Reliability Panel
AEMC

Australian Energy Market Commission
Reliability Panel

Level 5, 201 Elizabeth Street Sydney NSW 2000
PO Box A2449, Sydney South NSW 1235

P – 02 8296 7800
F – 02 8296 7899
E – panel@aemc.gov.au

ABN 49 236 270 144
www.aemc.gov.au

Our ref: REL0044

1 July 2011

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By email: john.pierce@aemc.gov.au

Dear Mr Pierce,

National Electricity Rules – Request for Rule: Expiry of the Reliability and Emergency Reserve Trader

The Reliability Panel (Panel) requests that the Australian Energy Market Commission (AEMC) consider making the enclosed proposed Rule under section 91 of the National Electricity Law. The Rule change proposal is intended to implement the recommendations from the Final Report of the Review of the Reliability and Emergency Reserve Trader (RERT).[1] The key amendments being proposed by the Panel are that:

- the specified date for the expiry of the RERT be postponed by one year, from 30 June 2012 to 30 June 2013 as a transitional measure. This will allow stakeholders whose core business may be affected by the expiration of the RERT; and
- that the requirement for the review of the RERT mechanism be removed in order to provide increased regulatory certainty to stakeholders of the expiry of the RERT.

The enclosed Rule change proposal includes:

- a statement of the issues being addressed by the proposed Rule and a description of how the proposed Rule would address these issues;
- a description of the proposed Rule;

[1] This report was published on 21 April 2011. The report is available on the AEMC website at: http://www.aemc.gov.au/Market-Reviews/Completed/Review-of-the-Reliability-and-Emergency-Reserve-Trader-RERT.html.

- a description of how the Panel considers the proposed Rule will contribute to the achievement of the National Electricity Objective;
- the Panel's explanation of the expected costs and benefits of the change; and
- a draft of the proposed Rule.

Please do not hesitate to contact Rory Campbell should you have any questions on this matter.

Yours sincerely

Neville Henderson
Chairman, Reliability Panel
Commissioner, AEMC

RULE CHANGE PROPOSAL

Reliability and Emergency Reserve Trader

1 July 2011

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: REL0044

Citation

AEMC Reliability Panel 2011, Rule change proposal, Reliability and Emergency Reserve Trader, 1 July 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.

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 National Electricity Law (NEL).

AEMC Reliability Panel Members

Chairman

Neville Henderson, Commissioner, Australian Energy Market Commission

Other AEMC Reliability Panel Members

Andrew Nance, Principal, St Kitts Associates

Chris Murphy, Chief Executive Officer, Secure Energy

David Swift, Executive General Manager, Australian Energy Market Operator

Mark Grenning, Chief Advisor Energy, Rio Tinto

Nick Sankey, Head of Utilities, Energy and Renewables, Commonwealth Bank

Simon Bartlett, Chief Operating Officer, Powerlink

Stephen Orr, Director Strategy and Regulation for Australia, International Power Australia

Tim O'Grady, Head of Public Policy, Origin Energy

Trevor Armstrong, Executive General Manager, System Planning and Regulation, Ausgrid

Contents

1 Background to the Rule change proposal

This Rule change proposal has been developed by the Reliability Panel following the completion of its Review of the Reliability and Emergency Reserve Trader

1.1 Reliability Panel

The Panel is a specialist panel established by the Australian Energy Market Commission (AEMC) in accordance with section 38 of the National Electricity Law (NEL) and the National Electricity Rules (NER or Rules) and comprises industry and consumer representatives. The Panel 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 and rule 8.8 of the NER.

1.2 The RERT

Under the Rules, the current Reliability and Emergency Reserve Trader (RERT) mechanism allows the Australian Energy Market Operator (AEMO) to intervene in the market to ensure reliability of supply and to maintain power system security. That is, the RERT enables AEMO to contract for additional reserves up to nine months ahead of a period where reserves are projected to be insufficient to meet the relevant power system security and reliability standards, and where practicable, to maintain power system security and dispatch these additional reserves should an actual shortfall occur. AEMO can contract for reserve under a range of timeframes, including:

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

The RERT is implemented by AEMO and allows:

- AEMO to obtain capacity that may not otherwise be available to the market;
- parties who have non-market generation capacity to make themselves known to AEMO and to declare what price those parties seek to be paid; and
- individuals or groups of consumers to declare what remuneration they would seek to have their load shed, in excess of the saving in energy cost.

