

Our Ref: A2007/3

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Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box H116
AUSTRALIAN SQUARE NSW 1215

Dear Dr ~~Tamblyn~~ ^{John},

**REQUEST FOR RULE CHANGES FOLLOWING AER'S INVESTIGATION INTO
THE EVENTS OF 16 JANUARY 2007**

The AEMC will be aware that the Australian Energy Regulator (AER) undertook a detailed investigation of 16 January 2007, when bushfires caused transmission lines between Victoria and New South Wales to fail. On that day, around a quarter of the demand in Victoria was interrupted and the national power system was separated into three electrical islands following the transmission line failure.

While most aspects of the power system worked well on that day, the AER identified scope for improvement in a number of areas and has already taken a number of steps to ensure that improvements are made, including seeking undertakings from NEMMCO with respect to its processes, and introducing a program of compliance audits related to technical performance. In addition, the AER is recommending to the AEMC two sets of Rule changes to be made, details of which are set out below.

Request for change to clause 4.2.3 of the NER

The AER proposes that clause 4.2.3 of the National Electricity Rules (NER) be changed to set out a clearer process for NEMMCO to re-classify contingency events during abnormal conditions, such as those that existed in the context of the events of 16 January.

The AER's investigation found that NEMMCO's re-classification process on 16 January 2007 was non-transparent and unduly relied upon the advice of the relevant transmission network service provider. The AER also found that NEMMCO's approach towards re-classification on 16 January appears to have been inconsistent with its approach earlier that summer, when similar conditions prevailed.

The proposed changes to clause 4.2.3 would ensure greater consistency, transparency and rigour to the process of re-classifying contingency events. Specifically, the changes would require NEMMCO to develop and then apply pre-determined risk assessment criteria when considering whether to re-classify a contingency event and to provide market participants with improved information about potential and actual re-classifications of contingency events.

Request for change to clause 3.9.2 of the NER

The AER proposes that the text of the NER be amended to alter the obligation imposed on NEMMCO under clause 3.9.2 of the NER to set the dispatch price within 3 dispatch intervals to the value of lost load (VoLL) following the shedding of interruptible load as a result of a contingency event.

The AER's investigation found that requiring NEMMCO to assess whether prices should be set to VoLL in circumstances such as those that existed on 16 January could compromise system security. The assessment is complex and must be undertaken by operational staff. The assessment process distracts NEMMCO's operational staff from their task of managing system security. In practice, the complexity of the process and the limited time-frames to properly consider the issues resulted in errors in setting the dispatch price to VoLL on 16 January. NEMMCO made similar errors on 8 March 2004 and on 14 March 2005. The errors compromise the NEM objective by distorting dispatch and demand-side responses.

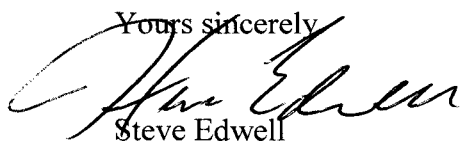
The AER's proposed rule changes to clause 3.9.2 would allow NEMMCO to focus solely on returning the power system to a secure operating state in such cases. Furthermore, the proposed changes would remove the risk of distorting generation dispatch and demand-side response by incorrectly setting prices to VoLL, thereby resulting in more efficient market outcomes.

In preparing this request, the AER sought comments from NEMMCO, Transmission Network Service Providers and the Victorian Department of Primary Industries regarding the changes to clause 4.2.3 and NEMMCO and the National Generators Forum with respect to changes to clause 3.9.2.

More details about the basis upon which the AER requests the AEMC to make changes to clauses 4.2.3 and 3.9.2 respectively are contained in the attached documents. The AER's request for Rule changes should also be read in conjunction with its report into the events of 16 January 2007. A copy of the report can be found on the AER's website: www.aer.gov.au.

If you have any questions in relation to this investigation please do not hesitate to contact either Peter Adams on (08) 8213 3408 or me on (03) 9290 1421

Yours sincerely



Steve Edwell
Chairman