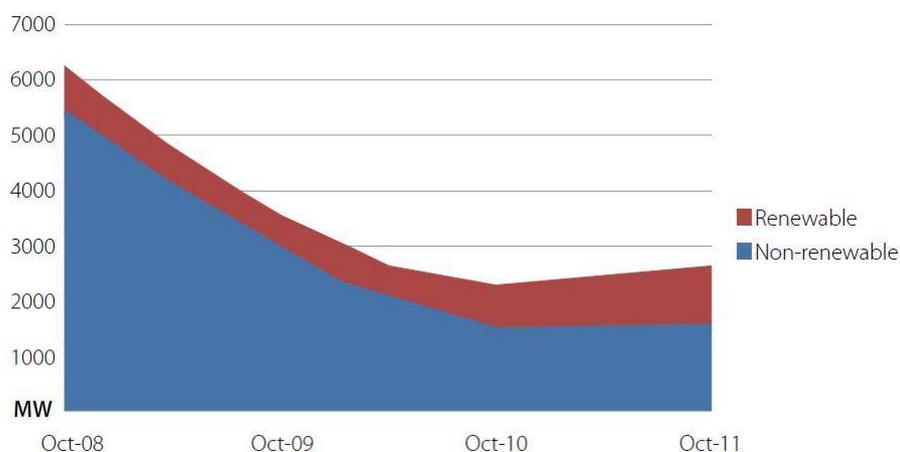
⁴¹ AEMO does also note that the Clean Energy Future Plane is not expected to affect power system operation during the period to 30 June 2013 given that the majority of policy measures do not commence until 1 July 2012; AEMO 2011 *Power System Adequacy for the National Electricity Market*, p. 2-1.

⁴² Bureau of Resources and Energy Economics, *Major electricity generation projects*, November 2011.

⁴³ Bureau of Resource and Energy Economics, *Major electricity generation projects*, November 2011, p. 5.

⁴⁴ Two projects with a capacity of 420MW are located in Western Australia and three projects with a capacity of 166 MW are located in the Northern Territory. See Bureau of Resources and Energy Economics, *Major electricity generation projects*, November 2011, p. 7.

Figure 5.1 Capacity of advanced projects, October 2011⁴⁵



The NEM has performed well in previous years in delivering generation capacity to the market. However, in recent years fewer projects appear to be moving through to completion stage, and especially non-renewable generation projects within NEM regions. This is of particular concern for meeting maximum demand and achieving the reliability standard as generally non-renewable generation, typically gas-fired generation, is required to meet periods of high demand.

Conversely, the number of advanced renewable generation projects relative to advanced non-renewable generation appears to have increased. While this contributes to an overall increase in installed generation capacity for recent years, it raises some concerns on the impact that this may have for attracting non-renewable peaker generation. Where the deployment of renewable generation is concentrated in specific NEM regions the wholesale pool price for electricity may be depressed. This dampens investment signals to non-renewable peaker generation which is required to meet periods of high demand and contributes towards achieving the reliability standard.

Reliability performance of the NEM

The Commission considers that the NEM has performed well to date in achieving the reliability standard. The level of unserved energy in all regions of the NEM has been less than 0.002 per cent for each of the past ten years, with the exception of Victoria and South Australia in 2008- 2009.⁴⁶

However, the Commission also notes that since the commencement of the NEM reserve contracts have been entered into under the RERT provision (or previous 'reserve trader' provisions) where AEMO has forecast a lack of reserve capacity during:

⁴⁵ Bureau of Resources and Energy Economics, Major electricity generation projects, November 2011, p. 8. 8

⁴⁶ See Australian Energy Market Commission, *Reliability Panel Draft Report: Annual Market Performance Review*, 10 November 2011, Sydney, p. 10.

- the period from 31 January 2005 to 4 March 2005 for Victoria and South Australia NEM regions where AEMO contracted for 84MW of reserve capacity;
- the period from 16 January 2006 to 10 March 2006 for Victoria and South Australia NEM regions where AEMO contracted for 375MW of reserve capacity.

5.4 Commission's conclusion

In its assessment of the proposed rule and draft rule, the Commission has considered the extent to which market uncertainty potentially impacts on investment decisions in generation capacity in the NEM. In particular, the Commission considers that if there is a potential risk that additional generation capacity is not deployed in sufficient time to meet increasing maximum demand, the reliability standard may not be achieved.

The Commission notes that uncertainty regarding the introduction of a carbon pricing regime may have previously delayed investment in the NEM, and it may be a period of time before market participants respond to the new policy settings. This is because generation investment requires substantial lead times for deployment. In addition, the Commission considers that there may be ongoing market uncertainty in relation to the impacts of the carbon pricing mechanism, which may cause further delays to generation investment decisions.

