4th June 2014

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submission lodged online at: www.aemc.gov.au

Project Number: ERC0165

Dear Mr Pierce

Supplementary Submission to: Generator ramp rates and dispatch inflexibility in bidding rule 2014

Snowy Hydro Limited is making this supplementary submission to highlight key issues and address some misconceptions that were canvassed at the Public Forum on the 5th May.

AEMC proposed assessment framework

Snowy Hydro believes the proposed assessment framework pre-empts that there may be a problem of significant materiality to underpin the rationale for the proposed Rule change. We believe a more appropriate assessment framework should initially define the problem and assess its materiality before identifying potential solutions.

The AEMC's assessment framework should be identical to that which is outlined in the Bidding in good faith Rule 2014 Consultation Paper. The four relevant steps in the assessment framework are:

1. Defining the problem or market failure that has been identified by the rule change request;
2. Assessing the materiality of the problem;
3. Given the materiality, identifying potential solutions to the problem; and
4. Determining whether any potential solutions would result in net benefits to the market and promote the NEO.

Using the assessment framework outlined above the following observations can be made from the presentations and discussion at the Public Forum.

Assessment framework	**Record from the Public Forum**
Defining the problem or market failure	There was no clear articulation or market failure identified by the Rule change. System security was confirmed not to be an issue. This was again reaffirmed by an AEMO employee at the Forum. Multiple transmission outages are the root cause of the need to "disorderly" bid to manage risks. The SRA value is negatively impacted by

	transmission outages. Finally, the ability to ramp underpins willingness to forward contract. Ramp rates are therefore commercial parameters.
Assessing the materiality of the problem	The materiality of this non "problem" is insignificant.
Given the materiality, identifying potential solutions to the problem	Given there is no material "problem" potential solutions are not required.
Determining whether any potential solutions would result in net benefits	Given there is no "problem" this step is not required.

In the second half of the morning session, time was devoted to debating alternative solutions to the current Rule requirement of a minimum ramp rate of 3MW/minute. As highlighted by the table above this session was of limited value given that the AER had not established that there is a material "problem" in the first instance.

The basis of the AER rule change

The AER's presentation asserted that ramp rates are a technical parameter on the basis of the AEMC's ruling in 2009. It would appear that the AER is quoting a paragraph from the 2009 Final Rule determination, "The Rule would require that the technical parameters in relation to ramp rates, market ancillary service offers and dispatch inflexibility reflect technical capability of plant, page vi)". The AER's assertion is clearly in error as the current minimum ramping requirement of 3MW/minute is not in any way related to the technical capability of generators in the NEM. We believe this point was also made by Commissioner Dr Brian Spalding who at the Public Forum indicated that if the 2009 Determination did indeed rule that ramp rates were "technical" then there is inconsistency on why the minimum requirement was set at 3MW/minute.

On the question of whether ramp rates are a commercial or technical parameter, we agree with the AEMC Chairman's view on this issue which was expressed at the Public Forum as a decision from a previous AEMC Chairman and previous Commission, and whether or not ramp rates are technical parameters would now need to be assessed on its merits.

We have reviewed the 2009 Rule determination and believe that the previous AEMC Commission had ruled that ramp rates were only "technical" in the context of requiring generators to offer at least 3MW/minute instead of the commercial practice at the time to reduce the ramp rates to 1MW per minute when relevant constraints bound. This 3MW/minute requirement was assessed as the amount "technically" required for AEMO to meet its system security and reliability obligations. The 2009 Rule determination did not in any way endorse the policy position that minimum ramp rates should be set at a generators maximum technical ramping capability.

Snowy Hydro's position on this issue was made clear at the Public Forum. Ramp rates are a commercial parameter which underpins a generators willingness to sell forward contracts and be exposed to the volume/dispatch risk.

System Security

One of the central tenants of the AER rule change proposal was to improve system security. It is important to note that the system is either secure or it is unsecure. If the system is unsecure than improving system security would impose costs on generators. Our point is improving system security is not a costless exercise.

We believe system security is not an issue and this was confirmed by AEMO[1] in their submission to the Consultation Paper and comments made at the Public Forum that there is no system security issue with the current requirement of 3MW/minute. That is, the current ramping requirements are sufficient to meet AEMO's system security obligations. This removes system security as a primary reason for this Rule change proposal.

Alternative Proposals

As highlighted above there is no problem associated with the current ramping requirements in the Rules. However, for the record, Alinta highlighted an alternative proposal to make minimum rates a technical parameter that could be achieved by a generator without incurring any additional costs.

This alternative proposal discriminates against incumbent peaking and flexible generators who have higher ramping capability and hence would not advance the NEO. Further to this there would be a high amount of subjectivity in setting up the minimum ramping capability for each generator.

