Hydro Tasmania
The power of natural thinking

7 May 2012

Elisabeth Ross

Australian Energy Market Commission

PO Box A2449

Sydney South NSW 1235

Negative offers from scheduled network service providers ERC0140

Dear Elisabeth,

Hydro Tasmania would like to thank the Commission for the invitation to comment on the Negative offers from Scheduled Network Service Providers rule change proposal.

Please find attached Hydro Tasmania's submission.

If you require any further information please contact me on (03) 6230 5775.

Yours sincerely,

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Hydro Tasmania Submission on Negative Offers from SNSP's

OVERVIEW

The proponents (IPRA and LYMMCo) have proposed a blanket ban on SNSPs[1] specifying a negative price in their network dispatch offers.

However, the mischief identified by the proponents is the specific use of negative bids by one particular SNSP (Basslink) in one particular circumstance (being the only circumstance permitted under Tasmanian legislation).

Basslink is a unique situation given the existence of the commercial agreement with Hydro Tasmania that underpinned its construction and applicable Tasmanian legislation (Part 3 Division 3 of the ESI Act). As such, the conduct of Basslink cannot provide a proper basis for any meaningful assessment of the merits or otherwise of a blanket rule for SNSPs in general.

What the AEMC has to do is to put aside any issue relating to Basslink conduct and assess whether there is a valid case for the blanket ban proposed by the proponents. Any such blanket ban cannot be specifically targeted at Basslink; it would have to be justified even if Basslink were exempt from that ban.

If, having put aside Basslink, there is a valid case for a blanket ban, then (and only then) is it appropriate to look at the specific use of negative bids by Basslink in the one circumstance permitted under Tasmanian legislation and ask whether there is any case for exempting Basslink from the ban.

If there is no valid case for the blanket ban proposed by the proponents other than to specifically target Basslink then the proponents' proposed rule change is a misuse of the rule change process. There are other more appropriate forums for dealing with the specific grievance the proponents have regarding the specific use of negative bids by Basslink in the one circumstance permitted under Tasmanian legislation.

Accordingly, Part 1 of this submission addresses the question whether there is a valid case for the blanket ban proposed by the proponents, assuming Basslink is disregarded. It is Hydro Tasmania's contention that the answer to this is no.

On that basis, it is inappropriate (and without justification) to examine Basslink's conduct in this forum. However, Hydro Tasmania has provided some background information in Part 2 of this submission to explain that the use of negative Basslink bidding has been and continues to be subject to oversight in other more appropriate forums.

Accordingly, it is Hydro Tasmania's contention that, even if a blanket rule were justifiable, Basslink should be exempt from that blanket rule.

Part 3 of this submission provides responses to the questions posed in the Consultation Paper.

[1] An SNSP is a scheduled network service provider. One specific type (and the only type currently) of an SNSP is a Market Network Service Provider. The MNSP is an SNSP which has some specific provisions including the safe harbour provisions which allow it to be converted to a regulated NSP if it chooses.

Fundamentally, all the proponents have articulated is a grievance with particular market outcomes in one particular circumstance. The outcomes complained about are simply the market at work. They cannot justify a rule change.

PART 1 General SNSP Case

1 Summary of Arguments Against the Proposed Rule Change

The National Electricity Market (NEM) relies on competition to be dispatched between spot market participants to contribute to the National Electricity Objective (NEO). It is a fundamental premise to the viability of Scheduled Network Service Providers (SNSP) that the term "spot market participants" includes both SNSP's and generators.

For an SNSP to recover their investment in their asset they require the ability to compete efficiently with generators to be dispatched in the spot market. This requires an SNSP to have at least the same floor price as a generator (-$1,000/MWh).

When a constraint binds, affected generators can bid at the market floor to ensure they are dispatched. An SNSP has the same incentive and also needs to be able to implement the same strategy.

In the case of a transmission constraint in Victoria which limits the dispatch of the LaTrobe Valley generators and Basslink. Instead of the impacted VIC generators being backed off by approximately 4% - 8% each, the proposed rule change would result in Basslink being backed off 100% instead.

The AEMC is required to establish that the proposed rule change advances the NEO.

The proposed rule change would have a detrimental impact on the future viability of SNSPs by disadvantaging their ability to compete for dispatch with generators, hence impacting their Inter Regional Revenues (IRR's). This would devalue SNSPs' expected revenues and thus affect their ability to enter into contractual arrangements to underpin investment in new developments or to provide certainty of revenue.

On the other hand, the proponents have identified no benefit to consumers from the proposed rule change.

The rule change proposal is in fact an incorrect characterisation of the problem. The proposal appears to attempt to challenge the nature of commercial arrangements between a generator and an MNSP in Tasmania. This has already been scrutinized by the appropriate legislators and competition regulators.

The outcome of the proposed rule change would be a transfer of revenue from SNSPs to generators. There is no market or consumer benefit and, more likely, when considering the broader ramifications there is a NEO detriment. The rule should not be made and no alternative rule is required.

2 Background

a. Energy balance equation

In 2007, Hydro Tasmania and NEMMCO conducted a joint study into the formulation of the energy balance equation[2] which was undertaken by IES. The process was initiated by Hydro Tasmania as a result of concerns about how the energy balance equation treated Basslink. The fundamental issue is whether a SNSP is treated as a generator or a regulated network element in the energy balance equation.

This study established that the formulation which AEMO applies treats SNSPs as regulated network elements which has the effect of **favouring generators** over SNSPs under certain conditions – namely:

- when generators and SNSP's are connected at the same connection point,
- the MLF of the connection point is less than 1 and
- there is a transmission constraint binding.

The example shown in Box 5.3 (and subsequent paragraph's conclusion on page 19) of the Consultation Paper, fails to take into account the energy balance equation. Although it is quite complex, a full consideration of the implications of the energy balance equation and the SNSP treatment under various scenarios shows that generators are favoured over the MNSP under the proposed rule change.

b. Tasmanian market structure

The proposed rule change would apply to all SNSP's (now and in the future) and any merits it may have should be independent of any specific region or market structure.

Yet, the AEMC has discussed the issue of the Tasmanian market structure in some length on pages 10, 11 and 12. This is irrelevant to the merits of a blanket rule and positions the rule change in a highly prejudicial context that makes it questionable whether a truly objective assessment can be undertaken.

This section also makes reference to "the problem" but the problem does not appear to be uniquely identified. The Consultation Paper discusses many problems, several of which are much more general than the one which the rule change proposal seeks to address.

If the specific situation of Basslink is put aside, all that is left as the basic premise for the proposed rule change is to say that non-negative bidding by SNSPs can mean that some generators may be dispatched preferentially to other generators, depending on the nature of the non-zero bid, the price in the exporting region and whether the generator is behind the SNSP or competing with the SNSP (so to speak).

[2] The energy balance equation ensures that the energy across the NEM is balanced, As electricity must always be in balance between supply and demand, this is an important constraint. Its formulation is complex.

c. Non-existence of Market floor for SNSPs

Proponents argue that the lack of bid floor for SNSPs in the current market rules is an oversight and that -$1000/MWh was intended by the rule. This is not an assumption which can be made. Introducing any floor for SNSPs would constitute changing the rules and would require a full assessment of whether the NEO is advanced by such a change. In addition, the AEMC would need to ensure that implementing a floor in this current rule change process was an alternative preferable rule which addresses the problem which has been identified by the proponent. Again, this would require some analysis. Hydro Tasmania's view is that such a change would not advance the NEO as the outcome would be indifferent from a customer perspective.

3 Proponents Arguments

The proponents make 4 arguments to support their proposal. They are:

- Negative bidding has no legitimate business reason for an SNSP
- No start up costs for an SNSP
- FCAS has a zero floor
- Negative bids distort effective competition

The discussion below rebuts each of these in turn.

a. Negative bidding has no legitimate business reason for an SNSP

For an SNSP, there appear to be two principal reasons for using negative bids. The first is to increase dispatch volumes towards the end of a trading interval when there has been a high price in the early dispatch intervals. This is a commercial response to the 5minute dispatch versus 30 minute settlement in the market and is the same behaviour as is used by generators.

The second reason is to overcome transmission congestion issues and ensure dispatch when disorderly bidding is occurring. This is again in line with the behaviour of generators.

The proponents make the comment that :

> *This view is reinforced by the absence of negative prices by any of the three scheduled network service that have operated in the NEM, apart from negative prices that are evidently to gain dispatch priority.*[3]

The phrase "to gain dispatch priority" is misleading in the current context. All negative bids (and indeed all dispatch offers) are intended to establish dispatch priority. If dispatch priority is not viewed as a logical objective for an SNPS, then an SNPS is being prevented from competing with generation. This deprives SNPS's of their entire raison d'etre and so this proposed rule change would relegate SNSP's to being little more than NSP's.

The table[4] below shows the degree to which negative bids have been used by SNSP's to date. The measure for the third column is the percentage of time that a negative bid was in place.

[3] Proponent Proposal page 8

MNSP	Direction	% of time negative
VIC-SA	South	1%
	North	25%
NSW-QLD	South	0.3%
	North	18%
Basslink	South	0%
	North	0.06%

Table 1 Percent of time negative bids are used by MNSPs historically[5]

The data shows that the use of negative bids is an inherent part of an SNSP's activity in the NEM and not, as the proponent suggests, a feature of Basslink linked to its commercial arrangements with Hydro Tasmania.

