

16 May 2019

Australian Energy Market Commission
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Submitted by email to aemc@aemc.gov.au

Project number: EPR0070

Investigation into intervention mechanisms and system strength in the NEM Consultation paper

Snowy Hydro Limited welcomes the opportunity to comment on matters raised in the Consultation Paper from the Australian Energy Market Commission (the Commission) on the Investigation into intervention mechanisms and system strength in the NEM.

Snowy Hydro Limited is a producer, supplier, trader and retailer of energy in the National Electricity Market ('NEM') and a leading provider of risk management financial hedge contracts. We are an integrated energy company with more than 5,500 megawatts (MW) of generating capacity. We are one of Australia's largest renewable generators, the third largest generator by capacity and the fourth largest retailer in the NEM through our award-winning retail energy companies - Red Energy and Lumo Energy.

Australia's energy system is undergoing a transformation, bringing about challenges to the design of climate policies and energy markets. It is therefore important that system security and reliability remains a critical aspect of effective energy delivery which should be achieved through minimal market intervention. Where possible competitive markets should be used or developed to deliver the required energy and ancillary services. All forms of interventions should remain a last resort.

Intervention mechanisms should remain focussed on intervening when market mechanisms do not, or cannot deliver. Snowy Hydro welcomes the Commission's review on intervention mechanisms and believe that the use of interventions in the NEM must only be used as a last resort and that there is adequate compensation so that Participants are no worse off than if the intervention had not occurred. In particular, Snowy Hydro has strong views on following:

- Intervention can compromise the current market design and its pricing signals affect wholesale electricity prices and market signals to investors.
- The intention of intervention pricing and any type of Australian Energy Market Operator (AEMO) intervention is to ensure that despite the action of intervening, there is still a signal on scarcity of the energy or ancillary service.
- The hierarchy of intervention mechanisms should preference the Reliability and Emergency Reserve Trader (RERT) to directions and instructions.
- When an intervention occurs, AEMO should be obliged to issue reports in a timely manner. For instance, purely factual information such as the demand, plant online, system frequency, and relevant transmission and system constraints should be collated in a brief report/note and published within a reasonable period after intervening. This would be followed by AEMO releasing a more detailed qualitative report within 3 months of the intervention which would further inform market participants of the incident.

- Support the removal of the mandatory restrictions framework.
- Support AEMO's rule change request to have the \$5,000 threshold apply to each event, rather than each trading interval which will allow market participants to not be adversely affected where an intervention event comprises a number of trading intervals.
- Support AEMO looking at flexible frameworks which may be utilised to limit the need for the use of directions and interventions.

Snowy Hydro appreciates the opportunity to respond to the Consultation Paper and any questions about this submission should be addressed to Panos Priftakis, Regulation Manager, by e-mail to panos.priftakis@snowyhydro.com.au.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K Ly', with a horizontal line underneath.

Kevin Ly
Head of Wholesale Regulation
Snowy Hydro



Detailed Submission

The Use of Intervention

Overtime contract offers for hedging in the financial markets are impacted if AEMO intervention becomes a routine feature of the market. Although AEMO is attempting to improve the number of interventions it is important to note that if intervention becomes a routine feature of the market then it would be contrary to the NEO. The concerning number of increased interventions and impacts is noted by the Commission which notes that:

- *As at late March 2019, around 210 directions have been issued to South Australian generators to maintain system strength, representing an unprecedented use of this intervention mechanism. For the first time in November 2018, AEMO also issued a direction to a generator in Victoria to maintain adequate system strength there.*
- *During 2018, directions were in place for 30 percent of the time on average – a very significant increase relative to the past, and one that is at odds with the principle in the NER that intervention mechanisms should only be used as a last resort.*
- *In South Australia, spot prices in 2018 were on average 10 per cent higher than they would have been had intervention pricing not been applied in connection with system strength directions.¹*

The Commission considers that *“intervention-based approaches, however well designed, are likely to be a second-best alternative to well-functioning markets at promoting economic efficiency in the long-term interests of consumers. Markets are generally the most efficient mechanism to further the interests of consumers through allowing efficient price discovery and production decisions based on competitive market dynamics.”²* Snowy Hydro therefore believe that the following are key principles that should always be in place for the use of interventions in the NEM.

