RULE CHANGE

Australian Energy Market Commission

CONSULTATION PAPER

National Electricity Amendment (Reliability Settings from 1 July 2012) Rule 2010

Rule Proponent(s)

Reliability Panel

11 November 2010

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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 to be the rule maker for national energy markets. The AEMC is currently responsible for rules and providing advice to the MCE on matters relevant to the national energy markets. We are an independent, national body. 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.

Contents

1 Introduction

On 27 August 2010, the Reliability Panel (Panel) submitted a Rule change request to the Australian Energy Market Commission (AEMC or Commission) in relation to the indexation of specified Reliability Settings and the process of review of the Reliability Standard and Reliability Settings, to be applied from 1 July 2012 (Rule Change Request).

In the context of the National Electricity Market (NEM), reliability is a measure of the adequacy of the electricity system in generating and transporting sufficient electricity supply to meet consumer demand. Balancing supply and demand to meet reliability (and other) requirements in the longer term is significantly affected by various of regulatory, market and pricing mechanisms, such as the market price cap (MPC) and cumulative price threshold (CPT).

The MPC sets the upper limit to which generators can price their supply into the market and is currently set at $12 500/MWh. The CPT is a pricing mechanism that is triggered once a particular threshold of protracted high prices is reached and acts to dampen them via the imposition of an administered price cap, thereby limiting the financial exposure of market participants. It is currently set at $187 500. At present the Panel is required under the National Electricity Rules (Rules or NER) to review these mechanisms on a regular basis.

This Rule Change Request seeks firstly, to fix the MPC and CPT at the 1 July 2010 levels and maintain the real values over time through indexation, and secondly, to implement significant changes to the regular review process. These changes are proposed to commence in 2012.

This Consultation Paper has been prepared by the staff of the AEMC to facilitate public consultation on the Rule Change Request and does not necessarily represent the views of the AEMC or any individual Commissioner of the AEMC.

This paper:

- sets out a summary of, and background to, the changes to the process for determining and reviewing the Reliability Standard and Reliability Settings as proposed by the Panel;
- identifies a number of questions and issues to facilitate the consultation on this Rule Change Request; and
- outlines the process for making submissions.

2 Background

2.1 About the Reliability Panel

The Panel is a specialist body established by the AEMC in accordance with National Electricity Law (NEL).[1] While chaired by a Commissioner of the AEMC, it is primarily constituted by various industry and consumer representatives. The Panel's particular functions and powers are set out in section 38(2) of the NEL as follows:

- to monitor, review and report on, in accordance with the Rules, the safety, security and reliability of the national electricity system;
- at the request of the AEMC, provide advice in relation to the safety, security and reliability of the national electricity system; and
- perform any other function or exercise any other power conferred on it under the NEL and the Rules.

Currently, the Rules also confer on the Panel responsibility for carrying out a biennial review of the Reliability Standard, the level of the MPC, the CPT and the market floor price (MFP) and, on completion of such review, publish a report.[2]

2.2 The Reliability Standard and Settings

2.2.1 The Reliability Standard

In this context, reliability refers to the system capacity to generate and transport sufficient electricity across the network to meet consumer demand. The NEM Reliability Standard (Reliability Standard or Standard) is a measure of the maximum expected unserved energy (USE) or the maximum electricity expected to be at risk of not being supplied to consumers due to a lack of available capacity, per financial year.

The current level of USE of 0.002% of the annual energy consumption was set by the Panel in 1998 (market start), and has remained unchanged since then. Performance against this measure is reviewed annually with particular attention given to where there have been incidents that have resulted in USE.[3]

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1 Section 38 of the NEL.

2 Rule 3.9.3A of the NER.

3 The current and operational version of the *NEM Reliability Standard - Generation and Bulk Supply* (December 2009) is available at http://www.aemc.gov.au/Panels-and-Committees/Reliability-Panel/Guidelines-and-standards.html.