The implication seems to be that, absent the commercial arrangements with Hydro Tasmania, Basslink would not be bidding. The table below presents the levels of re-bidding by SNSP's and shows that the two previous SNSPs were very active in the market. This covers both positive and negative bids. It is not possible to speculate what Basslink would do in the absence of the commercial arrangements with Hydro Tasmania and the Tasmanian legislation that applies to Basslink bidding. However the evidence suggests that it would be more active than it has been, not less.

Number of re-bids submitted				
Year	Murraylink	Directlink	Loy Yang	Basslink
2003	3920	3315	-	-
2004	-	2821	3341	-
2005	-	2298	4095	30
2006	-	-	3500	39
2007	-	-	6434	139
2008	-	-	5728	477
2009	-	-	8580	553
2010	-	-	6879	491
2011	-	-	7606	432
Average	3920	2811	5770	309
% of Loy Yang re-bids	**68%**	**49%**	**100%**	**5%**

Table 2: Rebidding activity by MNSP's historically

The generic reason for allowing SNSP's to bid negative is that they are competing with generators when they bid their link. It would lead to gross inefficiencies if SNSP's were not allowed to bid negative but generators were.

[5] Based on Data using 01-01-2002 to 31-10-2002 for VIC-SA, data using 01-01-2002 to 01-01-2004 for NSW-QLD and data using 01-01-2009 to 31-12-2011 for NSW-QLD

The evidence supports this generic conclusion that there is a legitimate business reason for a SNSP to have access to negative bids. The proponents assertion that no business reason exists is consequently comprehensively disproved by the evidence

b. No start up costs for an SNSP

The proponents argue that SNSP's don't have any startup costs so they should not be allowed negative bids. NEM caters for a wide variety of generators, all of which have different startup costs. Some of these are very low but $1000/MWh is not the actual startup cost of any generator and no generator bids are constrained by their startup costs.

While negative bidding can be related to startup costs incurred, this is not the only cost generators (or SNSP's) incur. SNSP and generator costs include the cost of backing sold contracts and their bids must be able to reflect this. SNSPs and generators also incur an opportunity cost, to the extent that they are unable to be dispatched to their preferred level at times of high price. Any consideration of SNSP costs should not be limited to start up costs as the proponents seek to do. There is no compulsion or expectation that generators or SNSP's will bid their actual costs.

c. FCAS has a zero floor

The proponents make the case that because there are no costs for FCAS providers in discontinuing the service, a zero floor is reasonable. They then attempt to extrapolate this position to SNSP's. This completely misses the point that FCAS is a separate set of services and no meaningful conclusions can be drawn from comparing the two.

As noted above, SNSP's are competing in dispatch with generators and need to have the same bidding parameters.

d. Negative bids distort effective competition

As a preliminary, but important, comment – competition in the market is much more than rivalry in short run spot market dispatch. Competition is a long run phenomenon; a dynamic process played out over time. To properly analyse impacts on competition it is necessary to consider total costs (fixed and variable), the extent to which there are sunk costs and how these are recovered, the dynamics of new entry and expansion, contract positions and many other factors. The proponents have not considered any of these, focusing purely on rivalry in 5 minute dispatch. While that means the focus of this response must also be on dispatch, the wider context of competition in the market must be kept in mind.

The proponents claim that negative SNSP bids can distort dispatch by giving preference to some generators over others, specifically generators behind the SNSP may be dispatched preferentially to generators competing with the SNSP in some circumstances.

In the limited situations where this might happen, dispatch has already been significantly distorted. This has happened initially because of the transmission congestion which leads to the "disorderly" bidding. The proposed rule change does not relieve the distortion, it merely changes which set of generators are dispatched over others. Dispatch in these limited situations is dependent on several variables including generator and SNSP starting positions, energy balance equation formulation and constraint coefficients.

Either way, this has nothing to do with effective competition.

Basically, where transmission constraints in Victoria have caused these situations, all Victorian and Tasmanian generators behind the constraint who are contracted will be affected. If all generators and the SNSP cannot be dispatched to their contracted position (due to the transmission constraint), then there is potential exposure to a loss for the relevant trading interval if the spot price is high. Presently that exposure is shared by the affected Victorian and Tasmanian generators in a particular way. What the proponents are saying is that they want more of that exposure to be borne in the first instance by Tasmanian generation.

4 Further Arguments Against the proposal

a. Viability of SNSP's

This rule would remove one tool which SNSP's have to maximize their revenues and minimise their risks in the market. This means that making this rule will make it less likely that an SNPS will be built. The transmission element may consequently be built as a regulated transmission asset, paid for by customers. This is a detriment to customers if building an SNSP would have represented a more efficient investment.

The issue is the impact on investment certainty. The Productivity Commission in its current review into interconnectors[6] comments on the concerns about under investment in interconnectors. They quote Garnaut's concern in Australia and Kapff and Peckamns' concern in the EU. Since the role of SNSP's in the NEM is as interconnectors, these concerns are relevant to this proposal.

b. Contract Liquidity

One implication of this rule change will be that an SNSP's ability to cover a contract position will be reduced. The reason for this is that the recipients of the inter-regional revenues (IRR) may be unable to cover their position using IRRs if flow is reduced or stopped as a consequence of this rule change. This will represent a cost to the MNSP owner in reduced contract premium but will also reduce the liquidity of the contract market. The liquidity is reduced as all of the reduction risk will be held by one participant instead of being spread across many participants.

c. Incorrect characterisation of the "problem"

Proponents deliberately combine a series of separate and inconvenient truths into an inappropriate package that might be addressed by the proposal.

The "problem" is simply that the proponents do not like particular market outcomes and want to shift risk onto a competitor (Hydro Tasmania).

To the extent that the market outcomes which the proponents dislike are the result of anti-competitive behaviour, there are appropriate remedies for that "problem" in other forums. Otherwise, they are simply the market at work.

[6]Productivity Commission Electricity Network Regulation Issues paper Page 32

d. Sovereign risk issue with Basslink

In addressing the proposal the AEMC should consider the sovereign risk it would be introducing to all future SNSP developers.

The Basslink business case, as would any business case for an SNSP, assumed the quality of dispatch was on a par with generators in the sending region. The rule change seeks to retrospectively change this critical aspect of the project. The precedent set, would likely introduce an unacceptable risk to developers, and reduce the likelihood of future SNSP projects in the NEM. It would also been seen by investors more generally as a risk for other NEM investments. This is a significant issue with the major new investment required in reducing the carbon intensity of the supply side.

5 Impact of the change on the NEO

a. No case made by the Proponents

The AEMC is required to assess the rule proposal in the context of whether it advances the NEO. Hydro Tasmania's view is that this rule proposal does not enhance the NEO and that the proponents have not made any case that it does. The proponents have not actually identified any problem; all they have done is raise an issue with how particular market outcomes impact on them – but that should be recognised as merely an individual grievance with the market at work (something which all market participants feel at some point in time).

Importantly, if AEMC wishes to undertake modeling for the purpose of examining the proposed rule change, none of the commercially available packages incorporate an energy balance equation and any Basslink related modeling exercise would need to allow for the impact of Tasmanian legislation and contract positions. These factors will need to be allowed for in any decision to accept a rule proposal, as the onus is on the AEMC to be satisfied that the rule has a positive effect on the NEO.

b. AEMC Guidelines

The AEMC have provided some guidance in the Consultation Paper. The relevant section is the Assessment Framework on page 8 which says:

> *In the context of this rule change, the Commission will inform its decisions by considering, in particular, the likely impact of the proposal on the following elements:*
>
> - *Efficient operation of electricity services:*
> - *MNSPs should have incentives to offer services at cost reflective prices; and*
> - *dispatch outcomes should maximise the value of trade to the market, optimised across both the energy and frequency control ancillary services (FCAS) markets.*
>
> - *Efficient investment in electricity services:*
> - *generators and MNSPs should be able to recover their efficient fixed and variable costs over the long run.*

- *The reliability, safety and security of the supply of electricity and of the national electricity system should be maintained.*

The Commission will also consider the materiality of the identified problem and the proportionality of any proposed solution.

Each of these four criteria is addressed separately below.

c. Efficient operation of electricity services

The first dot point under this criteria is stated as:
SNSPs should have incentives to offer services at cost reflective prices;

This should not be interpreted as an obligation for offers to reflect some short run physical cost of the MNSP. As explained in 3(b) above, SNSPs incur costs associated with the NEM's financial arrangements. SNSPs are also competing with generators, who need to have the same incentives and opportunities in terms of price offers if the competition is to be effective.

It should be considered that generators and SNSPs are likely to have the same incentives (under constrained dispatch scenarios) and that "cost reflective prices" should include:
- Opportunity cost
- Cost of covering contract positions
- Capital and operational cost recovery

This criteria is very difficult to apply to SNSP's as their cost is largely a capital cost but that does not mean it should be ignored. It means that the AEMC needs to understand the business models for how the efficient costs of building an SNSP are recovered in the market.

If these aspects are taken into account, the proposal reduces the efficiency of the operation of the market.

d. Efficient investment in electricity services

In the NEM, two out of three MNSP's have chosen to convert to regulated status. In each case, the owner suffered a significant loss of value. This indicates that these owners were unable to recover their costs. These SNSP's were able to bid negative and did so frequently and for extended periods as shown in Table 1.

