



16 May 2019

John Pierce  
Chairman  
Australian Energy Market Commission

Dear Mr Pierce

## **AEMC INTERVENTION MECHANISMS AND SYSTEM STRENGTH CONSULTATION PAPER**

Origin Energy Limited (Origin) welcomes the opportunity to provide feedback on the Australian Energy Market Commission's (AEMC) consultation paper on intervention mechanisms and system strength. Our views on the main issues are summarised below, with additional detail provided later in this submission.

**Minimum strength framework.** A primary focus of this review should be to prevent the excessive use of directions as a means of maintaining system security, that is now common place in South Australia. To minimise the need for future directions, the AEMC should assess the merits of a market based approach for the provision of system strength and inertia. While we understand the rationale for placing an obligation on transmission companies to provide these services in South Australia, this may not be the least cost, long term solution, for the NEM more broadly.

**Hierarchy of interventions.** Interventions should minimise costs to the system. With this in mind, the market operator should first look to utilise resources within the market through directions, before deploying the Reliability and Emergency Reserve Trader (RERT) or the use of instructions.

**Intervention pricing.** The merits of applying intervention pricing to system security events should be examined given the practice generally does not result in the preserving of an appropriate price signal to support efficient investment (which is the original intent).

**Counteractions.** The continued used of counteractions should be dependent on whether this provides a net benefit. We note that while counteractions help to minimise the distortionary impacts of interventions, they can in turn result in distortions themselves, including in adjacent regions.

### **Compensation following interventions**

The current approach of compensating directed participants based on historical energy prices should be reviewed to ensure adequate reimbursement. An appropriate level of compensation should account for fuel and opportunity costs as well as the physical impact on generating units.

- As per the rule change, we agree that the compensation threshold should apply per event and not per trading interval.
- We support the continued compensation to affected parties. We note, however, that in the case of South Australia, the compensation to generators that do not contribute to system strength is a perverse outcome.

**Transparency following interventions.** We support the establishment of a minimum timeline by which AEMO should be obliged to report on the details relating to an intervention.

**Regional Reference Node (RRN) Test.** We support the application of the RRN test to the RERT.

*AEMC should investigate establishment of a market based approach for the provision of system strength and inertia*

The ongoing reliance on directions to maintain system security is indicative of signals for generators not aligning with needs of the market. The efficient provision of these services is crucial, particularly if the low system strength conditions that have been occurring in South Australia begin to appear in other regions.

The framework introduced in 2017 places an obligation on Transmission Network Service Providers (TNSPs) to maintain system strength as part of their regulated activities. We understand the rationale for the implementation of the framework in SA given the immediacy of the issues there. However, we consider that there are a number of issues with this approach.

- The framework provides no incentive for generators to invest to resolve security issues. New entrants are required to “do no harm” but proactive and operational changes are not supported.
- TNSPs have an incentive to build their own assets. Market participants that consider they are able to provide system strength services are required to enter into agreement with TNSPs rather than developing their own solutions.
- Markets are generally the best way of determining the most cost-effective ways of providing competitive services.
- Regulatory approach slows innovation and incentives to invest in new technologies such as synthetic inertia.

The AEMC should set out a design for a market for system strength.

*The hierarchy of interventions should be based on a least cost approach*

The choice of hierarchy when intervening in the market should follow an approach of minimising the cost of the intervention.

As RERT is priced above the market price cap (which is the highest amount a directed generator can receive), directions should be generally used first to resolve issues where possible. The exception would be a situation where AEMO has pre-activated and committed to the RERT, and thus costs have already been borne. Instructions should always be the final option used, as the consumer cost is assumed to be the Value of Customer Reliability, which exceed both RERT costs and the market price cap.

*Intervention pricing should aim to minimise extent of distortion on market commodities*

The AEMC should assess the merits of applying intervention pricing when there are interventions due to system security. The ‘what if’ pricing process is used as a means of preserving the price signal to support investment. This signalling is appropriate in the case of reliability related interventions as the market has a shortage of supplied electricity, which would have occurred if not for the intervention. However, interventions for security purposes are not intended to affect the level of supply for any traded commodity, and so there is no shortfall to signal.

Additionally, we do not consider that the wholesale price should be the market price cap whenever the RERT is activated. RERT has a minimum period of activation, and thus cannot be fully responsive to a shortfall. AEMO may require RERT for a small period of time to maintain reliability and then continue the activation to for some time due to the RERT contract. In this situation, there is no shortfall to be signalled by maintaining the price at the market price cap for the full duration of the RERT activation. Due to the potential of the cumulative price gap starting to bind, later shortfalls of capacity may not be properly signalled if there are multiple shortfalls in quick succession.

*Counteractions should be examined in greater detail*

AEMO currently use counteractions to attempt minimise the distortion of market during an intervention. However, counteractions can end up creating their own distortions, specifically in adjacent regions. On the information available, it is difficult to comment as a general rule whether counteractions should be continued. We expect that the utility of counteractions differs on a case by case basis.

The AEMC as part of this review should consider the extent to which the use of counteractions as led to reductions in distortions of the energy market, and whether this justifies maintaining their usage.

As such, we consider that AEMO's future reports on the usage of directions should outline any counteractions made and their impact. We understand there is a backlog of reporting under the current requirements on the use of directions and consider that AEMO should have a maximum timeframe to publish the report. The backlog of reporting is making it difficult to fully understand the impact of the directions we have seen.

*Compensation framework should reflect the service provided*

Directed generators receive payment based on the 90<sup>th</sup> percentile of the historical annual wholesale electricity price in the region. We are concerned that if there has been prolonged low wholesale electricity price, this amount of payment will not appropriately value the service provided in maintaining system security. Consequently, we consider that the AEMC should review this process, to ensure that appropriate signals are maintained.

Generators in South Australia that do not contribute to system strength are receiving compensation payments after directions for security due to the what-if process presenting a higher price than the original dispatch. These generators should not be considered affected participants for the purposes of the compensation framework.

Origin agrees with the rule change proposed by AEMO that the compensation threshold applied after an intervention should be determined per event, and not per trading interval. It is our understanding that the threshold mainly exists to minimise the administrative burden of processing compensation where small amounts of money are involved. However, a direction over a relatively longer duration can result accumulate impacts which far exceed the administrative cost of calculating, and therefore compensation should be determined in these situations.

*RRN Test operation should be made clear*

The intention of the RRN test is that intervention pricing is provided where an intervention is needed to maintain security or reliability for an entire region, and not to resolve local issues. We consider that the text of the relevant clauses of the National Electricity Rules should reflect that intention.

Additionally, Origin Energy agrees with AEMO that the RRN test should also apply to the activation of RERT.

If you have any questions or wish to discuss this submission further, please contact Alex Fattal via email [alex.fattal@originenergy.com.au](mailto:alex.fattal@originenergy.com.au) or phone, on (02) 9375 5640.

Yours sincerely

A handwritten signature in blue ink, consisting of a stylized 'S' followed by a vertical line and a small flourish.

Steve Reid  
Group Manager, Regulatory Policy