2.2.2 The Reliability Settings

In the context of this Rule Change Request, the Reliability Settings (Reliability Settings or Settings) refer to the parameters governing the price envelope within which energy supply and demand is balanced in the wholesale market. These parameters provide important price signals to market participants in relation to the delivery of sufficient capacity to meet the Reliability Standard, with the additional objective of avoiding unmanageable risks for market participants.[4]

The MPC is a cap placed on regional reference (wholesale spot market) prices in the NEM, and is currently set at $12 500/MWh. This is the upper limit to which generators can price their supply in the spot market.

The CPT is an explicit risk management mechanism, designed to limit participants' exposure to protracted levels of high prices in the wholesale spot market. If the sum of the half-hourly wholesale market spot prices over a rolling seven-day period exceeds the CPT in a region[5] then the Australian Energy Market Operator (AEMO), in its capacity as the market operator, is obliged to impose the administered price cap (APC) in that region until such time as the sustained high prices fall away.[6]

The MFP is the lowest allowable limit for the spot price, and is currently set at -$1 000 /MWh. Periods of negative prices can and do arise, and may be associated with excess capacity or congestion in the market.

2.3 Relevant Reviews

2.3.1 Previous review of the Reliability Standard and Reliability Settings

The Rule Change Request seeks to put into effect the recommendations of the *Review of the Reliability Standard and Reliability Settings* undertaken earlier by the Panel in accordance with the Rules, and published on 30 April 2010 (Biennial Review).[7] As required, in this review the Panel considered the Reliability Standard, and the Settings to be applied in the NEM in order to be able to meet the Reliability Standard, from 1 July 2012.

The Biennial Review included market simulation studies to assess the Reliability Settings (in particular the MPC and CPT) and the impact of changing those Settings on

4 AEMC Reliability Panel, *Comprehensive Reliability Review, Final Report*, December 2007. This report is available on the AEMC's website. Note that this Rule Change Request relates only consideration of the Reliability Standard and the MPC, CPT and MFP settings. It does not consider the administered price cap or other mechanisms such as the reserve trader provisions.

5 Or, if a cumulative ancillary services price exceeds six times the CPT; see clause 3.14.2 of the NER for its application.

6 The APC is determined by the AEMC in accordance with the NER and is therefore not included in the Reliability Panel review process. It is currently set at $300/MWh.

7 *Reliability Standard and Reliability Settings Review*, final report, 30 April 2010. A copy of this report may be accessed from the AEMC website.

the Reliability Standard for the financial years 2012/13 and 2013/14. The modelling was undertaken by an independent consultant (ROAM Consulting) and was considered by the Panel to be consistent with the previous assessments and a valid proxy of the operation of the NEM.[8] A full consultation process was also carried out.

In the final report, and in accordance with the Rules, the Panel made a determination not to recommend any change to the nominal values of the MPC, CPT or MFP. It considered that it might not be appropriate to make changes to the MPC and CPT until the full impact of the recent 1 July 2010 increases are known. In addition it considered that the current value of the MPC ($12 500/MWh) is broadly consistent with the value of customer reliability (VCR).[9] This value was calculated to apply to the residential sector in Victoria of $13 250/MWh which, in the Panel's opinion, indicated that the current level of the MPC provides an efficient balance between the cost and value of reliability of electricity supply at the wholesale level.[10]

While the Panel considered that the Settings appeared to be set currently at levels that contribute to meeting the national electricity objective (NEO), it also noted (amongst other things) that the forecast 2012/13 capital costs of new entrant open cycle gas turbines (OCGTs) were significantly higher (21%) than the costs reported in 2007.[11] The Panel was therefore also concerned that the real values of the MPC and CPT be maintained over time, and recommended a process of indexation to apply annually to those values from 1 July 2012.[12]

The Panel also recommended that the requirements to review the Reliability Standard and the MFP be removed from the Rules since:

- the AEMC retains the power to request that the Panel undertake a review into these matters at any time; and
- any person can initiate a Rule change request at any time in relation to the Reliability Settings, including the MFP, if that person considers that a more appropriate value should apply.[13]

2.3.2 The Extreme Weather Events Review

On 28 April 2009 the Ministerial Council on Energy (MCE) directed the AEMC to conduct a review of the effectiveness of NEM security and reliability arrangements in

8 Benchmarking studies were also undertaken to ensure continuity of results from earlier studies undertaken by a different consultancy as part of the earlier 2007 *Comprehensive Reliability Review*. Full details of the modelling may be found in the Panel's *Review of the Reliability Standard and Reliability Settings,* ibid, section 3.3.4.1.

