Daniel Hamel
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

By online submission at www.aemc.gov.au

Friday 8 November, 2013

Dear Mr Hamel,

Re Negative offers from scheduled network service providers draft determination: Reference ERC0140

GDF Suez Australian Energy (GDFSAE) is appreciative of the consideration given by the AEMC to the Rule change proposal, jointly lodged by GDFSAE and LYMMCO (now part of the AGL group). Although GDFSAE is disappointed that the AEMC have not supported the Rule change proposal, we do recognise that the issue in question relates to the unique situation where the dominant generator in the Tasmanian region has operational control over the bidding of Basslink.

If an independent entity which was in competition with the generators in the NEM were managing Basslink's bidding, it is difficult to conceive of why it would ever offer a negative transport bid. It is only as a result of the unique joint bidding responsibility that HydroTas has for both their generation and Basslink, that this 'double negative' bidding issue arises.

Given the unique bidding responsibility applicable to the Basslink SNSP, it is perhaps more appropriate that the Rule change proposal be re-cast to apply only to any SNSP that is being bid into the market by a regionally dominant generator. Although GDFSAE recognises that a bespoke Rule change in response to a specific market structure and competition issue does not sit comfortably with the NEM Rule change process, this is the only avenue available to participants to address market distortions.

The Tasmanian structural issues were subject to considerable examination when Tasmania entered the NEM and with the subsequent commissioning of Basslink. In their consideration prior to Tasmanian NEM entry, the ACCC expressed concern that the Tasmanian generator HydroTas would have control over the Basslink transport price, and the resultant negative implications for competition in the NEM.

To allay these concerns the Tasmania Government offered guarantees to the ACCC that HydroTas would be constrained through regulation from bidding Basslink at a negative price for flows in either direction. In addition, HydroTas were restricted from bidding Basslink at a positive price in a southerly direction except in certain specific circumstances. The Tasmanian government issued a Ministerial Notice which imposed these bidding constraints on HydroTas.

In May 2008 the Ministerial Notice was amended to allow HydroTas to bid Basslink negative, provided that the Tasmanian price was negative, the Victorian price was higher than the Tasmanian price, and the constraint between Latrobe Valley and Melbourne was binding. Rather than being restrictions on HydroTas, these requirements essentially describe the conditions under which HydroTas would have an incentive to bid Basslink negative. These restrictions therefore have little if any practical purpose.

GDF SUEZ Australian Energy
Level 33, Rialto South Tower, 525 Collins Street
Melbourne, Victoria 3000, Australia
Tel. +61 3 9617 8400 Fax +61 3 9617 8301
www.gdfsuezau.com
INTERNATIONAL POWER (AUSTRALIA) PTY LTD
ABN 59 092 560 793

In response to concerns expressed by a number of mainland generators, the Tasmanian Treasurer wrote in July 2010 that the intent of the Ministerial Notice was to ensure that HydroTas is not able to influence flows across Basslink in a way that is inconsistent with the principles that underpin the NEM[1]. GDFSAE considers that the ability of HydroTas to combine their generator and Basslink bids to be effectively below the market price floor is inconsistent with the principles of the NEM.

The Tasmanian Treasurers reply also pointed to the (then) upcoming review if the Tasmanian electricity industry, noting that the expert panel would consider a range of issues, including the efficiency and effectiveness of the Tasmanian arrangements. That review subsequently found that competitive prices and services would not be available to small businesses and households in Tasmania without structural reforms in the retail and wholesale markets. The review also found that the main barriers for large, new entrant retailers to Tasmania are the unacceptable risks posed by the structure of the wholesale market in Tasmania, which are unparalleled elsewhere in the NEM.

Negative bids on Basslink may not impact on market outcomes very often, but the impact when it does occur can be substantial. To give an example, on the 2 and 3 February 2010, HydroTas offered all of its generation at -$1000/MWh and Basslink was rebid to -$968.20/MWh. This resulted in power flows from Tasmania across Basslink into Victoria at close to the export limit. This increased flow from Tasmania into Victoria caused the Latrobe Valley generators to be further constrained. The cost to the effected generators has been estimated to be in excess of $3.5 million over the two-day period.

Subsequent to the AEMC draft determination, GDFSAE has explored a number of alternatives to deal with the Basslink bidding issue as follows:

- Effective Basslink price at the Loy Yang terminal
- Basslink offers combined with the Tasmanian price
- HydroTas combined with Basslink offers
- Limiting Basslink to some share of network capability
- Removal of the Tasmanian region

A brief description of each of these options is provided in an appendix to this submission.

Although it may be beyond the scope of this Rule change proposal for the AEMC to take up the cause of Tasmanian market structural change, it is apparent from comments in the draft determination that the AEMC acknowledge that the current Tasmanian market structure does give rise to competition impediments and inefficiencies. With this in mind, it would be helpful if the AEMC were to include commentary in their final determination on how the Tasmanian market structure contributes to the issues, and what changes might be helpful in overcoming the issues.

In summary, the GDFSAE observes that:

- the AEMC acknowledge that there is a market structure issue in Tasmania causing incorrect market outcomes, but believes that it is powerless to correct the problem through a Rule change,
- the Tasmanian government, despite the findings of its own electricity industry review and appeals from NEM participants, has been reluctant to impose restrictions on its dominant generator HydroTas, and
- the ACCC have not shown any willingness to enforce the limitations that it sought to impose when Basslink joined the NEM.