This rule proposal will reduce the ability of an SNSP to recover their costs as it will take away one of the tools by which they maximize their revenue and minimise their risks. Given the benefits of an SNSP in that customers do not pay for them, it is hard to see that the rule change advances the NEO by this measure as it potentially reduces efficient investment in electricity services.

e. The reliability, safety and security of the supply of electricity and of the national electricity system should be maintained

This criteria is not directly affected by the proposed rule change. However, adverse impacts on investment can have an indirect effect in this regard.

f. Materiality of the Problem

There is no problem for the market or for consumers. As explained above, the problem is merely one of how market outcomes affect the proponents individually. The rule change may make the proponents more profitable but there is no case made by the proponents that this would be passed on by way of lower prices to consumers.

g. Summary

The AEMC have specified four criteria in the Assessment Framework to guide their assessment of this specific rule change. From our analysis, it fails on three criteria and the fourth is unaffected.

PART 2 Basslink Specific Arrangements

6 Summary

This section discusses the factual position regarding Basslink and explains how the use of negative Basslink bidding has been and continues to be subject to oversight in other more appropriate forums. Accordingly, it is Hydro Tasmania's contention that, even if the blanket rule put forward by the proponents were justifiable, Basslink should be exempt from that blanket rule.

The situation which has given rise to this rule change is when Basslink is bidding negative to maximize the flow from a low priced region to a high priced region when there is a constraint between Basslink and the regional reference node. In the NEM this leads to "disorderly" bidding which is a more general problem in the market. To date no effective solution has been found to this and a workable response has eluded the market. It is currently the principal focus of the Transmission Frameworks Review being run by the AEMC which has already been underway for over two years.

The relevance to this rule proposal is that at the relevant times, the market is not necessarily acting efficiently due to the distortion of the transmission constraint. However, the impact of this rule change, if implemented, would undoubtedly be to decrease the flow across Basslink from the low priced region to the high priced region, potentially to the point of counter-priced flows. This would undermine the legitimate rationale for permitting the use of negative Basslink bidding in such circumstances.

7 The specific situation

In the first instance, Basslink's non-zero bidding is subject to the provisions of the commercial agreement between Basslink and Hydro Tasmania (the Basslink Services Agreement or BSA). Under the BSA, Hydro Tasmania has the right to request that Basslink make a negative bid.

Tasmanian legislation (Part 3 Division 3 of the ESI Act) enables the Minister to give Hydro Tasmania directions regarding Basslink bidding and also places statutory obligations on Hydro Tasmania to comply with any such Ministerial directions.

Under this framework, negative Basslink bids can only be used in one very specific and very limited circumstance relating to northwards flows, namely where

i) the Victorian spot price is higher than the Tasmanian Spot Price;
ii) the Tasmanian price is negative; and
iii) transmission constraints that affect the Latrobe Valley connection point start to bind.

All three conditions need to be met for a negative Basslink bid and the negative bid needs to be withdrawn at the end of the current trading interval when any of the three conditions are not met.

This rule proposal has been submitted by two participants who do not like the market outcomes when Basslink negative bidding is used in this specific situation. As such, their issue is really about wanting to change how Basslink operates for their own financial benefit rather than wanting to change the rules for all SNSPs.

The situation in which there is a transmission constraint in Victoria limiting the dispatch of the LaTrobe Valley generators and Basslink is very complex, especially due to the interaction of the SNSP formulation in the energy balance equation. In fact the impact from this formulation is that, when a constraint exists, La Trobe Valley generation bids at the market floor and is favoured over Basslink. Without negative bidding, Basslink will be backed off and eventually forced into counter price flow.

In this circumstance, Basslink has the same incentive (to be dispatched into the high priced region) and typically will adopt the same strategy. The proposed rule change would prohibit these bids and would result in Basslink being backed off fully in preference to impacted Victorian generators.

The impact of this change in contract liquidity will be much greater under the proposed rule change. Under the current arrangements, the impact of the constraint is spread across the LaTrobe Valley generators. Under the proposed rule change Basslink might be backed off by 500MW. This represents only 4%-8% impact on each of the other Latrobe Valley generators. Under the proposed change, Basslink's dispatch will be reduced to zero (or more negative) which is a 100% reduction. The impact of the change is consequently to impact one participant significantly in place of several participants by a small amount. The risk is consequently harder to manage and the impact on contract liquidity will be commensurately larger. This effect would come on top of the reduced liquidity which is being driven by a reduction in contracting parties from the aggregation of existing parties.

8 The Tasmanian legislation

In late 2000, Hydro Tasmania and Basslink asked the ACCC to conduct a detailed assessment of the BSA under Part IV of the Trade Practices Act (now the Competition and Consumer Act).

The ACCC, in this review, recognised that it is simply not possible to make blanket generalisations as to whether the use of non-zero bidding by Basslink is pro-competitive or anti-competitive. It was understood by all concerned that this will always depend on the circumstances.

For example, the ACCC identified that negative Basslink bids could be a concern if used to create counter-priced flows of high priced Tasmanian energy into Victoria. On the other hand, it was acknowledged by the ACCC at the time of the initial review that there may be future circumstances (at that time unknown) in which negative Basslink bids might serve a legitimate purpose.

Because it was clearly understood that it is not possible to make blanket generalisations about non-zero bidding either way, the ACCC did not seek a blanket ban on all non-zero bidding – and equally Hydro Tasmania and Basslink did not seek blanket immunity (authorisation) for all non-zero bidding.

Subsequently, the Tasmanian Government introduced Part 3 Division 3 (sections 36 and 37) of the ESI Act to provide certainty and transparency as to the circumstances in which non-zero Basslink bids would be made. It was expressly recognised that a balance needed to be struck – providing certainty to market participants that non-zero Basslink bids would not be "misused" (eg to create the type of counter-priced flows the ACCC had expressed concerns about) while equally providing certainty as to the on-going flexibility to allow the use of non-zero bids in circumstances where there was a legitimate reason for doing so.

The June 2001 Enhancements Paper published by the Tasmanian Government made the following clear:

> *"… the Government has worked in consultation with the ACCC to ensure that there is greater certainty for market participants, Hydro Tasmania and BPL regarding the bidding arrangements for Basslink by defining the parameters of legitimate bidding behaviour consistent with the flexibility that Basslink is intended to provide."*

and

> *"… the Government is of the view that to assist the development of effective competition in Tasmania, particularly in the transition years, it would be desirable for there to be greater certainty regarding the way in which Basslink will be bid. In doing so, the Government is mindful that it must balance giving that certainty during the transitional phase while preserving the flexibility that Basslink provides."*

It is important to understand that this was all about ensuring that a blanket approach was not taken to non-zero bidding – because this would have affected the economics of Basslink.

It is also important to understand that a key reason for the framework that was introduced was to provide certainty to Hydro Tasmania and Basslink about the circumstances in which there were no concerns about non-zero bidding.

The legislative framework that was introduced sought to ensure that the use of non-zero bidding would be considered and assessed by the Government in consultation with the ACCC on a case by case basis according to the specific circumstances. That is precisely what

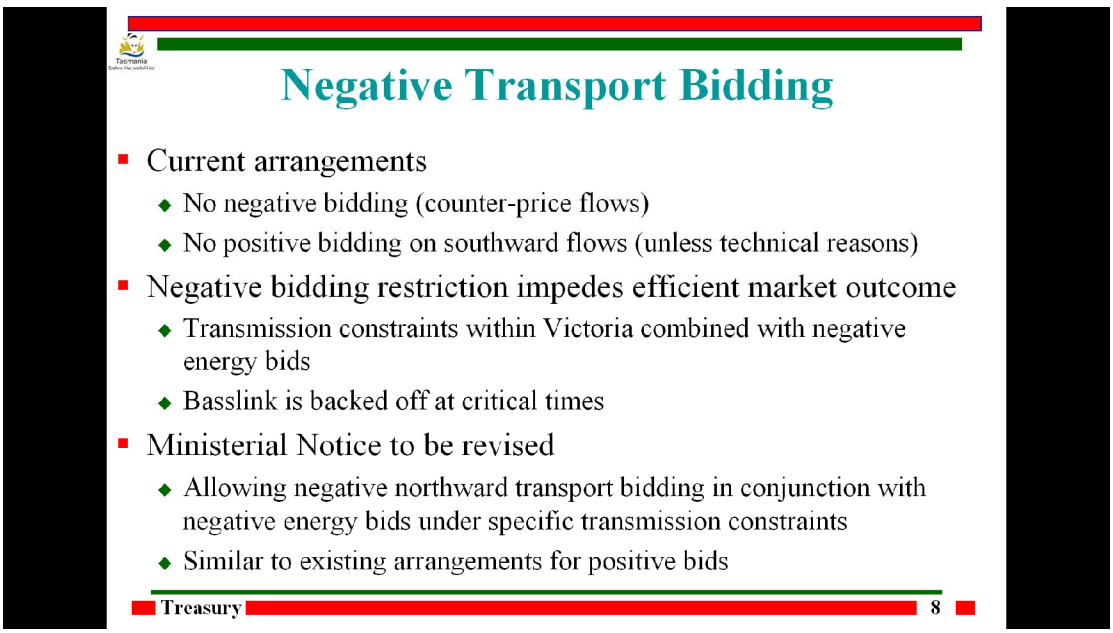
happened in 2007 in relation to the current permitted use of negative bidding on northwards flows into Victoria.