9 The VCR is a measure designed to reflect the value that consumers place on having a reliable supply.

10 *Review of the Reliability Standard and Reliability Settings,* ibid, section 4.6.1, p44.

11 ACIL Tasman, 2009, *Fuel resources, new entrant and generation costs in the NEM.*

12 Refer to p8 of the Rule Change Request for this discussion.

13 Section 91 of the NEL; p15 of the Rule Change Request.

light of extreme weather events (EWE). The EWE final report provides the AEMC's advice to the MCE on areas where the existing energy market frameworks require change, together with the AEMC's recommended changes to address identified risks and make improvements to the existing energy market frameworks to meet consumer expectations for quality and supply in the future.[14]

Recommendations of relevance to the Reliability Standard and Reliability Settings include:

- an expansion to the parameters of the Annual Market Performance Review, currently undertaken by the Panel;
- development and greater use of a national VCR measure[15] in determining efficient levels of investment in reliability across the supply chain and consideration of this value in the determination of the MPC and in transmission planning activities; and
- significant changes to the review governance arrangements and processes for determining reliability.

As acknowledged by the Panel in its Rule Change Request,[16] finalisation and release of the EWE final report coincided with that of the Biennial Review.

The EWE final report was provided to the MCE on 31 May 2010 and a formal response from the MCE in relation to the recommendations is pending. In its response, it is possible that the MCE may include Rule change proposals that relate to issues under consideration in the current Rule Change Request. However, the specific recommendations and proposals contained in the EWE final report are not included under the current Rule change and would appear likely to fall outside of its scope.

Nevertheless in assessing this Rule Change Request, the AEMC would be able to take into account the recommendations made in the EWE report to allow for consistency across these initiatives, where appropriate.

14 The full report *Review of the effectiveness of NEM Security and Reliability arrangements in light of extreme weather events*, final report, 31 May 2010, may accessed from the AEMC website.

15 This is currently being developed by AEMO.

16 See p6 of the Rule Change Request.

3 Details of the Rule Change Request

3.1 Key components

The key components of the Panel's Rule Change Request are as follows:

- starting on 1 July 2012, the current value of the MPC of $12 500/MWh would be amended on the basis of the change to the Intermediate (Stage 2) Producer Price Index (PPI) between the calendar year 2010 (the Base Year) and the year prior to the year that the adjusted MPC is intended to apply;
- starting on 1 July 2012, the current value of the CPT of $187 500 would be amended on the basis of the change to the PPI between the Base Year and the year prior to the year that the adjusted CPT is intended to apply;
- in amending the MPC and CPT, the values would be rounded to the nearest $100/MWh;
- the amended values of the MPC and CPT would not be lower than the previous year's values;
- the Panel would conduct an annual review to determine whether the index is no longer appropriate, having regard to how the indexed MPC and CPT have impacted on spot prices, investment in the NEM and the reliability of the power system;
- subject to the outcome of the annual review process, the MPC and CPT would continue to be indexed in the proposed manner indefinitely;
- the requirements for the biennial reviews of the Reliability Standard and the Reliability Settings would be removed; and
- the AEMC may request that the Panel undertake a more detailed analysis of some or all of the Reliability Standard and Reliability Settings at any time.

The proponent's Rule Change Request includes a proposed Rule.[17]

3.2 Indexation

As noted earlier, the Rule Change Request proposes that the MPC and CPT be indexed in accordance with the PPI. In relation to the indexation process the Panel have proposed the following:

- the 1 July 2010 values of the MPC and the CPT would be taken as the base values for the purpose of indexation;

17 Schedule 1 of the Rule Change Request.

- the Panel must determine and publish the indexed MPC and CPT values to apply from 1 July each year no later than 10 business days after 30 March of that year;
- determination of the indexed values would be in accordance with the methodology as set out in the Rule Change Request;
- for simplicity, the indexed values would be rounded to the nearest $100/MWh; and
- to further maintain market certainty, the values would not decrease from the previous year, irrespective of any negative movements of the underlying index.

