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A few words.

21 June 2016

John Pierce
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Submitted online via www.aemc.gov.au

Reference ERC0201

Dear Mr Pierce

National Electricity Amendment (Five Minute Settlement) Rule 2016

AGL welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) Consultation Paper on the National Electricity Amendment (Five Minute Settlement) Rule 2016 (Consultation Paper).

AGL is one of Australia's leading integrated energy companies and largest ASX listed owner, operator and developer of renewable generation. Our diverse power generation portfolio includes base, peaking and intermediate generation plants, spread across traditional generation fuel sources as well as renewable sources. AGL is also a significant retailer of energy, providing energy solutions to over 3.7 million customers throughout eastern Australia.

The views expressed in this submission leverage on AGL's considerable market experience.

AGL does not consider that there is a material problem with the design of the wholesale electricity market to the extent that changes to market settlement times are warranted. Accordingly, AGL does not support the proposed rule change.

AGL considers that the proposed rule, if made, could negatively impact market participation, particularly in the case of fast start generators and demand side response. Further, AGL considers that the Bidding in Good Faith rule, which commences on 1 July 2016, may go some way to addressing the behaviour Sun Metals appears to be targeting with its rule change request.

AGL provides the following points in support of its position.

Increased wholesale market volatility

AGL is concerned that the introduction of a five minute settlement period would actually increase market volatility.

On the generation side, most fast start generators are unable to deliver electricity within a five minute period and some are unable to respond to price spikes that occur within the second half of a thirty minute trading interval.

In AGL's experience, when a price spike occurs, the averaging process of the current 30 minute settlement period incentivises fast start generators to turn on, as they are often guaranteed a profit, which is likely to more than offset their start costs. These generators are further incentivised to remain on-load for a period of time as their start costs now become sunk. This typical response works to increase the level of competition in the market amongst generators subsequently diminishing market volatility (under most circumstances).

AGL contends that a five minute settlement would likely cloud the incentives of fast start generators during a price spike event. Without the strong possibility of a profit to turn on for, a fast start generator would be faced with the decision to incur a start cost in circumstances where profit is less assured. Accordingly, there may be occasions where fast start generators decide that the risk of starting up does not warrant only 'potential' reward.

Price spikes occur predominantly in the last five minute trading period precisely because fast start generators are forced to weigh the risks of incurring start costs for potential reward in the last five minutes of the interval. If a competitor were to create a significant spike in the price in the first few five minute periods, they risk fast start generators starting for a guaranteed profit and then continuing to generate for several trading intervals, thereby reducing the likelihood of further spikes and leading to an overall reduction in the half hour average price.

In a five minute settlement market, a generator may benefit by creating random five minute spikes at any point, (i.e. not just at the end of a 30 minute trading period), which fast start generators would fail to catch. If such spikes were sufficiently random, this may force fast start generators to exit the market – as they may no longer be capable of generating a sufficient revenue to remain viable.

In a five minute settlement market, AGL anticipates similar impacts on demand side response. In the event of price spikes, participants would be pressured to curtail their usage with the hope of only potential profit or reward for doing so.

Contractual arrangements

AGL agrees with the AEMC's statement in the Consultation Paper that hedging arrangements are likely to be less effective where contract parties are facing different settlement times.

Further to this, AGL considers that fast start generators (or participants with fast start generators in their asset portfolio) will be less likely to hedge their generation, as the five minute settlement environment would make such arrangements harder to physically defend – particularly if price spikes were sufficiently random. AGL is not convinced that this would be avoided by implementing new contracts based on a five minute settlement period.

At best, fast start generators would likely only hedge at prices that would compensate them for both the cost of random spikes, which they cannot catch, and the need to run at a loss at times when spikes are possible. All in all, AGL considers this would elevate prices in the contract market, and that such complications would likely discourage new fast start entrants from entering the market.

Additional concerns with the proposed rule

Sun Metals' rule change request refers to market distortions created by strategic generator late bidding, aided by the current settlement system, and the proposed rule is intended to address these distortions.

AGL considers that the Bidding in Good Faith rule could be far more effective in addressing the bidding behaviour Sun Metals is concerned about. In any case, the new rebidding rule should be allowed to operate for a period of time before alternative mechanisms to target bidding behaviour are considered.

Additionally, AGL considers that the costs of implementing the proposed rule would likely outweigh any benefits from its implementation. A system comprised of different settlement times would almost certainly increase the administrative (cost) burden on market participants and AEMO, with pricing flow on effects to customers.

Market participants would incur potentially significant costs in replacing existing metering equipment in favour of five minute metering. The alternative to this cost outlay would be to accept a settlement amount based on metering data modified by AEMO from SCADA data. The Consultation Paper details the difficulties of SCADA data, particularly the issues around measurement and accuracy. The suggested solution of AEMO modifying the SCADA data only adds to the complexity of an already complex dual settlement time system. All in all, the practicalities of the proposed rule are untidy.

In conclusion, AGL appreciates the motivation behind the proposed rule, but considers it best to wait and see whether the Bidding in Good Faith rule has a positive impact on generator bidding behaviour. In any case, based on the myriad difficulties outlined above, the proposed rule should not be made. Further, AGL does not consider that this matter warrants the AEMC to propose a more 'preferable' rule particularly because the changes to rebidding requirements, which will likely address Sun Metal's concerns, have yet to be bedded in.

If you have any queries about the submission or require further information, please contact Liz Gharghori at lgharghori@agl.com.au or on 03 8633 6723.

Yours sincerely,

Simon Camroux
Manager Wholesale Markets Regulation