

Reliability Panel AEMC

DRAFT REPORT

Review of the Reliability and Emergency Reserve Trader (RERT)

24 December 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.

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).

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Executive Summary

In July 2010, the Australian Energy Market Commission (AEMC) provided the Reliability Panel (Panel) with the Terms of Reference for the Review of the Reliability and Emergency Reserve Trader (RERT) (the RERT Review). The Panel is also required under clause 3.20.9 of the National Electricity Rules (the Rules) to undertake a review of the RERT, no later than one year prior to the date that the RERT is due to expire. Currently the RERT is due to expire on 30 June 2012.

In particular, this review should:

- 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;
- consider the National Electricity Objective (NEO) contained in section 7 of the National Electricity Law (NEL) when it considers issues that arise in the review and making associated recommendations.

Draft recommendations

This Draft Report presents the Panel's draft recommendations on this review. On balance, the Panel's draft recommendation is that the RERT should be extended for one year, and should expire on 30 June 2013. The Panel recommends that the provisions for the Panel to review the RERT be removed from the Rules. The Panel considers that there is a role for the RERT in the short term, but that it should not be maintained in the longer term.

The Panel notes that the purpose of the RERT is to allow the Australian Energy Market Operator (AEMO) to contract for reserves when a shortfall of reserve is projected. Therefore it provides an opportunity for the supply and demand sides to provide capacity that may not be otherwise available to the market. The Panel has considered a number of key issues for this review. These address both the supply and demand sides, and the short and long term.

The Panel acknowledges that the ability of the RERT to attract supply side capacity has shown to be limited. The current RERT design is such that it is unlikely to provide any additional incentives for the supply side to participate in the market. The Panel notes, however, that the RERT is more likely to attract demand side capacity as there may be a greater opportunity for demand side participants to participate in the National Electricity Market (NEM) in circumstances where other avenues are unsuitable.

While the Panel considers it is more efficient for the demand side to participate directly in the NEM, it notes that the RERT has to date provided an additional opportunity for demand side participation. Most of the responses that it has elicited to date have been from the demand side. The Panel notes that there is ongoing work on the role of the

demand side in the NEM.¹ When these work programs are complete, they should have addressed any reasonable constraints on efficient demand side participation which should provide another avenue for this demand side response and hence remove the need for the RERT. The Panel therefore recommends that the RERT should be retained in the short term for this purpose.

The Panel recommends that in the longer term, given the performance of the NEM to date, the strong reliability outlook, the current investment signals, and the fact that the RERT typically elicits a response that is relatively small in the context of those events that may result in unserved energy (USE), the RERT mechanism is not likely to be required. The Panel considers the current investment signals, in particular the market price cap (MPC), should provide incentive for sufficient capacity to be available to be dispatched to the market.² While the Panel recognises the issue of ongoing uncertainty in the market, such as increased renewable generation and uncertain climate change policies, the Panel notes that the market has continued to invest in new capacity, notwithstanding these uncertainties.

Recent reviews have noted that raising the MPC and cumulative price threshold (CPT) increases costs and risks in the market, and if there are barriers to managing these risks, then there may be a point at which the Reliability Settings may no longer be an efficient mechanism for achieving power system reliability.³ These reviews considered the performance of the current market design should be monitored to determine if the market design remains resilient and sustainable over time. In particular, the Panel recommended that the AEMC undertake a review of both the mechanism for delivery of the capacity to ensure reliability, and the impact of the risk allocation framework in the NEM on achievement of reliability in the long term.⁴

The Panel notes that there remains a residual risk of a short-term shortfall, however, under the current definition of the Reliability Standard, some USE is likely to occur occasionally. Furthermore, the Panel also notes that AEMO has powers to intervene in the market which could be used in some circumstances to assist with any supply shortfall.⁵

¹ 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 MCE review of demand side participation (DSP) in the electricity market.

² The MPC was recently reviewed as part of the Review of the Reliability Standard and Reliability Settings. For more information see <http://www.aemc.gov.au/Market-Reviews/Completed/Review-of-the-Reliability-Standard-and-Settings.html>.

³ AEMC Reliability Panel, Final Report of the Review of the Reliability Standard and Reliability Settings, p.x, and AEMC, Final Report of the Review of the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events, pp.125-127.

⁴ AEMC Reliability Panel, Final Report of the Review of the Reliability Standard and Reliability Settings, p.x,

⁵ These include, using network control ancillary services (where possible), directing Registered Participants with regard to scheduled plant or market generating units, or instructing Registered Participants with regard to any other action.

The Panel considers that the current form of the RERT may be effective in addressing relatively small, location-specific, supply shortfalls. However, the Panel notes it is not an appropriate mechanism to directly address major power system events, such as the short notice closure of major baseload plant. Primarily, this is because of the limited amount of capacity available under the RERT.

The Panel recognises that the RERT is a market distortion, however it notes that the current version of the RERT seeks to minimise its market impact and is only activated for a limited time, in a limited location. As a result, the Panel considers that the direct market distortions of the RERT may be small, however, the RERT may have secondary impacts that distort the market.

In light of the above comments, the Panel considers that the RERT should be maintained for a short period, to allow any potential recommendations from the ongoing work programs, discussed above, to be implemented. However, the Panel considers that the RERT mechanism is not likely to be required in the longer term given the strong reliability outlook and the current investment incentives in the market.

In reaching this conclusion, the Panel notes that it is difficult to obtain empirical evidence to support arguments for either removing or retaining the RERT and that much of the analysis on the RERT has been qualitative rather than quantitative.

Stakeholder consultation

The Panel is required to undertake this review in accordance with the Rules consultation procedures set out in rule 8.9 of the Rules and is therefore consulting with stakeholders. Submissions are invited on this Draft Report, and are due by 10 February 2011.

On 3 August 2010 the Panel published an Issues Paper seeking initial comments from stakeholders on this review. Submissions closed on 17 September, 2010. The submissions received are available on the AEMC website.⁶

The Panel intends to hold a Public Forum in Melbourne on Thursday, 3 March 2011 to discuss this Draft Report and stakeholder submissions. Further details on the venue and time of the Panel meeting will be published by the Panel on the AEMC's website and via AEMC stakeholder email.

⁶ The AEMC website can be found at www.aemc.gov.au.

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1 Introduction

This chapter sets out the context for this current review, including the Terms of Reference (TOR) requirements that the Panel must address. It also sets out details on the process for making a submission on this Draft Report.