This impasse is preventing a solution to the current distortion on the effective operation of the NEM. This represents a clear case of regulatory failure in the NEM.

GDFSAE notes the AEMC mission statement to deliver "high quality and impartial energy market Rules and advice to policy makers", and also notes that one of the AEMC strategic objectives as "contributing to energy market policy development as the leading source of advice on energy markets".

[1] Letter from Tasmanian Treasurer Mr Michael Aird to Mr Ken Thompson, July 2010.

We urge the AEMC to review the current situation in harmony with its mission and strategic priority objectives and examine this issue more broadly. If it believes it is unable to resolve the issue via a Rule change, then we would urge the AEMC to deal with the issue from a policy and regulatory failure perspective. In this case we would encourage the AEMC to influence policy changes to resolve this issue.

Please do not hesitate to contact me should you have any enquiries regarding this submission.

Yours sincerely,

Chris Deague
Senior Market Specialist

Appendix: Alternative options

In considering this issue, GDFSAE have tried to identify alternative regulatory options to overcome the Basslink negative bidding issue. Although a number of alternatives have been identified, GDFSAE accepts that these options would represent a solution focused on a specific competition issue rather than a general regulatory change aimed at advancing the NEO. In addition, GDFSAE recognises that some of the options identified would be very difficult to implement.

Despite the points noted above, GDFSAE has included brief descriptions of the alternative options that have been identified. These are included to indicate to the AEMC and other interested parties, that a genuine effort has been made to identify a regulatory solution to this market structure issue.

Effective Basslink Price at the Loy Yang Terminal

This option essentially aims to put the combined market presence of HydroTas and Basslink on the same footing as Latrobe Valley generators. The proposal would aim to limit the combined offers of Basslink and HydroTas such that the effective price for exports to Victoria at the Loy Yang terminal is greater than -$1000/MWh or perhaps greater than -$1000/MWh x MLF = -$970/MWh.

When there are no constraints between the Latrobe Valley and the Victorian regional reference node, this proposal would put the combined HydroTas and Basslink on a competitively neutral footing with the Latrobe Valley generators. However, when there is congestion between the Latrobe Valley and the regional reference node, HydroTas could be at a competitive disadvantage due to the treatment of losses in NEMDE.

In terms of being able to be implemented within the NEM's market management systems and NEMDE, this option would be extremely difficult. Losses on Basslink are a quadratic function of power flows and the marginal losses are a linear function of the flows. Thus for any given regional reference price in Tasmania, the effective price at the Loy Yang terminal of Basslink, given a $0/MWh offer for transport, will depend on the flows on Basslink.

Basslink offers combined with the Tasmanian Price

This option requires that that the combined Basslink offer and Tasmanian regional reference price is greater than -$1000/MWh. This option is very similar to the previous option, but aims to remove the uncertainty of Basslink flows and assumes that HydroTas can largely control the regional reference price in Tasmania.

When there are no constraints between the Latrobe Valley and the Victorian regional reference node, this proposal would put the combined HydroTas and Basslink on a reasonably competitively neutral footing with the Latrobe Valley generators. However, when there is congestion between the Latrobe Valley and the regional reference node, HydroTas could be at a competitive disadvantage due to the treatment of losses in NEMDE.

In terms of implementation, even though HydroTas can largely control the spot price in Tasmania, it cannot manage this precisely due the interaction of Tasmania with the rest of the NEM and the presence of local FCAS constraints. Thus, like the previous option, it would be difficult to implement and would require Basslink to bid conservatively.

HydroTas Combined with Basslink Offers

This option would require that all combinations of HydroTas's generator offers and Basslink transport offers be greater than -$1000/MWh. In turn this means that the lowest priced band with non-zero quantity offered for all generators plus the lowest priced band for a Basslink transport offer with non-zero quantity would have to be greater than -$1000. This arrangement could be a lot more restrictive than the previous option because the Tasmanian clearing price could be quite a lot higher than the lowest offer price band with a non-zero offered quantity.

This option could be implemented but would tightly couple Basslink bidding with HydroTas generator bidding. HydroTas and Basslink would have to set up bidding systems that checked that their initial bids and any changes to bids are always compliant and AEMO would also have to set up systems to check their bids.

If HydroTas wanted to maintain the use of offers priced at around -$1000/MWh for managing its generating units then this would mean that Basslink would have to offer its transport capacity at prices greater than or equal to zero, an option that AEMC has already rejected.

Limiting Basslink to Some Share of Network Capability

The issue of Basslink making negative offers is tied up with high prices in Victoria and network congestion between the Latrobe Valley and the Victorian regional reference node. In order to be dispatched and obtain the Victorian regional price, the Latrobe Valley generators and Basslink will bid as low as possible. In this bidding war, HydroTas has an advantage in that it can effectively bid both Basslink and its own generators and thus undercut the Latrobe Valley generators in most situations. If there are constraint violations and extremely high congestion costs, the Latrobe Valley generators will win.

One way that this bidding war could be resolved would be to share the congested link. This could be done by using the quantities of all the bids for Basslink and the Latrobe Valley generators which were less than or equal to some fixed value, say -$950/MWh or even $0/MWh, as a means to pro rata the congested transfer capacity.

Removal of the Tasmanian region

Another option worthy of consideration is the removal of the Tasmanian region from the NEM, and allowing it to participate on the Victorian node as a load/generator pair. A similar arrangement has been applied in the past for South Australia participation in the NEM1 market.