Specifically, determining the index to be applied in (for example) 2012, would involve the following steps:

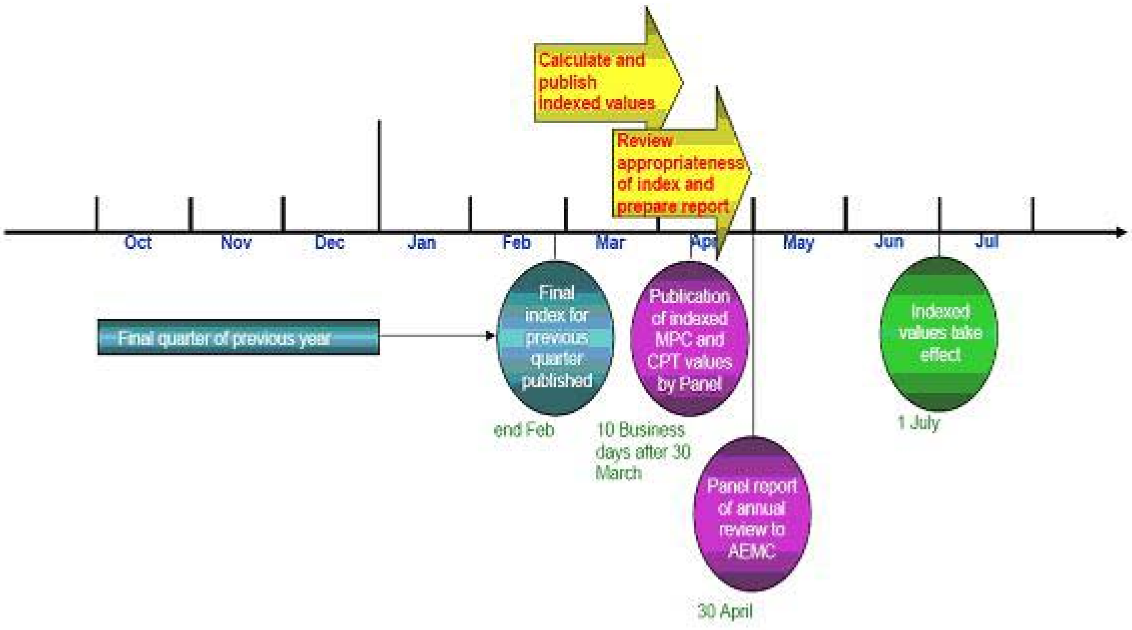
- determine the average of the four quarterly PPI values from the 2011 calendar year, noting that the index for final quarter of 2011 would be the value that is published as at the end of February in 2012.[18] This would be taken to be the index value for 2011.
- determine the index value calculated for the Base Year (2010) in the same manner as above;
- take the ratio of the two indices - if the ratio of the 2011 index to the 2010 index is greater than 1 then this ratio would be the index to be applied from 1 July 2012. If the ratio is less than 1 (or is lower than the previous year) then there would be no change to the MPC or CPT values from 1 July 2012;
- the indexed MPC and CPT values (rounded to the nearest $100/MWh) to apply from 1 July 2012 must be published by the Panel no later than 10 business days after 30 March 2012. Market Participants would therefore be given some prior notice of the indexed values to commence on 1 July of the indexed year;[19]
- the Panel must then complete a review and report to the AEMC by 30 April 2012 on whether it considers that the indexation is no longer appropriate.

This process is represented diagrammatically in Figure 3.1.

18 To take account of any late revisions to the last quarter value.

19 p12 of the Rule Change Request.

Figure 3.1 Representation of proposed process timetable



The average of the four quarterly values is proposed to be used rather than the published PPI value for a given year, as this is considered to smooth the quarterly values and make the indexing process less susceptible to shocks in the PPI while still capturing trends in the underlying costs.[20]

The six month delay between the December quarter and the July application date is not viewed by the Panel as a significant issue given that the annually indexed MPC and CPT values are intended to provide long term investment signals to participants.[21]

All things being equal, and subject to the annual review process, the Panel proposes that the indexation process should continue indefinitely with no sunset.[22] If the PPI ceases to be published or is substantially changed (including any change made to the Base Year for the PPI), then the AEMC may determine, on the advice of the Panel, another index to be applied.[23]

The Rule Change Request does not contain an equivalent request to index the MFP and it would therefore remain set at -$1 000/MWh.