9 The 2007 process for Amending the Ministerial Notice

A problem had been identified in the NEM relating to intra-regional congestion and counter-priced inter-regional flows. This was recognised as a problem by the AER: see the July 2007 presentation by Dr Darryl Biggar at the 2007 ACCC Regulatory Conference. The use of negative Basslink bids in the type of circumstance outlined by Darryl Biggar was proposed as a means of maintaining Basslink northwards flows, which would otherwise be backed off potentially giving rise to counter-price flows.

The Tasmanian Government consulted the ACCC in 2007 about a proposed change to the Ministerial Notice in force under s36 to permit negative Basslink bids in such circumstances. The concern expressed by the Tasmanian Government was to avoid or overcome counter-priced flows, to the best extent possible, something which the ACCC readily recognised as a legitimate circumstance. The ACCC's only concern was whether the detail of how this would be done might leave open the possibility of using negative bidding for some other reason.

There was a high level briefing on this by Tasmanian Treasury to the AER on 27 August 2007. Tasmanian Treasury covered several market related issues and the following slide is the one relevant to the current discussion.



In addition, a detailed joint presentation was made to the AER by Hydro Tasmania and Basslink on 17 October 2007. To assist the Commission in appreciating the thoroughness of this briefing, the slides which were used are shown as Attachment 1.

On 8 February 2008, the Treasurer wrote to Hydro Tasmania advising that the ACCC had indicated to the Government there were unlikely to be any competition issues with issuing a new amended Ministerial Notice allowing negative bids in "appropriate circumstances" including where mainland transmission constraints are causing Basslink northerly flow to be reduced. However, the ACCC reserved its right to take action if negative bidding was used in an anti-competitive manner.

The ACCC has always recognised that there are some circumstances where the use of non-zero bidding has a legitimate rationale. Its concern has always been that there might also be other circumstances where non-zero bidding might be used in an anti-competitive manner – in which case the ACCC has made it clear that it will take appropriate action. Hydro Tasmania takes this very seriously and has adhered strictly to its statutory obligations.

Consistent with the approach outlined in the Tasmanian Government's 2001 Enhancements Paper, the primary means for providing certainty as to legitimate bidding behaviour is the Compliance Plan which Hydro Tasmania must publish under Part 3 Division 3 of the ESI Act.

Thus, following the new Ministerial Notice issued in May 2008, clause 3.1 of the Compliance Plan sets out the following:

> *"In the event that Hydro Tasmania instructs BPL to submit a negative bid which applies to northward flows across Basslink, it must only be where:*
> *i) the Victorian spot price is higher than the Tasmanian Spot Price;*
> *ii) the Tasmanian price is negative; and*
> *iii) transmission constraints that affect the Latrobe Valley connection point start to bind.*
> *Any such negative bid would be submitted when all three conditions are met and would be withdrawn at the end of the current trading interval when any of the three conditions are not met."*

All the examples provided by the proponents have involved the use of negative bidding in these narrow circumstances that had been reviewed and considered in the 2007 process. This is not a case of a new use of negative Basslink bidding that is contrary to the circumstances assessed as legitimate in 2007.

Part 3 Responses to Consultation Paper Questions

The Commission has proposed a series of questions in their Consultation Paper. This section provides Hydro Tasmania's response to the specific questions.

Question 1

To what extent are the market outcomes identified by the proponents incentivised by the current market structure?

1.1 If Basslink was operated independently of Hydro Tasmania, would it have an incentive to offer negative prices (excluding for technical reasons which are discussed below)?

Answer: It is impossible to second guess this because it is not possible to know what commercial arrangements Basslink might have in place (eg what level and to whom it has

sold the IRRs). It is also impossible to conceive of what Basslink would be like as an SNSP but without the BSA, as without the BSA Basslink would not have been built.

However, if we look at Basslink's behaviour compared to the other MNSPs which have existed, the historical evidence suggests it would become around 10 times more active in its bidding and over 300 times more active in bidding negatively.

It should be noted that, in the case of Basslink, the contract with Hydro Tasmania has a finite term (and early termination triggers), so Basslink Pty Ltd, the owner of Basslink, has an independent exposure to the Basslink revenue stream. Current commercial arrangements for a single MNSP should consequently not form the basis for any regulatory assessment of the merits of the proposed rule change.

1.2 More generally, under what situations (excluding technical reasons) would an independently operated MNSP have an incentive to offer negative prices? Should the ability of such MNSPs to offer negative prices be viewed as anti-competitive or a legitimate business decision?
Answer: The principal reasons for an independent link to bid negative are to maximize its revenues for the 5min/30min dispatch arrangements in the NEM. This is in line with the approach adopted by generators. This option is not usually available to Basslink unless the conditions of the Tasmanian legislation are met .

The second reason is to manage their position when there is a network constraint and this is in line with the behaviour of generators.

Both reasons represent legitimate business decisions, for the reasons explained in the main body of our submission, particularly section 3(a).

1.3 If Hydro Tasmania did not receive the revenue accruing across Basslink would it have an incentive to risk driving low spot prices in Tasmania?
Answer: This depends on Hydro Tasmania's contract position and the specific future circumstances. For example, with a high contract position, Hydro Tasmania (like any other generator including the proponents) would be incentivised to ensure its contract position was covered and so it would be prepared to bid negative. However, under the proposed rule change and if Hydro Tasmania does not hold the IRRs, it has less incentive to bid at low prices since it can not establish dispatch priority over Victorian generators. The question is also incomplete as it does not specify who does hold the IRRs and this will impact on the outcomes.

Further, this is not relevant to the rule change as the proposed rule must be assessed regardless of whether or not it would apply to Basslink.

<u>Question 2</u>
Are there any technical reasons why BPL - or any other MNSP - should be able to offer negative prices?
Answer: MNSPs should be able to offer negative prices for the reasons given above. The overarching reason, however, is that they are competing with generators and so should have the same bidding parameters as generators.

2.1 Should BPL continue to be able to offer negative prices so as to (1) reverse flows more quickly; and/or (2) reduce the instances and/or duration of counter-price flows?

Answer: (1) Negative bids are not currently used to reverse flows more quickly due to the Tasmanian legislation. (2) Negative bids are only used in the specific circumstances set out in Hydro Tasmania's Compliance Plan and this assists by reducing the risk of counter price flow.

2.2 Is there a more efficient way to manage counter-price flows than through negative pricing?

Answer: Counter price flows across an SNSP are generally caused either by a transmission constraint (the situation being considered here) or because of the co-optimisation between energy and FCAS. Negative bidding can be used in both these cases by an SNSP to reduce the risk of counter price flows.

The Transmission Frameworks Review is seeking a solution to the transmission constraint induced counter price flows in their search for an effective congestion management regime. It is unclear whether any effective solution will be forthcoming from this process.

For co-optimised FCAS induced counter-price flows, AEMO have demonstrated that the counter priced flows are (counter intuitively) an efficient outcome for dispatch. They consequently do not require further management.

2.3 Are there any other technical reasons why MNSPs should be able to offer negative prices?

Answer: There appears to be confusion as to what are "technical" reasons. The response to the 30min/5 min issue and to transmission constraints are both commercial responses. The need for generators to bid negative to cover startup costs is also a commercial response. There are no "technical" issues to stopping and restarting plant but there are "commercial" impacts. In answer to the question, there are good reasons for SNSP's to be able to bid negative.

Question 3

Will the proposed solution resolve the identified problem?

3.1 Will the impact of losses mean that Hydro Tasmania would still be able to be dispatched before the Latrobe Valley generators even where BPL offers must not be negative?

Answer: Under the proposed rule, La Trobe valley generators will always be dispatched ahead of northward Basslink flows under the relevant conditions (see section 2a.) due to the impact of the energy balance equation.

Question 4

Is the proposed rule change a material response to the proposed problem?

4.1 How material is the identified problem?

Answer: There is no problem for the market or for consumers. The only problem identified is that the proponents do not like particular market outcomes associated with the negative bidding of Basslink in one particular circumstance. This should be recognised as merely an individual grievance with the market at work (something which all market participants feel at some point in time. In addition it should be noted that negative bidding has not been used

since Oct 2010 and negative bidding of Basslink is covered under legislation in a transparent manner.

4.2 Does the proposed solution represent a proportional response?
Answer: It is not a proportional response and the only proportional response is to reject the rule proposal. A general ban on SNSP negative bidding due to a single participant in a limited and specific situation is not a proportional response.

Question 5
What are the likely impacts on generators in the Latrobe Valley?
5.1 Are generators in the Latrobe Valley likely to benefit from this proposed rule change, taking into account the impact of losses?
Answer: Yes, if the rule change prevented negative Basslink bidding in the particular circumstance where it presently occurs, then there will be a direct financial benefit to the proponents and other Latrobe Valley generators.

5.2 Are there any other benefits or costs that are likely to affect the Latrobe Valley generators that have not been identified?
Answer: Not to Hydro Tasmania's knowledge.