1.3 Review of the Reliability and Emergency Reserve Trader

On 5 July 2010, the AEMC provided the Panel with the Terms of Reference (ToR) for a review of the Reliability and Emergency Reserve Trader (RERT Review). The AEMC requested the Panel to undertake the review in accordance with section 38 of the NEL, clause 8.8.3(c) of the Rules and the National Electricity Objective (NEO). In addition, the Panel is required to undertake a review of the RERT to determine its expiry date under clause 3.20.9 of the Rules.

According to the ToR from the AEMC, the review was to:

- consider if the RERT mechanism is required to ensure that the reliability of supply in a region or regions meets the relevant power system security and reliability standards and where practicable, to maintain power system security;

- examine the potential and/or actual effectiveness of the RERT arrangements as specified in the Rules; and

- consider the NEO contained in section 7 of the NEL, when it considers issues that arise in the review and when making associated recommendations.

The Panel published its Final Report on the Review of the RERT on 21 April 2011.[1]

1.3.1 Panel recommendation

The Panel recommended that the RERT should expire on 30 June 2013. The Panel also recommended that the requirement for the review of the RERT mechanism should be removed from the Rules.

1.3.2 Stakeholder consultation

The ToR provided that the Panel must conduct the review in accordance with the Rules consultation procedures set out in clauses 8.8.3(d) to (l) of the NER. As part of its review, the Panel consulted with stakeholders, including through submissions on the Issues Paper and Draft Report, and through two separate public meetings. The submissions and presentations from stakeholders for this consultation are available on the AEMC website.[2]

The following key dates outline the NER consultation process that led to the delivery of the Panel's Final Report to the AEMC.

---

1 This report is available on the AEMC's website at http://www.aemc.gov.au/Market-Reviews/Completed/Review-of-the-Reliability-and-Emergency-Reserve-Trader-RERT.html.

2 These documents are available at http://www.aemc.gov.au/Market-Reviews/Completed/Review-of-the-Reliability-and-Emergency-Reserve-Trader-RERT.html.

Milestone	Date
Publication of Issues Paper	3 August 2010
Public Meeting	2 September 2010
Close of submissions on Issues Paper	17 September 2010
Publication of Draft Report	24 December 2010
Close of submissions on Draft Report	10 February 2011
Public Meeting	3 March 2011
Publication of Final Report	21 April 2011

2 Statement of issues with the current Rules provisions

This section sets out the issues with the current provisions in the Rules and explains how the Rule proposed by the Panel (proposed Rule) would address these issues.

2.1 Expiry date of the RERT

Under the current Rules, clause 3.20.1 specifies that the RERT is due to expire on 30 June 2012 or a date determined by the AEMC on the advice of the Reliability Panel. In its recent review of the RERT, the Panel recommended that the expiry date of the RERT should be one year later, that is, 30 June 2013.

Previous reviews of the RERT have noted that the RERT (and the previous reserve trader) is a distortionary mechanism. For example, capacity might seek to receive higher revenue under the RERT, rather than contracting directly with retailers or other intermediaries, thereby increasing the costs for consumers, without increasing the available capacity. In the Comprehensive Reliability Review, the Panel noted that under ideal conditions the reserve trader provisions would not be necessary. However it considered that at that time, given the prevailing market conditions (that is, the impact of drought conditions and potential tighter supply-demand conditions), that the provisions should be maintained for a defined period of time. The Panel went on to note that in the longer term, the market should be able to operate without any need for such a distortionary mechanism.[3]

The Panel now considers that the National Electricity Market (NEM) has shown to perform adequately and has delivered additional capacity, notwithstanding ongoing uncertainty in the market. Since the commencement of the NEM, and particularly since the introduction of the RERT, market performance has been sufficient to ensure the security and reliability of electricity supply.[4] Furthermore, the outlook for reliability shows sufficient reserves for most regions for a number of years.[5] Therefore, the Panel considers that there is no longer any need to continue the RERT and its associated market distortions.