The Commission notes that AEMO's 2011 PSA report forecasts sufficient reserve capacity and energy adequacy up to the period of 30 June 2013. However, the 2011 ESOO has brought forward some of its forecast reserve shortfalls from the previous report, and forecasts that several regions of the NEM may experience reserve shortfalls in 2013-14 or 2014-15.⁴⁷ The Commission considers that because the requirement for investment in generation capacity has been brought forward by a year for some NEM regions, there is a potential risk that completion of investment in generation capacity may not be deployed in adequate time to meet forecast increases in maximum demand.

In addition, the recent report by BREE indicates that there is a decline in projects moving through to completion in recent years. Given that the two projects completed in the previous 12 months are wind generation, this gives weight to some stakeholders' concerns in relation to attracting non-renewable peak generation that is crucial to supplying increased maximum demand and therefore achieving the reliable and secure supply of electricity.

The Commission considers that to date the NEM has delivered sufficient investment in generation capacity to ensure that the reliability standard is met. However, if investment decisions are delayed in some NEM regions due to market uncertainty there is an increased risk that generation capacity will not be deployed in adequate time to meet forecast reserve shortfalls.

⁴⁷ See Australian Energy Market Operator, *2011 Electricity Statement of Opportunities*, Executive Briefing, p. 10.

The combination of insufficiently clear information on the likely state of reserve capacities in the near term and fewer projects progressing through to completion means that the Commission cannot be certain that there will be sufficient investment to ensure that the reliability standard will be met in all NEM regions over the next several years. If sufficient investment fails to occur the RERT may be a useful mechanism to allow AEMO to source additional generation capacity or demand side participation to reduce the risk of load shedding events and not meetings the reliability standard.

The Commission considers that the expiry date of the RERT should be postponed beyond 2013 as market uncertainty is unlikely to lessen in this time. Given the considerations outlined above, and those addressed in Chapter 7 of this draft determination, the Commission considers that the expiry of the RERT should be postponed to 30 June 2016. The Commission is of the view that a four year period will provide an adequate period of time for the market to respond to the new policy settings and the deployment of investment in generation capacity to be deployed in the market.

6 Market distortions and costs

In its assessment of the proposed rule and draft rule, the Commission has considered the extent to which the continuation of the RERT may contribute to market distortions. The RERT may create a potential secondary market for reserves, which is not subject to the MPC, by incentivising some participants to enter into reserve contracts with AEMO rather than retailers and other intermediaries in the primary market.

In the absence of the RERT, or any other reserve trader provisions, a market participant wishing to offer reserves would be likely to do so by contracting with a retailer or other intermediary in the primary market for reserves. The primary market for reserves also provides retailers with a mechanism for managing periods of high demand and therefore high prices.

Policies directed at increasing demand side participation seek to provide an additional mechanism for managing periods of high demand by increasing the pool of available reserves in the market.

In assessing the impacts of the potential market distortions created by the RERT, the Commission has considered the likelihood and materiality of these distortions. The Commission has also weighed this cost against the potential significant benefits of maintaining the RERT. This includes ensuring the reliable and secure supply of electricity and minimising load shedding events.

6.1 Rule proponent's view

In its rule change request, the Panel considered whether the RERT created a market distortion and consequently resulted in higher electricity costs for consumers. In its assessment, the Panel considered the views of stakeholders who were clearly divided on this issue. Stakeholders who viewed the RERT as a market distortion noted its impact of creating a secondary market for reserves and that reserves could be contracted for above the MPC. Stakeholders in favour of maintaining the RERT recognised that it may create a market distortion, but that it was a low cost risk management strategy that was limited to use during times of reserve shortfalls.

In its assessment on this matter, the Panel considered that:⁴⁸

“The RERT may be more attractive to some demand side participants ahead of the primary market. For example, participants with whom retailers may be unwilling to contract such as those with strict restrictions on availability (i.e. the timing of the outage, or the length of the notice period) may find the RERT more attractive.”

⁴⁸ Reliability Panel rule change request, p. 14.

The Panel acknowledged that retailers are unable to efficiently hedge against the costs of the RERT because the amount of the costs are unknown to retailers prior to it being exercised.

6.2 Stakeholders' views

In response to this issue, most stakeholders agreed that the RERT created a market distortion, but were generally divided as to how the market distortion manifests and its materiality.