Question 6
What are the likely impacts on generators in Tasmania?
6.1 Is Hydro Tasmania likely to incur costs if this proposed rule change is implemented, taking into account the impact of losses? Are there any other costs or benefits that are likely to accrue to Hydro Tasmania that have not been identified?
Answer: If the rule change prevented negative Basslink bidding in the particular circumstance where it presently occurs, then there are two areas of loss for Hydro Tasmania which are:

- Lost revenue which has averaged $1.5million per annum recently on the events quoted by the proponents. These costs only occur when events occur and this requires the right conditions so it is hard to predict precise future values.
- Reduced contract revenue from reduced Victorian contracting due to increased delivery risk.

6.2 On balance, what is the likely impact on AETV? Are there any other benefits or costs that are likely to affect AETV that have not been identified?
Answer: Hydro Tasmania can not comment on AETV's position.

Question 7 & 8 (We have combined the response to these questions as end-use consumers should be considered as a whole)
What are the likely impacts on end-use consumers?
7.1 Are end-use consumers likely to benefit from this proposed rule change?
Answer: The rule change may make the proponents more profitable but there is no case made by the proponents that this would be passed on by way of lower prices to consumers.
7.2 Are there any other benefits or costs that are likely to affect consumers that have not been identified?

Answer: SNSP development is less likely so associated transmission costs will be borne by customers.

Attachment 1: Slides from Joint Presentation by BPL and Hydro Tasmania to AER on 17 October 2007

Basslink Negative Bidding

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- How negative bidding works
- Impact
- South Morang Example
- Summary

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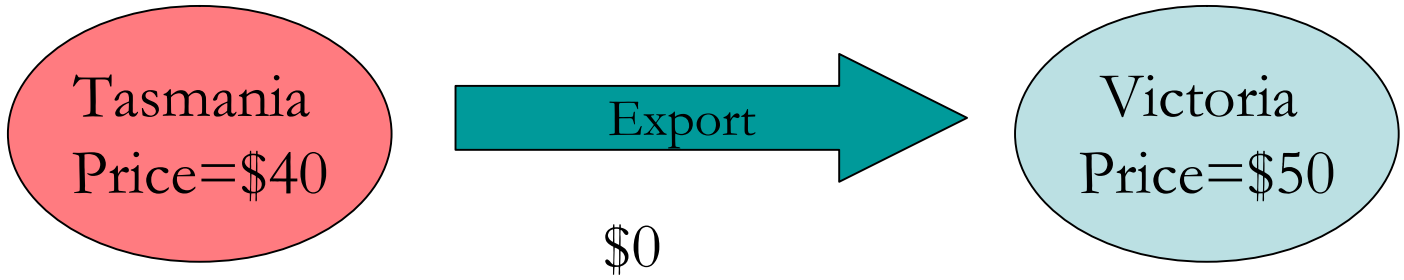

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Victoria bidstack with value

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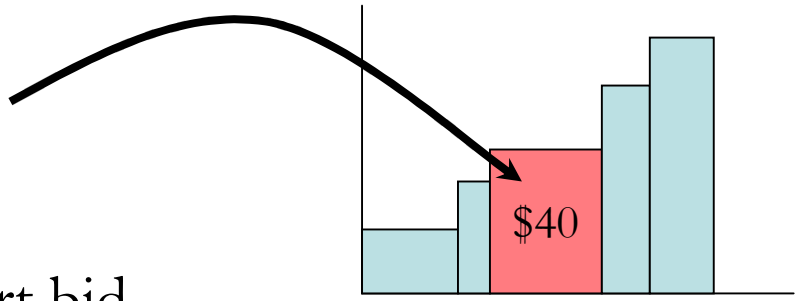

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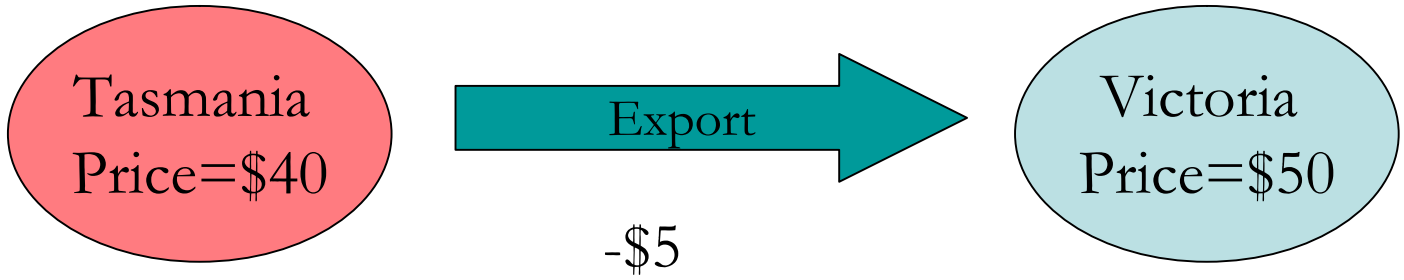

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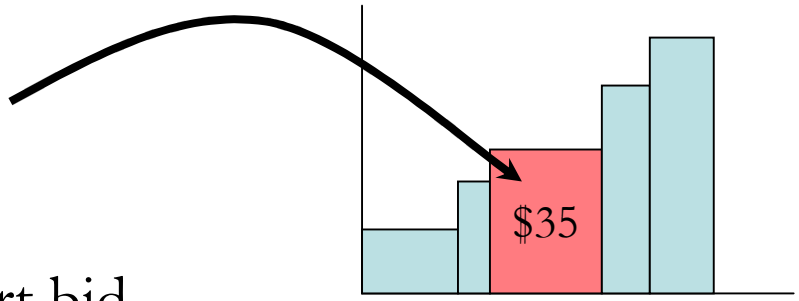

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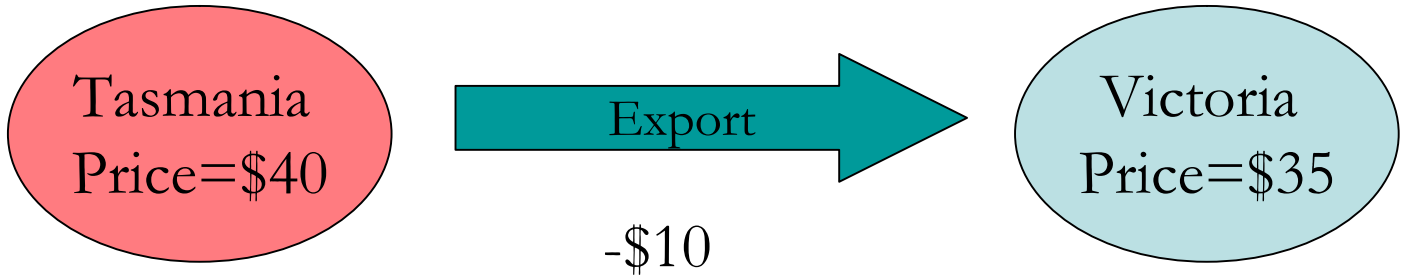
Counter price flow



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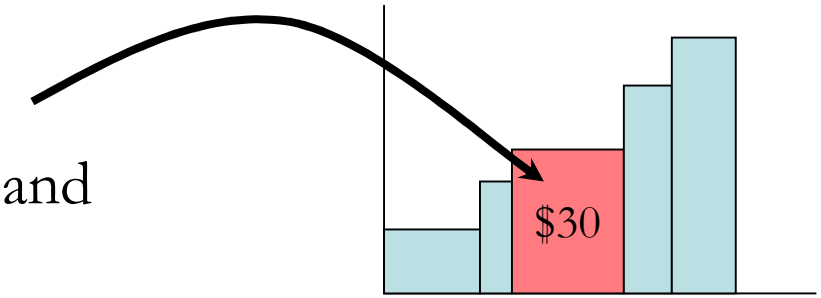