1.1 Context of the review

1.1.1 Rules requirements

Rule 3.20 of the Rules provides for the RERT and its operation. The Rules specify that the RERT is to expire on 30 June 2012, or alternatively on a date determined by the AEMC on the advice of the Panel in accordance with clause 3.20.9 of the Rules. Under clause 3.20.9 of the Rules, the Panel must, no later than one year prior to the date that the RERT is due to expire, complete a review of the RERT.

1.1.2 AEMC Terms of Reference

On 5 July 2010, the AEMC provided the Panel with a TOR for a review of the Reliability and Emergency Reserve Trader (RERT Review) in accordance with the requirements under the Rules.

In accordance with the TOR, the Panel is required to undertake a review of the RERT arrangements under the Rules to determine whether the mechanism should expire on, or prior to 30 June 2012, or whether the RERT should be extended beyond the current expiry date, and, if so, to what date.

The TOR specify that the RERT Review should specifically:

- 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;
- 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 TOR indicate that the Panel, in assessing the above, is not required to consider whether alternative arrangements should be put in place of the RERT.

The Panel is required to submit a written report to the AEMC on the RERT Review setting out its recommendations, supporting reasoning, and the procedure followed by the Panel in undertaking the review.⁷ On receipt of this report, the AEMC, taking into

⁷ Clause 8.8.3 (j) of the Rules.

account the report, may make a determination that the RERT is to expire and specify the date of expiry.⁸

1.2 Consultation process

1.2.1 Timetable

The following key dates outline the completed and intended consultation process leading up to the delivery of the Panel's Final Report to the AEMC.

Milestone	Date
Publication of Issues Paper	3 August 2010
Public Forum	2 September 2010
Close of submissions on Issues Paper	17 September 2010
Publication of the Draft Report	24 December 2010
Close of submissions on Draft Report	10 February 2011
Public meeting	3 March 2011
Publication of Final Report	22 April 2011

1.2.2 Submissions

The Panel invites comments from interested parties in response to this Draft Report by 5pm (Australian Eastern Standard Time) on 10 February 2011.

Lodging a submission electronically

Submissions must be lodged online through the AEMC's homepage at www.aemc.gov.au using the link entitled "online lodgement".

The submission must be on letterhead (if an organisation), signed and dated by the respondent, and the submission must be in PDF format.

Upon receipt of the electronic version of the submission, the Panel will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

⁸ Clause 3.20.9 (d) of the Rules.

Lodging a submission by mail

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

The Reliability Panel
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235
or by Fax: (02) 8296 7899.

The envelope or fax must be clearly marked with the project reference code "REL0041".

Except in circumstances where the submission has been submitted electronically, upon receipt of the hardcopy submission the Panel 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.

2 Context

2.1 Current RERT mechanism

Under the Rules, the current RERT mechanism allows 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 (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 wish to be paid to use that capacity; 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.

The Rules determine that the costs for contracting for reserves are shared between the affected jurisdictions, following consultation with jurisdictions.⁹ Market Customers in these jurisdictions are allocated a share of the regional costs, based on their relative energy consumption between 8am and 8pm.¹⁰

In order to implement the RERT, the Rules require the Panel to publish guidelines which outline the operation of the RERT.¹¹ AEMO must have regard to these guidelines, where relevant, when exercising the RERT. In addition, AEMO is required to publish RERT procedures which detail the operation of the RERT.¹²

In June 2010, the Panel published the revised RERT Guidelines which include amendments which were approved by the AEMC as part of the Improved RERT

⁹ Under clause 3.20.3(c) of the Rules.

¹⁰ In accordance with clause 3.15.9(e) of the Rules.

¹¹ Under clause 3.20.8 of the Rules.

¹² clause 3.20.7 of the Rules

Flexibility and Short-notice Reserve Contracts Rule.¹³ On 24 November 2010, AEMO completed its consultation on the Procedure for the exercise of the RERT.¹⁴

The RERT has a sunset clause in the Rules of 30 June 2012, with a requirement for the Panel to review the need for the RERT by 30 June 2011.¹⁵

2.2 Original Reserve Trader Provisions

Since the commencement of the NEM, the market operator (which is now known as AEMO) has had the power to contract for reserves (termed “reserve trading”). Reserve trading essentially enabled the market operator to procure additional reserves if a shortfall of reserves was forecast. It acted as a “safety net” in the event that the NEM did not deliver sufficient reserves to ensure that the Reliability Standard of 0.002% USE was met.

Over time, the power for the market operator to operate the Reserve Trader has been reviewed and the associated sunset clause extended. In December 2005, the Panel submitted a Rule change proposal to extend the Reserve Trader provisions until 30 June 2008. The Rule change was accepted with minor amendments and allowed the Reserve Trader to continue to operate while the Panel completed its Comprehensive Reliability Review (CRR).

2.3 Development of the RERT in the Comprehensive Reliability Review

On 21 December 2007 the Panel completed its CRR, which was a comprehensive review of a number of high level NEM standards and parameters, including the reliability standard and reliability settings (the MPC, market floor price and the CPT).¹⁶ The RERT was developed as part of this review and was incorporated into the Rules in June 2008.¹⁷ The RERT redesigned the original Reserve Trader provisions. The main operational changes included:

- allowing the market operator to contract for reserves up to nine months ahead of a projected shortfall, instead of six months; and

¹³ The RERT Guidelines were published in accordance with clause 11.31.3(d) of the Rules. More information is available on the AEMC website at <http://www.aemc.gov.au/Electricity/Rule-changes/Completed/Improved-RERT-Flexibility-and-Short-notice-Reserve-Contracts.html>.

¹⁴ More information is available on the AEMO website at <http://aemo.com.au/electricityops/rert.html>.

¹⁵ These requirements are in clauses 3.20.1 and 3.20.9. of the Rules

¹⁶ More information on the CRR is available on the AEMC website: <http://www.aemc.gov.au/Market-Reviews/Completed/Comprehensive-Reliability-Review.html>.

¹⁷ National Electricity Amendment (NEM Reliability Settings: Information, Safety Net and Directions) Rule 2008 No. 6, available on the AEMC website at <http://www.aemc.gov.au/Electricity/Rule-changes/Completed/NEM-Reliability-Settings-Information-Safety-Net-and-Directions.html>.

- allowing the market operator to perform multiple tendering rounds, instead of being limited to one, so that the level of reserve contracting can be adjusted as more information becomes available.

In making this recommendation, the Panel considered that:¹⁸

“although the Reserve Trader provisions are a market distortion which would not be necessary under ideal conditions, the prevailing market conditions are such that a revised form of the provisions needs to be maintained for a defined period of time.”

The Panel considered that the key prevailing market conditions were the tighter supply-demand conditions that were likely to be experienced over the next few years. These conditions were partly due to the effects of drought and risks from uncertain environmental policy. The Panel considered that given the tighter supply-demand balance, it would not be prudent to remove a key safety net provision such as the Reserve Trader.