Generators and retailers argued that the RERT created a market distortion by:

- allowing participants to contract for reserves above the MPC;
- marginalising demand side participants into a reserve market and away from contracting with retailers;
- reducing incentives for longer term capacity provision via investment in the primary market; and
- distorting the value for the secure operating state by attributing a greater value to load shedding than the MPC.

The Victorian DPI argued that the RERT was unlikely to incentivise market participants to withhold capacity from the primary market for reserves in expectation of entering into a reserve contract with AEMO. DPI considered that this represented an unlikely business strategy given the uncertain nature of revenue streams that could be derived through the RERT, and its highly infrequent use. Rather, DPI view that a greater distortion to the market that may impact on achieving the reliability standard are the current levels of the MPC and CPT which, DPI argues, do not accurately reflect the value that customers place on a reliable supply of electricity.

6.3 Commission's analysis

The Commission had previously considered in the Comprehensive Reliability Review (2007) whether an emergency trader provision in the NER creates a market distortion. Recommendations stemming from this review led to the subsequent adoption of the RERT in 2008, which was designed to minimise the impact of any apparent market distortions.⁴⁹

Changes to the reserve trader in 2008 included amending provisions in the NER:

- increase flexibility of how the market operator was able to tender and contract for reserves;

⁴⁹ See Australian Energy Market Commission, *National Electricity Amendment (NEM Reliability Settings: Information, Safety Net and Directions) Rule 2008*, final rule determination, 26 June 2008, Sydney, pp. 31- 43.

- ensure the contracted reserves cannot set the dispatch price; and
- ensure that contracted reserves are only dispatched subsequent to all other energy and ancillary services bids being dispatched.⁵⁰

Specifically, the Commission sought to ensure that by reducing market distortions it would preserve market signals to foster a market response to forecast reserve shortfalls. AEMO has not entered into reserve contracts since the adoption of the RERT in the rules. Therefore, it is unclear whether the market distortions created by the reserve trader, if any, have been lessened by the introduction of these new provisions.

As discussed in Chapter 5, the Commission understands that the market operator has entered into reserve contracts twice, and in each case has not exercised the dispatch of additional capacity.⁵¹

- 31 January 2005 to 4 March 2005 for Victoria and South Australia NEM regions AEMO sought to contract up to 230MW, and contracted for 84MW. The total availability payments to reserve providers was \$1,035,000; and
- 16 January 2006 to 10 March 2006 for Victoria and South Australia NEM regions AEMO sought to contract up to 500MW, and contracted for 375MW. The total availability payments to reserve providers was \$4,352,054.

The Commission understands that the successful tenders in 2005 were a combination of demand response providers and additional generation capacity.⁵²

In terms of the types of participants incentivised to enter into RERT contracts, the following participants were selected in response to forecast reserve shortfalls in 2006:

- VicPower Trading - 180MW (a provider of ancillary frequency services);
- Energy Response - 125MW (an open access aggregator of demand side response);
- The Australian Steel Company (Operations) - 55MW; and
- Zinifex Port Pirie - 15MW.⁵³

⁵⁰ Effectively, these changes required that AEMO seek reserve capacity from sources that would otherwise not be available to the primary market. Subsequent changes to the RERT were introduced in 2009 including the introduction of the short-notice and medium-notice RERT. The RERT guidelines developed by the Reliability Panel allow AEMO to establish a panel of entities that may be called upon to enter into reserve contracts for medium-notice (between 10 weeks' and 7 days' notice) and short-notice (between 3 hours' and 7 days' notice).

⁵¹ See National Electricity Market Management Company Limited, Communication No. 1937, *Reserve Trading Financial Year 2004/05*, version no. 1.0, p. 2; Communication No. 2203, *Reliability Safety Net Financial Year 2005/06*, version no. 1.0, p. 2.

⁵² Australian Energy Market Commission, *Review of the role of demand side participation in the National Electricity Market*, stage 1 final report, NERA Consulting, p. 49.

Given the above information, the average cost of availability payments to reserve providers was approximately \$12,321 per MW in 2005 and \$11,605 per MW in 2006.

It should be noted that if the reserve providers were dispatched, this would have likely incurred an additional payment and increased the overall contract price for reserves.

Given the very infrequent use of the reserve trader it is unlikely that participants with available reserves would withhold capacity for the unreasonably likely event that they will be able to enter into reserve contracts with AEMO in preference to contracting with retailers and other intermediaries in the primary market for reserves. A stronger business case would exist for market participants to directly enter into the primary market where additional revenue streams can be accessed on a more frequent and reliable basis.

