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The Reliability Panel
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Review of the Reliability and Emergency Reserve Trader – Issues Paper

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Reliability Panel's Issues Paper for its review of the Reliability and Emergency Reserve Trader (RERT).

esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of over 40 electricity and downstream natural gas businesses. These businesses own and operate some \$120 billion in assets, employ over 52,000 people and contribute \$16 billion dollars directly to the nation's Gross Domestic Product.

Australia's businesses and households rightfully expect their electricity supply to be delivered with a high degree of reliability. Since the commencement of the National Electricity Market (NEM) in 1998, the electricity industry has met this expectation, with all regions complying with the long-term Reliability Standard of 0.002 per cent unserved energy (USE).¹

While Australia's endowment of abundant, accessible and low-cost energy resources has no doubt contributed to this success, the NEM's impressive reliability performance has also hinged on the effective, open and competitive wholesale market supported by a comprehensive reliability regulatory framework.

The energy-only market model of the NEM has interacted with the elements of this regulatory framework – its institutions (the Australian Energy Market Commission (AEMC), the Reliability Panel, the Australian Energy Market Operator), its processes (recurrent and ad hoc reviews, information provision documents such as the Electricity Statement of Opportunities), and its market signposts and parameters (the Reliability Standard, the market price cap) – over the last 12 years to deliver enough capacity to underpin the reliability that Australia expects.

¹ Australian Energy Market Commission, Review of the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events: Final Report, 31 May 2010, page 55.

While delivering reliability in the NEM is primarily the responsibility of the market, the NEM's regulatory toolbox has also contained since market start a reserve trader function that empowers the market operator to procure additional reserves beyond those made available by the market if it is concerned about an impending shortfall. However, the reserve trader has not provided energy to the market as yet and has always sat awkwardly with the broader NEM paradigm of commercially-driven, decentralised decision-making and the reliability planning framework.

The Association took the opportunity to express its views on the current incarnation of the reserve trader – the RERT – in the *National Electricity Amendment (Improved RERT Flexibility and Short-notice Reserve Contracts) Rule 2009* Rule change proposal, which sought to expand the scope of the intervention mechanism by collapsing the timeframe for contracting reserves from 10 weeks before a projected shortfall to three to four hours before dispatch.

In its submission to that process, esaa's view was that the effective operation of the energy-only market was impacted by the ability to intervene to deliver capacity through mechanisms such as the RERT and that such a mechanism had the potential to introduce distortions that may have substantial and difficult-to-predict impacts on generator behaviour, the wholesale market and investor decision-making.²

However, in light of the impetus for the Rule change, esaa sought clarification from the AEMC and policy makers about what fundamental outcomes were expected from the market and whether reservations were held about the ability of the market and the current reliability framework to deliver those outcomes. Specifically, the Association's submission said:

esaa is of the view that if the Australian Energy Market Commission (AEMC) has reservations about the market's ability to deliver sufficient capacity to meet the current reliability expectations of the NEM, then a fulsome review into capacity availability and the drivers of market failure should be undertaken at the appropriate time, noting that this would likely be after the uncertainty around the impending introduction of the Carbon Pollution Reduction Scheme and the expanded Renewable Energy Target is resolved. The Association notes, however, that the NEM has historically performed well against the Reliability Standard and that no region has failed to comply with the long-term reliability standard.

Alternatively, if there is a view among policy makers that electricity supplies should be delivered with greater reliability than the current market and reliability framework are designed to achieve, then rather than incrementally expanding intervention powers to achieve an implicit higher reliability standard through regulatory means, a clear policy objective should be articulated following comprehensive reappraisal of the market framework. In this context, esaa notes that the current Reliability Standard and Settings

² One such distortion is the possibility that the reserve panels may crowd out the development of market-based demand-side responses. The submission noted that the prospect of demand-side reserves withdrawing from the market to join the panel may increase the probability that the RERT panels are deployed.

Review *and the* Review of the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events *would be instructive*.³

Since the completion of that Rule change process, which ultimately resulted in the AEMC expanding the RERT, the two reviews referred to in esaa's submission – the *Extreme Weather Events Review* and the *Reliability Standards and Settings Review* – have concluded. Between them these reviews canvassed a range of issues with the NEM's reliability framework and performance, and broadly concluded that: the current reliability objectives are appropriate (that is an USE target of 0.002 per cent); that the market price cap is an appropriate reflection of the value relevant consumers place on load (currently \$12,500 MWh); that the market is successfully delivering the objectives asked of it; and that the market design is effective.

While the Ministerial Council on Energy (MCE) is yet to respond to the *Extreme Weather Events* review and similarly the AEMC is still considering the recommendation of the *Reliability Standards and Settings Review*, prima facie these reviews are a strong endorsement of the ability of the market to deliver what the reliability regulatory framework asks of it. In this context, the question necessarily must be asked: if the market is doing its job, what role for the RERT?

