N A T I O N A L G E N E R A T O R S F O R U M

Energy Retailers Association of Australia Limited

18 September 2009

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted on line

Dear Dr Tamblyn,

ERC0094: Improved RERT Flexibility and Short-notice Reserve Contracts

The NGF and ERAA are pleased to comment on the proposal by the Reliability Panel.

The NGF and ERAA oppose this rule change for the following reasons:

- The ST RERT is not needed and represents a distortion to the market
- It is poor policy to develop a sub market for reserve
- The Reliability Panel have not made a case that the proposal advances the National Electricity Objective (NEO)
- The proposed Rule introduces an inconsistency in the rules which relates to the implied value of achieving a *secure operating state*
- Regulatory uncertainty is increased by the rule

The ST RERT is not needed and represents a distortion to the market

The Reliability Panel have recognised that the RERT and ST RERT are both distortions to the market.

The RERT (and previously the Reserve Trader) has not increased the actual supply reliability in 10 years. Although AEMO have contracted load under the Reserve Trader provisions, it has never been dispatched. Despite the lack of use of the Reserve Trader, the market has delivered a level of reliability which has, arguably, been an order of magnitude greater than the target set for unserved energy (0.002%).

The AEMC have written to the Department of Climate Change[1] expressing their confidence that shortages will not occur as a result of the implementation of the RET and CPRS. However, if the Reliability Panel were concerned at some medium term developments associated with the CPRS, such as the possible short notice closure of a large brown coal plant, the size of this event will dwarf any capacity which the ST RERT will be able to bring to bear on the situation. The way to manage this risk is certainly not through a ST RERT mechanism.

It is also unclear who the Reliability Panel consider will apply to be on the panel. During previous RERT (reserve trader) tenders, there has been difficulty in sourcing the required volume. Given that panel members will not be paid unless their capacity is actually called upon, it is unlikely that the take-up will be enthusiastic.

It is poor policy to develop a sub market for reserve

There are undoubtedly small generators and some loads which could be more actively involved in the market, but are not. The reasons for this are excessive complication, high technical requirements and disproportionate costs. These non-registered participants, although small, can possibly collectively make a reasonable impact at times of stress in the market. The focus should be on tweaking the market design arrangements to better encourage these sources to participate in the market, rather than achieve the opposite through the ST RERT, which has the effect of further discouraging such market participation.

This issue was considered by the Short Term Generation Capacity working group under the AEMC Energy Frameworks Review and it has also been a focus of the Demand Side work which has been progressing.

Efficiency will be maximised by having these participants involved in the market at their discretion. The ST RERT is a very administrative, limited and inefficient way to involve them which is likely to block innovation.

The Reliability Panel have indicated that their revised ST RERT is equivalent to NGF's alternative proposal.[2] The NGF does not support this view, for a number of reasons.

Firstly, there is an additional element as to whether the non-registered participant, by taking part in the market, can prevent the event which would trigger the use of the ST RERT. Loads are becoming more active in the

[1] AEMC letter to DCC 4 December 2008
[2] "Reliability Panel Rule Change Proposal page viii

market (at last). NGF's position remains that efforts should be focussed on bringing loads and small generators into the main market and not sidelining them into the reserve market.

Secondly, the RERT Panel would be more complex and more expensive to administer then specifically targeting non-scheduled loads to enter the market. This is because the RERT panel would be open to a wide range of technologies and thereby also subject to increased complexity and costs to accommodate these varying technologies. In contrast, the NGF was only advocating improving the existing Directions mechanism to incorporate non-scheduled loads.

The Reliability Panel have not made a case that the proposal advances the NEO

The NGF considers the analysis undertaken by the Reliability Panel to have some serious flaws. The NEO is specifically an objective for the long term. However, the Reliability Panel have chosen to take a very short term view. Their cost benefit analysis essentially weighs up the administrative cost of running a panel and the benefit of having additional capacity available at short notice. They do not consider how the ST RERT might change the longer term incentives and behaviour of participants in the NEM.

For example, it is possible that some participants may choose to withhold capacity from the market if they consider they can achieve higher or more certain returns under the RERT. This could reduce the liquidity and operational integrity of the NEM. However, it is not clear to the NGF that the Reliability Panel has considered this possibility in its analysis. A fulsome consideration of the ST RERT in light of the NEO, must consider such eventualities and the NGF would be pleased to assist the AEMC in this regard.