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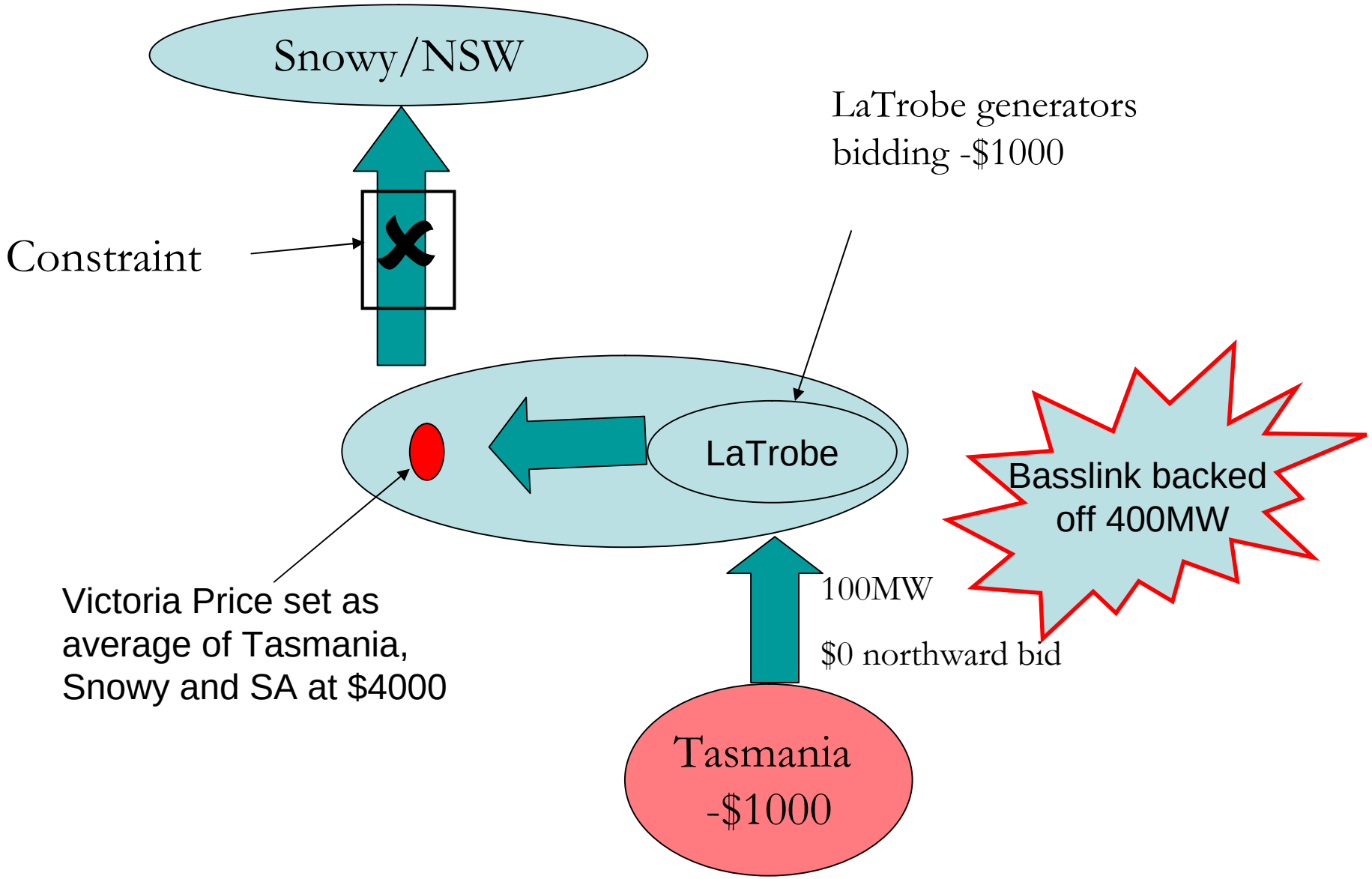
(Indicative numbers)



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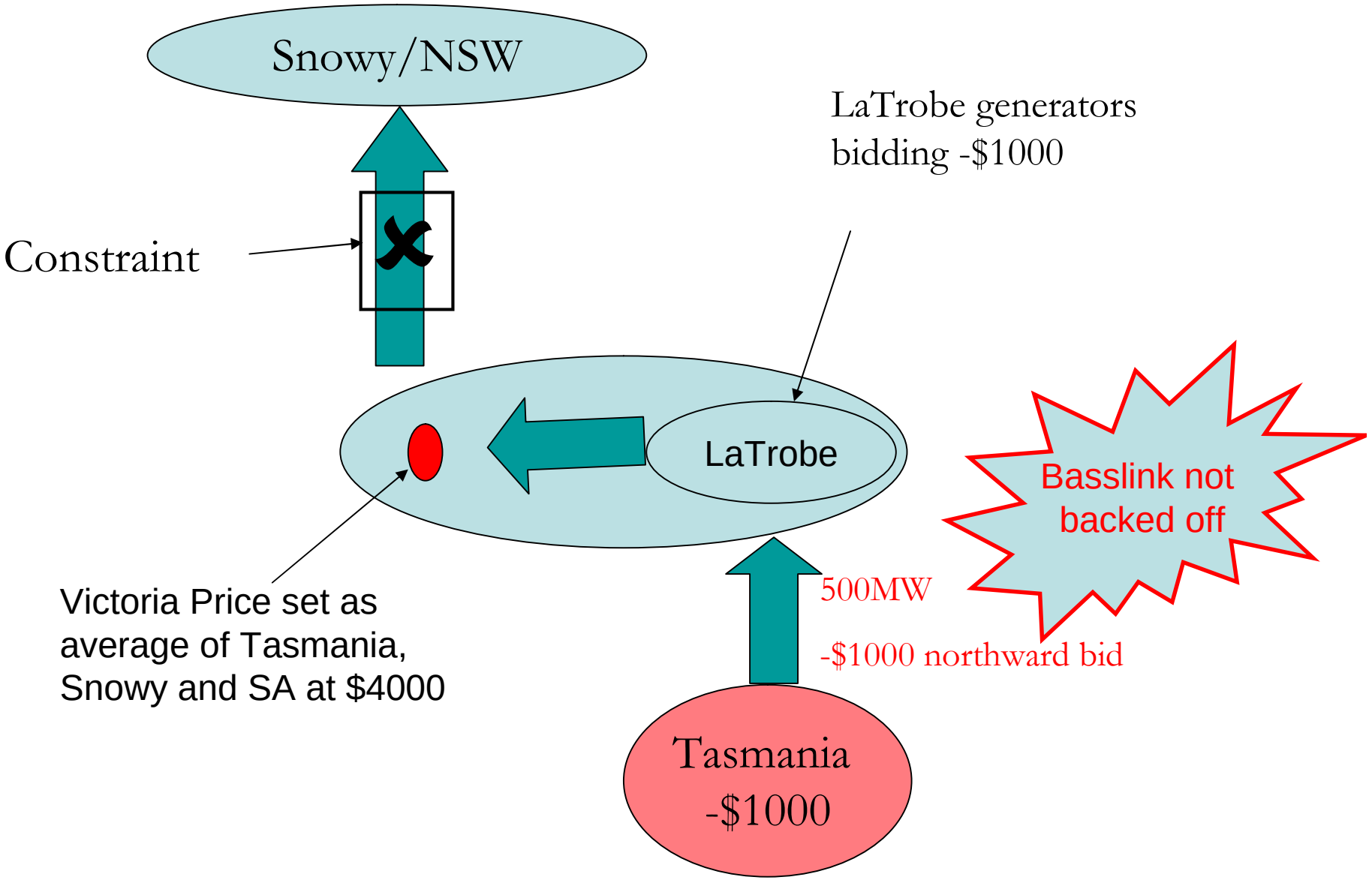

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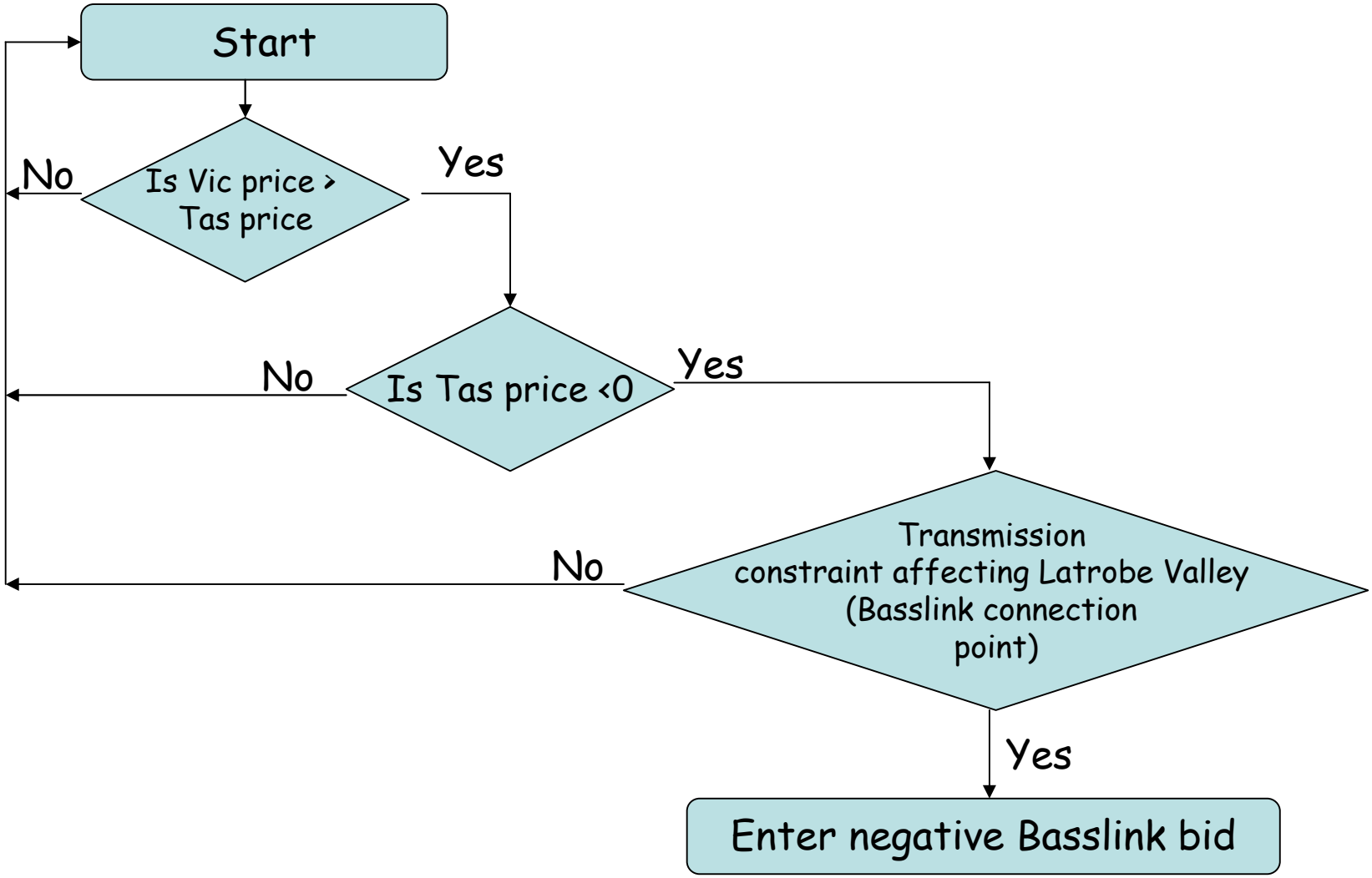