The Panel recognises that there are stakeholders, particularly those who work with the demand side, whose core business may be affected by the expiration of the RERT. For this reason, the Panel considered that the expiry of the RERT should be delayed for one year, to 30 June 2013, in order to provide these market participants with adequate notice of the change.

---

3 AEMC Reliability Panel, Comprehensive Reliability Review, Final Report, December 2007, Sydney, p.76.

4 There have been only two occasions in the period between 2000/01 and 2009/10 where the unserved energy (USE) has breached the Reliability Standard in a region. AEMC Reliability Panel, Annual Market Performance Review, Final Report, 23 December 2010, pp.12-13.

5 AEMO, 2010 Electricity Statement of Opportunities, pp.148-154. All NEM regions are expected to have sufficient reserves until 2015/16, with the exception of Queensland which is expected to have a shortfall in 2013/14.

In addition, the Panel notes that there is ongoing work on the role of the demand side in the NEM.[6] The Panel considers that it is most efficient for the demand side to participate directly in the NEM, however, it notes that the RERT mechanism provides an avenue for demand side participation. Extending the RERT for an additional year will also provide greater time for recommendations from the ongoing work regarding demand management to be implemented.

2.2 Panel review of the RERT

Under the current Rules, clause 3.20.9 specifies that the Panel is required to complete a review of the RERT, no later than one year prior to the date the RERT is due to expire, to determine whether the RERT should expire on, or prior to, the date specified in the Rules. The Panel is seeking to remove this requirement to review the RERT in order to provide stakeholders with greater certainty that the RERT will expire according to the sunset date in the Rules.

The Panel considers that, if the expiry date of the RERT is extended, the Rules 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 considers that there is little value in undertaking another review of the RERT within such a short period of time. In addition, this interpretation of the Rules may lead stakeholders to doubt that the RERT will expire in accordance with the date in the Rules. Removing the requirement for the review of the RERT would therefore 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.

6 For example, the Ministerial Council on Energy (MCE) work program on Demand Side Participation including the National Smart Meter Program and the National Stakeholder Steering Committee; the Australian Government's Smart Grid Smart City initiative; AEMO's consultation on the Small Generator Framework, and the proposed further MCE review of demand side participation (DSP) in the electricity market.

3 Proposed Rule

3.1 Description of the Proposed Rule

The proposed rule changes the date that the RERT is due to expire from 30 June 2012 to 30 June 2013 and removes the requirement for the Panel to undertake a review of the RERT.

3.2 Power of the AEMC to "fast track" this proposal

The Panel requests that the AEMC consider this Rule change proposal under section 96A of the NEL, that is, that the AEMC "fast track" this Rule change proposal. Section 96A applies if either:

- the request is made by an electricity market regulatory body that has consulted with the public on the nature and content of the request before making that request; or
- the request is made on the basis of a recommendation for the making of a Rule contained in a Ministerial Council on Energy (MCE) directed review.

Under section 87 of the NEL, the Reliability Panel is considered to be an electricity market regulatory body.

Section 96A of the NEL specifies that the AEMC may "fast track" a Rule change proposal on receipt of such a request if the AEMC is of the opinion that the consultation conducted by the Panel was adequate having regard to the:

- nature and content of the request; and
- kind of consultation conducted by the Panel.

In addition, clause 8(f) of the National Electricity Regulations requires that, where the Panel requests that a Rule change proposal be "fast tracked", the proposal must :

- contain a summary of the consultation conducted by the electricity market regulatory body; and
- include information about the extent of the consultation and about the issues raised during the consultation and the Panel's response to those issues.

The Panel believes that this Rule change proposal meets these two requirements in that:

- section 1.3.2 sets out the consultation process followed for this review;
- section 5 contains a further description of the consultation process that the Panel conducted for this review; and

- section 5 also sets out the issues raised by stakeholders and the Panel's response to these issues.

In summary, the Panel considers that it has adequately consulted the public in relation to the Rule change proposal.

3.3 Power of the Panel to submit this proposal

The Panel is a specialist body within the AEMC and comprises both 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 and rule 8.8 of the NER.

The Panel requests that the AEMC make this Proposed Rule in accordance with the NEL.

Under section 91(4) of the NEL the Panel may only request the AEMC to make a Rule that relates to the Panel's functions. Section 38(2)(c) of the NEL states that the functions of the Panel include any functions and powers conferred on it under the NEL and the NER.

