



**Australian Energy Market Commission**

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## **RULE DETERMINATION**

# National Electricity Amendment (Improved RERT Flexibility and Short-notice Reserve Contracts) Rule 2009

### **Rule Proponent**

Reliability Panel

### **Commissioners**

Tamblyn  
Ryan

15 October 2009

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Chairman

For and on behalf of the Australian Energy Market Commission

**RULE  
CHANGE**

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## **Citation**

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## **About the AEMC**

The Council of Australian Governments, through its Ministerial Council on Energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

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## Abbreviations

AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Commission	see AEMC
MCE	Ministerial Council on Energy
MNSP	Market Network Service Provider
NECA	National Electricity Code Administrator
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company

## Summary

### The Commission's determination

The Australian Energy Market Commission (Commission) makes this final Rule determination and attached Rule on the Reliability Panel's proposal relating to Improved Reliability and Emergency Reserve Trader (RERT) Flexibility and Short-notice Reserve Contracts. The Rule determination and Rule are made in accordance with section 102 and 103 of the National Electricity Law (NEL) and adopt the position of the Rule change proposal. The reasoning for the Commission's decision is provided below.

### Summary of the Rule change proposal

On 11 August 2009, the Reliability Panel submitted a Rule change proposal to the Commission seeking to amend the RERT. The proposed amendments aim to facilitate the Australian Energy Market Operator (AEMO) to contract for reserves at short notice, and to clarify that AEMO can use contracted reserves during system security events where practicable.

The amendments represent an incremental improvement in the operation of the RERT to enable reserve procurement ten weeks or closer to the time that the reserves may be required.

To allow more flexible reserve procurement in timeframes that are closer to real time the Reliability Panel has proposed that the current RERT arrangements be amended to clarify that AEMO can:

- undertake processes (to be outlined in the RERT Guidelines) to contract for reserves in long-notice, medium-notice and short-notice timeframes;
- can negotiate reserve contracts at any time, allowing AEMO to form a RERT Panel; and
- can use contracted reserves for system security events where practicable.

To allow the amended RERT to be operational for summer 2009/10, the Reliability Panel's Rule change proposal provided for transitional arrangements that:

- require the Reliability Panel to publish interim amendments to the RERT guidelines giving effect to the Reliability Panel's proposed amendments without being required to follow the process for amending the guidelines contained in the Rules;<sup>a</sup>

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<sup>a</sup> The process for amending the RERT Guidelines is contained in Rules clause 3.20.8(b).

- require the Reliability Panel to publish amendments to the RERT guidelines giving effect to the proposed amendments by 30 June 2010 in accordance with the processes provided for in the Rules;
- require AEMO to publish interim amendments to the RERT procedures giving effect to the proposed amendments without being required to follow the Rules consultation procedures<sup>b</sup> provided for in the Rules to amend the RERT procedures; and
- require AEMO to publish amendments to the RERT procedures giving effect to the proposed amendments by 30 November 2010 in accordance with the Rules consultation procedures.

### **The Commission’s reasoning for its determination**

The Commission is satisfied that the Rule is likely to promote the National Electricity Objective (NEO).

The RERT is a mechanism that delivers more efficient use of electricity services, by enabling supply to be maintained to those who value it most. It does this by providing a means for:

- parties who have non-market generation capacity to make themselves known to AEMO – and to declare what price those parties would need to be paid to use the non-market generation capacity; and
- individual or groups of consumers to declare what remuneration they would need to have their load shed voluntarily.

The proposed amendments to the RERT do this more effectively than the current RERT because they enable the assessment of the need for additional capacity to be undertaken, and acted on, much closer to real time. The RERT panel reduces lead times from around ten weeks to around one week, and the short-term RERT panel reduces lead times to a few hours. Significant new information relevant to an assessment of the adequacy of capacity can reveal itself close to real time. The information available to AEMO to assess capacity adequacy ten weeks out can therefore be quite different to the information available a few days or hours out. New information might relate to the availability and level of performance of particular generation plant, and the level of likely demand.

The Commission considers that the proposal has scope to deliver potentially significant economic benefits if the risk of capacity shortfalls materialises. Further, there are significant safeguards to minimise potential distortions to the market of introducing the proposed arrangements if the risk of capacity shortfalls does not materialise. While there is uncertainty over how much additional capacity could

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<sup>b</sup> The process for amending the RERT procedures is contained in Rules clause 3.20.7(e). The Rules consultation procedures are set out in Rules Rule 8.9.

potentially be drawn into the mechanism, the application of the amended mechanism will improve information in this regard. Such information will be relevant and useful in the planned review of these and related arrangements in 2011.

The proposed Rule therefore addresses a clear gap in the current arrangements, whereby the opportunity to enhance economic welfare through targeted intervention is missed because of the practicalities of timescales required to respond to new information. Further, while the likelihood of intervention being required is low, it cannot be discounted entirely – and under some circumstances the efficiency benefits could be potentially very large.

The Commission has therefore concluded that the Rule proposal meets the Rule making test.

### **Consultation on the Rule change proposal**

The Reliability Panel requested that the Rule change proposal be treated as a request for an urgent Rule, and that the assessment of the Rule change proposal be expedited under section 96 of the NEL. The Commission accepted the Reliability Panel's request subject to written objections.

On 3 September 2009 the Commission received an objection to the treatment of the Rule change proposal as a request for an urgent Rule. The objection was jointly submitted by the National Generators Forum (NGF) and the Electricity Retailers Association of Australia (ERAA).<sup>c</sup>

On 17 September 2009 the Commission decided that the reasons in the objection were misconceived or lacking in substance in accordance with section 96 of the NEL and therefore continued to treat the Rule change proposal as urgent (and continued the assessment of the proposal under the expedited process). This decision was communicated to the parties and published on the Commission's website on 18 September 2009.<sup>d</sup>

Submissions on the merits of the Rule change proposal closed on 17 September 2009. Five submissions on the merits of the proposal were received. Submissions were largely not supportive of the introduction of the proposed arrangements. The main points raised were that:

- the proposed arrangements are unlikely to elicit new capacity;
- the proposed arrangements potentially distort the market settings;

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<sup>c</sup> NGF/ERRA objection, 3 September 2009. The objection is available on the AEMC website under the Improved RERT Flexibility and Short-notice Reserve Contracts web page.