20 p11 of the Rule Change Request.

21 p12 of the Rule Change Request.

22 p14 of the Rule Change Request.

23 This provision is contained in the proposed definition of PPI; see Schedule 1 of the Rule Change Request.

3.3 Annual review

In relation to a review process, the Panel explicitly proposes two primary changes from the current review process:

- remove the current requirement on the Panel to conduct an integrated review of the Reliability Standard, and the effectiveness of the Reliability Settings in meeting the Standard, on a biennial basis;
- the Panel to conduct an annual review to consider whether the indexation of the MPC and CPT is no longer appropriate, with regard to how the calculated levels have impacted on:
  - spot prices;
  - investment in the NEM; and
  - power system reliability.

The review of the indexation is to be completed by the end of April in each indexed year following publication of the revised MPC and CPT values, and the Panel must then provide a report of its review to the AEMC by 30 April in each indexed year.

The AEMC retains the option to request the Panel undertake a more detailed review of some or all of the Reliability Standard and Settings under the proposed Rule change[24] and under the NEL generally, by providing the Panel with the specific terms of reference.[25] The review undertaken by the Panel pursuant to any such request would be in accordance with the Rules consultation procedures and would enable a more detailed review of the Reliability Standard and Settings.

24 Clause 3.9.3A(b) of the proposed Rule.

25 s38(2)(b) or (c) of the NEL.

4 Assessment Framework

The AEMC's assessment of this Rule Change Request must consider whether the proposed Rule promotes the NEO, which is set out under section 7 of the NEL as follows:

> "The objective of this Law 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."

In assessing the Rule Change Request against the NEO the AEMC would consider the likely long term effects of the Rule Change Request compared to the counterfactual of not making the proposed change to the Rules. It would also consider whether the proposed Rule satisfies the Rule making test in that it would, or is likely to, contribute to the achievement of the NEO.

Specifically, the AEMC will have regard to whether and to what extent the proposal to index the MPC and CPT, and amend the scope of and process for reviewing the Reliability Standard and Settings, would provide or promote greater certainty to potential investors regarding MPC movements and thereby facilitate sufficient investment in generation assets to meet consumer expectations for reliability of supply in the long run.

The AEMC will also inform its decision by considering the following elements:

- the effect of the Rule Change Request on efficiency in investment in electricity services, particularly generation assets;
- the effect of the Rule Change Request on the reliability of electricity supply in the long run;
- the effect of the Rule Change Request on wholesale energy price volatility and participant responses;
- the effect of the Rule Change Request on the administrative efficiency and costs of the Panel in carrying out the reviews; and
- whether the Rule Change Request is consistent with the principles of good regulatory practice.

5 Issues for Consultation

Taking into consideration the assessment framework and potential requirements to implement the proposed Rule change, we have identified a number of issues for consultation that appear to be relevant to this Rule Change Request.

The issues outlined below are provided for guidance. Stakeholders are encouraged to comment on these issues as well as any other aspect of the Rule Change Request or this paper including the proposed framework.

5.1 The proposed index and indexation process

5.1.1 Expected costs and benefits of indexation

This section discusses the Panel's rationale in relation to the Rule Change Request to introduce indexation.

In making its recommendations and the Rule Change Request, the Panel noted that the Reliability Settings are required to achieve multiple objectives:

- meet the Reliability Standard;
- manage the financial risk faced by market participants; and
- meet the customers' value of reliability.

The Panel expressed concern that meeting all of these multiple objectives might become increasingly difficult under the current framework, or that meeting one objective might detrimentally affect the meeting of another.

The Panel considered[26] that the long term interests of electricity consumers would be served by effectively fixing the real value of the MPC and CPT at current levels given that:

- sufficient levels of investment to meet the Reliability Standard are currently being delivered;
- these values maintain the balance between being high enough to attract investment in generation but not so high as to create unmanageable wholesale trading risks; and
- the current level of the MPC is arguably reflective of the value that residential customers would place on reliability.