One argument adduced for the RERT is as a vehicle to integrate demand-side options and small-scale generation into the market. The MCE has stated that it considers efficient demand-side decisions to be as important as efficient supply-side decisions in optimising the overall efficiency of the NEM.⁴ As a fuel and technology neutral organisation, esaa supports all sources of generation and demand-side response or small-scale generation integrating effectively and efficiently in the market as commercial circumstances dictate.

However, the issue is not whether such demand-side and small-scale generation options should be involved in contributing to reliability; the issue is at what cost? To the extent that such services require a higher price than the market price cap to be viable, their inclusion would seem to be superfluous to the agreed (and recently re-endorsed) reliability objectives of the market. Hence they could not be justified on economic efficiency grounds.

On the other hand, if such services are viable at prices below the market price cap, then they could be expected to enter the market if it was in the commercial interests of the relevant parties to do so. Indeed, as noted in the Reliability Panel's Issues Paper for the review, there is evidence and indication of demand-side activity beginning to engage in the market.

However, if there are some demand-side or small scale generation options that are viable at prices below the market price cap, but their participation is inhibited by unnecessary barriers, then this is inefficient and the Association would support this being addressed. The Association notes that work is being done by the AEMC in its *Demand Side Participation* review, which is now in its third stage, and by AEMO, in

³ esaa submission to the Consultation Paper for the *National Electricity Amendment (Improved RERT Flexibility and Short-notice Reserve Contracts) Rule 2009*.

⁴ Ministerial Council on Energy, *Demand-side Participation in the NEM: Response to the AEMC's Stage 2 Final Report*, June 2010.

its *Small Generator Framework* consultations to explore these issues. The Association would support barriers to market participation being addressed through forums such as these rather than trying to indirectly sponsor their involvement in the NEM through a supplementary sub-market for reserves through the RERT.

In its submission to the 2009 RERT Rule change esaa also highlighted the need for clarity in the two major policies likely to profoundly shape the sector over the next two decades: the Renewable Energy Target (RET) and the Carbon Pollution Reduction Scheme. After a tortuous policy development process, the uncertainty around the RET has been largely resolved with the sundering of the scheme into a large and small-scale components.

The same cannot be said about greenhouse policy. However, while the precise shape of future greenhouse policy is presently inchoate, the broad political support for emissions reductions and the likelihood that a significant proportion of these will be expected to come from the electricity sector means that Australia's electricity industry will almost certainly face an unprecedented period of transition over the coming years. The exact dynamics of this transition are impossible to predict without knowledge of the precise policy mechanism; however, it is generally accepted that it will involve some retirement of emissions-intensive generation assets.

Given the imperative of maintaining the reliability of electricity supply through the transition to a lower carbon footing, it is possible that the impending challenges facing the sector may be seen by policy makers as a justification for retaining the RERT. Such a perception may be in spite of the fact that the RERT is distortionary and inconsistent with the NEM's broader reliability framework, and that it would be more efficient to facilitate demand-side or other resources to integrate into the primary energy market rather than to continuing to court such resources indirectly through the RERT sub-market.

While this notion of an insurance policy against unexpected outcomes from climate change policies could prima facie be appealing to policy makers, the validity of such a proposition depends on what contribution, if any, the RERT could actually make to reliability outcomes during periods of stress in this period of transition, *beyond* what the other elements of the reliability framework provide.

As no detailed analysis or modelling of this question was undertaken by the AEMC in its 2009 *Review of Energy Market Frameworks in light of Climate Change Policies* or by the Panel in its recent work on the RERT, it is difficult to be categorical. However, the Association observes that if policy makers are of the view that the RERT offers protection against 'major' power system events, such as the short notice closure of a large brown coal plant, it should be noted that the size of such an event would likely dwarf the ability of the RERT to respond. As noted by the AEMC in its *Climate Change Review*, the RERT was not designed for either large amounts of capacity or frequent use.⁵ On the other hand, if climate change policies precipitate 'minor' generation incidents, the Association does not, on the face of it, see why such incidents would be any different to the 'business-as-usual' type occurrences the

⁵ Australian Energy Market Commission, *Review of Energy Market Frameworks in light of Climate Change Policies: Final Report*, 30 September 2009, page 70.

existing reliability framework has been designed to withstand and successfully accommodating since market start without deployment of the RERT.

Accordingly, it would be useful if in the Panel's subsequent reports for this review it discussed in detail what, if any, additional contribution to reliability it saw the RERT making under different possible scenarios of electricity sector stress associated with climate change policies. (Notwithstanding the present lack of detail on the precise form of climate change policies, certain highly emissive plant can be identified as being most likely to retire early under a range of possible policy choices.) Such a discussion would be useful in assisting policy makers to form a realistic view of the potential role of the RERT during the imposition of climate change policies and prevent an outcome where the RERT is retained, despite it being a market distortion, in the mistaken belief that it provided a safety net against the impact of greenhouse policy.

Any questions in respect of our submission should be addressed in the first instance to Kieran Donoghue, by email to kieran.donoghue@esaa.com.au or by telephone on (03) 9670 0188.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Brad Page', with a stylized flourish at the end.

Brad Page
Chief Executive Officer