The Commission notes however, that residential customers, who are usually load shed first, may value customer reliability differently to industrial and commercial customers. The value that residential customers place on reliability is a factor in determining the appropriate level of the MPC that forms part of the reliability settings.⁵⁴

6.4 Commission's conclusion

The Commission has considered the likelihood and materiality of potential market distortion created by the RERT and weighed it against the benefits of maintaining this provision in the NER for a period of time. While it is likely that the RERT may create some potential market distortion the Commission considers that the impact of those market distortions are minor and are outweighed by the benefits of maintaining the RERT for a period of time.

To date, AEMO has only entered into reserve contracts twice, and on both occasions opted to not dispatch additional capacity available under the contracts. Given the very infrequent use of the reserve trader the argument that the RERT creates a secondary market is less persuasive. Indeed, it appears very unlikely that participants with available reserves would withhold capacity for the reasonably unlikely event that they will be able to enter into reserve contracts with AEMO in preference to contracting with retailers and other intermediaries in the primary market. The Commission is of the view that a stronger business case would exist for market participants to directly enter into the primary market where additional revenue streams can be accessed on a more frequent and reliable basis.

⁵³ Australian Energy Market Commission, *Review of the role of demand side participation in the National Electricity Market*, stage 1 final report, NERA Consulting, 9 May 2008, p. 49.

⁵⁴ The value that customers place on reliability of supply is likely to be subjective in nature. However, it may be measured by determining the costs incurred by customers from interruption to their power supply. Currently, the only widely used estimate of customer willingness to pay for reliability is AEMO's estimate of the Victorian value of customer reliability (VCR). The Victorian VCR is used by Victorian transmission businesses to assess whether network augmentation should proceed. It calculates separate VCRs for residential, agricultural, commercial and industrial customers.

The Commission acknowledges that consumers may face higher electricity costs associated with AEMO's entry into reserve contracts, but notes that these costs are allocated across jurisdictions that stand to benefit from the contracts. However, it is not clear to the Commission whether retailers recover these costs more broadly from residential users of electricity (which would be limited in some jurisdictions due to regulated retail prices or the ability to readily change market contract tariffs) or whether retailers are able to pass costs through to large scale industrial users that are typically not on a standard contract.

For some firms that are subject to high input costs, such as steel or aluminium manufacturing, the MPC offered in the primary market may not provide a sufficient inducement to reduce demand or offer additional capacity into the market during periods of high demand. These firms may value their capacity above the MPC which means that the RERT may potentially provide an effective mechanism for attracting additional capacity.⁵⁵

The reliability standard provides a translation of the community's general willingness to pay for reliability and toleration of load shedding events. For some consumers of electricity, load shedding can result in substantial economic costs in terms of productivity. The RERT therefore provides a mechanism to ensure that the risk of load shedding events, that may result in the reliability standard not being met, is minimised and gives a greater degree of confidence to consumers that they are able to access a reliable and secure supply of electricity.

As discussed in Chapters 5 and 7, until market uncertainty lessens, the Commission considers the RERT is of some benefit to the market. On balance the Commission considers that any potential, minor market distortions created by the RERT are outweighed by the benefits of maintaining reliability and security of supply to consumers and ensuring that the risk of load shedding events are minimised.

⁵⁵ The implications for demand side participation are considered in greater detail in the next chapter.

7 Market development and implementation issues

In its assessment of whether the expiry date of the RERT should be postponed the Commission has considered the interaction and timing of policies relating to demand side participation and the Panel's review of reliability standards and settings due to be completed in April 2014.

Demand side participation policies seek to minimise the total cost of balancing supply and demand and may result in additional mechanisms for managing periods of high demand. This could be achieved by:

- increasing the pool of available reserves to the market by incentivising distributed generation, for example, to offer additional capacity;
- incentivising consumers to reduce demand during periods of high demand and high prices.

7.1 Rule proponent's views

In its assessment of whether the RERT continues to be required in the NER and whether its expiry should be postponed, the Panel considered the timing of the implementation of demand side policies. Demand side participants represent a significant segment of the market that can respond with additional reserves in order to reduce the levels of maximum demand that would not otherwise be available to the wholesale market.

The Panel considered that there was value in postponing the expiry of the RERT for one year to allow greater time for recommendations from ongoing work on demand side participation to be implemented. The Panel also considered that there was additional value in postponing the RERT for that period of time to provide sufficient notice of the expiry of the RERT to those stakeholders whose core business will be affected, particularly those who provide demand side capacity to the market.⁵⁶

7.2 Stakeholders' views

No stakeholders that responded to the consultation paper supported postponing the expiry of the RERT by a period of one year. Stakeholders considered that the RERT should expire according to the current provisions in 2012, or that the expiry date should be postponed for at least four years or indefinitely.