Clause 3.20.9 of the NER relates to the functions and powers of the Panel. Specifically, clause 3.20.9 requires that, no later than one year prior to the date the RERT is due to expire, the Reliability Panel must conduct a review of the RERT in accordance with clauses 8.8.3(d) to (l). The Panel is required to submit a report to the AEMC that determines whether the RERT should expire on the date specified in the Rules, or whether the RERT should expire prior to that date, and if so, what date.

The Panel completed this review and published its Final Report on 21 April 2011. The Panel recommended that the RERT should expire on 30 June 2012 and that the requirements for the review of the RERT mechanism should be removed from the Rules. This Rule change proposal, if made, would implement the Panel's recommendations.

The Panel considers that this proposal relates to the overall reliability of the power system and, therefore, is within the power of the Panel to recommend changes to the Rules.

3.4 Power of the AEMC to make the proposed Rule

The subject matters about which the AEMC may make Rules are set out in section 34 to the NEL and, more specifically, in Schedule 1 to the NEL.

The Panel considers that this proposed Rule change falls within the subject matters that the AEMC may make Rules about, as it relates to:

- the operation of the national electricity market because it involves contracting for reserves;

- the operation of the national electricity system for the purposes of safety, security and reliability of that system because it involves the ability of the market operator to contract for reserves; and

- the activities of persons (including registered participants) participating in the national electricity market or involved in the operation of the national electricity system because it involves market participants who choose to participate in reserve contracting.

The Panel also considers that this proposed Rule change is also within the matters set out in Schedule 1 to the NEL as it relates to:

- the operation of generating systems, transmission systems, distribution systems or other facilities, in that the proposed Rule change relates to AEMO's power to procure and dispatch contracted reserves (item 11 of Schedule 1 to the NEL); and

- reviews by or on behalf of the Reliability Panel (item 33(b) of Schedule 1 of the NEL).

4 Requirements in terms of the National Electricity Objective and the economic impact

4.1 How the proposed Rule will, or is likely to, contribute to the achievement of the National Electricity Objective

In accordance with clause 8(d) of the National Electricity Regulations, this section presents an explanation of how the proposed Rule will, or is likely to, contribute to the achievement of the NEO.

The NEO is defined in section 7 of the NEL as:

> "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."

In summary, this rule change proposal seeks to allow the RERT to expire on 30 June 2013, one year later than the current expiry date, and to remove the requirement for the Panel to undertake a review of the RERT mechanism, which is to be completed no later than one year prior to its expiry.

The Panel considers that in the long term, its proposal that the RERT should expire will, or is likely to, contribute to achievement of the NEO in the following areas:

- efficient investment in electricity services;
- efficient use of electricity services;
- price of supply of electricity; and
- reliability of the national electricity system.

It has previously been recognised by both the Panel and stakeholders that the RERT (and the previous reserve trader) is a distortionary mechanism and that in the long term, it would be preferable for the NEM to operate without these provisions.[7] In the Comprehensive Reliability Review, the Panel considered that given there were uncertain market conditions, particularly regarding the impact of drought conditions,

7 For example: AEMC Reliability Panel, Comprehensive Reliability Review, Final Report, December 2007, Sydney, p.76; AEMC, Improved RERT Flexibility and Short-notice Reserve Contracts, Rule Determination, 15 October 2009, p.18; Energy Supply Association of Australia (esaa), Review of the RERT, Draft Report submission, p.2; National Generators Forum (NGF) and Energy Retailers Association of Australia (ERAA), Review of the RERT, Draft Report submission, p.3; Origin Energy, Review of the RERT, Draft Report submission, p.2.

potential tighter supply-demand conditions and climate change policies, the removal of provisions for AEMO to reserve trade would not be prudent.[8] However, The Panel now considers that the NEM has shown to perform adequately and has delivered additional capacity, notwithstanding ongoing uncertainty in the market.

Currently, under the RERT, capacity can be valued at a price that is higher than the maximum price it could receive for participating directly in the electricity market, that is, the market price cap (MPC). This means that during market failure conditions (i.e. when the RERT is invoked due to a lack of available capacity), retailers, and therefore consumers, could face costs that are unknown and difficult to manage through contracting.