<sup>d</sup> Letters to the NGF and ERAA, 18 September 2009. These letters are available on the AEMC website under the Improved RERT Flexibility and Short-notice Reserve Contracts web page.

- certain costs have not been taken into account (such as the costs associated with increased regulatory risk for electricity retailers); and
- further analysis of the costs and benefits of short-notice reserve procurement is required.

### **Extensions of time for publication of the final Rule determination**

On 1 October 2009, and 8 October 2009 the Commission issued notices under section 107 of the NEL extending the time for the publication of the final Rule determination. These notices were issued to provide the Commission with sufficient time to analyse complex and difficult issues raised in submissions (including late submissions) to the Rule change proposal.

# 1 Reliability Panel's Rule change proposal

On 11 August 2009, the Commission received a Rule change proposal from the Reliability Panel on Improved RERT Flexibility and Short-notice Reserve Contracts. The Reliability Panel is a panel of the Commission, made up of stakeholder representatives<sup>1</sup> that is charged with monitoring, reviewing and reporting on the safety, security and reliability of the national electricity system.<sup>2</sup>

The Rule change proposal sought to elicit additional reserve in short-notice timeframes (ten weeks or closer to the actual time the reserves are required) through amendments to the RERT mechanism. It also sought to make the proposed amendments operational for the summer of 2009/10.

## 1.1 Problem to be addressed by the Rule change proposal

The problem identified was that the options for AEMO to procure and utilise reserves at short-notice (and therefore minimise involuntary load shedding) were limited. Further options would be useful particularly during times of critical supply shortages.

## 1.2 Proponent's proposed solution

The Reliability Panel's solution to the problem was to submit a Rule change proposal to amending the RERT. The amendments provide an avenue for AEMO to procure and utilise reserve at shorter notice than is practicably possible under the current RERT process. The Reliability Panel states that these amendments are enhancements to an existing NEM intervention mechanism.<sup>3</sup>

The amendments also allow AEMO to procure reserve from a wider set of potential providers than the directions power that is currently invoked by AEMO in short-notice reserve shortfall situations.<sup>4</sup>

## 1.3 Reliability Panel's proposed amendments to the RERT

The Reliability Panel proposed that the RERT be amended to clarify that AEMO can:

- undertake processes (to be outlined in the RERT Guidelines) to contract for reserves in long-notice, medium-notice and short-notice timeframes;
- negotiate reserve contracts at any time, allowing AEMO to form a RERT Panel; and

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<sup>1</sup> The members of the Reliability Panel are contained in Rules clause 8.8.1.

<sup>2</sup> The functions of the Reliability panel are contained in Rules clause 8.8.2.

<sup>3</sup> Reliability Panel Rule change proposal pvii.

<sup>4</sup> Reliability panel Rule change proposal p29.

- use contracted reserves for system security events where practicable.

## 1.4 Implementation for summer 2009/10

To allow for the amended RERT to be operational by summer 2009/10, the Reliability Panel's Rule change proposal provided for transitional arrangements that:

- require the Reliability Panel to publish interim amendments to the RERT guidelines giving effect to the Reliability Panel's proposed amendments without being required to follow the process for amending the guidelines contained in the Rules;<sup>5</sup>
- require the Reliability Panel to publish amendments to the RERT guidelines giving effect to the proposed amendments by 30 June 2010 in accordance with the processes provided for in the Rules;
- require AEMO to publish interim amendments to the RERT procedures giving effect to the proposed amendments without being required to follow the Rules consultation procedures<sup>6</sup> provided for in the Rules to amend the RERT procedures; and
- require AEMO to publish amendments to the RERT procedures giving effect to the proposed amendments by 30 November 2010 in accordance with the Rules consultation procedures.

## 1.5 Overview – current operation of the RERT

The RERT arrangements consist of:

- Provisions in the Rules which provide a framework through which the RERT operates, including the RERT principles which AEMO must have regard to in exercising the RERT.<sup>7</sup> Amendments to the Rules provisions are made through the Rule change process and are assessed by the Commission against the NEO.<sup>8</sup>
- The RERT guidelines, which outline the detailed operation of the RERT.<sup>9</sup> AEMO must also have regard to the RERT guidelines, where relevant, when exercising the RERT. The RERT guidelines are published and amended from time to time

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<sup>5</sup> The process for amending the RERT Guidelines is contained in Rules clause 3.20.8(b).

<sup>6</sup> The process for amending the RERT procedures is contained in Rules clause 3.20.7(e). The Rules consultation procedures are set out in rule 8.9.

<sup>7</sup> The RERT provisions are contained in rule 3.20. The RERT Principles are contained in Rules clause 3.20.2.

<sup>8</sup> This process is found in section 88 of the NEL. The national electricity objective is found in section 7 of the NEL.

<sup>9</sup> The requirement for RERT Guidelines are contained in Rules clause 3.20.8.

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by the Reliability Panel. The RERT guidelines contain information relating to (amongst other things):<sup>10</sup>

- what information AEMO must take into account when deciding whether to exercise the RERT
  - the process AEMO should undertake in contracting for reserves, including the process for tendering for contracts for such reserves; and
  - any specific or additional assumptions about key parameters that AEMO must take into account in assessing the cost effectiveness of exercising the RERT.
- The RERT procedures, which also give the RERT operational effect, and are developed and amended from time to time by AEMO.<sup>11</sup> The RERT procedures include measures to be adopted in order to reduce the possibility that generating units or loads likely to be activated under reserve contracts are otherwise engaged at the time the reserves contracts are entered into by AEMO.<sup>12</sup>

To facilitate the Reliability Panel's proposed operation of the RERT in long-notice, medium-notice and short-notice situations, amendments will be made to the Rules, the RERT guidelines and the RERT procedures. The Commission can only assess the amendments to the Rules.

