



**Government
of South Australia**

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Mr Ian Woodward
Chairman, Reliability Panel
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Woodward

I write in relation to the Reliability Panel's second Interim Report on the Comprehensive Reliability Review (CRR).

The State Government is concerned that the report does not adequately address issues raised in previous Government submissions in relation to the National Energy Market Company's (NEMMCO) methodology for calculating minimum reserve levels (MRL) used to operationalise the reliability standard of 0.002% unserved energy (USE).

NEMMCO's current methodology is to identify the minimum level of installed generation across the NEM that delivers 0.002% USE in each region simultaneously. The outcome of this methodology is that significant reserve capacity is identified as being required in South Australia and Queensland. i.e. the regions at the ends of the transmission network.

For the 2006/07 period, NEMMCO's calculations indicated a reserve requirement under this methodology of 370 MW greater than peak demand in South Australia and 0 MW in Victoria. NEMMCO recognised, however, that under the current market settings (i.e. Value of Lost Load (VoLL) and the Cumulative Price Threshold (CPT)), there were practical difficulties associated with sourcing 370 MW of generation in South Australia in excess of the 10% Probability of Exceedence (PoE) scheduled maximum demand. This suggests that there is a fundamental disjoint between the market settings and the methodology for calculating the MRLs.

In recognition of these difficulties, to be pragmatic NEMMCO adopted an arbitrary MRL for South Australia of 50 MW below 10% PoE forecast demand.

Given the current NEMMCO methodology to target reserves at the ends of the network, South Australia is more likely to be in reserve deficit if the current methodology is continued. While South Australia is in deficit, it is in effect providing a shared resource, that should be recovered from all customers across the National Electricity Market on an equitable basis.

This could be implemented by adopting the approach used for regulation ancillary services where costs are generally recovered on global basis rather than from where they are sourced (except when the region is islanded).

NEMMCO's methodology for setting MRLs has changed on an ad hoc basis over the last few years. As highlighted in Energy Division's supplementary submission of January 2007, it is important that greater clarity is provided to guide the interpretation and operational implementation of USE.

The State Government considers that the Rules should require guidelines be issued to provide NEMMCO with clarity on the methodology for calculating MRLs, and require NEMMCO to undertake a transparent consultation process prior to changing the methodology for establishing reserve levels.

The State Government also considers that it is important to ensure that there are incentives to maintain investment to meet appropriate levels of reliability. The State Government considers there is merit in the Reliability Panel's proposal to escalate VoLL in line with an appropriate index to maintain its real value over time. The Government also considers that the proposal to replace the annual review of VoLL with a three-yearly review will provide market participants with a greater level of certainty.

In relation to the Reliability Emergency Reserve Mechanism, the State Government is not convinced that extending the timeframe in which to contract for reserves by three months will have any significant effect on the outcome. As highlighted in its submission to the Issues Paper, the Government supports transforming the Reserve Trader into a permanent standing reserve capacity offer.

The State Government supports the Reliability Panel's proposal to implement an energy adequacy assessment projection (EAAP) and the inclusion of longer term capacity information in the Statement of Opportunities, as it will provide useful information to the market.

Mr Vince Duffy, Acting Executive Director, Energy Division, Department for Transport Energy and Infrastructure (08 8204 1724) will be contacting you to further discuss South Australia's issues.

Yours sincerely



HON PATRICK CONLON MP
MINISTER FOR ENERGY

9 October 2007