

16 July 2020

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Compensation following directions for services other than energy and market ancillary services

Snowy Hydro Limited welcomes the opportunity to comment on matters raised in the rule change request related to compensation following directions for services other than energy and market ancillary services.

Snowy Hydro is opposed to the proposed rule. AEMO's Statement of Issue misdescribes the current compensation arrangements under clauses 3.15.7A and 3.15.7B and wrongly characterises its proposal as one relating to administrative efficiency. In fact, the proposed rule would be highly prejudicial to directed participants' ability to receive fair compensation. This rule change is a wolf in sheep's clothing.

This rule change does not satisfy, nor is it likely to contribute to, the achievement of the National Electricity Objective. In light of the work being undertaken by the Energy Security Board and the Australian Energy Market Commission on Essential System Services, there should be a focus on incentivising system services and not removing administrative burdens for AEMO. In the long term, services need to be valued appropriately and the AEMC needs to take this into consideration.

Clauses 3.15.7A and 3.15.7B represent separate heads of compensation. The former is intended to ensure directed participants receive a fair payment price, while the latter is a mechanism by which participants can recover additional costs, to the extent not otherwise provided for under clause 3.15.7A. Rule 3.15.7B is a backstop to ensure participants are not out of pocket, and for this reason includes pricing considerations separate from those under clause 3.15.7A. Rule 3.15.7B is not relevant to the determination of a fair payment price.

It is no accident that clause 3.15.7A makes no reference to participants' costs. The calculation of a fair payment price for energy services is not dependent on the "additional net direct costs" of providing such services, particularly those compensable under this provision. The type of services most recently provided by Snowy Hydro subject to clause 3.15.7A - non-market ancillary services - incur little in the way of what could be described as additional or marginal operating costs yet are nonetheless extremely expensive to provide, owing to the large capital investment needed to offer them.

AEMO's rule change is apparently intended to create an omnibus process under which the independent expert, in determining a fair payment price, would also take into account a participant's costs. Yet this would undermine the very reason for having a two stage process and two separate heads of compensation. It would conflate issues of fair payment and cost. It would also tend to depress the total compensation payable and therefore undermine the intent of clause 3.15.7A, which is to establish a fair payment price, independent of the direct cost of providing the service.

AEMO's expert's report following the direction to Snowy Hydro on 24 Jan 2019 highlights the danger of AEMO's rule change. In that report, the expert wrongly concluded that clause 3.15.7B provided "relevant guidance as to the compensation a Directed Participant is entitled to in the absence of relevant market based benchmarks for the fair payment price. Since there is no loss of revenue to the Directed Participant in this case, the remaining components are the additional net direct costs

and reasonable rate of return.”¹ The expert then used this approach to determine a total compensation amount which, in Snowy Hydro’s opinion, was manifestly inadequate. The synchronous services provided by Snowy Hydro relieved voltage limitations constraining energy imports from NSW to Victoria, alleviating load shedding being experienced across Victoria. The expert valued such services at the derisory sum of \$16,874.30.

In that case, the expert effectively concluded that they could not determine a fair payment price under clause 3.15.7A, and so instead determined the price under clause 3.15.7B, even though clause 3.15.7B had not been engaged by Snowy Hydro. The effect of this approach was that the expert used its estimate of the ‘costs’ of providing the directed service (which estimate Snowy Hydro did not in any case accept) as a proxy for the fair payment price.

Snowy Hydro believes that the approach taken by the expert was wrong, both as a matter of interpretation of the Rules and as an appropriate means for determining the fair payment price. As stated above, a fair payment price is not and should not be contingent on the costs incurred by the participant in providing the service. That is why clauses 3.15.7A and 3.15.7B are treated separately under the Rules. Yet AEMO’s rule change would legitimise the approach taken by the expert. The expert would, in future compensation determinations, be entitled and required to consider the net, direct additional costs of a service as a means for determining the fair payment price. These issues - the fair payment price of a service and the cost incurred in providing it - should remain separate.

AEMO’s proposed rule would alter the compensation arrangements under 3.15.7A away from a genuine fair payment price in favour of one focused on short-run marginal cost pricing. This would be particularly prejudicial to providers of peaking services. In an energy only market like the NEM, such providers have relatively few opportunities to recover their capital costs, which are critical to maintaining investment. Compensation arrangements based on participants’ direct costs would ultimately result in less investment and a less secure energy system. This would also contribute to the use of expensive out-of-market resources through AEMO’s reserve trader mechanism, exacerbating a growing problem in the NEM. This is not consistent with the National Energy Objective and the Commission should reject the proposed rule.

About the Snowy Hydro Group

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. Collectively, they retail gas and electricity in South Australia, Victoria, New South Wales, Queensland and the ACT to over 1 million customers. Snowy Hydro appreciates the opportunity to respond to the Commission in relation to this rule change.

Yours sincerely,



Leigh Creswell

Snowy Hydro Limited

¹ IES Advisory Services, *AEMO Direction to a New South Wales Generator - IES Final Determination*, 17 July 2019, p4