The current RERT process and the Reliability Panel's proposed amendments do not operate within the parameters (including the pricing parameters) of the wholesale electricity market. The maximum price of the reserve procured and deployed through the RERT is effectively decided by representatives of each of the NEM jurisdictions in response to an offer by reserve providers.<sup>13</sup>

Under the current RERT provisions AEMO can contract for scheduled or non-scheduled reserves up to nine months before a reserve shortfall is due to occur. The requirement for reserves is assessed against the reliability standard (a standard of unserved energy over the long term, which is set and reviewed by the Reliability Panel). The standard is operationalised by estimating minimum reserve levels required in each region of the NEM.<sup>14</sup> The RERT is 'enabled' if a shortfall in the minimum reserve levels is forecast.<sup>15</sup>

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<sup>10</sup> The requirement for RERT Guidelines are contained in Rules clause 3.20.8.

<sup>11</sup> The requirement for RERT procedures is contained in Rules clause 3.20.7(e).

<sup>12</sup> Rules clause 3.20.7(e).

<sup>13</sup> Reliability Panel Rule change proposal p13.

<sup>14</sup> More information on how the Reliability Standard is operationalised is found in Reliability Panel, Review of the Operational Arrangements for the Reliability Standard - Issues Paper, p.8.

<sup>15</sup> Reliability Panel, Review of the Operational Arrangements for the Reliability Standard - Issues paper, p.12.

The costs of invoking the RERT are recovered from market customers in the regions for which the reserves were engaged.<sup>16</sup>

The RERT arrangements (including the arrangements proposed in the Reliability Panel's Rule change proposal) will sunset in 2012.<sup>17</sup> In addition the Reliability Panel will undertake a review of all RERT arrangements in 2011.<sup>18</sup>

## 1.6 Proposed Operation of the RERT with Reliability Panel amendments

The Reliability Panel submitted proposed interim RERT guidelines as part of its Rule change proposal package, which provided an indication of the amended RERT processes for the proposed long-notice, medium-notice and short-notice RERT. These arrangements are summarised below.

*Proposed long-notice RERT – AEMO has at least ten weeks notice of a reserve shortfall*

The Reliability Panel's proposed interim amendments to the RERT guidelines state that AEMO is expected to conduct a full tender process to procure reserve contracts if it has more than ten weeks notice of an anticipated reserve shortfall. The full tender process would include requesting responses from members of the RERT Panel and other potential reserve providers. This process also involves consultation between AEMO and representatives of affected jurisdictions prior to procuring reserve contracts.

*Medium-notice RERT – AEMO has between ten and one weeks notice of a reserve shortfall*

The Reliability Panel's proposed interim amendments to the RERT Guidelines state that AEMO is expected to conduct a shortened tender process with only members of the RERT panel.

The RERT Panel would consist of entities that have resolved in advance with AEMO some of the technical and legal issues that lengthen the time taken to negotiate reserve contracts under the current full tender process. Once reserve providers are members of the RERT panel, reserve contracts could be finalised more quickly than through the full tender process.

*Short-notice RERT – AEMO has between seven days and three hours notice*

The Reliability Panel's proposed interim amendments to the RERT guidelines state that AEMO may procure reserve contracts from the members of the short-notice RERT Panel where AEMO has between seven days and three hours notice of a projected reserve shortfall. This panel will operate differently to that described above for the medium-notice RERT, as it would be necessary for AEMO to have already been negotiating with potential reserve providers and to have provisionally agreed to terms and conditions, technical requirements and offer processes before entering short-notice reserve contracts.

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<sup>16</sup> Rules clause 3.15.9.

<sup>17</sup> Rules clause 3.20.1.

<sup>18</sup> Rules clause 3.20.9.

## 1.7 Background – development of the Rule change proposal

### *Background to the Rule change proposal*

On 6 February 2009, the Ministerial Council on Energy (MCE) indicated that the AEMC would review energy market frameworks in light of the impact on electricity supplies of an extreme heatwave in southern Australia on 29-31 January 2009. This followed a number of reliability incidents (and a system security incident) in Victoria and South Australia in late January 2009.

On 3 March 2009, the AEMC issued the Reliability Panel with a Terms of Reference (TOR) for a review of the Operational Arrangements for the Reliability Standards. The TOR included a requirement for the Reliability Panel to consider the need and possible design for a short term version of the RERT that could be used in a critical emergency. The TOR also noted the desirability of implementing any appropriate changes (e.g to Guidelines or by proposing Rule changes) in a timely way for the 2009/10 summer.

On 1 May 2009, the Reliability Panel published an Exposure draft of a Rule change proposal for consultation with stakeholders.

### *Consultation on the Reliability Panel's exposure draft*

The Reliability Panel received six submissions from stakeholders on its exposure draft from the following parties:

- Ergon Energy;
- Energy Response;
- AEMO;
- The National Generators Forum;
- Origin Energy; and
- The South Australian Government.

## 1.8 Context - management of supply shortfalls

### *Price mechanisms*

The NEM is designed to provide electricity supply measured against a standard of unserved energy over the long term (the reliability standard). Incentives to invest in the provision of electricity supply capacity are provided through prices in the spot and contract markets. These prices are constrained by market price settings which include:

- the market price cap (maximum permitted market price);
- the floor price (minimum permitted market clearing price);

- the cumulative price threshold (cumulative spot price totalled over 336 half hour intervals, if this threshold is breached administered pricing is substituted for the market price until the high prices fall away); and
- the administered price cap (pricing that is substituted for the market price when the cumulative price threshold is breached).

These settings aim to balance the supply and demand of electricity to deliver capacity to meet the reliability standard, while avoiding unmanageable price risks for market participants.

#### *Intervention mechanisms*

AEMO has powers under the Rules to intervene in the market if capacity shortfalls arise through the market mechanism. AEMO's options for intervention are:

- Its power in the Rules to issue directions to certain market participants<sup>19</sup> to provide capacity. These participants are compensated for the direction based on a cost recovery methodology provided in the Rules.<sup>20</sup> Directions are issued at the time of dispatch (in the short-notice timeframe).
- Its power in the Rules to issue instructions to market participants. Instructions are usually to network service providers to shed electricity load. Currently network service providers shed electricity load according to a schedule provided by NEM jurisdictions. To a large extent however, electricity load is shed on an involuntary basis.