The Panel considers that it is more efficient for capacity to participate directly in the market rather than through the RERT mechanism. At present, the RERT may create a secondary market for reserves that encourages providers of peak reserves to contract with AEMO, rather than a retailer or other intermediary. For example, in the extreme, it is possible that currently non-scheduled capacity that could be economic in the market seeks to obtain additional revenue through the RERT. Under the RERT, the prices paid for reserve are set administratively and are not transparent to the market. In this example, there would be no additional capacity, however the economic costs may increase as the capacity may be remunerated more generously through the RERT than through the NEM. Consequently, the existence of a RERT mechanism may lead to market distortions resulting in an increase in costs faced by consumers.

Relatedly, reliance on the RERT would undermine the market forces in the NEM as it would reduce the incentives for generators, retailers and customers to enter into negotiated contracts. This may deter investment in the NEM in the long term, as investors may choose to participate in the RERT instead, thereby increasing costs for consumers.

The Panel considers that it would be more efficient to allow the RERT to expire and to rely on the market forces in the NEM to produce an efficient level of reserve capacity. With the expiry of the RERT there would be greater incentive for this capacity to be market facing and therefore to contract with retailers or other intermediaries. This would mean the costs faced by customers, could be smaller and limited (i.e. not greater than the MPC). In addition, the investment signals for investors may be clearer. By allowing the RERT to expire, this would promote the NEO by encouraging efficient investment and use of electricity services (that is, the provision of reserve capacity), in the long term interests of consumers.

The Panel considers that given the performance of the NEM to date, there is no longer any need for consumers to continue to face these higher costs. Furthermore, the Panel notes that the RERT itself has inadequacies. In particular, the ability of the RERT to address situations of supply shortfall is limited, as the RERT typically attracts a response that is relatively small given the magnitude of those events that may result in

8 AEMC Reliability Panel, Comprehensive Reliability Review, Final Report, December 2007, Sydney, p.76.

unserved energy (USE). The Panel therefore considers that allowing the RERT to expire would promote the NEO by providing arrangements that enable the more efficient and effective provision of reserve capacity and thus facilitating efficient use of, and investment of electricity services in the NEM.

However, while the Panel considers that allowing the RERT to expire is in the long term interests of consumers, the Panel considers that in the shorter term, the RERT should be extended for one year. The Panel recognises that there are stakeholders, particularly those who work with the demand side, whose core business may be affected by the expiration of the RERT. The Panel considers that delaying the expiry of the RERT for one year, to 30 June 2013, will provide these market participants with adequate notice of this change. This would promote the NEO by providing greater regulatory certainty to market participants, which will, in turn, promote efficient investment in, and use of, the electricity services, in the long term interests of consumers.

Similarly, the Panel considers that the requirement for the review of the RERT should be removed from the Rules. The Panel considers that if the expiry date of the RERT is extended, it is possible that market participants may expect the Panel to undertake an additional review of the RERT mechanism. This may create uncertainty for stakeholders over whether the RERT will expire in accordance with the date in the Rules. Removing this requirement for a review would increase market certainty about the future of the RERT, which is important for those stakeholders whose core business will be affected by the operation or expiry of the RERT. This would promote the NEO by increasing regulatory certainty and thus facilitating greater efficiency in investment in, and use of electricity services, which is in the long term interests of consumers.

4.2 The expected benefits and costs of the proposed change and the potential impacts of the change on those likely to be affected

The Panel considers that allowing the RERT to expire will have a number of benefits. In particular, the expiry of the RERT will remove possible market distortion and increase the incentives for efficient market operation. Without the RERT, providers of peak reserves and retailers, or other intermediaries, will have greater incentive to contract, and the price that is paid for these reserves may be more efficient than the price paid under the RERT. This will replace the costs of the RERT, which are unknown and difficult to manage, with the costs of contracting, which are more efficient, thereby decreasing the costs that are passed on to consumers. In addition, this direct contracting between providers of reserve and retailers or other intermediaries will provide clearer investment signals for the market.

In addition, allowing the RERT to expire will remove the administration costs to AEMO of activities undertaken to:

- obtain offers of prospective capacity;
- understand the technical nature and potential limitations of each offer;

- consult with jurisdictions; and
- monitor the need to invoke the contracts at its disposal.