2.4 Amendment to the RERT for critical emergencies

In March 2009 as part of the Review of the Operational Arrangements for the Reliability Standards, the Panel reviewed “the need and possible design of a short-notice version of the RERT that could be used in a critical emergency”. The subsequent Rule change proposal was approved by the AEMC and the Rules were amended to:

- provide for long-notice, medium-notice and short-notice reserve contracting;
- clarify that AEMO can form a RERT panel; and
- clarify that AEMO may use reserve contracts during system security events.¹⁹

In making this recommendation, the Panel still considered that the RERT was a market distortion, but considered that prudent incremental improvements to the RERT were warranted to further increase the flexibility. The Panel noted that the proposed changes aimed to minimise the market distortion and that the RERT would be subject to a review prior to 30 June 2012.²⁰

¹⁸ AEMC Reliability Panel, Comprehensive Reliability Review, Final Report, December 2007, p.76.

¹⁹ The Commission determined to make the Rule and published its final Rule determination and Rule on 15 October 2009. For more information see: National Electricity Amendment (Improved RERT Flexibility and Short-notice Reserve Contracts) Rule 2009 No. 19, available on the AEMC website at <http://www.aemc.gov.au/Electricity/Rule-changes/Completed/Improved-RERT-Flexibility-and-Short-notice-Reserve-Contracts.html>.

²⁰ AEMC Reliability Panel, Review of the Operational Arrangements for the Reliability Standard: Final Report, 21 December 2009, p.45.

3 Panel's draft recommendation

This chapter sets out the Panel's draft recommendations in response to the TOR issued by the AEMC. These TOR specified that the Panel should:

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

The Panel is then to recommend to the AEMC whether the RERT should expire on, or prior to 30 June 2012 or whether the RERT should be extended beyond the current expiry date.

3.1 Is the RERT required to ensure reliability?

The Panel's draft recommendation is that the RERT should not be maintained in the longer term, however, the mechanism should be retained in the short term. The Panel considers that the RERT should be retained in the short term as it provides an opportunity for demand side participants, who may not otherwise present, to operate in the market. The Panel considers that in the longer term, the RERT mechanism is not likely to be required given the strong reliability outlook and the current investment incentives in the market and the relatively small level of response it elicits compared to the typical events that impact on system security and reliability.

To date, market performance has been sufficient to ensure the security and reliability of electricity supply. The outlook for reliability shows that the majority of the NEM regions are expected to have sufficient reserves up to 2015/16.²¹ Historically, when the SOO has forecast a supply deficit, the market has delivered sufficient capacity.

In the longer term, the Panel considers that an MPC of \$12 500/MWh should generally provide incentive for sufficient capacity to present to the market. The Panel also notes that there are other existing market mechanisms which can be used by AEMO to assist with any supply shortfall. These include, where possible, using network control ancillary services, directing Registered Participants with regard to scheduled plant or market generating units, or instructing Registered Participants with regard to any other action.

Recent reviews by the Panel and the AEMC noted that raising the MPC and CPT increases costs and risks in the market, and if there are barriers to managing these risks, then there may be a point at which the benefits of changing the Reliability

²¹ AEMO, 2010 Electricity Statement of Opportunities, pp.148-154.

Settings do not offset the costs in terms of market risks.²² Given this, both reviews considered the performance of the current design should be monitored to determine if the market design remains resilient and sustainable over time. In particular, the Panel recommended that the AEMC undertake a review of both the mechanism for the delivery of capacity to ensure reliability, and the impact of the risk allocation framework in the NEM on achievement of reliability in the long term.

In reaching the draft recommendation for this Review, the Panel has considered a range of issues that were raised in submissions on the Issues Paper. In particular, the Panel considered the performance of the market to date, the outlook for reliability and the role of the demand side. These issues and the Panel's considerations are discussed further in Chapter 4.

The Panel notes that the purpose of the RERT is to allow AEMO to contract for reserves when a shortfall of reserve is projected. The RERT, therefore, provides an opportunity for the supply and demand sides to provide capacity that may not be otherwise available to the market. While the RERT has been a mechanism to achieve additional capacity, the Panel notes that the RERT has not been exercised since its introduction in 2009.

The Panel considers that the ability of the RERT to attract supply side capacity has shown to be limited. Under the RERT, AEMO is only permitted to contract for reserves up to nine months in advance of a projected shortfall to avoid distorting investment in new generation plant. The RERT may provide sufficient incentive to accelerate existing plans to build or expand generation. However, most generators would already plan construction so that the generation plant is available for the peak demand periods, which is when the RERT is likely to be used. The Panel therefore considers it is unlikely that the RERT would be able to provide any additional incentives for the supply side to participate in the market.

The Panel considers that the RERT is more likely to attract demand side capacity, particularly demand side aggregators and industrial customers. The Panel considers that the RERT may currently provide an opportunity for demand side participants to participate in the NEM in circumstances where other avenues, such as through retailers, are unsuitable.

However, the Panel notes that there is ongoing work on the role of demand side participation in the NEM.²³ When these work programs are complete, they should have addressed any reasonable remaining constraints on efficient demand side participation. This should remove the last substantive reason for continuing the RERT,

²² AEMC Reliability Panel, Final Report of the Review of the Reliability Standard and Reliability Settings, 30 April 2010, p.x, and AEMC, Final Report of the Review of the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events, 31 May 2010, pp.125-127.

²³ For example, the 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 DSP in the electricity market.

particularly given the market distortions that it introduces. The Panel considers that the RERT should be extended for a short period, to allow any potential recommendations from these reviews to be implemented.

3.2 Is the RERT effective?

The Panel considers that the RERT, in its current form, may assist in addressing relatively small, location specific, supply shortfalls of short durations. The Panel was advised that the previous reserve trader and the RERT have elicited demand and supply side responses from the market that may not otherwise have presented in the given market conditions, although the Panel notes that these market responses may not have been contracted.²⁴

In reaching its draft recommendation, the Panel has considered issues that were raised in submissions. In particular, the Panel has considered potential market distortion, market costs and other market mechanisms that can be used to ensure reliability. Chapter 4 discusses these issues and the Panel's considerations in detail.

The Panel notes that some stakeholders may consider that reserve trading has not been effective in delivering capacity, given that it has only been contracted and never dispatched. However, the Panel notes that reserve trading has provided a safety net that was used successfully on two occasions.²⁵ On these occasions, there was insufficient capacity to meet forecast demand and as a result, AEMO activated the reserve trader. The reserve trader was effective in providing additional capacity that could be called on when required, even though favourable conditions meant that at those times, the RERT was not actually dispatched.