⁵⁶ Reliability Panel proposed rule change, pp. 13- 14.

Stakeholders that did not support maintaining the RERT contended that businesses would not be impacted by its removal given its infrequent utilisation and unlikely use in the future.⁵⁷

In terms of the implementation and timing issues, NGF/esaa noted that the RERT's expiry should not be postponed for two reasons:

- the third stage of the Demand Side Participation review is focussed on the consumer area, as indicated by the title of the review Power of Choice- giving consumers options in the way they use electricity; and
- if the RERT was required to support the viability of some demand side participants, then a one year extension of the RERT will do little to support their long term involvement.⁵⁸

South Australia's DTEI argued that the RERT should remain in the NER until such time that the AEMC develops an appropriate alternative reserve trader mechanism.⁵⁹ Victoria's DPI considered that the RERT should remain in the NER until 1 July 2016, by which time the Panel would have reviewed reliability settings and any changes in levels for the MPC and the CPT would have been implemented in the NER.⁶⁰

No submissions were received from stakeholders whose core business may be affected by the removal of the RERT.

7.3 Commission's analysis

Demand side participation

The Commission is currently progressing a number of work programs in relation to demand side participation, all of which are directed at reducing barriers to participation. These include:

- Distribution Network Planning and Expansion Framework rule change;
- Inclusion of Embedded Generation Research into the Demand Management Incentive Scheme rule change;
- Efficiency Benefit Sharing Scheme and Demand Management Expenditure by Transmission Businesses rule change; and
- Demand Side Participation Stage 3 market review.

⁵⁷ TRUenergy, consultation paper submission, p. 3, Private Generators Group, consultation paper submission, p. 3, NGF/esaa, consultation paper submission, p. 3.

⁵⁸ NGF/esaa, consultation paper submission, pp. 3- 4.

⁵⁹ South Australian Department for Transport, Energy and Infrastructure, consultation paper submission, p. 3.

⁶⁰ Victorian Department of Primary Industries, consultation paper submission, p. 1.

In addition, new arrangements governing the connection of distributed generation are due to commence in the NER in July 2012, as part of the National Energy Customer Framework reform package.

The Distribution Network Planning and Expansion Framework rule change seeks to implement a national framework for electricity distribution network planning and expansion. A key element of this rule change proposes requiring Distribution Network Service Providers (DNSPs) to establish and implement a "Demand Side Engagement Strategy" which would outline DNSP processes for considering non-network proposals and engaging with non-network providers. Under the proposed rule, DNSPs would review and publish a Demand Side Engagement Strategy at least once every three years.⁶¹

The Inclusion of Embedded Generation Research into the Demand Management Incentive Scheme rule change results from the Demand Side Participation Stage 2 review which found that DNSPs have a strong incentive to focus on network reliability and safety issues, and weak incentives to minimise the costs associated with connecting embedded generators to their network. This rule change proposes that the Australian Energy Regulator (AER) consider improving the incentives placed on DNSPs under the Demand Management Incentive Scheme to more efficiently connect embedded generators.⁶²

The Efficiency Benefit Sharing Scheme and Demand Management Expenditure by Transmission Businesses rule change results from the Demand Side Participation Stage 2 review. The rule change proposes excluding non-network alternative expenditures from the scheme, which if otherwise included may act as a disincentive to transmission companies undertaking efficient non-network alternatives.⁶³

The Demand Side Participation Stage 3 review (Power of Choice) will consider a range of market features that can contribute to facilitating and promoting an efficient demand side response that may include potential recommendations regarding demand side participation actions, market conditions and regulatory arrangements. Included within the scope of the review is the utilisation of distributed generation and the role of energy aggregators in facilitating a demand side response. Given that the final report for this review is due for completion at the end of 2012, it may take some time to see any recommendations implemented in market and regulatory arrangements.⁶⁴

⁶¹ Australian Market Energy Commission, *National Electricity Amendment (Distribution Network Planning and Expansion Framework) Rule 2011*, consultation paper, 29 September 2011, Sydney.

⁶² Australian Energy Market Commission, *National Amendment (Inclusion of Embedded Generation Research into the Demand Management Incentive Scheme) Rule 2011*, draft determination, 29 September 2011, Sydney.

⁶³ Australian Energy Market Commission, *National Electricity Amendment (Efficiency Benefit Sharing Scheme and Demand Management Expenditure by Transmission Businesses) Rule 2011*, draft determination, 29 September 2011, Sydney.

