



## Reliability Settings from 1 July 2012

Final Rule Determination 16 June 2011

**The Australian Energy Market Commission has decided to make a Rule in response to the Reliability Panel's Rule change request regarding Reliability Settings to apply from 1 July 2012. It establishes a process of indexation to preserve the real values of the market price cap and the cumulative price threshold over time, and amends the regular process for review of the Reliability Standard and Settings by the Reliability Panel. These are important mechanisms for balancing the incentives for reliability and managing participant financial risk in the National Electricity Market.**

Reliability, in the context of this Rule change, is a long term issue regarding the maintenance of adequate levels of generation capacity to meet consumers' energy demand. The Reliability Standard defines a targeted maximum of unmet energy demand. In setting this standard, regard is had to the value of supply and the increase in costs necessary to meet higher reliability standards.

The Reliability Settings, such as the market price cap (MPC) and the cumulative price threshold (CPT) are important regulatory mechanisms which are designed to provide sufficiently strong price signals to incentivise adequate and efficient generation investment to meet the Reliability Standard, while minimising the financial risk for market participants and consumers.

### Current arrangements

To date the Reliability Standard and Settings have been reviewed by the Reliability Panel on a two-yearly basis. The Reliability Panel has been required (amongst other things) to review the prevailing values of these parameters and consider whether they require resetting to continue to meet their market objectives.

Any proposed changes that require an amendment to the National Electricity Rules (Rules), including changes to the dollar values of any of the Reliability Settings, must then be submitted to the AEMC for consideration and final decision.

### Primary issues raised

In its most recent review, the Reliability Panel made the following observations:

- it is important to ensure that the real values of the Reliability Settings continue to be maintained, rather than be allowed to decrease over time, since this could lead to a risk of inefficient levels of investment in generation occurring and increase the likelihood that the Reliability Standard might not be met in the future, and
- the current two-yearly review of the Reliability Standard and Settings created uncertainty of outcome for investors, which was likely to be a disincentive to investment.

### Rule change request

Given the above views, the Reliability Panel sought to introduce two mechanisms that would, in its opinion, implement improvements in efficiency and market certainty to existing processes:

- the adjustment of the values of the MPC and the CPT in line with changes in the Intermediate (Stage 2) Producer Price Index (Stage 2 PPI) on an annual basis with effect from 1 July 2012; and

The Rule is designed to ensure reliable supply to consumers by providing a strong and continuous price signal to investors, with the aim of stimulating adequate levels of future investment while managing financial risk to market participants.

- an annual review process to be undertaken by the Reliability Panel to determine whether “indexation is no longer appropriate” having regard to how the indexed MPC and CPT impact on spot prices, investment and the reliability of the power system. This would replace the existing obligation on the Reliability Panel to undertake a two-yearly review of the Reliability Standard and Settings.

### Commission’s decision

The Commission has made a more preferable Rule, incorporating many of the features proposed in the Rule change request, while changing others. Specifically the Commission has determined to make a Rule to provide for:

- the adjustment of the values of the MPC and the CPT in line with changes in the Consumer Price Index (CPI) on an annual basis with effect from 1 July 2012; and
- a four-yearly comprehensive review of the Reliability Standard and Settings, including indexation, to be undertaken by the Reliability Panel. This would replace the existing obligation on the Reliability Panel to undertake a two-yearly review of the Reliability Standard and Settings.

### Commission’s reasoning

The Commission considers that:

- indexation of the MPC and CPT to maintain their values in real terms over time will provide a strong and continuous signal to incentivise an efficient level of investment to deliver the Reliability Standard, while limiting the financial exposure of market participants and consumers;
- adoption of the CPI introduces an index which is more commonly used in business and investment decisions, provides a higher degree of stability and predictability to the market than the Stage 2 PPI, and will provide a strong revenue signal for investors;
- retention of the requirement for a comprehensive and integrated review of the Reliability Standard and Settings, including the manner of the indexation of the MPC and CPT, on a four-yearly basis will ensure that these values remain calibrated to the relevant underlying cost drivers. It will also allow for any changes that have been introduced to take effect before the next review is commenced (unlike the current biennial process);
- the extension of the time period between reviews of the Reliability Settings from two to four years will provide a greater measure of certainty and predictability for market participants;
- the Rule as Made will send a clear signal to the market that the intention in the Rules is to preserve the value of the Reliability Settings over time, which should act to provide further certainty and reassurance to investors; and
- a degree of administrative efficiency is provided by implementing a relatively automated process to affect incremental increases to the MPC and CPT, and avoiding the need to undertake a formal Rule change process to implement any such changes.

Indexation will commence on 1 July 2012, with the first four-yearly comprehensive review to be completed by 30 April 2014. Any changes recommended by the Reliability Panel, and which are subsequently approved by the AEMC, will be effective from 1 July 2016.

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