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Dear Dr Tamblyn

## SHORT-NOTICE RESERVE CONTRACTS

Macquarie Generation appreciates the opportunity to comment on the proposed National Electricity Amendment (*Improved RERT flexibility and short-notice reserve contracts*) Rule 2009, released for public comment on 20 August 2009.

Macquarie Generation strongly opposes the package of measures detailed in the Reliability Panel's proposed Rule change. The use of centralised, administrative mechanisms to recruit reserves runs completely counter to the concept of using a gross energy market to elicit efficient supply and demand responses. The shift away from relying on market price signals creates the risk that system operator will become increasingly involved in making judgements about when and how reserve services are recruited and activated.

The move to give the system operator greater responsibility and control in managing market outcomes has a number of weaknesses:

- The proposed changes will dampen the incentive for new generation investors to commit to new projects if the risk exists that the frequency and duration of high price events will be reduced. The NEM framework relies on short periods of volatile prices to offset the high fixed costs associated with investing in generation facilities.
- Demand side providers may find it more profitable to offer demand curtailment through the RERT mechanisms than through directly contracting with retailers or demand side aggregators. By moderating the incentive to offer a demand side response through normal commercial arrangements, the system operator may find that it is increasingly necessary to activate the RERT arrangements to mitigate reliability problems. There is also a high risk that the RERT will further delay the development of an efficient demand side response in the NEM.

To date, the NEM has never called on ‘reserve trader’ arrangements to address a reliability problem and the NEM has performed exceptionally well in delivering a reliable supply at efficient prices.

Overall, the NEM has consistently satisfied the long term unserved energy target of 0.002 USE per annum and AEMO does not anticipate that this target will be breached in 2009-10. The proposed medium and short-term RERT mechanisms will only serve to weaken existing market signals and may actually create reliability problems where none currently exist.

### *Specific issues with the RERT proposals*

Macquarie Generation accepts that there is a willingness by the MCE and Reliability Panel to put in place shorter notice RERT arrangements to enable the system operator to respond to emergency or unanticipated reliability and security problems. While the distortionary effects of the RERT arrangements are likely to outweigh any short-term benefits, we would like to propose some changes that would mitigate some of the costs of these measures.

#### *1. Intervention pricing during RERT events*

Macquarie Generation considers that AEMO should apply ‘intervention pricing’ (clause 3.9.3) during RERT events. Under this clause, AEMO would set the price at the dispatch price for a trading interval at the price that would have prevailed if the AEMO intervention (activation of short term RERT) had not occurred. The “what-if” pricing approach should be maintained for the period of the RERT intervention. Such an approach would help maintain the incentives for non-RERT load and generation to respond appropriately to the price signal that would have been set had AEMO not triggered a RERT event. Should the medium and short term RERT rule change be approved, this should include activation of intervention pricing in the event of activation of the RERT.

#### *2. Ex-post review of short and medium-term RERT events*

If AEMO enters into a contract for reserves under the short or medium-term RERT, there should be a post-event review to assess the extent to which the RERT contributed to relieving a reliability or security problem. In particular, the review should examine whether the AEMO demand forecasts that were used to make the judgement about a likely reliability event were reasonable given actual demand levels. For example, AEMO should be required to report whether the actual demand levels were outside a 2% threshold of the forecast demand level in a particular region. Ensuring sufficient scrutiny of the events leading up to the use of RERT may lessen participant concerns about how often the RERT mechanisms may be triggered and also ensure that AEMO ensure load forecasts used to trigger RERT intervention are within a reasonable tolerance.

### *3. Trigger for a RERT event*

The Reliability Panel's guidelines for the short and medium-term RERT set out that reserve contracts could only be activated if the a LOR 2 event was forecast in the ST PASA (a single credible contingency event). Macquarie Generation agrees that an LOR2 condition is the appropriate trigger if AEMO is to apply a shorter term reliability mechanism. However, we believe that the trigger should be built into the Rules rather than the Reliability Panel guidelines. This would give participants a higher level of assurance as to the RERT trigger and would improve AEMO accountability for operational decisions.

### *4. Defining system security events*

The Rule change proposal significantly extends the RERT concept by allowing reserves to be used for system security events should there be RERT services available to assist with a system security problem (associated with the transmission system). Macquarie Generation considers that Reliability Panel guidelines should clearly spell out the circumstances in which RERT services can be used for this purpose. Given that the Rule change proposal extends the scope of the operational decisions that AEMO can make at short notice, it seems reasonable that market participants should be aware of the limits of AEMO discretion during system security events.

### ***Summary***

Macquarie Generation considers that the case has not been made for introducing the additional short and medium-term RERT mechanisms. By establishing a RERT panel and creating the expectation that AEMO will be able to avert reliability and security problems, the risk exists that the NEM will come to rely more and more on the actions of the system operators rather than the commercial decisions of market participants responding to price signals. Given the decision to fast-track this Rule proposal, we anticipate that the AEMC will be inclined to endorse changes to the RERT arrangements. On this basis Macquarie Generation has proposed several modifications to the Rule proposal that we consider would mitigate some of the distortionary impacts of the short and medium-term RERT mechanisms.

Yours faithfully



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A/MANAGER MARKETING & TRADING

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