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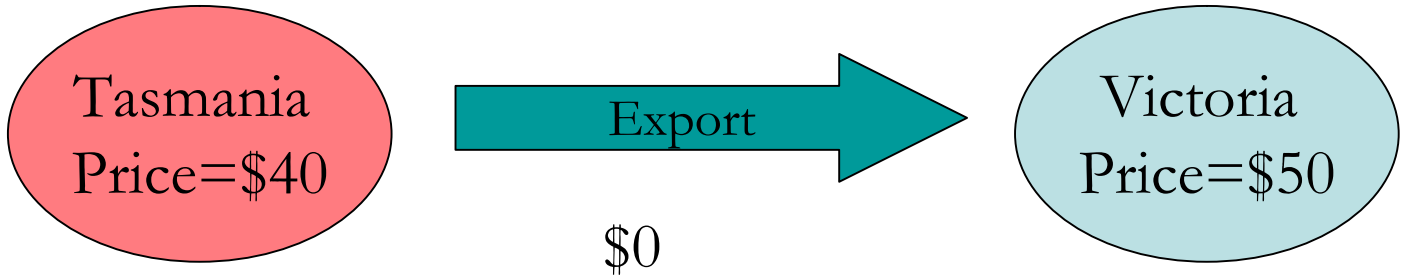

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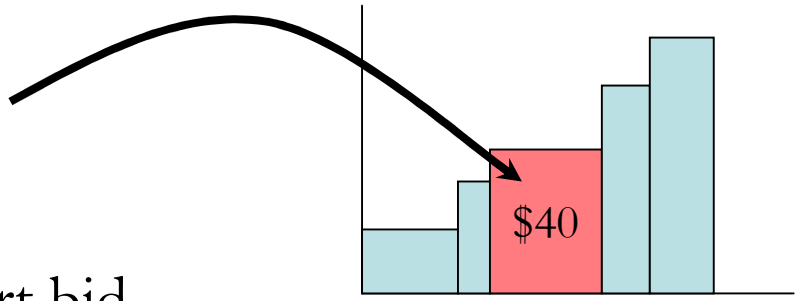

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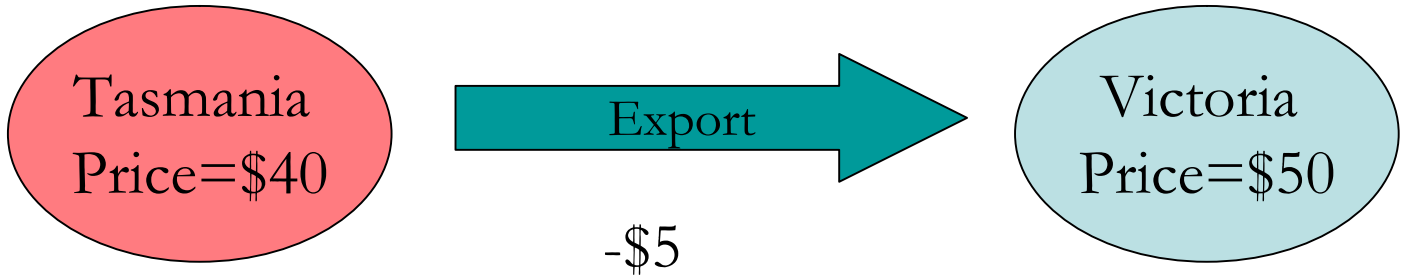

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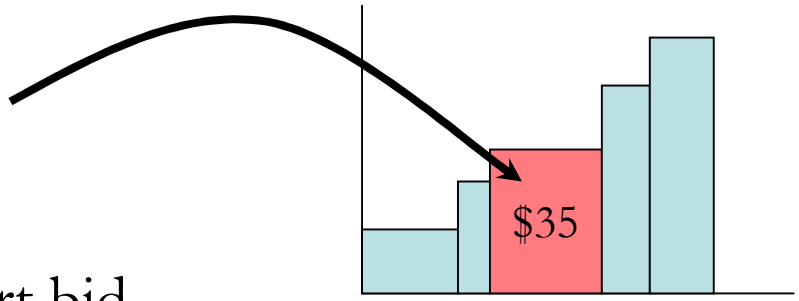

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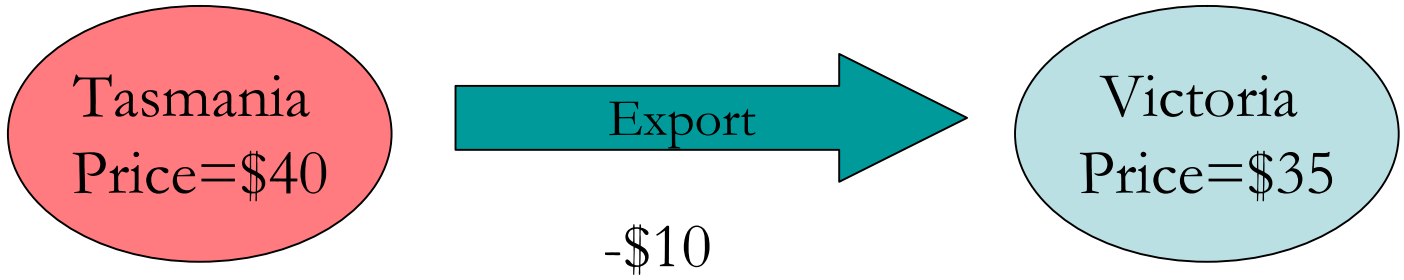

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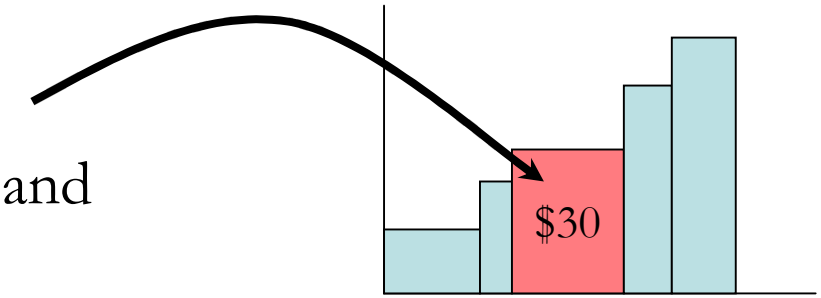

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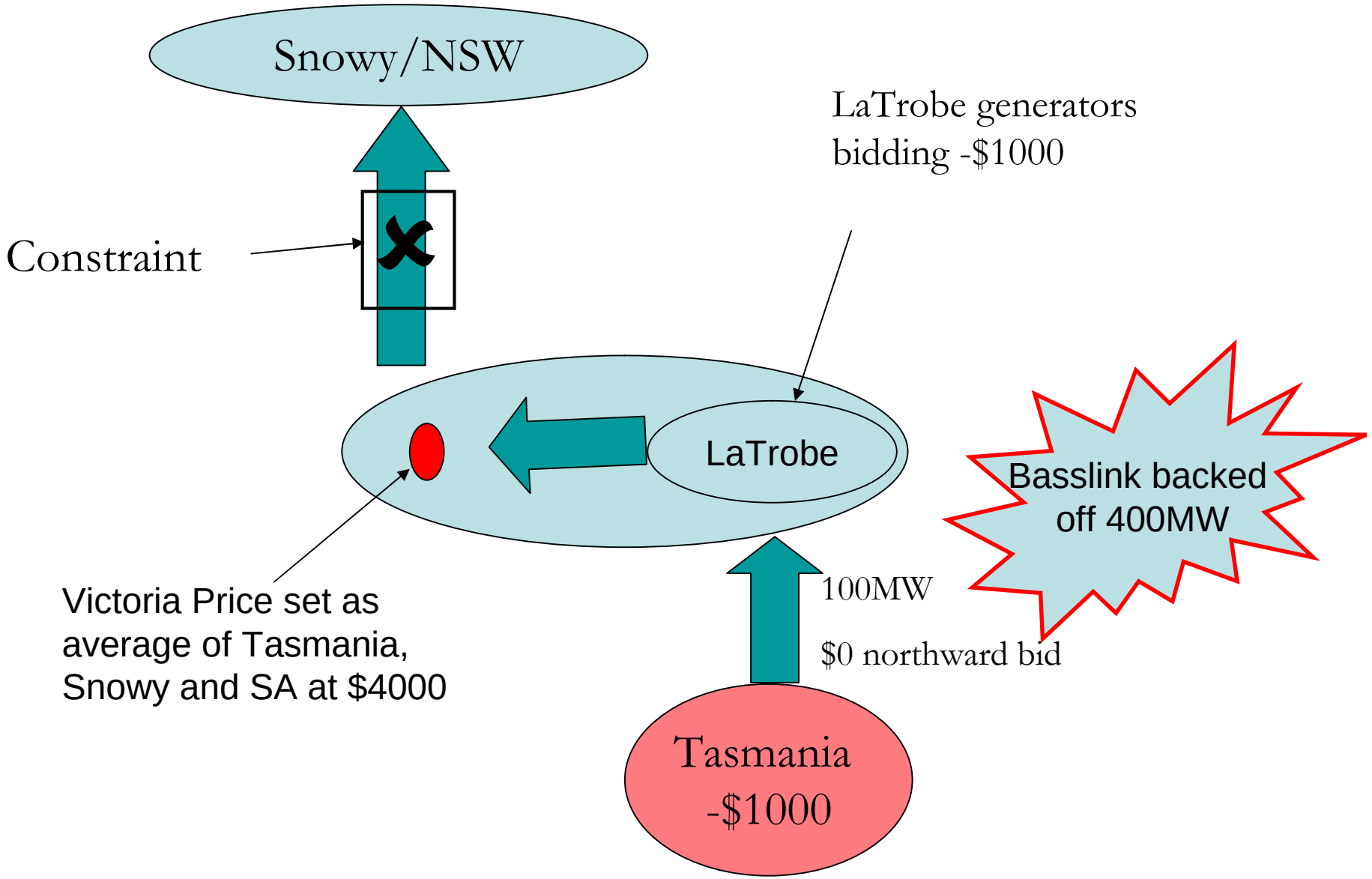