The design of the RERT is primarily focussed on relatively small, location specific, supply shortfalls. The Panel does not consider that the RERT would deliver the amount of capacity involved in directly addressing major power system events, such as the short notice closure of a major power station units. Furthermore, in the event of such a closure the supply shortfall would lead to an increase in the spot market price and other plants, such as peaking plant, would be likely to increase output. Over time, this increase in the spot market price would provide a signal for additional generation investment.

As described above, the RERT provides an opportunity for both supply and demand side capacity, that may not otherwise be available to participate in the NEM. However, the Panel notes that participation in the RERT has been limited and that only one participant has joined the RERT Panel since its introduction in 2009. This limited

²⁴ The Panel received this advice through confidential discussions with AEMO.

²⁵ NEMMCO contracted for 84 MW of additional reserves for the South Australian and Victorian regions for February 2005 based on forecasts which showed a potential shortfall of 195 MW. The cost of acquiring these services was \$1.035m. NEMMCO also acquired an additional 375 MW of reserves for the same regions for the summer of 2005/06 based on delays in the commissioning of Basslink and Laverton North power station. Acquiring these services cost approximately \$4.4m. In both cases the reserves were not dispatched as conditions during those periods were favourable.

participation has restricted the effectiveness of the RERT as it would not be available to address supply shortfalls in areas with no RERT participants. Therefore, in principle, while the RERT design may be effective, its practical effectiveness is somewhat limited.

3.3 Should the RERT expire as planned or should it be extended?

In light of the discussion above, the Panel's draft recommendation is that the RERT should be extended for one year, and should expire permanently on 30 June 2013.

The Panel notes the ongoing reviews on the role of demand side participants in the NEM and considers that these should address any reasonable remaining constraints on efficient demand side participation which should therefore reduce the remaining benefit provided by the RERT. However, the Panel notes that any recommendations from these reviews are unlikely to be implemented by the current expiry date of 30 June 2012. Therefore the Panel is recommending extending the current expiry date by one year to allow sufficient time for any recommendations to be implemented.

The Panel also recommends is that the provisions for the Panel to review the RERT be removed from the Rules.

4 Key issues raised by submissions

This chapter summarises the Panel's responses to stakeholders' comments in relation to the key questions posed by the Panel in its Issues Paper²⁶. These questions are:

1. Do stakeholders consider that the residual risk of insufficient capacity being available in the future is high enough to retain a form of reliability safety net (of a similar form to the reserve trader)?
2. If a form of reliability safety net is required, do stakeholders consider that the current short, medium and long notice forms of the RERT are effective?

This chapter also discusses changes to the RERT that were proposed in submissions on the Issues Paper.

4.1 Is a safety net required to ensure reliability?

Comments from submissions were divided on whether there is a need for a safety net mechanism to ensure reliability of supply. The key comments from submissions and the Panel's response are discussed below.

4.1.1 Reliability performance and outlook

In the Issues Paper, the Panel noted that since the commencement of the NEM, the security and reliability of electricity supply has been sound. Furthermore, the outlook for reliability shows that all regions in the NEM are expected to have sufficient reserves up to 2015/16, with the exception of Queensland which is expected to have a shortfall in 2013/14.²⁷

To date, the RERT (including the reserve trader) has only been used twice and both times, reserve contracts were not dispatched because the forecast supply demand balance extremes did not eventuate due to favourable conditions. Some submissions considered that load shedding in January 2009 in Victoria and South Australia could have been avoided if the short notice RERT had been available.²⁸

Some submissions noted that the NEM has consistently met the Reliability Standard and that adequate investment in the electricity market has been announced despite uncertainty over climate change policies.²⁹ However, the Department of Primary Industries (Victoria) considered the good performance of the NEM to date, is partly

²⁶ AEMC Reliability Panel, Review of the Reliability and Emergency Reserve Trader (RERT) - Issues Paper, 3 August 2010.

²⁷ AEMO, 2010, Electricity Statement of Opportunities, p.3.

²⁸ Government of South Australia, Issues Paper submission, p.1; Major Energy Users (MEU), Issues Paper submission, p.10.

²⁹ Origin, Issues Paper submission, p.1; National Generators Forum (NGF) and Energy Retailers Association of Australia (ERAA), Issues Paper submission, p.1.

due to the excess of capacity that was available at market start. Furthermore, it considered that infrequent use of the RERT in the past does not mean it will not be needed in future as insurance to address times of extreme demand or supply shortfall.³⁰

4.1.2 Investment signals

The Reliability Settings (the MPC, market floor price and the CPT) are the key price mechanisms within which the wholesale spot market seeks to balance supply and demand, and deliver capacity to meet the Reliability Standard.³¹ These mechanisms provide signals for supply and demand side investment and usage. For example, if the MPC is set too high, market customers and generators can be exposed to very large financial risks. However, if set too low, there may be insufficient incentives to invest in new generation capacity and demand-side response to meet the Reliability Standard.³²

In its submission on the Issues Paper, Origin 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.³³ Similarly, the Loy Yang Marketing Management Company (LYMMCO) noted that targeting the Reliability Standard means that some USE is likely to occur from time to time.³⁴

In contrast, the MEU considered that the MPC is an indirect method for achieving reliability. It considered that the MPC and Electricity Statement of Opportunities (ESOO) provide necessary input to providing generation investment, but they cannot address any shortfall that is forecast for the near future due to the lead times involved in commissioning new generation.³⁵

4.1.3 Broader factors affecting investment

Some submissions considered that there is still uncertainty in the market with regard to factors such as the impact of climate change policies and the recent increase in the MPC.³⁶ Some of these submissions considered that given this uncertainty in the market, there was a role for the RERT in minimising electricity supply interruptions.³⁷ However, the ESAA noted that while the notion of an "insurance policy" could be

³⁰ Department of Primary Industries, Issues Paper submission, pp.1-2.

³¹ For more information see: AEMC Reliability Panel 2010, Reliability Standard and Reliability Settings Review, Final Report, 30 April 2010, Sydney.

³² AEMC Reliability Panel, Review of the Reliability and Emergency Reserve Trader, Issues Paper, 3 August 2010, p.10.

³³ Origin, Issues Paper submission, p.1.

³⁴ LYMMCO, Issues Paper submission, p.2.

³⁵ MEU, Issues Paper submission, p.12.

³⁶ Origin, Issues Paper submission, p.2; Electricity Supply Association of Australia (ESAA), Issues Paper submission, p.4.