Despite this, the Panel was concerned of the risk that the real value of these Settings may erode over time and increase the risk of under-investment, concluding that the

26 at p 17 of the Rule Change Request.

values should therefore be appropriately indexed to maintain their real values, i.e., at a level that would continue to encourage sufficient investment in generation to meet the Reliability Standard.

The Panel suggested a number of expected benefits of indexing the MPC which go some way to meeting these objectives, including:[27]

- aiming to meet the Reliability Standard efficiently with respect to price and supply, while meeting the value of consumer reliability;
- promoting market certainty by maintaining the real value of MPC for investor and the potential revenue that generators can expect to earn over the long run;
- minimising potential volatility of wholesale market prices for retailers and end users; and
- reducing the administrative costs to the Panel by minimising the review requirements.

In relation to indexing the CPT, the Panel suggest that the expected benefit is to maintain consistency with the philosophy that underpinned its creation, namely to act as a financial safety net without hindering investment.

Against these expected benefits, the suggested costs of indexing are:[28]

- the potential risk that the indexing of the MPC and CPT does not fully support the investment in new capacity required to maintain the Reliability Standard; and
- the relatively small annual administrative cost of undertaking the process.

In considering the costs and benefits of indexation, stakeholders may wish to reflect on the effectiveness of the proposed indexation process to allow it to run as envisaged. All things being equal, the introduction of a relatively automated process (indexation) should lead to reduced administrative costs. However this may in turn be dependent on the level of active intervention that is actually required. For instance some level of review and/or analysis would be required on an annual basis, to determine the appropriateness of the index, and particularly when some deviation has occurred.

It is also noted that the indexation process proposed by the Panel requires the index to be increased where the PPI increases, relative to the Base Year, but not to decrease even if the PPI reflects any negative growth. The Panel refers to the ACIL Tasman report and notes that while the 2012/2013 forecast capital costs of new entrant OCGTs were forecast to be approximately 21% above 2007 levels, they were also subsequently forecast to fall in real terms until the end of the forecasting period of 2016/17. While the Panel has indicated that this 'ratcheting' effect would provide greater certainty to

27 pp18-19 of the Rule Change Request.

28 p19 of the Rule Change Request.

investors, stakeholders may wish to consider whether this strikes the right balance with issues of cost reflectivity and meeting the long term interests of consumers.

Question 1 Expected costs and benefits of indexation

1. **Would the maintenance of the MPC and CPT in real terms be beneficial and effective in achieving the Reliability Standard in the long run?**

2. **Do you agree that the process of indexation as proposed by the Panel would provide increased certainty of MPC and CPT movements to market participants?**

3. **Do you think that the suggested benefits of indexation could otherwise be achieved in the long run under the status quo or with minor amendments to the status quo?**

4. **Do you think that the administrative costs of the proposed annual review are sufficiently identified in light of the level of actual intervention that might be required? Are these costs likely to be significantly different from the costs associated with the Biennial Review process?**

5. **Does the effective ratcheting of the index strike the appropriate balance between certainty for investors and cost reflectivity?**

5.1.2 Criteria for selection of an index

Given the importance of the proposed index to the market and that the choice of the index has not been tested through the consultation process,[29] stakeholders may wish to consider and provide comments on the method and criterion for selecting an appropriate index.

In reviewing the requirements for a suitable index, the Panel considered that it should:[30]

- be based on the supply side costs of meeting the Reliability Standard;
- follow similar economic trends to those parameters used in setting the MPC and CPT, particularly the capital cost of new OCGTs;
- be independently verifiable; and
- be amenable to forecasting.

The Panel considered that the Intermediate (Stage 2) Producer Price Index (PPI) adequately fulfils the criteria identified above. This index is published by the Australian Bureau of Statistics (ABS) and provides a summary measure of the

29 p11 of the Rule Change Request.

30 Page 11 of the proposed Rule change.

movements in the prices of commodities over time, using a 'stage of production' framework whereby commodities are categorised on a sequential basis along the production chain, from preliminary (Stage1) through to final (Stage 3).

