

**Australian Energy Market Commission
Reliability Panel**

Review of VoLL 2008

Final determination

April 2008

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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.

About the AEMC Reliability Panel

The Panel is a specialist body within the AEMC and comprises industry and consumer representatives. It is responsible for monitoring, reviewing and reporting on the safety, security and reliability of the national electricity system and advising the AEMC in respect of such matters. The Panel's responsibilities are specified in section 38 of the NEL.

Disclaimer

The views and recommendations set out in this document are those of the Reliability Panel and are not necessarily those of the Australian Energy Market Commission.

Reliability Panel Members

Chairman

Ian C Woodward, Commissioner, Australian Energy Market Commission

Other AEMC Reliability Panel Members

Kerry Connors, Executive Officer, Consumer Utilities Advocacy Centre

Jeff Dimery, General Manager, Merchant Power, AGL Energy

Mark Grenning, Chief Advisor Energy, Rio Tinto

Les Hosking, Managing Director and CEO, NEMMCO

Gordon Jardine, Chief Executive, Powerlink

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1 Introduction

This paper presents the final determination by the Reliability Panel (the Panel) of the 2008 review of the Value of Lost Load (VoLL) and market floor price. Under clauses 3.9.4(c) and 3.9.6(c) of the National Electricity Rules (Rules), the Panel is required to conduct such a review by 30 April each year with any changes to take effect from July two years after the determination is made.¹

2 Context – Comprehensive Reliability Review

The AEMC requested the Panel to undertake, in a comprehensive and integrated process, several reviews relating to a number of key NEM reliability standards and parameters, including VoLL, the market floor price and the and Cumulative Price Threshold (CPT). The Reliability Panel published its Final Report for the Comprehensive Reliability Review (CRR)² on 21 December 2007.

3 Requirements under the Rules

The Panel is required under clause 3.9.4(c) and 3.9.6(c) of the Rules to review VoLL and the market floor price by 30 April each year.

Clause 3.9.4(c) states that:

- (c) By 30 April each year *the Reliability Panel* must conduct a review in accordance with the *Rules consultation procedures* and publish a report on the value of *VoLL* that it recommends should apply from 1 July in the year commencing 2 years after the year in which the review is conducted. In conducting a review in accordance with this clause 3.9.4(c) *the Reliability Panel* must have regard, in addition to any other Rules obligations, to the potential impact of any proposed increase in *VoLL* on:
 - (1) spot prices;
 - (2) investment in the national electricity market; and
 - (3) the reliability of the power system.

Clauses 3.9.4(c1) and (c2) outline what the Panel must consider in undertaking the Review:

- (c1) The value of *VoLL* recommended by the *Reliability Panel* must be a level which the *Reliability Panel* considers will:

¹ In certain circumstances, the Panel may change the level of VoLL to take effect one year after its determination – Rules 3.9.4(d). The Panel does not propose to do so here.

² The Panel’s Final Report of the CRR appears on the AEMC’s website at www.aemc.gov.au/electricity.php?r=20051215.142656.

- (1) allow the standard for reliability established by the *Reliability Panel* as part of the *power system security and reliability standards* to be satisfied without use of NEMMCO's powers to intervene under clauses 4.8.6(a) and 4.8.9(a);
 - (2) in conjunction with other provisions of the *Rules*, not create risks which threaten the overall integrity of the *market*; and
 - (3) take into account any other matters the *Reliability Panel* considers relevant.
- (c2) The *Reliability Panel's* report must set out the conclusions of its review and the recommendation in relation to the level of *VoLL* along with supporting information including:
- (1) details of all relevant *market* conditions and circumstances on which the recommendation is based; and
 - (2) an assessment of whether the level of *VoLL* together with the operation of the *cumulative price threshold* has achieved the objectives set out in clauses 3.9.4(c1)(1) and (2).

Clause 3.9.6 (c) states that:

- (c) By 30 April each year the *Reliability Panel* must, as part of its review of *VoLL* under clause 3.9.4(c), conduct a review in accordance with the *Rules consultation procedures* and publish a report on the value of the *market floor price* that it recommends should apply from 1 July in the year commencing after the year in which the review is conducted.

Further, clauses 3.9.6 (d) and (e) outline what the Panel must consider in reaching a conclusion:

- (d) The value of the *market floor price* recommended by the *Reliability Panel* must be a level which the *Reliability Panel* considers will:
 - (1) allow the *market* to clear in most circumstances;
 - (2) not create substantial risks which threaten the overall stability and integrity of the *market*; and
 - (3) take into account any other matters the *Reliability Panel* considers relevant.
- (e) The *Reliability Panel's* report must set out the conclusions of its review and the recommendation in relation to the level of the *market floor price*, including details of all relevant *market* conditions and circumstances on which the recommendation is based.