There is currently no provision under the Rules for compensation to be paid to customers whose electricity load is shed involuntarily through instructions. If customers wish to be shed voluntarily they may currently only do so through the market (for example by contracting with retailers, or participating in the market as scheduled loads) or to the extent permitted by jurisdictions through the load shedding schedule.

- Its power in the Rules to contract for reserves under the RERT mechanism. The RERT allows AEMO to contract for reserves up to nine months from when a reserve shortfall occurs. A further description of the operation of the RERT is included in section 1.5 above.

## **1.9 Consultation on the Reliability Panel's Rule change proposal**

The Reliability Panel requested that the Rule change proposal be assessed under an expedited process as an urgent proposal in accordance with section 96 of the NEL.

The expedited process provides for:

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<sup>19</sup> Directions apply to scheduled plant and market generating units as stated in Rules clause 4.8.9(a1)(1).

<sup>20</sup> Rules clauses 3.15.7 and 3.15.7A.

- a two week period for objections to the application of the expedited process to the Rule change proposal;
- four weeks of consultation on the merits of the Rule change proposal against the national electricity objective (two weeks of this consultation runs concurrently with consultation described above); and
- a total timeframe of six weeks for the publication of a final Rule determination.

The Reliability Panel considered the Rule change proposal as urgent as it considered that:

- providing for AEMO's procurement of reserves at short notice could be critical in managing a projected shortfall of reserves when there is only short notice; and
- it will be necessary to have the amended Rule, interim amendments to the RERT Guidelines, and interim amendments to the RERT Procedures in place by about October 2009 to ensure that AEMO has sufficient time to form a RERT panel to manage the amended RERT processes.

The Reliability Panel stated that failure to expedite the proposed Rule under section 96 of the NEL could create the risk of insufficient time for AEMO to form a RERT panel and have expressions of interest for reserve contracts that are available for short notice. This in turn could exacerbate the risk of AEMO not being prepared if a shortfall occurs at short notice in summer 2009/10.

The Commission decided to treat the proposal as a request for an urgent Rule subject to written objections.

The Commission considered the proposed Rule change to be urgent because the proposed RERT amendments are designed to provide AEMO with additional mechanisms to manage supply during the coming summer period. Summer is the period of peak demand, and is therefore the period most exposed to a short-notice shortfall in capacity, e.g. should there be a major technical failure of existing generation plant. The Commission considered that the RERT amendments would enhance AEMO's ability to maintain reliable supplies and avoid involuntary load shedding in these circumstances.

#### *Consultation on the expedited process*

The closing date for objections to the expedited process was 3 September 2009. The Commission received one objection submitted jointly by the NGF and ERAA<sup>21</sup>. The Commission considered the reasons provided in the objection to be misconceived or lacking in substance against its reasons for treating the Rule change proposal as urgent. In accordance with section 96 of the NEL. The Commission therefore continued to treat the Rule change proposal as a request for an urgent Rule (and therefore to be assessed under the expedited process).

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<sup>21</sup> NGF/ERAA objection submitted 3 September 2009. This is available on the AEMC website under the Improved RERT Flexibility and Short-notice Reserve Contracts project web page.

On 18 September 2009 the Commission notified the parties of its decision, including the reasons for its decision.<sup>22</sup>

*Consultation on the substance of the Rule change proposal*

The Commission received six submissions on the merits of the Rule change proposal. Submissions were received from:

- Energy Response;
- Total Environment Centre (TEC);
- NGF/ERAA;
- Energy Users Association of Australia (EUAA);
- Energy Supply Association of Australia (ESAA); and
- Macquarie Generation.

The submissions were largely not supportive of the proposed arrangements for a variety of reasons including:

- **That the proposed amendments are unlikely to elicit new capacity**, as the incentives favour reserve providers who are likely to be already participating in the market. Submissions stated that a scheme with more income certainty for smaller providers is required to elicit further capacity.<sup>23</sup>
- **The proposed amendments potentially distort the operation of the NEM energy only market**, as capacity may be withdrawn from the market in favour of potentially higher returns from participating in the amended RERT processes.<sup>24</sup>
- **The focus for delivering further capacity should be on the market.** The proposed RERT amendments represent further regulatory intervention in the market rather than a focus on the market mechanism. Submissions stated that the current RERT arrangements have rarely been called on, and therefore extensions were unnecessary.<sup>25</sup>
- **Further analysis of the costs and benefits of short-notice reserve procurement is required.** Given the development, assessment and implementation timeframes for the proposed arrangements, that further analysis of costs and benefits is

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<sup>22</sup> AEMC Letters to NGF and ERAA, 18 September 2009. This information is available on the AEMC website under the Improved RERT Flexibility and Short-notice Reserve Contracts project web page.

<sup>23</sup> Energy Response submission, p1, TEC submission, p1.

<sup>24</sup> NGF/ERAA submission, p. 1; EUAA, p. 2, ESAA, p. 2; Macquarie Generation submission, p. 1.

<sup>25</sup> NGF/ERAA submission pp. 2 and ;, EUAA submission p. 2.

required.<sup>26</sup> In addition some particular costs that required analysis were raised including:

- the administrative burden of the arrangements;<sup>27</sup>
- costs to retailers and consumers from increased scope of intervention;<sup>28</sup> and
- monitoring that reserve providers do not receive payments for capacity through the proposed arrangements and other mechanisms at the same time (this is known as “double dipping”).<sup>29</sup>

Further detail of the points raised in submissions, and the Commission’s response to these points are contained in Appendix A to the this final Rule determination.

### **1.10 Extensions of time for publishing the final Rule determination**

On 1 October 2009, the Commission issued a notice under section 107 of the NEL extending the time for the publication of the final Rule determination for 1 week. This extension was required for the Commission to sufficiently analyse difficult and complex matters identified by the Commission’s own analysis and raised in submissions to the Rule change proposal (including late submissions).

On 8 October 2009 the Commission issued a further notice under section 107 of the NEL extending the time for the publication of the final Rule determination for a further 1 week period. This further extension was again for the Commission to adequately consider complex and difficult matters raised in submissions to the Rule change proposal and the Commission’s own analysis.