⁶⁴ Australian Energy Market Commission, *Power of Choice- giving consumers options in the way they use electricity*, issues paper, 15 July 2011, Sydney, pp. i- iii.

The introduction of Chapter 5A in the NER will provide a framework for the connection for non-registered micro and embedded generation to the distribution network, which is directed at supporting demand side participation in the NEM. The new arrangement includes:

- standing offer contracts for basic micro and distributed generation (in particular solar residential);
- the ability for DNSPs to propose additional standing offers for other types of distributed generation connections;
- establishing a negotiating framework specific to retail customers and non-registered distributed generation; and
- access to dispute resolution processes.⁶⁵

Demand side participation policies potentially provide a pathway to managing periods of high demand and reducing the risk of load shedding events. This increases the range of policy tools available to the market to achieve the reliability standard and potentially reduces the need for the RERT. However, it is likely to take time for these policies to be implemented, or for market participants to respond.

Reliability Panel review of reliability standard and settings

The NER requires the Panel to undertake a review of reliability standard and settings by April 2014. The reliability settings are the key mechanisms for balancing supply and demand in the wholesale market and delivering capacity to meet the reliability standard over the long term. Therefore, under this review the Panel will be required to assess the current levels of the MPC and CPT in order to determine whether they are delivering sufficient generation capacity to the NEM. This assessment will be in light of current and future market conditions.

Any recommendations stemming from this review will require a period of time to be implemented in the NER.

7.4 Commission's conclusion

The Commission considers that there are substantial policy initiatives currently in development that may have a material impact on reducing the barriers to demand side participation. This has the potential to result in attracting additional capacity to the primary market for reserves.

The rule changes and policies currently under development seek to provide a general framework for the efficient connection of distributed generation and other demand side responses. It is likely that the combination of the new Chapter 5A arrangements and the proposed Distribution Network Planning and Expansion Framework rule change can reduce the barriers to demand side participation, especially for distributed

⁶⁵ See the Ministerial Council for Energy website: www.mce.gov.au.

generation. Increasing demand side participation will provide an additional mechanism for minimising the risk of load shedding events, in conjunction with investment in generation capacity by increasing the pool of available reserves in the market.

The Commission considers that it will take a period of time for these policy changes to be implemented, which will be more than the one year period contemplated by the Panel in their proposed rule change.

The Commission notes the concerns raised by jurisdictional governments in relation to the ability of the current reliability settings to deliver sufficient investment generation capacity. The Commission considers that the reliability settings, in the absence of significant market uncertainty, are likely to provide sufficient investment in generation capacity to the market. However, as a result of market uncertainty discussed in Chapter 5, there is a risk that the current reliability settings may not result in sufficient investment to meet the reliability standard in all NEM regions. Therefore, until the reliability standards and settings are reviewed against current and future market conditions, there is benefit in retaining the RERT.

The Commission considers that the expiry of the RERT should be postponed for a period of four years. This will allow sufficient time for:

- demand side participation rule changes, and recommendations stemming from reviews, to be implemented;
- any recommendations relating to the Reliability Panel's review of reliability standards and settings to be implemented; and
- the market uncertainty as a result of the changes in policy settings discussed in Chapter 5 to lessen.

The Commission considers that postponing the expiry of the RERT is a temporary measure primarily directed at accommodating a period of market uncertainty that may be a result of the transition to a carbon pricing regime. This market uncertainty is expected to have abated by 2016 and the Commission considers that another review of the RERT prior to its expiry is unnecessary. Removing the requirement for the Panel to review the RERT should also provide market participants with greater certainty as to the status of the RERT.

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AFP	Administered Floor Price
APC	Administered Price Cap
APP	Administered Price Period
BREE	Bureau of Resources and Energy Economics
Commission	See AEMC
CPT	Cumulative Price Threshold
DNSP	Distribution Network Service Providers
DPI	Department of Primary Industries
DTEI	Department for Transport, Energy and Infrastructure
ESOO	Electricity Statement of Opportunities
MCE	Ministerial Council on Energy
MPC	Market Price Cap
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
PSA	Power System Adequacy
RERT	Reliability and Emergency Reserve Trader
the Panel	Reliability Panel
VCR	value of customer reliability

