

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

11 October 2011

Dear Mr Pierce

Expiry of the Reliability and Emergency Reserve Trader

The generators supporting this submission welcome the opportunity to make a submission in response to Australian Energy Market Commission's (AEMC) consultation paper on the National Electricity Amendment (Expiry of the Reliability and Emergency Reserve Trader) Rule 2012.

Discussion

The Reliability and Emergency Reserve Trader (RERT) has been the subject of numerous consultations where stakeholders have previously argued:

- the RERT (and previously the Reserve Trader) has not increased actual supply reliability in 10 years, making the case that its retention is not necessary;
- the size of any possible closure of large scale base-load plant in the near term due to climate change policy, would dwarf any capacity which AEMO will be able to procure under the long-, medium- and short-term RERT mechanisms;
- AEMO has very extensive powers to direct participants when system security is at risk. These powers can be used to address shortfalls as a last resort;
- by keeping the RERT, the market marginalises the activities of non-active participants into a reserve market;
- it creates an inconsistency in the implied value of achieving a secure operating state; and
- the RERT creates additional costs, is not transparent and distorts the market.

The Private Generators agree with the thrust of these arguments as detailed below.

AGL Energy

Alinta Energy

Energy Brix

InterGen

International Power
GDF-Suez

LYMMCo

TRUenergy

The AEMC asked question 1:

- a) *What market distortion is created by the RERT, and what evidence is there in support of that position?*
- b) *What are the benefits of retaining the RERT, does the RERT in its current form provide a safety net benefit?*

As it pertains to market distortions the Private Generators note that it is difficult to empirically outline market distortions for a number of reasons including:

- market participants whose actions are affected or impacted by the RERT are not readily identifiable and do not identify to the wider market;
- those participants who are contracted by the Australian Energy Market Operator (AEMO) or have been contracted in the past have not been identified;
- the price at which the market would clear in the absence of price cap arrangements is difficult to establish and the existence of price caps is a driver of support for the RERT in some jurisdictions; and
- non-market participants who may be induced into the market in the absence of a RERT are unlikely to be identifiable.

In raising these points, stakeholders have argued, and the Private Generators agree, that the RERT does not improve market outcomes overall.

At present it is difficult to clearly examine the extent to which the RERT distorts the market. However, if the concern that the RERT disincentivises some participants from joining the primary market is fundamentally correct then its continuation is clearly problematic. Conversely, if evidence indicates that few parties seek to engage in the RERT process and it therefore does not disincentivise primary market participation this suggests that the RERT is of little real value and is merely a governance anachronism which generates uncertainty. Either way the case for the RERT is not supportable.

Importantly, there is little, if any, incentive for generators to not make capacity available where it can bid into the market; as times of high prices are invariably periods where cost recovery, for long-run costs, can be achieved. The notion that generators are withholding capacity given existing reliability settings and the RERT has a role to play to overcome this is incorrect, and reflects a fundamental misunderstanding of generator business models and the importance of getting supply to the market during periods of high demand.

More importantly, the RERT ineffectively focuses on supply, by allowing it to be valued at a price beyond which it is currently valued across the market, when the bulk of outages that effect consumers and businesses arise in the supply chain through transmission and distribution. Hence, a more effective policy would be to mitigate the risk of loss through the distribution and transmission systems.

As for the safety net benefits of the RERT, the case for the RERT has not been made. It is also not clear that the RERT is capable of dealing with the type of shortfall it appears some parties are

concerned with, i.e. catastrophic risks, or the risk of enduring undersupply to households and businesses that have specific supply expectations.

We note AEMO has the power to issue directions to market customers and generators. This includes load shedding or demand response, the most likely outcome given the near certain absence of generator capacity at times of high demand (where those generators will already be bidding into the market). In these circumstances, load shedding will occur in accordance with information provided by the jurisdictional system security coordinator (with appropriate compensation). This safety net appears appropriate and provides an opportunity for jurisdictions to consider the sensitivities of load shedding within an individual region (which can be further refined by those jurisdictions if desired) without removing the incentive for load to operate in the market of its own accord.

The AEMC asked question 2:

- a) *Are stakeholders of the view that it is necessary to extend the expiry date of the RERT to 30 June 2013?*
- b) *If so, why?*

We retain the position held by the majority of stakeholders for a extended period of time that the RERT is not needed, has a number of undesirable features, is not transparent and distorts the market. Further, the RERT is inefficient and distortionary because the rates are set in advance when any RERT costs are unknown; and the RERT costs cannot be readily passed on by retailers to customers.

Since reliability settings are set at levels which are sufficient to encourage new investment and the market continues to meet consumers needs we see no compelling reason for retaining the RERT. In any case, the types of shortfall that are being considered are within the scope of events which the NEM is expected to experience. The unserved energy target of 0.002% ensures that unexpected load shedding is likely to occur from time to time; however, the NEM performance to date has bettered the unserved energy target and minimised load shedding arising from lack of capacity.

As it stands, in the absence of a compelling case to retain the RERT, the status quo position of allowing the RERT to lapse on 30 June 2012 remains appropriate. While we appreciate additional transition time may generally be desirable for a small number of affected businesses as no compelling market need for an additional year's transition has been articulated we believe the Rule change should not proceed.

The AEMC asked question 3:

- a) *Does the proposed legislation have any impacts relevant to the existence of the RERT?*
- b) *If so, what are they?*

The RERT has not been designed to manage climate change policy risk. Hence, we are of the view the size of any possible closure of large scale base-load plant in the near term due to climate change policy, would dwarf any capacity which AEMO will be able to procure under the long-, medium- and short-term RERT mechanisms.

In any case, as part of the contract for closure process which may lead to closure of 2000MW of plant in the coming years AEMO is required to make an assessment of any potential closure on system security and the compensation arrangements in the legislation have specific provisions regarding energy security.

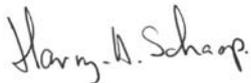
Therefore, as the obligations and interest in maintaining security of supply in light of climate change policy is significant and overshadows the purpose of the RERT suggestions the RERT has a role to play in managing climate change policy are not justifiable.

Conclusion

The Private Generators do not support the progression of the proposed rule change and contends the issues raised in this submission, and the comprehensive analysis of the course of numerous reviews to date supports this position.

If you have any queries in relation to this matter please do not hesitate to contact Mr Jamie Lowe, telephone, 03 9372 2633.

Yours sincerely



Harry Schaap

For the businesses listed on the side panel

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