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<sup>26</sup> NGF/ERAA submission, p3, EUAA submission, p4.

<sup>27</sup> Energy Response submission, p2.

<sup>28</sup> Macquarie Generation submission, p1.

<sup>29</sup> Energy response submission, p2.

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## 2 Rule Determination

### 2.1 The Commission's Determination

The Commission has made and published this Rule determination in accordance with section 102 of the NEL. The Commission has made the *National Electricity Amendment (Improved RERT Flexibility and Short-notice Reserve Contracts) Rule 2009* (Rule as Made) in accordance with section 103 of the NEL. The Rule as Made adopts the position of the Rule change proposal.

The Rule as Made will commence on 15 October 2009.

### 2.2 The Commission's considerations

This Rule determination sets out the Commission's reasons for making the Rule as Made. In coming to its decision in favour of the Rule as Made, the Commission has taken into account:

- the Commission's powers under the NEL to make the Rule as Made;
- the Rule change proposal and proposed Rule;
- the submissions received on the Rule change proposal;
- relevant material that informs the Rule change proposal;
- the Commission's analysis as to the ways in which the Rule change proposal will or is likely to, contribute the achievement of the NEO so that the Rule making test is satisfied.

The Commission considers the Rule as Made will, or is likely to, contribute to the achievement of the NEO. The Rule as Made satisfies the Rule making test as the proposal has scope to deliver potentially significant economic benefits if the risk of capacity shortfalls materialises. The RERT is a mechanism that potentially delivers a more efficient use of electricity services by enabling supply to be maintained to those who value it most. The proposed amendments to the RERT do this more effectively than the current RERT because it enables the assessment of the need for additional capacity to be undertaken, and acted, on much closer to real time. Significant new information relevant to an assessment of the adequacy of capacity can reveal itself close to real time.

The proposed amendments have significant safeguards to minimise potential distortions to the market if the risk of capacity shortfalls does not materialise. While there is uncertainty over how much additional capacity could potentially be drawn into the mechanism, the application of the amended mechanism will improve information in this regard. Such information will be relevant and useful in the planned review of these and related arrangements in 2012.

The proposed Rule therefore addresses a clear gap in the current arrangements, whereby the opportunity to enhance economic welfare through targeted intervention is missed because of the practicalities of timescales required to respond to new information. Further, while the likelihood of intervention being required is low, it cannot be discounted entirely – and under some circumstances the efficiency benefits could be potentially very large.

### **2.3 The Commission’s power to make the Rule**

The Commission is satisfied that the Rule as Made falls within the subject matters for which the Commission may make a Rule as set out in section 34 of the NEL and in schedule 1 to the NEL. The proposed Rule is within the matters set out in:

- section 34(1)(a)(i) of the NEL relating to the operation of the national electricity market;
- section 34(1)(a)(ii) of the NEL relating to the operation of the national electricity system for the purposes of the safety, security, and reliability of that system;
- section 34(1)(a)(iii) of the NEL relating to the activities of persons (including Registered Participants) participating in the national electricity market or involved in the operation of the national electricity system;
- item 11 of Schedule 1 of the NEL (the operation of generating systems, transmission systems distribution systems or other facilities, in that the proposed Rule relates to AEMO’s power to procure and dispatch contracted reserves and non-scheduled reserves) as it relates to AEMO’s power to procure and dispatch contracted reserves and non-scheduled reserves;
- item 33(b) of Schedule 1 of the NEL as it relates to a review by the Reliability Panel.

### **2.4 MCE statements of policy principles**

The NEL also requires the Commission to have regard to any MCE statements of policy principles in making a Rule under the NEL. The Commission notes that there are no relevant MCE statements of policy principles to which it must have regard for this Rule change proposal.

### **3 Commission's assessment of the Proposed Rule against the National Electricity Objective**

This chapter sets out the Commission's assessment of the Rule change proposal and its reasons for making the Rule as Made.

#### **3.1 Rule making test and the National Electricity Objective**

The Rule making test states that 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 objective of the NEL 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 NEO is founded on the concepts of:

- economic efficiency (including productive, allocative and dynamic dimensions of efficiency);
- good regulatory practice (which refers to the means by which regulatory arrangements are designed and operated); and
- reliability, safety and security priorities.

#### **3.2 Analysis of the relevant issues**

This section presents the Commission's analysis of issues that were raised in the Reliability Panel's Rule change proposal and submissions. It discusses the various issues in turn, then draws together an overall assessment of the Rule proposal against the Rule making test.

##### **3.2.1 The effective use of capacity reserves**

###### **3.2.1.1 Rule proposal and submissions**

The Reliability Panel's Rule proposal states that the proposed amendments are likely to lead to more efficient utilisation of potential electricity services during critical emergencies. This is achieved by providing a mechanism that enables additional capacity reserves over and above those already in the NEM to be called on at short-notice, potentially reducing the need for involuntary load shedding during power system reliability and security incidents.

### 3.2.1.2 The Commission's analysis

The facet of the NEO that has most relevance to the consideration of this particular consequence of the Rule proposal would appear to be the efficient operation and use of electricity services with respect to the price and reliability of electricity.

If there is a lack of capacity, then AEMO might need to shed load (i.e. cut supply) to individual or groups of customers on a managed basis, in order to maintain the security of the power system. This is to avoid much larger, longer interruptions to supply if the security of the power system is compromised.

The wholesale market price is capped at \$10 000 per MWh. This price cap will determine an amount of capacity that it is economic to sell in the market. For example, if a source of additional capacity could deliver energy at a cost of \$15 000 per MWh, then it would not be sold in the market because no market participant would have an incentive to buy it. The price cap is set at a level designed to be sufficient to ensure adequate capacity to meet the desired reliability standard, and is reviewed periodically by the Reliability Panel with this objective in mind.

If, for whatever reason, there is a lack of capacity presented by the market, then in some circumstances it can be more efficient for AEMO to seek to buy additional capacity (that could potentially deliver energy at a cost above \$10 000 per MWh) rather than invoke involuntary load shedding. There is an economic efficiency because involuntary load shedding does not differentiate between customers who place a very high value on continuing supply and customers who place a lower value on continuing supply. A mechanism which enables supply to be maintained to those who value it most will deliver a more efficient use of electricity services.