A Summary of issues raised in submissions

Stakeholder	Issue	AEMC Response
DPI	Investor uncertainty will continue in the NEM for a while, as evidenced by AEMO forecast which forecasts generation investment not likely to meet requirements of the NEM.	The Commission considers that recent periods of market uncertainty, and the extent to which this impacts on investment uncertainty, may potentially delay the completion of generation capacity in some NEM regions. Where market signals are dulled or investment decisions are delayed due to changes in policy settings there is potentially a risk that generation capacity may not be deployed in adequate time to meet maximum demand in all NEM regions, consistent with the reliability standard.
DPI	Investment challenge over the next decade means there is a risk that new capacity does not come on stream quickly enough to maintain supply reliability.	The Commission considers that recent periods of market uncertainty, and the extent to which this impacts on investment uncertainty, may potentially delay the completion generation capacity in some NEM regions. Where market signals are dulled or investment decisions are delayed due to changes in policy settings there is potentially a risk that generation capacity may not be deployed in adequate time to meet maximum demand in all NEM regions, consistent with the reliability standard.
DTEI	Decision to postpone expiry of RERT by 12 months only is based on historic performance and does not take into account challenges faced by market.	The Commission notes that AEMO's 2011 Power System Adequacy report forecasts sufficient reserve capacity and energy adequacy up to the period of 30 June 2013. However, the 2011 ESOO has brought forward some of its forecast reserve shortfalls from the previous report, and forecasts that several regions of the NEM may experience reserve shortfalls in 2013-14 or 2014-15.
DTEI	DTEI considers uncertainty in the market, the potential lack of investment and the impact of wind generation suggests there is a need for a last resort support mechanism.	The Commission considers that the combined effect of market uncertainty with respect to the impacts of carbon pricing and deployment of renewable energy generation on wholesale electricity prices may potentially dampen investment signals for generation capacity in some NEM regions. Maintaining the RERT for a period of time provides a safety

Stakeholder	Issue	AEMC Response
		net for consumers if investment in generation capacity is not sufficient to meet the reliability standard in some NEM regions.
NGF/esaa	The RERT creates an inconsistency to the implied value of achieving a secure operating state.	The Commission agrees that the RERT potentially creates an inconsistency in the implied value of achieving a secure operation state because reserve contracts under the RERT are not subject to the MPC. However, the Commission considers that maintaining the RERT as a safety net for a defined period is likely to provide consumers with a greater degree of confidence that they are able to access a reliable and secure supply of electricity.
NGF/esaa	Keeping the RERT continually marginalises the activities of non-active market participants into a reserve market. This includes sharper and more accurate demand side signals.	Based on the fact that the RERT has rarely been used in the past, the Commission considers that it appears very unlikely that participants with available reserves would withhold capacity for the reasonably unlikely event that they will be able to enter into reserve contracts with AEMO in preference to contracting with retailers and other intermediaries in the primary market for reserves. The Commission is of the view that a stronger business case would exist for market participants to directly enter into the primary market where additional revenue streams can be accessed on a more frequent and reliable basis.
NGF/esaa	The RERT has not increased the actual supply reliability in 10 years.	The Commission notes that the purpose of the RERT is not to increase the supply in generation capacity to the market. The reliability settings, more specifically the MPC and CPT, provide signals to generators for investment and are the appropriate policy tool to achieve and meet the reliability standard. The RERT potentially provides a safety net if the reliability settings do not result in enough investment to achieve the reliability standard, especially as market uncertainty may persist.
NGF/esaa	According to AEMO's latest Power System Adequacy report, the reliability standard will comfortably be exceeded for the next two years.	The Commission notes that AEMO's 2011 Power System Adequacy report forecasts sufficient reserve capacity and energy adequacy up to the period of 30 June 2013. However, the 2011 ES00 has brought forward some of its forecast reserve shortfalls from the previous report, and forecasts that several regions of the NEM may experience reserve

Stakeholder	Issue	AEMC Response
		shortfalls in 2013-14 or 2014-15.
DPI	Significant distortions arise from the MPC and CPT which are set at levels that do not significantly recognise the importance that consumers place on a reliable supply of electricity.	The Commission notes that the Reliability Panel will be reviewing reliability standards and settings by April 2014.
NGF/esaa	Linking outcomes from the Demand Side Participation review to the expiry of the RERT runs the risk of re-conceptualising the RERT as a demand side management tool.	The Commission considers that demand side participation policies potentially provide a pathway to managing periods of high demand and reducing the risk of load shedding events. In particular, distributed generation is likely to provide the market with additional capacity where reserve shortfalls are forecast. However, in the absence of demand side participation policies that can enable distributed generation to respond, there may be benefit in maintaining the RERT for a period of time as a safety net for attracting additional capacity to ensure reliability and security of supply of electricity, consistent with the reliability standard.
NGF/esaa	The RERT was not a policy tool designed for either large amounts of capacity on frequent use.	The Commission agrees with the point.
Private Generators Group	By keeping the RERT the market marginalises the activities of non-active participants into a reserve market.	Based on the fact that the RERT has rarely been used in the past, the Commission considers that it appears very unlikely that participants with available reserves would withhold capacity for the reasonably unlikely event that they will be able to enter into reserve contracts with AEMO in preference to contracting with retailers and other intermediaries in the primary market for reserves. The Commission is of the view that a stronger business case would exist for market participants to directly enter into the primary market where additional revenue streams can be accessed on a more frequent and reliable basis.
Private Generators Group	The RERT creates additional costs, is not transparent and distorts the market.	Given the infrequent use of the RERT consumers are not likely to face materially higher electricity costs. The Commission considers that while the RERT may create some minor market distortions, the impact on consumers of these are outweighed by the benefit of maintaining the