The Panel also considered that Stage 2 of the PPI provided a good reflection of the costs associated with meeting reliability, avoided being too general, such as would be the case with a consumer price index (CPI) type index, or too specific, as with a commodity specific index. In assessing the appropriateness of the proposed or any other index, it might be useful to consider the components that make up the basket of inputs and how each of them is weighted. Another consideration may be whether it would be more useful to construct a specific index.

Question 2 Criteria for selection of an index

1. **Do you agree that the requirements identified by the Panel are the appropriate requirements for the purpose of selecting a suitable index?**

2. **Is the PPI the most appropriate index to use? Is there a more suitable index and, if so, why?**

5.2 The proposed annual review

5.2.1 Removal of the Biennial Review process

Currently, the Panel is required to review the level of the Reliability Settings on a biennial basis. The purpose of the Biennial Review is essentially to undertake an integrated review to consider:

- the existing Reliability Standard and its appropriateness for the future; and

- whether the price mechanisms are set adequately to ensure that the Standard is met, with the additional aim of avoiding the creation of unmanageable risks for market participants.

These requirements were recommended by the Panel in its Comprehensive Reliability Review,[31] and were formally incorporated into the Rules by the AEMC following the 2009 Rule change determination.[32] In recommending an integrated review, the Panel was of the opinion at that time that all the settings have an effect (albeit an unequal one) on USE and should therefore be reviewed together.[33]

The Rule Change Request removes the requirement for an integrated review and introduces an annual review of whether the proposed indexation is no longer

31 refer to chapter 8 of that review, specifically pp88-90.

32 *National Electricity Amendment (NEM Reliability Settings: VoLL, CPT and Future Reliability Review) Rule 2009*, final determination, 28 May 2009, pp 28-29.

33 *Comprehensive Reliability Review*, final report, December 2007, AEMC Reliability Panel, p89.

appropriate. The Panel considered that, together with indexation, this would provide greater regulatory certainty, transparency and predictability of outcomes in terms of changes in MPC and CPT values for market participants, and is therefore likely to promote a more efficient level of investment in electricity services.[34] Some observations regarding this aspect of the Rule Change Request are:

- The current Biennial Review process is a highly consultative one. By contrast, it is noted that the annual review process as outlined in the Rule Change Request contains little or no opportunity for public consultation. Arguably, given the timeframe for the indexation, review and reporting processes to be completed on an annual basis, consultation would be difficult to accommodate. Stakeholders may wish to consider whether this is material or whether, for example, the mechanical nature implied by the proposed process provides sufficient certainty and transparency.

- The proposed Rule includes provision for the AEMC to request that the Panel undertake a more detailed review of some or all of the Reliability Standard and Settings at any time under the Rules. However the timing and scope of any review would likely be on a more ad hoc basis. In addition, it is noted that the Rule Change Request does not prevent any person from lodging a Rule change request in relation to any of the Settings if that person considers that a more appropriate value should be applied.

Question 3 Removal of the Biennial Review process

1. **Do you agree that removal of the requirement to review the Reliability Standard and the MFP would support greater regulatory certainty, transparency and predictability of outcomes for market participants?**

2. **Is the limited opportunity for consultation during the annual review process of material concern, or does the proposed process provide sufficient certainty and transparency?**

3. **Should the Reliability Standard and Settings continue to be subject to a regular process of review which allows for the consideration of other factors, such as forecasts or use of the VCR, rather than a review initiated at the discretion of the AEMC?**

5.2.2 Focus and clarity of the proposed annual review process

The proposed Rule change introduces a new annual process, which represents a change in the emphasis and direction from the current review process. In assessing the relative merits of the proposed process, stakeholders may find it useful to consider the comparative differences between the proposed process against the status quo.

34 p18 of the Rule Change Request.

For example, stakeholders may wish to compare the purpose and scope of each process, and the steps involved with both. The Biennial Review was intended to be a fully integrated review of the Reliability Standard and Reliability Settings, and included extensive economic analysis and modelling to assess and recommend the appropriate levels (real values) of the Settings to meet the Standard going forward. For the reasons outlined earlier, the Panel's proposal is to establish a new process to review, on an annual basis, whether the index is no longer appropriate.