The RERT represents a mechanism that enables this efficiency gain to be more effectively captured. It does this by providing a means for:

- parties who have non-market generation capacity to make themselves known to AEMO - and to declare what price those parties would need to be paid to use the non-market generation capacity; and
- individual or groups of consumers to declare what remuneration they would need to have their load shed voluntarily.

The proposed Rule does this more effectively than the current RERT because it enables the assessment of the need for additional capacity to be undertaken, and acted on, much closer to real time. The RERT panel reduces lead times from around 10 weeks to around 1 week, and the Short Term RERT panel reduces lead times to a few hours. Significant new information relevant to an assessment of the adequacy of capacity can reveal itself close to real time. The information available to AEMO to assess capacity adequacy ten weeks out can therefore be quite different to the information available a few days or hours out. New information might relate to the availability and level of performance of particular generation plant, and the level of likely demand. To illustrate, in late January 2009 in Victoria and South Australia new information was revealed in short term about the maximum physical availability of individual generators, and about the level of demand.

The value of this potential efficiency saving is inherently difficult to quantify. It depends on the likelihood of capacity shortfalls occurring, the range of values placed on continuing supply by different consumers, and the availability and cost of non-market generation. There are, however, some observations that can be made.

- First, the range of values that customers place on continuing supply is very wide. For example, AEMO routinely assumes an average value of customer reliability of \$47 850 per MWh when undertaking analysis of the costs and benefits of prospective transmission investments in Victoria.<sup>30</sup> In contrast, some relatively large reductions in demand from industrial users have been observed in response to high prices in the market, which implies a value for those businesses of less than \$10 000 per MWh at those times.
- Second, public statements by interested parties suggest that there are large volumes of latent capacity (in the form of non-market generation or demand response) available to be drawn on if required. In the context of the load shedding events in Victoria in January 2009, Ross Fraser (chairman, Energy Response) was reported as saying “more than 1000 megawatts of capacity in Victoria could be contracted back into the system”.<sup>31</sup> Similarly, EUAA executive director, Roman Domanski, was reported as estimating load reduction to be a potential 1000 to 2000 megawatts.<sup>32</sup>
- Third, while the likelihood of reserve shortfalls occurring remains low, it is heightened at times when the surplus of capacity over and above Minimum Reserve Levels is relatively low. The period covered by the Rule proposal (i.e. up to June 2012) is a period in which capacity margins are forecast to be at historically low levels in some regions. This risk materialised in Victoria and South Australia in January 2009, where levels of available capacity were one (relatively small) contributory factor to overall levels of involuntary load shedding.
- Fourth, we note the rationale for the current RERT stated by the Reliability Panel in its Comprehensive Reliability Review. Specifically, that there appear to be risks, e.g. associated with external policy factors and movements in input costs, to the attainment of the reliability standard under the prevailing market settings. Further, that on balance it was prudent to maintain a revised form of the Reserve Trader provisions in the Rules, with an explicit sunset date of June 2012.
- Fifth, we note that the current framework provides for individual jurisdictions to issue guidance to AEMO on how to manage involuntary load shedding, if it is required. This provides for some targeting of load-shedding on economic grounds, e.g. by requiring the supply to hospitals and other essential facilities to be maintained where practicable. These arrangements lack transparency and

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<sup>30</sup> VENCORP, 2009 Annual Planning Report, p. 113.

<sup>31</sup> The Age, 2 February 2009. In this context, we also note the submission from Energy Response to the consultation on this Rule proposal that the absence of guaranteed funding to bring additional capacity in to the RERT will reduce its effectiveness. We also note similar comments made by TEC in its submission.

<sup>32</sup> The Australian, 4 February 2009.

precision. Hence, they are unlikely to capture the potential benefits of targeting load shedding as effectively as the RERT.

- Sixth, the RERT mechanism is scheduled to lapse in June 2012, and there will be a review of its operation, in concert with other related issues, in 2011. There is therefore an early review point, in the light of new information on practical operation.

### **3.2.1.3 The Commission's position**

The proposed Rule addresses a clear gap in the current arrangements, whereby the opportunity to enhance economic welfare through targeted intervention is missed because of the practicalities of timescales required to respond to new information. Further, while the likelihood of the intervention being required is low, it cannot be discounted entirely – and under some circumstances the efficiency benefits could potentially be very large.

## **3.2.2 Potential interactions between the amended RERT and the contract market**

### **3.2.2.1 Rule proposal and submissions**

The Reliability Panel, in referring back to its earlier Comprehensive Reliability Review, recognised that the RERT is a market distortion. It also noted that the RERT has been designed to impose minimal distortion on the market. It was noted that this objective is embodied in the RERT principles.

Some submissions expressed concern that the Rule proposal would have the effect of distorting the operation of the market,<sup>33</sup> by implication to a greater extent than the current RERT.

### **3.2.2.2 The Commission's analysis**

The facet of the NEO that has most relevance to the consideration of this particular consequence of the Rule proposal would appear to be the efficient operation and use of electricity services with respect to the price and reliability of electricity.

The Commission in making the Rule to give effect to the current RERT, recognised the potential for market distortion, and concluded that, on balance, it still met the Rule making test, given the potential benefits of the mechanism. The potential for the current RERT, and modified RERT as proposed, to create a market distortion remains a concern. There are, however, constraints around the operation of the current RERT – and, by extension, the RERT amended pursuant to this Rule proposal:

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<sup>33</sup> NGF/ERAA submission, p1; EUAA submission, p. 2;; ESAA submission, p. 2; Macquarie generation submission, p. 1.

- First, intervention is limited to the short-term, and as a last resort.
- Second, capacity which is already scheduled in the market cannot offer itself under the RERT.
- Third, if the RERT is invoked and additional contracted capacity is dispatched, then the market is priced ‘as if’ the capacity had not been available. This ensures that the long-term price signal provided through the spot market is not diluted as a result of the intervention.
- Fourth, because the RERT is only invoked as a last resort, there is risk associated with a commercial strategy which relies on it being invoked. If capacity is economic in the market, then a more certain strategy is to sell that capacity in the market. Holding back capacity in the hope of the RERT being invoked appears to be a relatively high-risk strategy.