Stakeholder	Issue	AEMC Response
		RERT for a period of time, especially while market uncertainty may persist.
Private Generators Group	The RERT creates an inconsistency in the implied value of achieving a secure operating state.	The Commission agrees that the RERT potentially creates an inconsistency in the implied value of achieving a secure operation state because reserve contracts under the RERT are not subject to the MPC. However, the Commission considers that maintaining the RERT as a safety net for a defined period is likely to provide consumers with a greater degree of confidence that they are able to access a reliable and secure supply of electricity.
Private Generators Group	The RERT (and previously the Reserve Trader) has not increased actual supply in reliability in 10 years.	The Commission notes that the purpose of the RERT is not to increase the supply in generation capacity to the market. The reliability settings, more specifically the MPC and CPT, provide signals to generators for investment and are the appropriate policy tool to achieve and meet the reliability standard. The RERT potentially provides a safety net if the reliability settings do not result in enough investment to achieve the reliability standard, especially as market uncertainty may persist.
Private Generators Group	Size of any possible closure of large-scale base load plant in the near term due to climate change policy would dwarf any capacity that AEMO will be able to procure under the long-, medium- and short term mechanisms.	The Commission agrees that the RERT is not a policy tool designed to deliver capacity in the event of significant withdrawals of generation capacity from the NEM, but it can provide a useful safety net to manage other risks. The Commission notes that the Australian Government is currently progressing a number of policies directed at managing the withdrawal of up to 2,000MW of high carbon emitting generation from the NEM, and other policies to manage the transition to a carbon pricing regime.
Private Generators Group	AEMO has extensive powers to direct participants when system security is at risk. These powers can address shortfalls as a last resort.	The Commission notes this point.
TRUenergy	The RERT distorts the price of energy in the NEM, and if energy reserves were to tighten, the RERT	Based on the fact that the RERT has rarely been used in the past, the Commission considers that it appears very unlikely that participants with

Stakeholder	Issue	AEMC Response
	would act as an even greater distortion and reduce incentives for longer term capacity provision via investment in the primary market.	available reserves would rather withhold capacity for the reasonably unlikely event that they will be able to enter into reserve contracts with AEMO in preference to contracting with retailers and other intermediaries in the primary market for reserves. The Commission is of the view that a stronger business case would exist for market participants to directly enter into the primary market where additional revenue streams can be accessed on a more frequent and reliable basis.
TRUenergy	Considers that capacity would be priced more efficiently if it were contracted through a market mechanism either directly with retailers or other market participants rather than through AEMO.	The Commission agrees that the RERT potentially creates a market distortion because reserves contracted under the RERT are not subject to the MPC. However, the Commission considers that maintaining the RERT as a safety net for a defined period is likely to provide consumers with a greater degree of confidence that they are able to access a reliable and secure supply of electricity.
TRUenergy	It would be impractical for an interim approach for the RERT to provide enough capacity to fill the gap caused by the departure of a large scale based load plant as a result of the introduction of a price on carbon.	The Commission agrees that the RERT is not a policy tool designed to deliver capacity in the event of significant withdrawals of generation capacity from the NEM, but can provide a useful safety net to manage other risks. The Commission notes that the Australian Government is currently progressing a number of policies directed at managing the withdrawal of up to 2,000MW of high carbon emitting generation from the NEM, and other policies to manage the transition to a carbon pricing regime.
TRUenergy	We believe that maintaining the RERT for another year to support the demand side is irrelevant and would contribute to ongoing inefficiency by subsidising uncompetitive business models.	The Commission considers that the RERT does not support or subsidise uncompetitive business models, based on the fact that the RERT has rarely been used in the past and that a stronger business case would exist for market participants to directly enter into the primary market for reserves where additional revenue streams can be accessed on a more frequent and reliable basis.