The proposed rule introduces an inconsistency in the rules

A further concern the NGF has with respect to the ST RERT rule change proposal is that it may inadvertently create an inconsistency within the Rules. This inconsistency relates to the implied value of achieving a *secure operating state*.

Rule 3.8.1(c) requires AEMO to establish procedures to relax constraints to resolve unfeasible dispatch solutions in order to determine prices. This implicitly accepts that dispatch at times will not comply with security constraints. In other words load shedding will not be used to avoid a risk of load shedding.

This Rule thus sets a value of achieving a *secure operating state* that is less than the value attributed to load shedding, namely the market price cap.

In contrast, the proposed Rule would allow contracted reserves under the RERT to be used to address a power system security event, in other words these reserves may be used to achieve a *secure operating state*.

The primary effect of the RERT is to provide a role for services that could be in the market, but choose not to deal with the difficulties and costs of market entry given revenue available is restricted by the *market price cap*. Thus the application of reserves acquired under the RERT implies a willingness to pay more than the m*arket price cap.*

The proposed Rule would thus introduce an inconsistency, with the achievement of a *secure operating state* valued in one context at up to the *market price cap*, but in the proposed new provision, valued at above the *market price cap*. This is a symptom of the separate reserve market which is in danger of developing.

We note that the most common departures from a *secure operating state* involve a risk that some load shedding will become necessary in the unlikely event that a critical contingency event occurs. Thus from the perspective of the customers, who are faced with the cost of market intervention, the actual value of achieving a *secure operating state* is, in most cases, very much lower than the value of lost load.

NGF concludes that the existing Rules are a better fit with the NEO than the proposed rule change. We submit that a consistent approach to the important issue of system security is required under the National Electricity Objective, and that the Reliability Panel has failed to give any consideration to this important issue in formulating the proposed Rule change. This issue is, in effect, a part of the issue referenced earlier where the reserve market is uncapped compared with the $12,500 for the main market.

Regulatory uncertainty

The NGF noted in its 6 June 2009 submission to the Reliability Panel:

> "Detailed cost / benefit analysis is required to justify the proposed RERT flexibility arrangements. What are the potential short term gains from these arrangements versus long term efficiency losses through reduced investment certainty due to the on-going threat of increased interventions and regulatory creep";

This comment highlights another detriment which the Reliability Panel have not recognised (in spite of our submission). The Reliability Panel states in its Rule change proposal[3] that:

> "The Panel does not agree that a detailed cost-benefit analysis is required to justify the proposed amendments to the RERT arrangements. The RERT is an existing mechanism in the Rules and

[3] Reliability Panel, Rule change proposal, 10 August 2009, page 23.

the Panel considers that the proposed amendments are predominantly administrative in nature".

The parties to this submission strongly disagree with the Panel's disregard for consideration of a detailed cost-benefit analysis. The proposed "improved" RERT is potentially much more administratively complex and more costly to implement than the original RERT. Perhaps more importantly, the "improved" RERT is potentially much more distortionary for long term investments. Some additional capacity which can be introduced at short notice, potentially at times of high prices, will have an impact on investment certainty which needs to be recognised.

The key point is that the "improved" RERT will have some quantifiable costs in the short term and potentially much more significant long term efficiency / cost implications. The parties to this submission believe it is imperative that some detailed cost / benefit analysis is undertaken to quantify whether the proposed Rule change will advance the NEO given that it is not equivalent to the existing RERT.

The other signal which this rule change indicates to a potential investor is an increasing lack of faith in the market to meet the reliability criteria which has been set. This "regulatory creep" is of concern and the magnitude of the detriment needs to be included in the assessment of this rule.

Summary

The NGF and ERAA submit that this rule does not enhance the National Electricity Objective and should not therefore be made. We believe there is no need for the rule and that the Reliability Panel has not demonstrated its benefit. Indeed, they have omitted some of the longer term detriments.

Please contact me on (03) 8633 6026 or by email to acruicks@agl.com.au if you wish to discuss this submission.

Yours faithfully,

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