

Australian Energy Market Commission
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Extension of the Reliability & Emergency Reserve Trader (ERC0198)

The Australian Energy Council (the “**Energy Council**”) welcomes the opportunity to comment on the Australian Energy Market Commission’s (“**AEMC**”) National Electricity Amendment (Extension of the Reliability and Emergency Reserve Trader) Rule 2016 Draft Rule Determination.

The Energy Council is the industry body representing 22 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

Discussion

The Reliability and Emergency Reserve Trader (“**RERT**”) arrangements (or its forebears) have been in place since the establishment of the National Electricity Market in 1998, but on the basis of history alone, the Energy Council questions whether a further extension of the RERT arrangements is necessary, and more importantly, whether the implementation of a perpetual arrangement is appropriate.

Extension of RERT arrangements

Despite the availability of reliability directions and Clause 4.8.9 instructions, the RERT arrangements have been extended six times to date. In each case, the purported rationale for extension is that the market cannot be relied upon to provide ongoing reliable supply to consumers, and supplementation in the form of the RERT arrangements is required. The AEMC has outlined a similar view in the Draft Rule Determination, arguing market conditions are again uncertain. On this basis, the AEMC considers it appropriate to not only extend the RERT arrangements for another three years, as requested by the Council of Australian Governments’ Energy Council (“**CoAGEC**”), but also remove the sunset clause, so the arrangements continue indefinitely without any assessment of the mechanism’s ongoing effectiveness and efficiency.

The Energy Council disagrees with this position and contends that retention of the RERT is largely unjustified. Based on any measure and comparison with other electricity supply systems elsewhere in the world, the National Electricity Market (“**NEM**”) has exhibited extremely high levels of reliability since its commencement in 1998. This is despite perceptions of uncertain market response over this time. Further, reserve contracts have only been entered into three times over this period and on none of those occasions were the reserves actually dispatched.

In the Energy Council’s view, prolonging the RERT arrangements distorts the market signals for additional investment in generation capacity. Market price volatility sends important signals to market participants and encourages the necessary changes in generation mix required to satisfy demand. Maintaining the RERT arrangements encourages the development of a secondary market for capacity, and compromises the efficiency of the existing market.

At Section 4.3.1 the AEMC argues that “improving the accuracy of AEMO’s projections may increase the chance that reserve contracts, when entered into, are dispatched”, but the Energy Council believes improved accuracy is more likely to indicate that reserve contracts are not required. This is supported by the AEMC’s subsequent statement that from September 2016, AEMO will be able to obtain Demand Side Participation information which may “potentially reduce the size and/or likelihood of projected reserve shortfalls and consequent need for the RERT”. (Although it is noted that the effect of the rule change is that the timing for the provision of new information is likely to be from January 2017.)

The Energy Council also notes the AEMC’s finding (at Section 4.3.2) that the pace of change in generation mix is “faster than the market had anticipated, as suggested by the surge in electricity futures prices, particularly in South Australia”. While it is acknowledged the generation mix is changing, the extent to which this finding holds true is unclear. In the Energy Council view, the increase in prices in CY16 Base Electricity Futures is more likely due to increasing liquidity in the market and the buying patterns of participants linked to the publication of the Medium Term Projected Assessment of System Adequacy, rather than any unexpected change in generation mix.

The AEMC concludes (at Section 4.4) that “market responses to potential reserve shortfalls are preferred to intervention mechanisms, such as the RERT”. The Energy Council therefore questions why the AEMC would prefer an indefinite continuation of the RERT arrangements rather than an extension, as per the CoAGEC’s initial request. The argument that industry prefers regulatory certainty, while certainly a valid statement in many consultations, does not carry much weight in this circumstance. In fact, the Energy Council believes that regulatory certainty in this instance would be best served by allowing the RERT provisions to cease on 30 June 2016, as originally intended.

Reduced timeframe for contracting reserves

Despite the reservations described above, the Energy Council is supportive of the proposal to reduce the period in which AEMO may enter into reserve contracts prior to a projected reserve shortfall from nine months to ten weeks. This will go some way to reducing the market distortions associated with the indefinite extension of the RERT arrangements, although the Energy Council is cautious about the processes associated with the selection and appointment of the RERT Panel.

Notwithstanding the Energy Council’s support for this change, if the RERT provisions are to be retained in the Rules, then the proposed rule change to amend Clause 3.20.3(d) and reduce the timeframe in which AEMO may contract for reserves must be implemented at the same time as the RERT extension (i.e. the amendment to Clause 3.20.3(d) must apply from 1 July 2016). In practice, the AEMC’s proposal to delay the commencement of this amendment to 1 July 2017 simply “closes a door but opens a window” to a further rule change request to maintain the ability for AEMO to contract for reserves at extended time periods into the future.

In practice, the proposed amendment to Clause 3.20.3(d) removes the ability for AEMO to procure reserves under the current RERT guidelines under the long notice provision, while retaining the medium and short notice provisions. Delaying the commencement of the amendment to Clause 3.20.3(d) to allow the current RERT Guidelines to be amended is not required, as the proposed amendment aligns exactly to remove the current long notice provision. In the future, the Reliability Panel may choose to consult to amend the RERT Guidelines to alter the time periods for the medium and short notice provisions (and possibly a new amended long notice provision). However, this is not a valid reason to delay the amendment to Clause 3.20.3(d) past 1 July 2016.

The Energy Council also believes that in order to lessen the distortionary impact of the RERT extension, Clause 3.20.3(d) requires further amendment to remove the last sentence,

“For the avoidance of doubt, AEMO may negotiate with potential tenderers in relation to reserve contracts at any time.”

The Energy Council believes that retaining this last sentence allows AEMO to commence negotiations to allow a RERT transaction in the future at any time it unilaterally decides, effectively rendering any proposed amendment to Clause 3.20.3(d) meaningless. Allowing AEMO to negotiate with potential tenderers outside the proposed ten week period will make it more difficult for load serving entities to negotiate with suppliers of demand management and smaller capacity generation additions, an outworking of which may be increased costs to consumers. To the extent the RERT arrangements are to be extended, the Energy Council considers the NEM would be best served by limiting AEMO's ability to negotiate RERT contracts (either informally or formally) to within the ten week period.

Conclusion

In conclusion, the Energy Council opposes any extension to the RERT, and in particular, their extension without expiry.

If a decision is made to extend the RERT provisions of the National Electricity Rules ("NER"), the Energy Council supports:

- (a) the reduction in the RERT contracting period from nine months to ten weeks, as long as this occurs from the expiry of the existing RERT arrangements (i.e. 1 July 2016). Bringing forward the new contracting period will go some way to reducing the market distortions present in maintaining the RERT indefinitely; and
- (b) deleting the last sentence of Clause 3.20.3(d) to remove AEMO's ability to negotiate with potential tenderers at any time.

Any questions about this submission should be addressed to the writer, by e-mail to kieran.donoghue@energycouncil.com.au or by telephone on (03) 9205 3116.

Yours sincerely,



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