



Department of Primary Industries

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
South Sydney NSW 1235

1 Spring Street
GPO Box 4440 Melbourne
Victoria 3001 Australia
Telephone: (03) 9658 4000
Facsimile: (03) 9658 4400
ABN 42 579 412 233
DX 210404

Our Ref:

Dear Mr Pierce

National Electricity Rules – Request for Rule: Expiry of the Reliability and Emergency Reserve Trader

The Victorian Department of Primary Industries (DPI), as the portfolio agency responsible for energy policy in Victoria, is pleased to make this submission in relation to the proposed Rule Change regarding the expiry of the Reliability and Emergency Reserve Trader (RERT) submitted by the Australian Energy Market Commission (AEMC) Reliability Panel.

Any queries in relation to the submission should be directed to Mr Mark Feather Acting Executive Director, Energy Sector Development Division by email at mark.feather@dpi.vic.gov.au or on telephone (03) 9658 4793.

Proposed DPI amendments to the Rule Change

The Rule Change proposed by the AEMC Reliability Panel would postpone the specified date for the expiry of the RERT by one year, from 30 June 2012 to 30 June 2013, and remove from the Rules the requirement for a Reliability Panel initiated review of the RERT mechanism no later than one year before it is due to expire.

DPI proposes that the Rule Change be amended to postpone the specified date for the expiry of the RERT to no earlier than 1 July 2016 and that the requirement for a Reliability Panel initiated review of the RERT mechanism be retained.

The proposed amendments would ensure that the RERT would not expire before the Reliability Panel is required to conduct a comprehensive review of the Reliability Standard and Reliability Settings and implement any recommendations arising from that review.



Market distortions in the NEM

DPI accepts that the RERT is a potential market distortion. It might provide an incentive for some capacity to seek to receive higher returns through participation in the RERT in preference to direct participation in the National Electricity Market (NEM). However, in view of the uncertain nature of the revenue streams from using such a strategy, it is believed that the risk of distortion is minimal.

As we have noted in previous submissions to both the AEMC and the AEMC Reliability Panel, the more significant market distortions to the market arise from the current Market Price Cap (MPC) and Cumulative Price Threshold (CPT) which, in our view, are set at levels that do not significantly recognise the importance that consumers place on a reliable supply of electricity.

The effect of the distortions introduced by the MPC and CPT is that the market may not deliver sufficient capacity to meet consumers' preferences for reliability of supply. In particular, the MPC arrangements serve to dull the market incentives on retailers and generators, and instead transfer risk away from these parties and onto consumers, thereby increasing the potential for emergencies.

Role of the RERT in NEM reliability

By enabling AEMO to contract for additional capacity to meet demand at a price that is higher than the MPC, the RERT should help to promote the efficient use of electricity services for the long term interests of consumers with respect to reliability and security of supply. *The RERT is therefore an important safety net for consumers given the distortions that have been introduced through the MPC and CPT arrangements.* In particular, without the RERT in place, there remains a risk that, with the existing arrangements in place, there will be insufficient incentives on market participants to manage the risk associated with supply shortfalls or demand peaks, particularly during extreme weather events.

The Rule Change proponent argues that the NEM has been shown to perform adequately and that it has delivered additional capacity, notwithstanding ongoing uncertainty in the market. There are reasonable grounds on which this assessment can be challenged. While RERT capacity has not been bid into the market, there have been occasions on which tenders have taken place for capacity due to identified supply shortfalls against regional reserve requirements.

Investment challenges facing the energy sector

The NEM now faces significant new challenges associated with the potential impacts of the introduction of a price on carbon and significant ongoing turmoil in world financial markets. Investor uncertainty is likely to continue despite the passage of the carbon price legislation through the Commonwealth Parliament, given the uncertain future of the package following the next election as well as the uncertainty surrounding the likely trajectory of a carbon price. These matters will only be resolved through a period of actual experience with the outcomes of the carbon pricing framework within the NEM.

The effect of this uncertainty can be seen in the current pipeline for new investment in the NEM. The Australian Energy Market Operator's Executive Briefing on the 2011 Electricity Statement of Opportunities identifies approximately 1,280 Megawatts (MW) of committed new generation projects across the NEM, compared with an annual requirement for approximately 1,000 MW a year of new generation to meet load growth. Moreover, 588 MW of the committed new generation is wind generation, which makes only a very limited contribution to the ability of the NEM to meet peak demand.

The Investment Reference Group Report of April 2011¹ found that the sector faces an unprecedented investment challenge over the next decade, driven by the need to maintain the reliability and security of the system within the changing policy and market framework. The Report notes that the investment and financing challenge in the electricity sector would be significant even in the absence of a carbon pricing mechanism, and would be on a scale that has not previously occurred within the NEM framework.

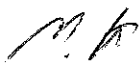
An ongoing role for the RERT

Given the current investment environment and the anticipated environment over the next decade, there is a risk that the new capacity does not come on-stream quickly enough to maintain supply reliability. While the RERT might be unable to practically deliver sufficient additional capacity to replace the output of a major baseload power station, it might reasonably help to alleviate more limited supply shortfalls at periods of peak demand.

Conclusion

DPI believes that the RERT should be retained both as an important mechanism to assist in maintaining supply reliability during a significant period of transition in the NEM, as well as a necessary response to the market distortions associated with the presence of an MPC and CPT.

Yours sincerely,



Mark Feather
Acting Executive Director
Energy Sector Development Division

13 /10/2011

¹ <http://www.ret.gov.au/energy/Documents/Energy-Security/IRG-report.pdf>