In the meantime, extending the RERT for one year, and removing the requirement for the review of the RERT, will provide greater regulatory certainty to market participants.

The Panel notes that allowing the RERT to expire may create a slight risk to the reliability of the electricity system, however, the Panel considers that this risk is small, given the limited use of reserve trading to date. Furthermore, the Panel notes that participation in the RERT panel has been limited and therefore, there is limited capacity to call on at short notice, if required.

The Panel also notes that the expiry of the RERT may lead to an increase in the need for and costs of other intervention mechanisms, such as directions or instructions. However, as above, the Panel considers that this is a relatively minor risk given the limited use of the RERT to date.

The Panel recognises that extending the RERT for a year will also extend the costs of the RERT, including AEMO's administrative costs and any potential costs of implementing the RERT, however, the Panel considers that these are not significant.

5 Key issues raised by stakeholders

The Panel undertook the Review of the RERT in accordance with clauses 8.8.3(d) - (l) of the Rules and consulted with stakeholders throughout the review. All of the reports were published on the AEMC website and submissions from interested parties were invited on both the Issues Paper and the Draft Report. For this review, the Panel also held two Public Forums in Melbourne, which were open to all interested parties. Notice of these forums was given on the AEMC website. All submissions on this review and presentations from the forums are available on the AEMC website.[9]

Below is a summary of the key issues that were raised by stakeholders and the Panel's response.

5.1 Market distortion

A number of submissions on the Review commented on the market distortion introduced by the RERT. Some considered that, despite precautions to minimise the market distortion, the RERT creates a secondary market for reserves and encourages providers of peak reserves to participate indirectly in the market, by contracting with AEMO, rather than participating directly by contracting with a retailer.[10] They considered that this approach was blunting the signals for participants to enter into commercially negotiated contracts and may deter investment in the NEM in the long term, as investors participate in the reserve market instead.

In contrast, other submissions considered that the distortionary effects of the RERT were not significant.[11] They noted that the RERT is only operated in those areas that experience shortfall and is only used for a limited amount of time, as required.

The Panel also received a supplementary submission containing a qualitative report on the distortionary effects of the RERT.[12] It considered that the use of the RERT created an economic inefficiency that was the difference between the value to consumers of consumption beyond the quantity supplied at the MPC and the opportunity cost of the extra resources that would be used to provide additional supply greater than the amount offered at the MPC.

9 The AEMC website can be found at www.aemc.gov.au.

10 Origin Energy, Issues Paper submission, p.2; Origin Energy, Draft Report submission, p.1; NGF and ERAA, Issues Paper submission, p.3; NGF and ERAA, Draft Report submission, p.2.

11 South Australian Department of Transport, Energy and Infrastructure (DTEI), Issues Paper submission, p.1; Energy Response, Issues Paper submission, p.3; Major Energy Users (MEU), Issues Paper submission, p.13.

12 ACIL Tasman, NEM Reliability and Emergency Reserve Trader: Assessment of distortions arising from arrangement, 17 November 2010, p.6.

5.1.1 Panel's response

While the Panel considers that the direct market distortions of the RERT may be small, the Panel acknowledges that the RERT may have secondary impacts that distort the market. 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. The Panel agrees with submissions that this capacity would be more efficiently used if it were to contract directly with retailers or other intermediaries rather than with AEMO through the RERT. For this reason, the Panel considers that the RERT should expire.

5.2 Market costs

A number of submissions noted that payment under the RERT, for capacity acquired for both system security and reliability reasons, is not limited to the MPC.[13] These submissions considered that any reserve that was efficient to use should not be valued at a price beyond the market value (the MPC). In contrast, other submissions considered that the RERT is a low cost, risk management strategy.[14] The Major Energy Users (MEU) considered that the cost of installing new standby generation is significantly higher than the cost of standby capacity provided by the reserve trader.[15] The South Australian Department of Transport, Energy and Infrastructure (DTEI) noted that the costs of the RERT are minimal when compared to the costs in the market overall. In particular, any additional costs are only incurred by consumers when reserve is required.[16]

5.2.1 Panel's response

While the current Rules require AEMO to take those actions which are most effective and minimise the cost to end use consumers, the Panel recognises that in conditions when the RERT is invoked (this includes both reliability and system security events), capacity can be valued above the MPC. This is higher than the price this capacity would receive by participating directly in the electricity market. In such situations, retailers, and therefore consumers, could face costs that are not limited to any upper boundary and therefore could be difficult to hedge. The Panel considers that given the performance of the market to date, there is no longer any need for consumers to continue to face these higher prices. As such, the Panel considers that the RERT should be allowed to expire on 30 June 2013.