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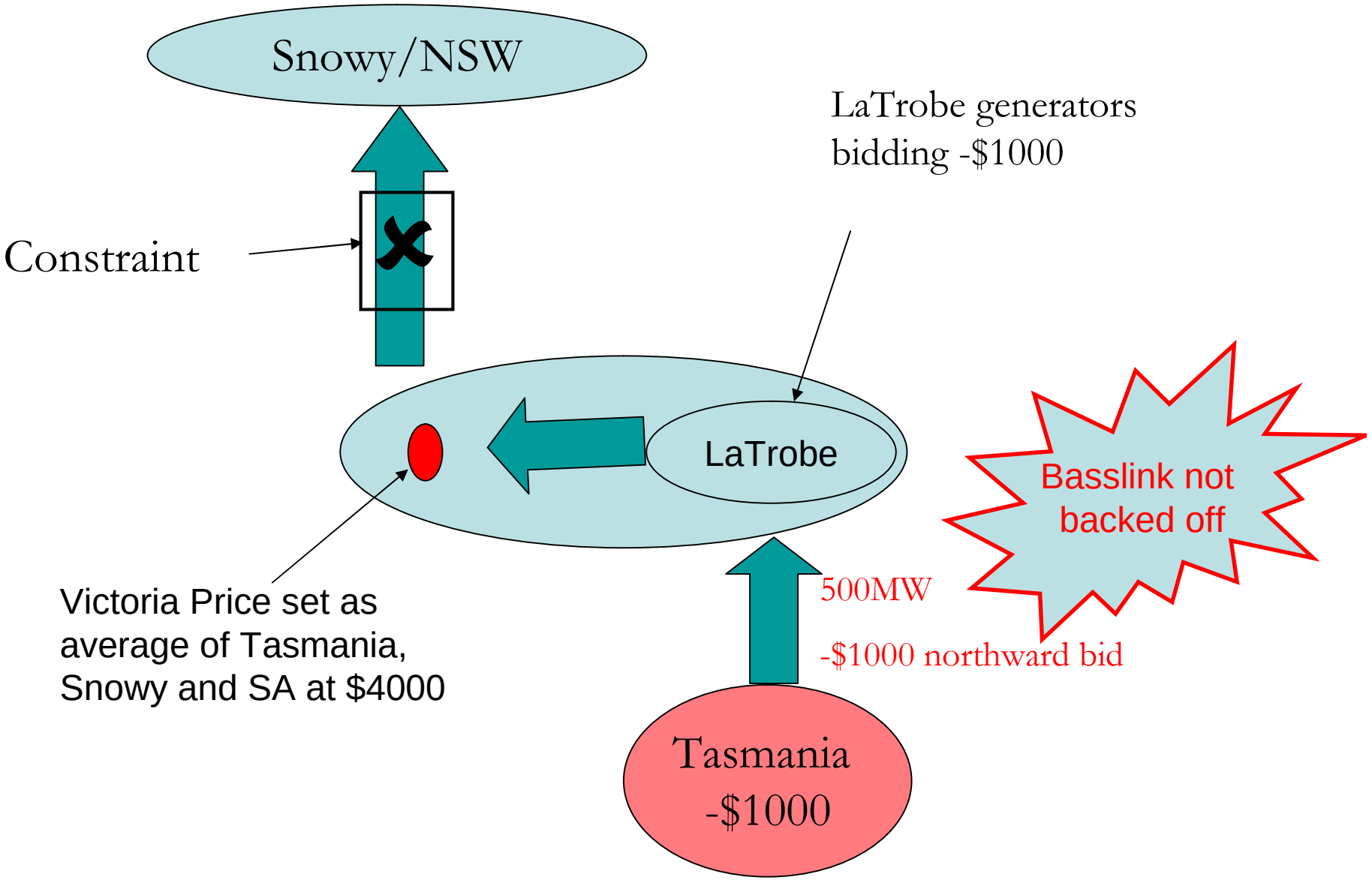

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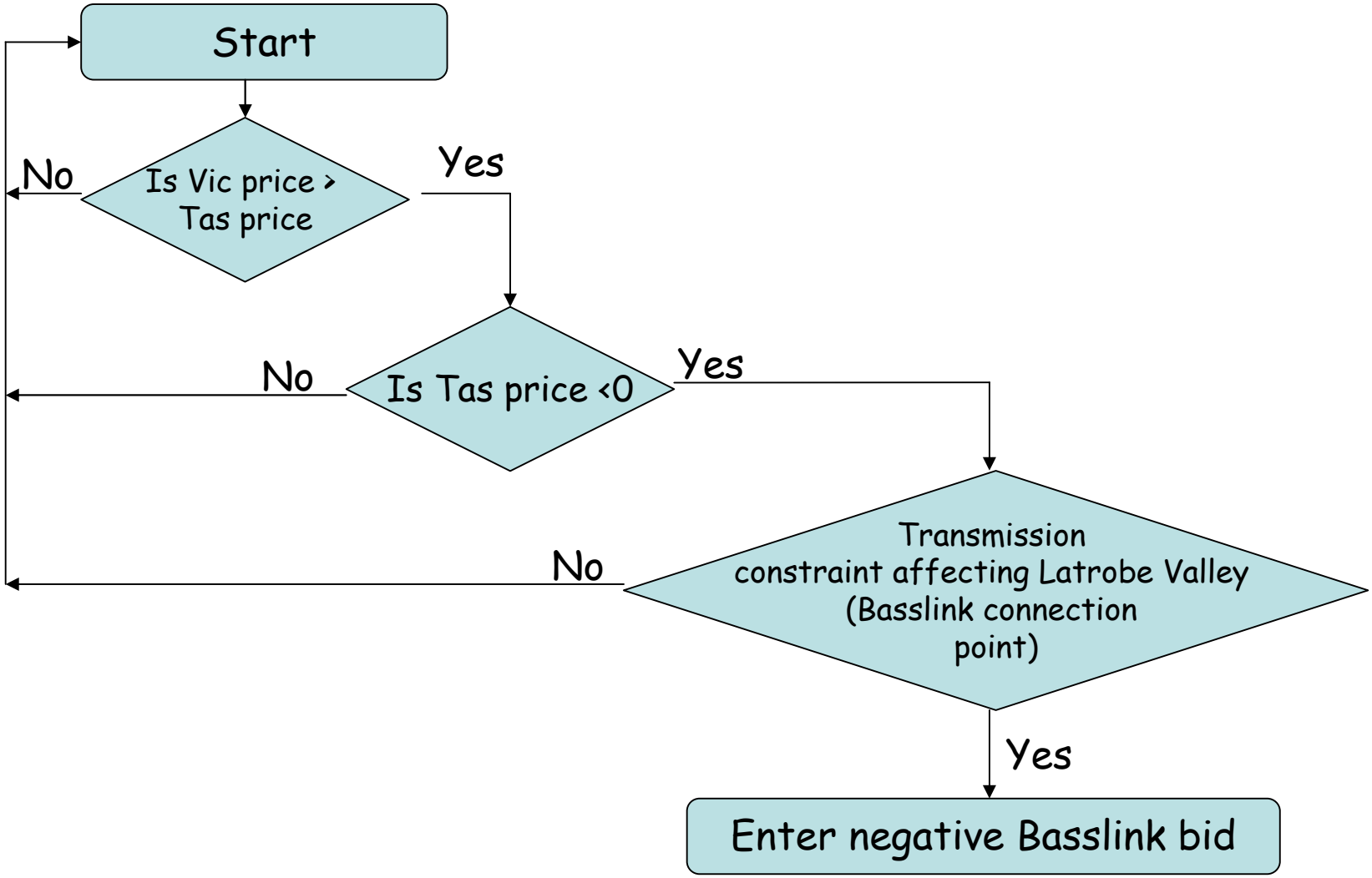

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