



Victorian jurisdictional derogation - RERT contracting

The Australian Energy Market Commission (AEMC or the Commission) has made a 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 final 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 that the market will not meet the reliability standard, and the market fails to respond adequately 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 full changes come into effect on 26 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. The conditions and events faced during the 2019-20 summer highlight the challenging reliability issues being faced in Victoria. The RERT was activated twice during the past summer in Victoria totalling 980MWh, and LOR-2 and LOR-3 conditions declared four times. In addition, AEMO entered into short notice RERT contracts on four occasions in Victoria during the 2019-20 summer period.

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.

The RRO is yet to be triggered in Victoria and so 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 final determination

The Commission considers that while in-market responses to reliability challenges are preferable, out-of-market mechanisms such as the RERT are necessary as a last resort should the market fail to respond. The Commission has made a 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 is not 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. Therefore, the final rule contains specific requirements to make sure AEMO only uses multi-year contracts where it considers that emergency reserves are necessary for the later years of the contract and therefore used where it minimises costs to consumers.

Under the final rule, multi-year contracting is subject to key provisions of the *Enhancement to the RERT* rule. 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. In addition, the *Enhancement to the RERT* rule out-of-market provisions, that aim to reduce the risk of distortions to the wholesale market, will apply to multi-year contracting.

Under the final 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 and a forecast of low reserve conditions (LRC). This trigger would not be required to be met in years two and three. However, AEMO can only enter into a long notice RERT contract that is longer than 12 months, where it is considered to be reasonably necessary for maintaining reliability in Victoria. In addition, the contract cannot be longer than a maximum of three years. The volume of the reserves procured in year one of the contract, must be based on what is required to meet the reliability standard and in the subsequent years of the contract, the volume must be what AEMO consider to be reasonably necessary for maintaining reliability of supply in Victoria. In considering what would be an appropriate volume of emergency reserves and term for the contract, and AEMO must also have regard to any potential impact of, and interaction with, the RRO. This additional requirement was added in response to stakeholder concern that if the RRO were triggered in Victoria, then this could lead to competition between market customers and AEMO for resources covering the same period, which could drive up costs.

Transparency

The final rule introduces reporting requirements specific to multi-year contracting. The final 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
- for each multi-year contract, an explanation for whether the total payments under the contract are likely to be lower than what AEMO would have made under non-multi-year contracts (in aggregate) for the same period
- outline how the AEMO had regard to any potential impact of, and interactions with the RRO, in deciding on an appropriate contract duration and volume of emergency reserves

The last two reporting requirements are additional to those set out in the draft rule.

Duration of the Derogation

The final rule specifies that the derogation will 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 potentially enter into multi-year contracts up until such time the RRO could next address reliability issues.

Rule change request and background

The Commission has made its final determination in response to a rule change request from the Hon Lily D'Ambrosio MP, Minister for Energy, Environment and Climate Change, Minister for SolarHomes (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 was assessed under the standard rule making process. In recognition of the Victorian Government's concerns about reliability in Victoria, the AEMC delivered all milestones in the fastest time-frame possible, while still meeting our statutory timeframes for consultation.

The Energy Security Board (ESB) was recently tasked by the COAG Energy Council to provide advice 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. This review is currently under-way, with further milestones occurring throughout 2020.

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