---

13 Loy Yang Marketing Management Company (LYMMCO), Issues Paper submission, p.2; NGF and ERAA, Issues Paper submission, p.6; esaa, Issues Paper submission, p.3.

14 Major Energy Users (MEU), Issues Paper submission, p.11; MEU, Draft Report submission, p.10; DTEI, Draft Report submission, p.1.

15 MEU, Issues Paper submission, p.11.

16 DTEI, Issues Paper submission, p.1.

5.3 Demand side participation

A number of Issues Paper submissions noted that the RERT may encourage the demand side to participate through the RERT, rather than in the primary market.[17] These submissions considered that these services cannot be justified at a cost higher than the MPC and therefore participating in the primary market would be more economically efficient for the market as a whole.

A number of submissions on the Draft Report commented on the role of the demand side in providing capacity to the NEM. In particular, some submissions considered that processes to facilitate demand side participation (DSP) should be unrelated to the RERT.[18] Views in submissions ranged from support for work to address barriers to efficient DSP[19] to those who considered that a new market mechanism should be created to attract demand side resources.[20]

5.3.1 Panel's response

The Panel agrees that demand side capacity is more efficiently used when contracted directly with retailers or other intermediaries rather than with AEMO through the RERT. Market participants are each able to make contracting decisions that are most efficient for themselves and therefore for the market as a whole.

Regarding the role of the RERT in providing an avenue for DSP in the NEM, the Panel notes that the purpose of the RERT is to allow AEMO to contract for reserves when a shortfall of reserve is projected. While the RERT provides an opportunity for both the supply and demand sides to provide capacity, the Panel considers that the RERT is more likely to attract demand side capacity as most supply side capacity would already plan to be available for the peak demand periods.

There is ongoing work on the role of the demand side in the electricity market. The Panel notes that the transitional arrangements to extend the RERT by one year will allow greater time for recommendations from this ongoing work to be implemented.

5.4 Need for a capacity mechanism

A number of submissions noted that the current RERT mechanism was not effective in attracting capacity.[21] However, some submissions considered that there was a need for

17 LYMMCO, Issues Paper submission, p.2; NGF, Issues Paper submission, p.3; esaa, Issues Paper submission, p.3.

18 Victorian Department of Primary Industries (DPI), Draft Report submission, p.4; esaa, Draft Report submissions p.2; NGF and ERAA, Draft Report submission, p.3.

19 esaa, Draft Report submission, p.2.

20 DTEI, Draft Report submission, p.1; EnerNOC, Draft Report submission, p.4.

21 Energy Response, Issues Paper submission, p.1; EnerNOC, Draft Report submission, p.4; esaa, Draft Report submission, p.1; MEU, Draft Report submission, pp.7, 9; NGF and ERAA, Issues Paper submission, p.4; NGF and ERAA, Draft Report submission, p.2.

a safety net mechanism to ensure reliability of supply[22] or to encourage DSP[23]. Others proposed improvements to the RERT which they considered would increase its ability to attract capacity, particularly the demand side.[24]

5.4.1 Panel's response

The Panel does not consider, given the current market performance, that there is a need for a safety net mechanism to ensure reliability. The Panel considers that the current Reliability Settings are sufficient to ensure reliability and the RERT is no longer required. Furthermore, the Panel notes that the RERT mechanism is not intended to be a driver for new investment, instead there are other mechanisms, such as the MPC which serve this purpose.