³⁷ Government of South Australia, Issues Paper submission, p.1; MEU, Issues Paper submission, p.15.

appealing, the validity of such a proposition depends on what contribution can be made by the RERT to reliability outcomes, beyond what is provided by other market elements.³⁸

LYMMCO considered that AEMO's power to issue directions to market customers and generators could be used in place of the RERT.³⁹

A number of submissions noted that the RERT would be unsuitable to address any major power system incidents, such as the closure of baseload plant.⁴⁰

4.1.4 Role of demand side participation

Demand side participants are likely to have an increasing role in the future market. In the Issues Paper, the Panel noted there were a number of developments which have the potential to affect electricity usage and DSP, including the roll-out of smart meters, widespread adoption of hybrid electric vehicles, carbon capture and storage and alternative electrical energy technologies.⁴¹

This increasing role for DSP will help to discipline the supply side by voluntarily reducing demand as the price of electricity rises. A number of submissions considered that the demand side should be participating in the primary market rather than participating through the RERT.⁴² 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.

4.1.5 Panel's response

Overall, the Panel considers that there is a role for the RERT in the short term, but that it should not be maintained in the longer term. The Panel considers that the RERT currently provides an opportunity for some demand side participants to participate in the NEM that otherwise may not be utilised. In the longer term, the Panel considers that the current market conditions and the performance of the market to date have shown that the RERT is no longer required to ensure reliability, and that in any event, the RERT typically elicits a response that is relatively small in the context of those events that may result in USE.

³⁸ ESAA, Issues Paper submission, p.4

³⁹ LYMMCO, Issues Paper submission, p.2.

⁴⁰ ESAA, Issues Paper submission, p.4; Origin, Issues Paper submissions, p.2; NGF and ERAA, Issues Paper submission, p.2; LYMMCO, Issues Paper submission, p.1.

⁴¹ AEMC Reliability Panel, Review of the Reliability and Emergency Reserve Trader, Issues Paper, 3 August 2010, p.18.

⁴² LYMMCO, p.2; NGF, p.3; ESAA, p.3.

In the CRR, the Panel considered that:⁴³

“although the Reserve Trader provisions are a market distortion which would not be necessary under ideal conditions, the prevailing market conditions are such that a revised form of the provisions needs to be maintained for a defined period of time. Ideally, in the longer-term, the market should be able to operate without the need for a distortionary intervention mechanism.”

In making this statement, the Panel was referring primarily to the tighter supply-demand conditions which were expected over the next few years, the risk of insufficient energy due to drought conditions and the uncertainty about potential environmental policies. The Panel notes the most recent outlook for reliability has shown that the majority of regions will have sufficient reserves up to 2015/16.⁴⁴ The Panel also considers that, while in part, the good performance of the market has been due to excess capacity available at the start of the market, the market has been shown to respond to forecast supply shortfalls. The Panel notes that, partly as a result of this good performance, the RERT has not been exercised since its introduction in 2009.

The Panel recognises the issue of ongoing uncertainty in the market, resulting from factors such as the increased presence of renewable generation, uncertain climate change policies and the recent increase in the MPC. However, the Panel notes that these issues have been faced by the market for some time and that to date, the market has continued to invest in new capacity, notwithstanding these uncertainties.

In the longer term, the Panel considers that an MPC of \$12 500/MWh should provide incentive for sufficient capacity to be available to be dispatched to the market. Furthermore, the Panel notes that the number of supply interruptions resulting from reliability events in the generation or transmission sectors are very small.⁴⁵ While there remains a residual risk of a short-term shortfall due to factors such as extreme weather or plant failure, the Panel agrees with submissions that the current process of planning to achieve the Reliability Standard is likely to result in USE occurring rarely.⁴⁶

The RERT allows AEMO to contract for reserves when a shortfall of reserve is projected and therefore, provides an opportunity for the supply and demand sides to provide capacity that may not be otherwise available to the market. While the Panel considers that the ability of the RERT to attract additional supply side capacity is limited when compared with the primary market, the Panel considers that the RERT currently provides an opportunity for some demand side participants who may not otherwise enter the market. However, the Panel notes that there is ongoing work on

⁴³ AEMC Reliability Panel, Comprehensive Reliability Review, 21 December 2007, p.76

⁴⁴ AEMO, 2010, Electricity Statement of Opportunities, p.3.

⁴⁵ AEMC, Final Report of the Review of the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events, 31 May 2010, p.i.

⁴⁶ The form of the Reliability Standard was recently reviewed in the Review of the Reliability Standard and Reliability Settings. Following consultation with stakeholders, the Panel considered the form of the Reliability Standard should continue to be based on a USE limit. AEMC Reliability Panel, Final Report - Reliability Standard and Reliability Settings Review, 30 April 2010, p.16.

the role of demand side participation in the NEM. The Panel considers that when this work is complete, it should address any reasonable remaining constraints on efficient demand side participation which could remove the need for the RERT.

In the Final Report of the Review of the Reliability Standard and Reliability Settings⁴⁷ and the Final Report of the Review of the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events⁴⁸, it was noted that raising the MPC and CPT increases costs and risks in the market, and if there are barriers to managing these risks, then there may be a point at which the Reliability Settings may no longer be an efficient mechanism for achieving power system reliability. Given this, both reviews considered the performance of the current design should be monitored to determine if the market design remains resilient and sustainable over time.

In particular, in the Review of the Reliability Standard and Reliability Settings, the Panel recommended that the AEMC undertake a review of both the mechanism for the delivery of capacity to ensure reliability, and the impact of the risk allocation framework in the NEM on the achievement of reliability in the long term.⁴⁹

In light of the above comments, the Panel considers that the RERT should be maintained for a short period, to allow any potential recommendations from the ongoing work programs, discussed above, to be implemented. However, the Panel considers that the RERT mechanism is not likely to be required nor effective in the longer term given the strong reliability outlook and the current investment incentives in the market, and the fact that the RERT typically elicits a response that is relatively small in the context of those events that may result in USE.

4.2 Is the RERT effective?

While the current form of the RERT, with its short, medium and long-notice forms, is yet to be tested, comments from submissions were divided on whether it is effective. The key issues from submissions and the Panel's response are discussed below.

4.2.1 Market distortion

In the Issues Paper, the Panel noted that since the introduction of the reserve trader, there has been concern about the impact of such a mechanism on the market and the potential for intervention mechanisms to diminish incentives for the market to respond to reserve shortfalls.⁵⁰ Currently under clause 3.20.2(b)(1) of the Rules, AEMO is required to undertake actions that "have the least distortionary effect on the operation

⁴⁷ AEMC Reliability Panel, Final Report of the Review of the Reliability Standard and Reliability Settings, 30 April 2010, p.x.

