

C Revised MCE Direction

MCE

Ministerial Council on Energy

CHAIR

The Hon Martin Ferguson AM MP
Minister for Resources and Energy

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18 AUG 2009

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
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14 AUG 2009

Dear Dr Tamblyn 

The Ministerial Council on Energy (MCE) considered matters related to the Australian Energy Market Commission (AEMC) review of the effectiveness of National Electricity Market (NEM) security and reliability arrangements in the light of extreme weather events ("the review") at its meeting of 10 July 2009.

The MCE agreed to commission the review in February 2009 following the impact of the 29-31 January 2009 heat wave events on electricity supplies, particularly in Victoria and South Australia.

The MCE communiqué of 6 February 2009 noted that matters that the review would consider included whether the level of the NEM market price cap (MPC), formerly called the Value of Lost Load or VoLL, should be raised to ensure adequate levels of generation to reduce the risk of loss of supply during heat wave events.

The MCE notes the Interim Report of 29 May 2009 for the review, as required by the terms of reference, reported on measures that are currently under consideration that would improve system reliability and security, and further measures that could be taken in the short term that would impact on system reliability for the summer of 2009-10.

The Interim Report noted the proposed increase in the MPC to \$12,500 per MWh from 1 July 2010, the periodic two yearly reviews of MPC and other reliability settings to be undertaken in future by the NEM Reliability Panel (including the *Review of the Operationalisation of the Reliability Standards* and the *Review of Reliability Standards and Settings* commissioned by the AEMC on 3 March 2009), and the proposal published by the Reliability Panel on 1 May 2009 for improved flexibility for the Reliability and Emergency Reserve Trader (RERT) and short term reserve contracts in the NEM.

The terms of reference for the review require that the final report for the review be published by 30 October 2009, and report on any cost-effective changes that could be made to energy market frameworks that would improve system reliability and contribute to the more effective management of system reliability during future extreme weather events.

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Community Expectations of Supply Reliability

Substantial load shedding of the kind which occurred in the Victorian and South Australian regions on 29-30 January 2009 had significant economic and social impacts due to the simultaneous and widespread loss of electricity-dependent services. This has highlighted community concerns about supply reliability, and whether the current level of the MPC reflects the true value of lost load.

NEM Rules, including those for setting the level of the MPC, are made by the AEMC on the basis that the Rule will or is likely to contribute to the achievement of the National Electricity Objective (NEO). The NEO promotes efficient investment in electricity services for the long term interest of consumers with respect to two criteria:

- (i) price, quality, safety, reliability, and security of supply; and
- (ii) the reliability, safety and security of the national electricity system.

When considering the impacts of Rule changes on affordable prices for electricity and security of supply, it is possible for these objectives to conflict. The National Electricity Law (NEL) provides for the AEMC's Rule making activities to weight any aspect of the NEO as appropriate, having regard to any relevant MCE statement of policy principles.

To date, the MCE has not provided any policy advice to the AEMC or the Reliability Panel as to how potentially conflicting objectives in the NEO should be balanced when reviewing reliability related market parameters.

The AEMC's Comprehensive Reliability Review (CRR), as published on 21 December 2007, and subsequent related work on incremental adjustments to the reliability settings, have taken into account expectations of public willingness to accept electricity price increases in return for greater security and reliability of supply. The AEMC has also noted industry concerns about the economic costs of the inherent volatility of pricing in the NEM under the current market design.

The recent load shedding events, and the risk identified in the 2008 NEM Statement of Opportunities of insufficient generation to meet minimum reserve levels in the combined Victorian and South Australian regions in the period up to the summer of 2010-11 indicate investment in generation and transmission infrastructure in these regions may not be occurring in a timely manner. While factors outside of the NEM framework may be influencing investment decisions, the current Reliability Panel review of the effectiveness of the NEM reliability settings and incentives is timely.

In that context, a number of energy market policy matters will require consideration by the MCE, including whether:

- the NEM reliability standard, which was set at the commencement of the NEM in 1998, and subsequent interpretations of the price component of the NEM reliability settings, conform with contemporary public expectations of supply reliability;
- the MCE should provide related policy advice to the AEMC on the relative weighting of price and reliability objectives in the NEO in the determination of the reliability settings in the NEM; or
- vary the terms of reference for the extreme weather events review to include provision for the AEMC to recommend changes to the NEL or NER that would strengthen the processes for determining the NEM reliability settings and MPC.

To be able to further consider these policy matters the MCE will require, among other things, detailed information on the potential costs that would be associated with a range of reliability levels in the NEM.

MCE Direction to the AEMC

As provided for under Section 41 of the National Electricity Law, the MCE therefore directs the AEMC to provide a second interim report for the review, with the following information, supported by analysis by the Australian Energy Market Operator (AEMO) and relevant economic modelling:

- (i) a comparison of historical NEM reliability forecasts with outcomes that occurred in the first ten years of the NEM (averages and extremes);
- (ii) the expected distribution of reliability outcomes, particularly the frequency of extreme load shedding events, that are implicit in forecasts of average levels of reliability in the NEM;
- (iii) an analysis of the reliance that may be placed on NEM reliability forecasting methods, taking into account the outcome of (i) and (ii), sensitivity analysis and other relevant considerations;
- (iv) modelling projections of the price-reliability trade-offs of a phased increase in the NEM MPC to:
 - a) an interim level of \$20,000 per MWh;
 - b) the current value of customer reliability in the study by CRA International dated 12 August 2008 for VENCORP; and
 - c) any other level that the AEMC decides is relevant to the MCE's consideration.

The AEMC is also requested to advise on:

- (i) whether the NEM Reliability Standard has been interpreted to date either as a maximum which cannot be exceeded, or as a mean which is not to be exceeded over a number of years;
- (ii) the appropriate specification and interpretation of the NEM Reliability Standard in future;
- (iii) the appropriate roles for the MCE, the AEMC, AEMO, and the Reliability Panel in policy decision-making on reliability standards; and
- (iv) the feasibility of mechanisms for recognising differences in jurisdictional expectations regarding the price-reliability trade-off and delivery outcomes consistent with those expectations.

Timing and Process

The AEMC is to provide a briefing on the second interim report to the 4 December 2009 meeting of the MCE and a full written report by 18 December 2009.

The timing for the final report of the review is extended to 30 April 2010. The final report will have regard to any policy guidance given by the MCE following its consideration of the second interim report.

Copies of the second interim report are to be provided to the Australian Energy Market Operator and the Australian Energy Regulator. The MCE will determine whether the second interim report is to be published.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'M Ferguson', with a long horizontal flourish extending to the right.

Martin Ferguson