In addition, clause 3.12.1 (b) as referred to under Part 7 of Chapter 8A states that:

- (b) The Reliability Panel must, at the same time as it conducts a review of VoLL under clause 3.9.4(c), recommend whether the reliability safety net provided for by the power granted to NEMMCO under this clause 3.12.1 to enter into reserve contracts or non-scheduled reserve contracts can be removed from the Rules prior to 1 July 2008.

4 Current Settings

VoLL is currently set at \$10,000/MWh and the market floor price is set at -\$1,000/MWh. The CPT is the cap for the cumulative price over a rolling 7-day, 336 trading interval, period and is currently set at \$150,000/MWh. The cumulative price exceeds this threshold then administered prices are invoked. The administered prices are set by the AEMC (previously by NECA) and are currently at \$100/MWh for peak periods and \$50/MWh for off-peak periods. The AEMC is currently reviewing the schedule for the Administered Price Cap with a final report to be published by the Commission on 24 April 2008³.

5 Final Determination – 2008 VoLL Review

The Panel's Final Determination for the 2008 review of the Value of Lost Load (VoLL) is formed from the Panel's recommendations and conclusions in the Final Report of the CRR.

The Panel has decided not to perform a further formal VoLL review in 2008 because it has just completed the CRR, which was a comprehensive review of the reliability mechanisms in the NEM and included a robust analysis of the level of VoLL. Therefore, for the purposes of this Final Determination, the Panel intends to adopt the recommendations in the CRR. That is, on balance, the Panel considers that raising VoLL in the medium term is the prudent approach given the risks identified and the constraints of an energy-only market. The Panel intends to put forward a Rule change proposal to the AEMC to raise VoLL to \$12,500 effective 1 July 2010. The Panel notes that the proposed level of VoLL to apply from 2010 would reflect a similar level of the current level of VoLL (set five years ago) and indexed either for inflation or for cost increases. The Panel is not recommending an automatic indexation of the level of VoLL, but rather the ability to review its level in the context of all the reliability settings every two years, with at least a two year notification period of any proposed change.

The Panel recommends that the Market Floor Price should remain unchanged at -\$1,000/MWh.

In addition, the Panel recommended in the final report for the CRR that the CPT should be similarly raised to \$187,500 by explicitly specifying the value of the CPT as 15 times VoLL. This recommendation does not form part of the 2008 VoLL review.

³ Further information is available on the AEMC website at www.aemc.gov.au/electricity.php?r=20071105.151356

These matters will be subject to the formal Rule change process and consultations by the AEMC. Due to the impact on the market that a change in the level of VoLL would have, the Panel intends to first issue an exposure draft of its Rule change proposal in order to gain stakeholder feedback prior to submitting the proposal to the AEMC for consideration. The exposure draft would be published by the Panel in April or May 2008 and then subject to consultation, with the aim of submitting the final Rule change proposal to the AEMC in the second half of 2008 to have effect from 1 July 2010.

6 Final Determination – Reliability Safety Net

The Panel also considered in the CRR whether the reliability safety net (Reserve Trader) should be retained in some form or removed from the Rules. The Panel recommended in the CRR that the current safety net or 'Reserve Trader' should be redesigned to become a Reliability and Emergency Reserve Trader (RERT); and that this mechanism should be retained for a sunset period of four years.

The Panel issued an exposure draft that included the RERT as part of the recommendations contained in the Second Interim Report of the CRR, published in August 2007. With the benefit of amendments suggested through stakeholder responses in the Review consultations, and broad support for the proposal, the Panel intends to submit the recommendation, by way of a formal Rule change proposal to the AEMC, in the first quarter 2008. This should allow its consideration ahead of the current expiry date for the existing 'Reserve Trader' of 30 June 2008.

A Rule change package which addresses the re-designed reserve trader (RERT) has been submitted in early 2008. The content of this Rule change has already had extensive consultation through an exposure draft in the Second Interim Report.

7 CRR Recommendation – Review Cycle and Renaming VoLL

The Panel recommended in the final report of the CRR that the current annual review of VoLL should be replaced by a Reliability Standards and Mechanisms review of all the reliability settings (i.e. the reliability standard, VoLL (MPL), the CPT, the market floor price, the RERT and any additional reliability mechanisms) that should take place every two years. With respect to any recommendations from the biannual Review which may suggest changes to VoLL, the market floor price and the CPT, there should be a two year notification period. In essence, this process means an average four-year cycle of potential changes which appears to be a balanced and appropriate time scale.

As discussed in its final CRR report, the Panel also considers that, to reflect its true nature as a limit on prices in the market, VoLL should be renamed the Market Price Limit (MPL).

A Rule change package, which addresses the name of VoLL (to be changed to the Maximum Price Limit (MPL)) and the timing and process of future review of the reliability settings (the cycle of which would commence from 2010), will be submitted in 2008.

8 Consultation

The Panel published its VoLL 2008 Review draft determination on 21 February 2008 and sought comments from stakeholders by 27 March 2008. There was only one submission received from the Energy Retailers Association of Australia supporting the Panel's proposal not to perform a further formal VoLL review in 2008.