⁴⁸ AEMC, Final Report of the Review of the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events, 31 May 2010, pp.125-127.

⁴⁹ AEMC Reliability Panel, Final Report of the Review of the Reliability Standard and Reliability Settings, 30 April 2010, p.x.

⁵⁰ AEMC Reliability Panel, Review of the Reliability and Emergency Reserve Trader (RERT) Issues Paper, 3 August 2010, pp.19-20.

of the market" in exercising the RERT. This requirement is mirrored in the RERT Guidelines which specify that AEMO should minimise the distortionary effect in relation to both the short term impact on the spot prices and the long term impact on investment signals.⁵¹ In addition, the market operator is only able to contract for reserves for a short period prior to the anticipated shortfall (currently this is 9 months) to avoid diminishing market signals.

Some submissions considered that, despite these precautions, the RERT creates a secondary market for reserves and encourages providers of peak reserves to by-pass the "primary market" by contracting with AEMO, rather than a retailer.⁵² These submissions considered that this approach was less efficient. However, LYMMCO considered that the extent of the distortion was difficult to establish as there was a lack of transparency in the operation of the RERT. It also considered that this lack of transparency meant it is difficult to know if capacity that is made available under RERT would have been available anyway.⁵³

Some submissions stated that these effects were made worse by the lack of a price cap under the RERT.⁵⁴ This is discussed further in section 4.2.2 below.

The NGF and ERAA considered that the RERT was blunting the signals for generators, retailers and customers to enter into commercially negotiated contracts.⁵⁵ Origin considered that the presence of the RERT may act in the long term to deter investment in the NEM as investors participate in the reserve market instead.⁵⁶

In contrast, other submissions considered that the distortionary effects of the RERT were not significant.⁵⁷ 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. In addition, Energy Response considered that under the RERT, demand side response would only be used at the direction of AEMO. It noted that in situations where the market price is high, but there is no reserve shortfall, then the RERT is not needed and capacity is left on standby.⁵⁸ The MEU stated that there was no other instrument in the energy only market design that provides reliability in such short time frames.⁵⁹

In a supplementary submission, the NGF, ERAA and LYMMCO presented a qualitative report from ACIL Tasman on the distortionary effects of the RERT. The report noted that the existence of the RERT is a consequence of the MPC and CPT.

51 See section 5.1 of the RERT Guidelines.

52 Origin, Issues Paper submission, p.2; NGF and ERAA, Issues Paper submission, p.3.

53 LYMMCO, Issues Paper submission, p.2.

54 LYMMCO, Issues Paper submission, p.2; NGF and ERAA, Issues Paper submission, p.6; ESAA, Issues Paper submission, p.3.

55 NGF and ERAA, Issues Paper submission, p.3.

56 Origin, Issues Paper submission, p.2.

57 Government of South Australia, Issues Paper submission, p.1; Energy Response, Issues Paper submission, p.3; MEU, Issues Paper submission, p.13.

58 Energy Response, Issues Paper submission, p.3.

59 MEU, Issues Paper submission, p.13.

ACIL 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.⁶⁰

4.2.2 Market costs

Under the current Rules, the maximum price of the reserve contracted and dispatched through the RERT is effectively decided by representatives of each of the NEM jurisdictions in response to an offer by reserve providers.⁶¹ The Rules require that:

“actions taken should aim to maximise the effectiveness of *reserve contracts* at the least cost to end use consumers of electricity.”

AEMO specifies that the prices payable for reserve under the RERT are the following:

- Availability charge - applies where significant overheads are incurred in making the reserve available. It is payable when the reserve is contracted and available to AEMO, regardless of whether it is dispatched. No availability charge is available for reserves procured in short notice situations;
- Pre-activation charge - applies where significant additional operating costs are incurred in making unscheduled reserve available for activation and applies to unscheduled reserve that can be activated quickly. It is payable when AEMO issues a "pre-activation instruction" to alert a provider to be ready to respond;
- Usage charge - applies to reserve where significant operating costs are incurred by a provider when the reserve is delivered in response to a dispatch or activation instruction; and
- Early termination charge - applies only to reserve procured in medium notice situations where AEMO opts to prematurely terminate a reserve contract.⁶²

A number of submissions noted that payment under the RERT is not limited to the MPC.⁶³ 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.⁶⁴ They considered that the cost of installing new standby generation is

⁶⁰ ACIL Tasman, NEM Reliability and Emergency Reserve Trader: Assessment of distortions arising from arrangement, 17 November 2010, p.6.

⁶¹ Clauses 3.20.3(c) and (f) of the Rules require AEMO to consult with the affected Jurisdictions when it determines whether to enter into reserve contracts and to assess how the associated costs will be shared between these Jurisdictions.

⁶² More detail is available in AEMO's *Request for expressions of interest - RERT Panel* at <http://www.aemo.com.au/electricityops/0240-0006.html>.

⁶³ LYMMCO, Issues Paper submission, p.2; NGF and ERAA, Issues Paper submission, p.6; ESAA, Issues Paper submission, p.3.

significantly higher than the cost of standby provided by the reserve trader. The Government of South Australia 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.⁶⁵

The NGF and ERAA consider that there is an inconsistency between the RERT and the implied value of achieving a secure operating state. Clause 3.8.1(c) of the Rules requires AEMO to establish procedures to relax constraints in order to resolve infeasible dispatch solutions, subject to maintaining consistency with AEMO's obligations to maintain power system security and the pricing principles in clause 3.9.1 of the Rules. The NGF and ERAA consider that the objective of clause 3.8.1(c) is to relax constraints to resolve infeasible dispatch solutions in order to determine prices, and this implicitly accepts that dispatch at times will not comply with security constraints. They also consider that this implies that the value of achieving a secure operating state is less than the value attributed to load shedding, namely the MPC. They further note that the RERT allows contracting of reserves, and these reserves may be used to achieve a secure operating state.⁶⁶

4.2.3 Existing market mechanisms

Some submissions noted that there are alternative options to using the RERT that are already in the market structure.⁶⁷ Under the current Rules, AEMO may intervene in the market through the RERT, or by issuing directions or instructions under clause 3.8.14 of the Rules.⁶⁸ Under the Rules, a subject of a direction is entitled to claim for compensation.⁶⁹ Clause 3.12.2 of the Rules states that Affected Participants are entitled to receive from AEMO an amount such that the Affected Participant is in the position that it would have been, had the intervention not occurred. The amount must be equal to, or greater than, \$5 000. There is no compensation paid to participants which are the subject of an instruction.