As noted in the previous section, the objective of the RERT is to contract additional capacity that would not be viable in the market at the prevailing market price cap at times of capacity shortfall. This provides additional options for AEMO before resorting to involuntary load shedding. Further, using these options can result in more efficient outcomes.

However, in this context, there is a residual, theoretical risk that currently non-scheduled capacity that could be economic in the market seeks to obtain additional revenue through the RERT. Potentially, the extension of the RERT into timescales close to real time increases this theoretical risk. This is because decisions over whether to sell in the market or hold out for the RERT contract can be made closer to real time, when there is more accurate information available as to the likelihood of a RERT contract being invoked. In such circumstances there would be no net additional capacity – and therefore no efficiency benefits. Rather, there would be a net economic cost, given that the capacity will be remunerated more generously under the RERT than through the market. The net cost to consumers would be further inflated if providers of capacity were able to sell the same capacity in both the market and the RERT. This is termed “double dipping” and is prohibited under the RERT arrangements. Capacity may only be offered to AEMO under the RERT if it is not already contracted for, and any change in the contracted status must be notified to AEMO.

While the reclassification into the RERT of some capacity that would be economically viable in the market is a possible distortion, the Commission is not aware of any evidence of this type of behaviour under the current RERT arrangements. Further, while eligibility criteria could potentially be introduced seeking to exclude providers that are commercially viable in the market, this appears to be administratively complex and retains a residual risk that such capacity is not contracted for in the short term market. Finally, and most significantly, it appears impractical to introduce measures that seek to limit the scope of potential market distortions without also constraining the ability of genuine increases in net capacity (i.e. capacity which would not be viable in the market absent the RERT) to reveal themselves.

### **3.2.2.3 The Commission's position**

The Commission recognises the potential for the RERT to distort behaviour in the market. This is also explicitly recognised by the Rule proponent, the Reliability Panel.

However, the Commission notes the range of factors in place to constrain the scope and materiality of such potential distortions. There is also a lack of evidence that such distortions have been material in the past. Further, that it appears impractical to introduce additional measures into the design without also constraining the ability to attract genuine new capacity into the mechanism, and hence capture the efficiency benefits discussed in the previous section.

### **3.2.3 Administrative and other costs**

#### **3.2.3.1 Rule proposal and submissions**

The Rule proposal implies additional costs being incurred by AEMO and, potentially, by others. The proponent noted such costs, but did not seek to quantify them. Submissions also identified potential costs, and expressed concern that they might be significant. No explicit quantification of costs was provided in submissions, although concern was expressed about the adequacy of the analysis of benefits and costs provided by the Rule proponent.

#### **3.2.3.2 The Commission's analysis**

The facet of the NEO that has most relevance to the consideration of this particular consequence of the Rule proposal would appear to be the efficient operation and use of electricity services with respect to the price and reliability of electricity.

There are two broad types of cost increases potentially attributable to the Rule proposal, over and above the direct costs of the contracts that would be incurred by AEMO pursuant to the Rule proposal if it were made:

- AEMO administration costs; and
- market participant administration and risk management costs.

The proposed Rule would involve AEMO undertaking additional activities to obtain offers from prospective providers of capacity, to understand the technical nature and potential limitations of each offer, to consult with jurisdictions, and to monitor the need to invoke the contracts at its disposal. These costs will form part of the general operating costs of AEMO, recoverable through market fees. Under the Rule as proposed, these additional costs would be incurred until 2012, when the ability for AEMO to contract for capacity under the RERT is scheduled to lapse. Given that this would represent an incremental change to the level of costs currently being recovered, and would not alter the vehicle for cost recovery, we do not anticipate any net additional administrative costs for the parties who are liable for market fees.

The second class of costs attributable to the Rule proposal relates to how the costs of using RERT contracts are recovered by AEMO. This would represent a net increase in costs compared to the current arrangements if the Rule proposal resulted in RERT contracts being used more extensively. The net additional costs incurred by AEMO would be recovered via market fees and, in turn, the parties liable to pay market fees would seek to recover the additional costs from their respective customers. The ability to recover such costs will be influenced by the nature and extent of regulation and competition in those markets, and the extent to which the additional costs are borne by all businesses active in those markets. There are likely to be administrative costs associated in managing this consequent process of cost recovery, e.g. to adjust prices or invoke terms in contracts.

There are also likely to be costs associated with managing the risk of additional costs being incurred. The parties liable to fund AEMO's costs should it use RERT contracts do not know in advance whether the costs will be incurred or not, or what level of costs will be incurred. Though subject to jurisdictional approval, there is no formal limit on the total costs incurred by AEMO, and the period for payment could be relatively short. This implies a net increase in working capital, which has an associated cost.

The Commission notes the comments of one submission that the Rule proposal implicitly establishes a more demanding reliability standard. If this were the case, then a relevant consideration for the assessment of the Rule proposal would be the extent of any additional costs. However, the Commission does not consider the Rule proposal to alter the overall reliability standard and the ways which the standard is applied operationally in the short term. The market settings and associated mechanisms, including the RERT, are designed with reference to a target standard of 0.002% unserved energy. This is made operational by AEMO through the use of Minimum Reserve Levels, which are continuously monitored up to the time of dispatch. The Rule proposal does not alter this framework.

It is also important to note that, to the extent that the proposed Rule results in less frequent use of involuntary load shedding, then the direct and indirect costs of administering involuntary load shedding will be reduced.

### **3.2.3.3 The Commission's position**

The Commission recognises that additional costs would be incurred if the Rule proposal were made. The Commission notes that the costs appear to be primarily administrative in nature, and have not been explicitly quantified by the proponent or through evidence provided in submissions. The presence of likely costs are, however, a relevant consideration in assessing the proposal overall in the context of the economic benefits of making less frequent use of involuntary load shedding.