- Must only be used as a last resort
- When used they must minimise the distortionary effects to the primary NEM Spot and Contract markets
- There should be adequate compensation in a timely manner so Participants are no worse off than if the intervention had not occurred

Intervention can compromise the current market design and its pricing signals affecting wholesale electricity prices and market signals to investors, and the energy and compensation costs faced by consumers. The NEM design gives equal opportunity/incentives on both the supply side (generators) and the demand side. Increased intervention would further distort spot price signals. Longer term customer outcomes are best protected by undistorted pricing signals that provide the investment signal for ongoing investment in new assets.

AEMO recently commissioned a paper on intervention pricing by SW Advisory and Endgame Economics³. The paper correctly notes that intervention may prevent an immediate problem for the power system but it has the potential to create a new problem. The act of intervening may mute the signal of scarcity provided by the market at a time that we need those signals to be preserved.

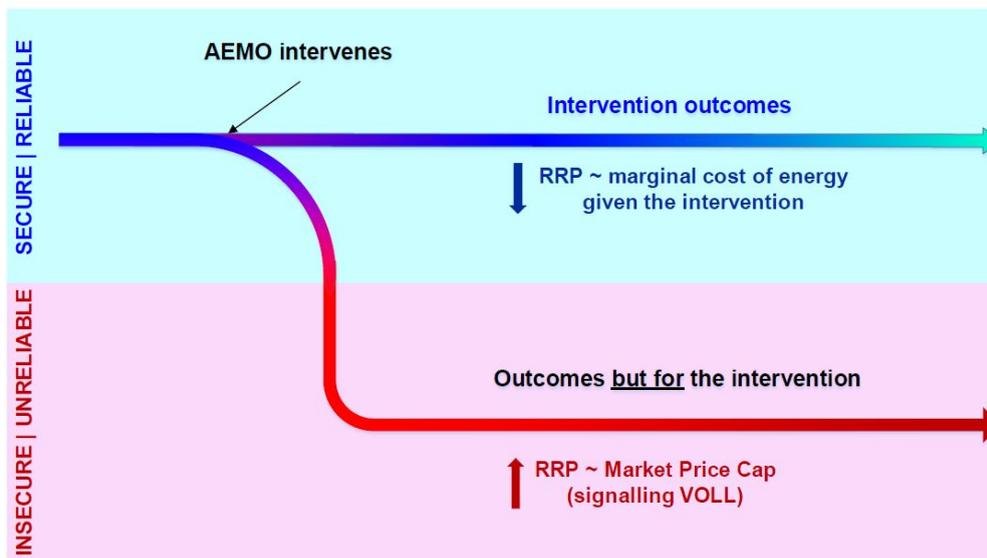
¹ AEMC, Investigation into intervention mechanisms and system strength in the NEM, Consultation paper, 4 April 2019, pp ii-iv

² AEMC, Investigation into intervention mechanisms and system strength in the NEM, Consultation paper, 4 April 2019, pp 14

³ SW Advisory and Endgame Economics, 2017, “Review of Intervention Pricing”

In the absence of the intervention the market outcomes, highlighted in Figure 1, would be associated high price signalling the scarcity of supply. The prices should signal this scarcity of supply, so as to provide an incentive for generators and loads to respond. The intention of intervention pricing and any type of AEMO intervention is to ensure that despite the action of intervening, there is still a signal of scarcity. Further intervention would not achieve this.

Figure 1: Intervention distorts the signal for supply scarcity⁴



Interventions are a form of moral hazard. A situation where economic actors make inefficient decisions because they are able to avoid costs associated with their conduct. This risk of moral hazard is that investors undertake projects without adequately assessing the externalities created by interventions resulting in inefficient investment decisions. Interventions should only be used in cases of genuine market failure insuring that it does not undermine the market it is actually trying to protect. The market should be left to deliver the economic level of bulk supply reliability to customers.

Hierarchy of Intervention Mechanisms

The Commission considers the hierarchy of interventions mechanisms set out in the NER, in particular the requirement that, where the Reliability and Emergency Reserve Trader (RERT) has been procured, it should be used in preference to directions and instructions. Snowy Hydro believes that any approach which is chosen should minimise costs to consumers while maintaining system reliability.

Snowy Hydro understands that the NEM has always had some form of regulatory mechanism that has allowed AEMO to contract for emergency reserves and we therefore believe that the RERT is the best first response mechanism followed by either directions or instructions to maintain system reliability.