4.2.4 Panel's response

On balance, the Panel considers that the design of the RERT is reasonably effective in ensuring that capacity is available locally in times of short term supply scarcity. The RERT provides an opportunity for the both supply and demand side capacity to participate in the NEM, in addition to the primary market. The Panel notes that

⁶⁴ MEU, Issues Paper submission, p.11; Government of South Australia, p.1.

⁶⁵ Government of South Australia, Issues Paper submission, p.1.

⁶⁶ NGF and ERAA, Issues Paper submission, p.4.

⁶⁷ ESAA, Issues Paper submission, p.4;

⁶⁸ In its Issues Paper submission, AEMO also noted that it would be able to use network control ancillary services to the extent that the shortfall is affected by a network limitation that can be relieved by these services. AEMO, Issues Paper submission, pp.4-5.

⁶⁹ The subject must be both a Registered Participant and an Affected Participant. An Affected Participant is defined in the Rules as a scheduled generator, scheduled network service provider (NSP) or the holder of the right to the relevant settlement residue.

although the RERT has only one participant on the panel, the RERT (and the reserve trader) have attracted a number of supply and demand side responses from the market.

In reaching this conclusion, the Panel notes that it is difficult to obtain empirical evidence to support arguments for either removing or retaining the RERT and that much of the analysis on the RERT has been speculative, particularly with regard to the potential market distortions.

The Panel has previously stated that the RERT is a market distortion,⁷⁰ however, the current version of the RERT seeks to minimise its market impact and is only activated for a limited time, in a limited location. The aspects of the RERT that minimise distortion are:

- intervention is limited to the short-term, and as a last resort;
- capacity which is already scheduled in the market cannot offer itself under the RERT; and
- if the RERT is invoked and additional contracted capacity is dispatched, then the market is priced "as if" the capacity had not been available. This ensures that the long-term price signal provided through the spot market is not diluted as a result of the intervention.

While the Panel considers that, as a result of these design specifications, 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 Panel acknowledges that the RERT may be more attractive to some demand side participants ahead of the primary market. For example, these participants may have strict restrictions on availability (such as the timing of the outage, or the length of the notice period) that mean retailers are unwilling to contract with them. The Panel agrees with submissions that this capacity would be more efficiently used if it were to contract directly with retailers rather than with AEMO through the RERT. This would allow generators, retailers and demand side participants to make contracting decisions that are most efficient for each participant. Regarding the role of demand side participation in the NEM, the Panel notes that there are a number of ongoing work programs on this issue, as discussed above in section 3.1.

In addition to requiring AEMO to minimise the market distortions of the RERT, the Rules also require AEMO to maximise the effectiveness of the reserve contracts at least cost to consumers. The Panel notes that under the current arrangements, AEMO only exercises the RERT to the extent that it remains cost effective to a level pre-determined by the affected jurisdiction. The Panel considers that the costs of the RERT are not significant when compared with the overall costs of the market. Section 4.3.1 provides further discussion on valuing reserve above the MPC.

⁷⁰ AEMC Reliability Panel, Final Report of the Comprehensive Reliability Review, 21 December 2007, p.76.

As discussed in section 3.2, the Panel does not consider that the RERT is an appropriate mechanism to directly address major power system events, such as the short notice closure of major baseload plant. In such circumstances, the RERT is unlikely to have sufficient available capacity and would only be used, as it was intended, to address any short-notice supply shortfalls and not to address larger and longer term shortfalls.

In its Review of the Reliability Standard and Reliability Settings, the Panel reviewed the level of the MPC and considered that a level of \$12 500/MWh should provide incentive for sufficient capacity to present to the market. In addition, the Panel notes that there are other market mechanisms which can be used by AEMO to assist with any supply shortfall. These include using network control ancillary services where possible, directing registered participants with regard to scheduled plant or market generating units, or instructing registered participants with regard to any other action.

4.3 Proposed changes to the RERT

A number of submissions to the Issues Paper considered that if the RERT was to be maintained, it could be modified to improve its effectiveness. These suggestions are discussed below. The Panel notes that at this stage, given its draft recommendation that the RERT should expire in 2013, there is insufficient benefit to be gained from processing any changes to the RERT.

4.3.1 Capping revenue earned under the RERT to the MPC

As discussed above in section 4.2.2, under the current Rules, the maximum price of the reserve contracted and dispatched through the RERT can exceed the MPC and is effectively decided by each of the NEM jurisdictions in response to an offer by reserve providers.

The submission from the NGF and ERAA considered that the revenue received by a RERT provider should be limited to the MPC. The NGF and ERAA considered that this would remove inconsistency in the Rules where the value of a secure operating state is less than the value attributed to load shedding, which is the MPC.⁷¹

Panel's response

The Panel notes that the decision to enter into reserve contracts requires AEMO to make a number of economic tradeoffs. In addition, the costs of operating the RERT are recovered only from market participants in the affected region(s). These assessments will impact market customers and end-use consumers. As a result, the Rules require AEMO to consult with the affected, participating jurisdictions when entering into reserve contracts and, when more than one region is affected, to determine the cost allocation. This requirement recognises the differences in jurisdictional expectations and delivers outcomes which are consistent with that expectation.

⁷¹ NGF and ERAA, Issues Paper submission, p.6.

4.3.2 Removing the "double dipping" check

In this context, double dipping is where an entity already receives payment for providing its reserves to the market, for example through a contract with a Market Participant, and also contracts with AEMO to provide the reserves through the RERT. This would be ineffective as the entity would be selling the reserves twice, while only providing the reserves once. Under the current arrangements, AEMO is not able to enter into contracts for capacity if AEMO considers the reserve is likely to be submitted or otherwise available for dispatch. In addition, the reserve contract must contain a provision that the other party has not and will not otherwise offer the reserve for the relevant trading intervals.⁷²

Section 7 of the current RERT Guidelines sets out the actions that AEMO may take to be satisfied that the reserve is not available to the market through any other arrangement. These include requiring a tenderer to enter an undertaking that the reserve is not available to the market through any other arrangement, making reasonable enquiries in the market, and assessing any information available to AEMO on whether the reserve are available through any other arrangement.⁷³

In its submission to the Issues Paper, AEMO proposed that relaxing or removing this double-dipping check should be considered given that:⁷⁴

- “ • those providers receive no availability payments to set aside reserves for exclusive use by AEMO
- there are reserve shortfall situations where it is apparent to AEMO that no demand side response is, or will be, required by the other contracting party, such as during administered pricing periods where the market signal is dampened and there is little incentive for a retailer to use that service”

In its submission to the Issues Paper, AEMO also proposed that "reserve providers should be compensated for prudent and demonstrable costs incurred in establishing and proving their reserves".⁷⁵ Under the current RERT panel arrangements, no payments are provided for short-notice reserves unless used and AEMO considered that this may be a deterrent to demand side participants to participate in the RERT panel.⁷⁶ This was supported by the submission from Energy Response which considered that the work involved in contracting an end user is substantial and the current fee structure "provides no incentive to entice aggregators and end users to join this program".⁷⁷

⁷² These requirements are in clauses 3.20.3(h) and (j) of the Rules.