Further, it is noted that the starting point for analysis in the current Biennial Review process is to review the status quo and test whether changes are justified. This is reversed in the proposed annual review whereby the starting point is that the newly indexed values of the MPC and CPT are appropriate, with the review then to test whether the indexation is not appropriate.

The Panel's proposal is not prescriptive about what the annual review process would involve or what the Panel would consider. For example, it may be possible to infer that it would involve an assessment of whether the PPI is on track with, or is diverging from, the real capital costs of new entrant OCGTs, but this is not explicit. However this might also be to provide the Panel with adequate flexibility in the review process. Other matters to consider may include:

- at what point something would be considered as 'no longer appropriate', although this is likely to be a matter of judgement;
- the timeframe contemplated by the phrase 'no longer appropriate', i.e., whether it refers to the short term or long term application of the index and whether if after a period of time use of the index would resume;
- how the review would take the impact of the newly indexed values on spot prices, the level of investment in the NEM or power system reliability into account;
- what the default process would be if the Panel consider the index not to be appropriate following a review.

In relation to the final point, we note that there is potential for some practical challenges as a result of the combination of the order of the proposed indexation and review process, and the proposed timetable. For example if, following the publication of the indexed values and the annual review, the Panel decides that the indexation is no longer appropriate there is no provision for the Panel to alter the indexed value in line with the review findings. The indexed values would therefore still apply on 1 July of that year.[35]

Under the proposal the Panel would determine the indexed values by way of a prescriptive methodology set out in the proposed Rule, and publish them prior to 1 July of the year in which they are to be implemented. However, in practical terms, the

35 This is subject to any Rule change to alter the indexed values, but under the standard Rule change process, such a request could not be implemented by 1 July of that year.

proposed Rule does not appear to allow the Panel any flexibility in the determination process. If the key activities are the calculation and publication of the indexed values, stakeholders may wish to consider whether a formal determination process is required or whether a more simplified process covering the calculation and publication of the values is more appropriate.

Question 4 Focus and clarity of the proposed annual review process

1. **Is there a need to review the appropriateness or otherwise of the indexation of the MPC and CPT on an annual basis?**

2. **Is the proposed timeframe, scope and process of the annual review satisfactorily defined, and if not, what other matters should be considered or included?**

3. **Do you think the parameters around the process should be more explicit? For example, do you consider that the process to be followed in the event that the Panel concluded that indexation is no longer appropriate is sufficiently clear?**

4. **Do you agree that the proposal to obligate the Panel to determine and publish the indexed MPC and CPT values in the proposed manner is an efficient method of implementing this process? Is there is a more efficient way of implementation?**

6 Lodging a Submission

The AEMC has published a notice under section 95 of the NEL for this Rule Change Request inviting written submission. Submissions are to be lodged online or by mail by 9 December 2010 in accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the AEMC's Guidelines for making written submissions on Rule change proposals.[36] The AEMC publishes all submissions on its website subject to a claim of confidentiality.

All enquiries on this project should be addressed to Tina Wong on (02) 8296 7800.

6.1 Lodging a submission electronically

Electronic submissions must be lodged online via the AEMC's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code "ERC0115". The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic submission, the AEMC will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

6.2 Lodging a submission by mail

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Or by fax to (02) 8296 7899.

The envelope must be clearly marked with the project reference code: ERC0115.

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the AEMC will issue a confirmation letter.

If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

36 This guideline is available on the AEMC's website.

Abbreviations

ABS	Australian Bureau of Statistics
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
APC	administered price cap
Base Year	calendar year 2010
Commission	See AEMC
CPI	consumer price index
CPT	cumulative price threshold
EWE	extreme weather events
MCE	Ministerial Council on Energy
MFP	market floor price
MPC	market price cap
NEL	National Electricity Law
NEM	National Electricity Market
NEO	national electricity objective
NER	See Rules
OCGT	open cycle gas turbine
Panel	Reliability Panel
PPI	Intermediate (Stage 2) Producer Price Index
Reliability Settings	Reliability Settings
Reliability Standard	NEM Reliability Standard
Rules	National Electricity Rules
Settings	See Reliability Settings

Standard	See Reliability Standard
USE	expected unserved energy
VCR	value of customer reliability