Establishing a market or Offer price mechanism for Ramp rates

A common theme throughout the Public Forum was that if there was a genuine problem with the level of ramping capability in the NEM then any requirement for ramping beyond the current minimum requirement of 3MW/minute may be better incentivised through a market or Offer price mechanism. We encourage the AEMC to firstly establish if there is in fact a problem, if a problem is established and it is material then assess what the minimum ramping requirement should be for all generators to allow AEMO to fulfil its system security and reliability obligations, and then explore options to establish a market for ramping capability beyond the minimum ramping requirements.

TNSP incentives

Snowy Hydro showed that 17 out of 20 of the Market events highlighted by the AER as examples supporting their rule change proposal were the direct result of transmission outages. We showed that transmission outages were the root cause of counter price flows (negative SRAs) and "price volatility". We highlight this because:

- Attention should shift to TNSP incentives and incentive schemes to remove ill-timed transmission outages instead of the current focus on ramp rates and "disorderly bidding".

- In considering the costs identified by the AER rule change proposal which may be directly attributable to the rebidding of ramp rates under constraint conditions we highlight that more emphasis must be placed on the root cause of constraint

[1] The AEMO representative at the Public Forum was Mr Brian Nelson

conditions. The "costs" of these events should not be attributed to generators but should be attributable to TNSPs.

Importance of the Contract Markets

The NEM regional market design facilitates depth and liquidity in the Contract markets. As a result the majority of electricity is sold ahead of time in the Contracts market. We therefore believe that the efficiency of the Contract market is of much greater economic importance than any perceived and uncertain small incremental improvements in dispatch efficiency.

The AEMC's Chairman commented that the Commission wanted to see more evidence on the importance of maintaining a deep and liquid forward Contracts market.

The ACCC's recent report[2] to the Australian Competition Tribunal on the proposed acquisition of Macquarie Generation by AGL Energy Limited provides independent analysis and commentary that supports our assertion that maintaining generators intra-regional access to its Region's regional reference node is essential to maintaining a competitive, deep, and liquid forward contracts market which underpins the ability of second tier Retailers to enter the market and stimulate competition in the wholesale market.

From section 7.13 – "Requirement of use hedge contracts referencing the NSW spot price".

> *Section 7.15 – Therefore, the ACC considers that hedge contracts referencing a spot price in another region do not provide a substitute for hedge contracts referencing the NSW spot price. While interregional hedging strategies are possible, and may be engaged in to a small degree by market participants from time to time, hedge contracts referencing the NSW spot price provide clearly the most effective form of hedge cover for NSW retail loads and are an input that is fundamentally required by electricity retailers supplying end-users in NSW.*
>
> *Section 7.32 – The ACCC considers that while IRSR units can be purchased to manage the risk of price separation:*
>
> *a. The trading of IRSR units requires a high level of sophistication, so it is unlikely that second tier retailers without some form of significant generation would trade IRSR units, and*
>
> *b. IRSR units do not constitute a form hedge and can only be deployed to a limited extent because of timing, exposure to low interconnector flows at times of price differences between regions.*
>
> *Conclusion*
>
> *Section 7.47 – In summary, based on analysis of AGL's own approach to hedging in NSW, evidence from other retailers, and quantitative analysis of the magnitude of interregional price separation risk and the lack of reliability of IRSR units, the ACCC does not consider that interregional hedging is a substitute for hedging against the NSW spot price. The ACCC considers that the evidence demonstrates that retailers in NSW must fundamentally hedge against the NSW spot price to effectively cover their exposure to the NSW spot price.*

[2] ACCC's Report to the Australian Competition Tribunal, File No. 1 of 2014. Refer to http://www.competitiontribunal.gov.au/authorisations#list

The implementation of the AER's rule change proposal would adversely reduce the depth and liquidity of the Contracts market as dispatch risk would significantly be shifted to peaking and flexible generators who are the primary providers of flexible load following and Cap contracts. This fact in combination with the ACCC's analysis outlined above supports Snowy Hydro's belief that to advance the NEO the NEM needs the availability of intra-regional hedges which are predominantly provided by intra-regional generators (Generators within the same pricing Region). Any reduction in the ability of generators to sell in their own region won't be replaced in full by inter-regional products because these products are riskier (i.e. transmission outage risks and transportation losses) and hence Retailers (especially second-tier and start-up Retailers) will incur additional risk mitigation costs which will stifle competition in the NEM.

Conclusion

No evidence presented at the Public Forum supports the AER's rule change proposal. The AER has not established a material problem with the current market arrangements. There should be no consideration of alternative proposals until a material problem has been unambiguously determined. The current minimum ramping requirement is sufficient to meet AEMO's system security and reliability requirements. Finally ramp rates are a commercial parameter which underpins a generators willingness to forward sell forward contracts. In conclusion Snowy Hydro sees no justification for the AER Rule change proposal and hence the proposal should be rejected.

Snowy Hydro appreciates the opportunity to make this supplementary submission. Please contact Kevin Ly, Manager Market Development and Strategy on (02) 9278 1862 if you would like to discuss any issue associated with this submission.

Yours sincerely,

Roger Whitby
Executive Officer, Trading