⁷³ These requirements are set out in section 7.1 of the RERT Guidelines.

⁷⁴ AEMO, Issues Paper submission, p.5.

⁷⁵ AEMO, Issues Paper submission, p.5.

⁷⁶ AEMO, Issues Paper submission, p.5.

⁷⁷ Energy Response, Issues Paper submission, p.3.

Panel's response

The Panel has considered the issue of the double-dipping check. This check was included in the design of the RERT in order to ensure that AEMO is fully aware of the availability of capacity in the event that the RERT is activated. The Panel notes the similarities between AEMO's proposal and earlier suggestions by Energy Response where it stated that it is unreasonable to reject any tender where a tenderer refuses to provide AEMO with signed consent that enables AEMO to contact the tenderer's electricity retailers to confirm whether the offered reserve is the subject of any existing contract.⁷⁸

The Panel considers that the above requirement is particularly important in circumstances where there is very little notice and AEMO has insufficient time to perform due diligence checks. As such, both the Rules and the RERT Guidelines set out requirements for AEMO to ensure the reserves are not the subject of any other arrangements.

In order to implement this requirement AEMO, in the current RERT Procedure,⁷⁹ has chosen to reject any tenders where a tenderer refuses to provide AEMO with signed consent. This signed consent would enable AEMO to contact the relevant retailer to confirm whether the offered reserve is the subject of any demand side management for the period which AEMO is seeking reserve.

The Panel considers that it is appropriate for AEMO to determine how it will operationalise this requirement, given that AEMO is responsible for ensuring that the RERT is available when necessary. As such, the Panel supports AEMO's position. However, the Panel notes that the current process undertaken by AEMO, in which a participant is required to authorise AEMO to contact its retailer, is particularly rigorous. The Panel considers it may not be necessary for AEMO to take such a strict approach, particularly as a participant may only enter a contract with AEMO if it includes an undertaking that the participant has not and will not otherwise offer the reserve in the market.

In relation to compensation for costs incurred in establishing and proving reserves for use in the short notice form of the RERT, the Panel has previously considered payments for one-off, auditable expenses associated with resolving technical and legal issues with AEMO.⁸⁰ At this time, the Panel noted that:

“such one-off auditable expenses should not be paid as this still represents a form of capacity payment and it may be difficult to define which specific costs should be included.”

⁷⁸ Energy Response, Submission on the Draft Report for the Consultation on the Amended RERT Guidelines, pp.2-3.

⁷⁹ AEMO, Interim amendments to the procedure for the exercise of reliability and emergency reserve trader, v.2.0, pp.19-20.

⁸⁰ AEMC Reliability Panel, Rule change proposal - NEM Reliability Settings: Improved RERT Flexibility and Short-notice Reserve Contracts, 2009, p.8.

The Panel remains of the view that RERT panel members should not received any payment as it considers any payment outside of the energy-only framework should only be made where there is a demonstrated market failure to deliver supply.

4.3.3 RERT tender process

In 2008, the Commission made the National Electricity Amendment (NEM Reliability Settings: Information Safety Net and Directions) Rule 2008 No. 6. which replaced the reserve trader with the RERT and allowed AEMO to contract for reserve up to nine months in advance. As part of this determination, the Commission considered that:⁸¹

“A panel arrangement by nature limits the sources of potential reserves that [AEMO] can contract.”

Subsequently, in 2009, the Commission made the National Electricity Amendment (Improved RERT Flexibility and Short-notice Reserve Contracts) Rule 2009. As part of this determination, the Commission determined to allow AEMO to create a RERT panel for medium and short-notice situations. This RERT panel consists of potential, pre-accredited providers and reduces the time taken for AEMO to enter into reserve contracts. The Panel considered a RERT panel should not be used for long notice situations, in order to avoid limiting the sources of potential reserve capacity options to participate in the RERT.

The current RERT guidelines require that AEMO conduct a full tender process where there is more than ten weeks notice of a projected reserve shortfall. AEMO noted, in its Issues Paper submission, that the tender process is complex, lengthy and relatively costly and that the process could be streamlined by removing this requirement and conducting all reserve contracting through the RERT panel.⁸²

Panel's response

The Panel notes the difficulties faced by AEMO in conducting the full tender process for more than ten weeks notice of a projected shortfall. However, the Panel considers it is important to ensure that all available reserves are eligible to participate. Given that the benefits of such a process are significant, the Panel is inclined to retain the requirement for the full tender process.

4.3.4 Transparency of the RERT

A number of submissions commented on the lack of transparency of the RERT.⁸³ They considered that additional information could be published to inform the market of the type of generation or loads that are being contracted, while still protecting

⁸¹ AEMC 2008, NEM Reliability Settings: Information, Safety Net and Directions , Final Rule Determination, 26 June 2008, Sydney, p.41.

⁸² AEMO, Issues Paper submission, p.6.

⁸³ LYMMCO, Issues Paper submission, p.2, NGF and ERAA, Issues Paper submission, p.6.

commercially sensitive information. These submissions considered making the RERT more transparent would help to identify any potential barriers that were preventing RERT participants from participating in the primary market.

Panel's response

The Panel does not consider that publishing this additional information would help identify any barriers to the demand side participating in the primary market. The Panel considers this information would be better considered through other avenues, such as the upcoming AEMC review of demand side participation. The Panel's initial view is that publishing additional information such as this, may potentially act as a barrier to new participants in itself.

The Panel considers that the information that is of most significance to the market is information on the activation and dispatch of RERT capacity. To this end, the Panel notes that AEMO is required under clause 3.20.6 of the Rules to report on the circumstances surrounding the need for, and the dispatch of, a reserve contract.

Lastly, the Panel also notes that parties that contract with AEMO are not prevented from also contracting with retailers and participant in the primary market, provided they do not "double dip", that is, offer the same capacity in the same trading intervals to both AEMO and the retailer. For example, a party who chooses to contract part of its load with a retailer may offer another portion of its load to AEMO for the RERT (and potentially be paid a greater price).

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
CPT	cumulative price threshold
CRR	Comprehensive Reliability Review
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
NSP	network service provider
Panel	Reliability Panel
RERT	Reliability and Emergency Reserve Trader
Rules	National Electricity Rules
TOR	Terms of Reference
USE	unserved energy