The RERT should only be used as a last resort safety net and the market should be left to deliver the economic level of bulk supply reliability to customers. Should the RERT be necessary, where possible the Short-Notice (SN) or Medium-Notice (MN) RERT mechanisms should be utilised to procure reserves for anticipated shortfalls. This is because longer lead times greater than 10 weeks are more

⁴ SW Advisory and Endgame Economics, 2017, "Review of Intervention Pricing"

prone to less accurate forecasts of demand and may trigger procurement of unnecessary Long Notice RERT resources.

Transparency information provided to the market

Increased and enhanced transparency in reporting will improve the ability of retailers, consumer groups, governments and policy makers to explain the costs and benefits of the intervention to consumers.

The Commission notes that the *“delay in the publication of reports is likely to reflect the resource intensive nature of the directions process, and the fact that – as at late March 2019 – around 210 system strength directions have been issued in South Australia. However this is problematic in terms of transparency and warrants additional attention and appropriate resourcing.”*⁵ Snowy Hydro believes the lack of transparency is problematic.

Snowy Hydro welcomes the Commission’s principle which notes that the interventions frameworks should promote transparency as well as being predictable, so that market participants can make efficient investment and operational decisions. The Commission has worked to enhance the transparency of the RERT. As noted in the recent Enhanced RERT Final Determination the increased transparency and reporting will assist market participants and consumers in planning for RERT costs⁶.

Following on from the Enhanced RERT changes, Snowy Hydro believes the clause should be amended to oblige AEMO to issue reports in a timely manner. We propose that the clause should be amended so that AEMO in the first stage provides factual evidence of an intervention within a reasonable period after intervening. In the second stage AEMO would release a more detailed qualitative report within 3 months which would inform market participants.

Mandatory restrictions framework

Snowy Hydro submits that the mandatory restrictions frameworks should not be retained. The Consultation Paper has correctly noted that mandatory restrictions are distortionary and should be avoided.

The challenges identified in the Consultation Paper highlight the significant concerns with the mandatory restrictions framework. These include:

- *An overestimation of the demand reduction due to restrictions would cause a situation where the spot price is set at the MPC for an extended period which could have a major impact on market customers, particularly those who are not fully hedged.*
- *An extended period of prices at the MPC will eventually exceed the cumulative price threshold and trigger an administered price period (effectively capping retailers’ market risk), risk exposure in the interim period could nonetheless be significant. Contract prices could rise as there are incentives for generators to become less hedged and retailers to become more hedged.*
- *Mandatory restrictions may result in outcomes that would leave market customers worse off than if restrictions and related pricing procedures had not been imposed.*⁷

⁵ AEMC, Investigation into intervention mechanisms and system strength in the NEM, Consultation paper, 4 April 2019, pp 27

⁶ AEMC, Enhancement to the Reliability and Emergency Reserve Trader, Rule determination, May 2019

⁷ AEMC, Investigation into intervention mechanisms and system strength in the NEM, Consultation paper, 4 April 2019, pp 41-42

With the mandatory restriction pricing arrangements having not been applied in any of the jurisdictions to date and no mandatory restriction event occurring since 2000, the framework should be removed with the operation of the spot market (supported by the RERT and directions) to enable participants on both the supply and demand side to respond to price signals, even in extreme conditions. The market should be left to deliver the economic level of bulk supply reliability to customers and there are numerous last-resort intervention mechanisms which include the RERT, directions and instructions which could be utilised in cases of genuine market shortfall. The mandatory restrictions frameworks should be removed.

Compensation

Compensation costs paid to directed and affected participants should reflect what the market participant should receive had the intervention not occurred, signalling the scarcity of supply and that the market distortion from the intervention is minimised. Ideally the role of directions should reduce and compensation thereof.

Snowy Hydro supports AEMO's rule change request to have the \$5,000 threshold apply to each event, rather than each trading interval so that market participants are not adversely affected where an intervention event comprises a number of trading intervals.

Minimum Levels of System Strength and Inertia

The Commission's intention to explore whether adjustments could be made to framework to improve the flexibility with which they can be applied to address issues as they begin to emerge in other NEM regions is welcomed.

Snowy Hydro believes more flexible frameworks may limit the need for the use of directions and interventions pricing, which can have unintended impacts on the wholesale price and investment signals as noted by the Commission.

Strategic transmission investments will overtime play a fundamental role in ensuring power system reliability and security by allowing the full utilisation of resources.