### **3.3 Overall assessment against the Rule making test**

The Commission recognises that there are a range of factors to consider in assessing this proposal against the Rule making test, and that the evidence to inform the assessment is mainly qualitative.

The proposal has scope to deliver potentially significant economic benefits if the risk of capacity shortfalls materialises. Further, there are significant safeguards to ensure that it minimises potential distortions to the market if the risk of capacity shortfalls does not materialise. There is uncertainty over how much additional capacity could potentially be drawn in to the mechanism, and the application of the amended mechanism will improve information in this regard. Such information will be relevant and useful in the planned review of these and related arrangements in 2011.

The Commission has therefore concluded that the Rule proposal meets the Rule making test.

## A Summary of submissions

This appendix lists the main points made in submissions in respect of the merits of the Rule change proposal and the Commission’s response to those points. These views are reflected in the Commission’s analysis and decision.

Key point	Stakeholder	Commission response
The proposed RERT arrangements favour large end users. This may impede access to medium and small demand side providers and therefore not elicit new capacity, as large end users would most likely already be participating in the market.	Energy Response, TEC	The Commission considers that the proposed arrangements will provide additional capacity. Furthermore there are no restrictions on who can bid, and alternative models to remunerate panel membership would have larger distortionary effects on the market.
Issue of double dipping.	Energy Response	The Commission considers this to be a valid issue, and one that existed prior to the introduction of the proposed arrangements. The Commission considers that current safeguards are appropriate, but should be monitored.
The administrative burden the scheme will place on AEMO will be overbearing.	Energy Response	The Commission recognises that there will be costs for administering the scheme and the Commission has had regard to this in making an overall assessment of the Rule.
The scheme will not be effective as an emergency supply as the capacity is not required to be firm.	Energy Response, TEC	The Commission considers that it is inappropriate to limit the proposed arrangements to only accept firm capacity. Non-firm capacity might still be useful and valuable.

Key point	Stakeholder	Commission response
The proposed amendments represent a distortion to the market, including a distortion to the short-term contract market.	ERAA/NGF, EUAA, ESAA, Macquarie Generation	The Commission notes the Reliability Panel's view that the original RERT mechanism and the proposed arrangements constitute a distortion to the market. However, overall the Commission considers that the proposed arrangements are likely to elicit new capacity for use at short notice. Furthermore, steps to minimise the distortionary effects of the mechanism (such as intervention pricing of the market when the RERT is invoked) are in place.
It is poor policy to develop a sub market for reserve. The focus should be in bringing additional capacity into the market.	ERAA/NGF, EUAA	The proposed arrangements retain the primary role of the market in signalling the need for capacity. They are designed to strengthen the effectiveness of the 'safety net' if the market does not present capacity, recognising that customers might place a value of supply in excess of the market price cap.
The RERT panel is too complex. There are simpler ways to bring in additional capacity such as amending the existing directions power.	ERAA/NGF	The proposed arrangements do not appear to be unduly complex. The Commission is not persuaded that alternatives would necessarily be any less complex.
The Reliability Panel has not made a case that the proposal advances the NEO, including insufficient analysis of the costs and benefits.	ERAA/NGF, EUAA	It is the role of the Commission to assess the proposal against the NEO. This determination sets out that analysis.

Key point	Stakeholder	Commission response
The proposed Rule creates an inconsistency in the pricing of power system security in the NEM.	ERAA/NGF	The Commission considers that a key principle in exercising the RERT is that AEMO must take actions that have the least distortionary effect on the market (as stated in clause 3.20.2(b) of the Rules). There is also the practical consideration of the difference between security and reliability events close to real time.
The proposal represents regulatory creep and a lack of faith in the market to deliver reliability.	ERAA/NGF, EUAA	The Commission considers that in introducing the proposed arrangements the primary role of the market is retained. While the Commission recognises there is some distortion, it has assessed the arrangements against the NEO. The Commission further notes that a review of the arrangements will be undertaken by the Reliability Panel in 2011.
The Commission should ensure the presence of small and medium size demand side providers. Other mechanisms such as a standing reserve are therefore more preferable.	TEC	The objective of the Rule change proposal is to elicit further capacity in an economically efficient manner, through the parameters of the scheme for deployment at short notice. Favours particular sectors of the reserve market (particularly if they are not economic) would not be likely to promote the NEO. The Commission further notes that ex-ante payments would be a greater distortion to the energy only market.
The proposed arrangements will provide an implicit change to the reliability standard.	ESAA	The Commission considers that in short term timeframes the reliability standard is currently operationalised by AEMO through monitoring against the lack of reserve level 2 (LOR 2). This will not change as a result of the proposal.

Key point	Stakeholder	Commission response
To minimise distortionary effects of the proposed arrangements, intervention pricing should be adopted during RERT events.	Macquarie Generation	Exercise of the RERT (including the proposed arrangements) is an AEMO intervention event, and intervention pricing under the Rules is applicable.
AEMO should be required to conduct an ex-post review should it enter a reserve contract. In particular the review should focus on whether the AEMO forecast was reasonable given the actual demand levels.	Macquarie Generation	There are currently review arrangements provided in the Rules, for when AEMO activates or dispatches the RERT. Extending the review provision has some merit, however given the timeframes to assess this Rule change proposal (due to its urgency and the late lodgement of the submission) the Commission has been unable to consider the effects of the implementation of this proposal. The Commission recommends that this issue receive further consideration in the upcoming review of the RERT arrangements (in 2011), and in the implementation of the amended RERT Guidelines (due by 30 June 2010).
The LOR 2 trigger for the proposed arrangements should be built into the Rules not the RERT Guidelines.	Macquarie Generation	The Commission considers that the RERT Guidelines are appropriate to contain the trigger for the exercise of the RERT. This is consistent with the operational issues dealt with in the Guidelines and overseen by the Reliability Panel.
The RERT Guidelines should define the circumstances that the RERT can be used in system security events.	Macquarie Generation	This is an issue for the Reliability Panel to consider for inclusion in the RERT Guidelines. The certainty of added prescription needs to be balanced with adding complexity to decisions, and the practical difficulty of distinguishing between security and reliability close to real time.