



INFORMATION

AUSTRALIAN ENERGY MARKET COMMISSION LEVEL 6, 201 ELIZABETH STREET SYDNEY NSW 2000
T: 02 8296 7800 E: AEMC@AEMC.GOV.AU W: WWW.AEMC.GOV.AU

Victorian jurisdictional derogation - RERT contracting

The Australian Energy Market Commission (AEMC or the Commission) has released a draft rule to provide the Australian Energy Market Operator (AEMO) with the flexibility to enter into multi-year contracts under the Reliability and Emergency Reserve Trader (RERT) mechanism in Victoria. This will help address the short to medium term reliability challenges facing that state. The time limited derogation will end in June 2023, and apply only in Victoria. The draft rule contains robust checks and balances so that multi-year contracts are only entered into in circumstances where they minimise costs to consumers.

Context

The Reliability and Emergency Reserve Trader (RERT) is a mechanism that forms part of the reliability framework of the National Electricity Market (NEM). It allows the AEMO to contract for emergency reserves, such as generation or demand response, that are not otherwise being traded in the market.

AEMO can use the RERT in the event that it forecasts the market will not meet the reliability standard, if the market fails to respond to published forecast information. The RERT is one of three 'last resort' intervention mechanisms in the reliability framework.

The Commission recently enhanced the RERT mechanism through the Enhancement to the RERT rule change (completed in May 2019). The key changes come into effect in March 2020.

Reliability in Victoria in the short to medium term

AEMO, the AER and others have highlighted there are challenging reliability issues facing Victoria over the short to medium term. The state has a tight supply-demand balance. The region relies on a relatively small number of ageing brown coal generators, which AEMO found to have recent forced outage rates sitting well above the long-term average.

While important, AEMO notes that in the short term upcoming renewable investment will make "only a small improvement to the reliability outlook" for the state. Over the next two to five years, AEMO considers that Victoria is particularly vulnerable to uncontrollable, high impact events, such as prolonged or coincident generator outages combined with low variable generator output.

Over the short to medium term, the current suite of risks to reliability in Victoria may change, and AEMO is continually assessing and updating these risks.

The role of the Retailer Reliability Obligation

As well as market forces driving change in the market, the Retailer Reliability Obligation (RRO) is a key mechanism that can facilitate an in-market response. If the RRO is triggered, it will require retailers to enter into sufficient contracts to meet their share of expected system peak demand. Market participants can increase contracting levels with existing market participants as well as invest in the right technologies in regions where it is needed, to support reliability in the NEM.

It is important to note that the RRO does not take effect unless triggered three years in advance of a forecast shortfall. The RRO is yet to be triggered and the earliest it could next take effect in Victoria is for the summer of 2023-24, following an assessment by AEMO in the 2020 Electricity Statement of Opportunities (ESOO).

Overview of the draft determination

The Commission considers that while out-of-market responses to reliability challenges are not ideal, they are necessary as a last resort should the market fail to respond. The Commission has made a draft rule to provide AEMO with the flexibility to enter into multi-year contracts with providers of emergency resources in Victoria to help address the short to medium term reliability challenges in the state. The derogation is limited to Victoria and will not be permanent.

The Commission considers it important that the introduction of multi-year contracting in Victoria does not result in unnecessary or inefficient procurement of RERT, the costs of which would be recovered from Victorian consumers. The draft rule contains specific requirements to make sure AEMO only uses multi-year contracts where it considers that emergency reserves will be required for the later years of the contract and therefore used where it minimises costs to consumers.

Under the draft rule multi-year contracting is to be subject to key changes made under the Enhancement to the RERT rule change. This means that the RERT principles that seek to minimise impacts on customer bills, keep RERT procurement costs under the Value of Customer Reliability and minimise market distortions, will apply to decisions about whether to enter into multi-year contracts.

Under the draft rule, the trigger for procuring emergency reserves under the Enhancement to the RERT rule, would apply to the first year before AEMO were to enter into a multi-year contract; this is an expected breach of the reliability standard. However, the trigger would not be required to be met in years two and three. Instead, under the draft rule, prior to entering into a multi-year contract, AEMO would need to consider what the appropriate term and structure of a Victorian reserve contract would be, including the appropriate volume of emergency reserves procured.

The existing RERT principles and Enhancement to the RERT rule out-of-market provisions, that both aim to reduce the risk of distortions to the wholesale market, will also apply to multi-year contracting.

Transparency

The draft rule introduces reporting requirements specific to multi-year contracting.

The draft rule requires AEMO make the following additional information public in its quarterly RERT reports:

- any contracts that have a term greater than 12 months
- an explanation of why such contracts were entered into for a term greater than 12 months, including the basis on which AEMO considered the term and volume to be reasonably necessary to ensure the reliability of supply in the Victorian region
- the basis on which AEMO had regard to the RERT principles when entering into the multi year contracts.

Duration of the Derogation

The draft rule specifies that the derogation be in place for approximately three years, rather than five as proposed by the Victorian Government, and end on 30 June 2023.

This gives AEMO flexibility to enter into multi-year contracts up until such time the RRO could next address reliability issues, for the summer of 2023-24. The ability of AEMO to enter into multi year contracts would end prior to the time at which, were the RRO to be triggered for 2023-24, retailers would be required to enter into contracts to meet their share of expected system peak demand. Otherwise, the RERT multi-year procurement timeframe would overlap with the obligations and incentives market participants face under the RRO. If this were to occur it would diminish the incentives for liable entities to contract under the RRO in Victoria since AEMO would also be in the market procuring three year RERT contracts at the same time.

Rule change request and background

The draft rule was made in response to a rule change request from the Hon Lily

D'Ambrosio MP, Minister for Energy, Environment and Climate Change, Minister for Solar Homes (Victoria), to amend the NER to provide for a longer contract duration under the RERT mechanism. Specifically, the Minister requested that AEMO be able to enter into long notice RERT contracts of up to three years, instead of a maximum contract duration of one year (as of 26 March 2020).

The Minister asked for the proposed derogation to be treated as urgent so that it could be considered under the expedited process and determined in advance of the 2019-20 summer peak, to assist AEMO in procuring adequate volumes of RERT to cover the forecast shortfall.

The rule was initiated under the expedited process, however following valid objections to the rule being treated as urgent, the derogation proposal is now being assessed under the standard rule making process. In recognition of the Victorian Government's concerns about reliability in Victoria this summer, the AEMC is working to deliver all milestones in the fastest time-frame possible. Due to the required consultation time-frames under the National Electricity Law, the final Rule will not be made for the 2019-20 summer.

The Energy Security Board (ESB) was recently tasked by the COAG Energy Council to provide advice for decision in March 2020 on immediate measures to ensure reliability and security of the electricity system. The AEMC is working closely with the ESB and other market bodies on this work since this will influence matters considered in this derogation.

Next steps

The AEMC invites submissions on the draft determination by **30 January 2020**.

The final determination will be published on **12 March 2020**.

For information contact:

Jackie Biro, **Director** 02 8296 0606

Kate Degen, **Senior Adviser** 02 8296 7812

Media: Communication Director, Prudence Anderson 0404 821 935 or (02) 8296 7817

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