5.5 Uncertainty in the market

A number of submissions commented on the impact of ongoing uncertainty on investment in the market.[25] Some noted that, despite several years of uncertainty around carbon policies, AEMO's 2010 Electricity Statement of Opportunities (ESOO) shows that the market is working well.[26] Origin Energy noted that forecast supply deficits are an important function of the market as they indicate the need for additional generation. If the market is working effectively, investment should occur in a timely manner.[27]

However, others considered that the climate for investment in new generation is significantly more uncertain than it has been previously[28], while EnerNOC considered that a lack of investment in the NEM may be becoming a significant matter.[29]

5.5.1 Panel's response

The Panel notes that the outlook for reliability shows that the majority of the NEM regions are expected to have sufficient reserves up to 2015/16.[30] Since 2009, there have been eight new major generation projects completed, with a combined registered

---

22 DTEI, Issues Paper submission, p.1; DTEI, Draft Report submission, p.1; DPI, Issues Paper submission, p.3; DPI, Draft Report submission, p.4; Energy Response, Issues Paper submission, p.1; MEU, Draft Report submission, p.11.

23 Energy Response, Issues Paper submission, p.4; EnerNOC, Draft Report submission, p.1; MEU, Draft Report submission, pp.11-12.

24 MEU, Draft Report submission, pp.11-12; EnerNOC, Draft Report submission, p.4.

25 For example, NGF and ERAA, Issues Paper submission, p.4; Origin Energy, Issues Paper submission, p.1; Department of Primary Industries Victoria, Draft Report submission, p.3; ERAA, Draft Report submission, p.2; EnerNOC, Draft Report submission, p.1.

26 NGF and ERAA, Issues Paper submission, p.4.

27 Origin Energy, Issues Paper submission, p.1.

28 Department of Primary Industries Victoria, Draft Report submission, pp.3-4.

29 EnerNOC, Draft Report submission, p.1.

30 AEMO, 2010 Electricity Statement of Opportunities, pp.148-154.

capacity of approximately 2 305 MW[31] and as of the end of October 2010, there were twelve projects at an advanced stage of development with a total capacity of 1 768 MW.[32]

The Panel notes that, historically, when the Statement of Opportunities (SOO) has forecast a supply deficit, the market has delivered sufficient capacity. The Panel considers that to date, market performance has been sufficient to ensure the security and reliability of electricity supply, although the Panel makes no comment on the commerciality of these projects. The Panel considers that given the performance and outlook for capacity and reliability in the NEM, the RERT is no longer required.

5.6 Extension of RERT until 2013

A number of submissions on the Draft Report agreed with the Panel's draft recommendation to allow the RERT to expire, however, they did not agree with the recommendation that the RERT should be extended for one year until 2013. The esaa and the NGF and ERAA submissions questioned the value of extending the RERT for a year to allow work on DSP to be completed.[33] They considered that the purpose of the RERT was as a mechanism to support reliability, rather than as a sectoral mechanism to support the demand side.

5.6.1 Panel's response

The Panel considers that there is value in extending the RERT for one year in order 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. In addition, extending the RERT will provide additional time for outcomes from current work programs on demand side participation to be implemented.

31 AEMO, ESOO 2010, p.87; Australian Bureau of Agriculture and Resource Economics - Bureau of Rural Sciences, Electricity Generation: Major development projects - October 2010 listing, p.8.

32 Australian Bureau of Agriculture and Resource Economics - Bureau of Rural Sciences, Electricity Generation: Major development projects - October 2010 listing, p.9.

33 esaa, Draft Report submission, p.1; NGF and ERAA, Draft Report submission, pp.2-3.

A Proposed Rule

Proposed National Electricity Amendment (Reliability and Emergency Reserve Trader) Rule 2011

1 Title of Rule

This Rule is the *Proposed National Electricity Amendment (Reliability and Emergency Reserve Trader) Rule 2011*.

2 Commencement

This Rule commences operation on [COMMENCEMENT_DATE].

3 Amendment of the National Electricity Rules

The National Electricity Rules are amended as set out in Schedule 1.

Schedule 1 Amendments of the National Electricity Rules (Clause 3)

[1] Clause 3.20.1 Expiry of reserve and emergency reliability trader

Omit clause 3.20.1 and substitute "This rule 3.20 expires on 30 June 2013.".

[2] Clause 3.20.9 Review of reserve and emergency reliability trader

Omit clause 3.20.9 in its entirety, including the heading, and substitute "[Deleted]".

[END OF RULE AS MADE]

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
DSP	demand side participation
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	See Rules
RERT	Reliability and Emergency Reserve Trader
Rules	National Electricity Rules
SOO	Statement of Opportunities
ToR	Terms of Reference
USE	unserved energy