



17 November 2022

Ms Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2000

Lodged electronically: <https://www.aemc.gov.au/contact-us/lodge-submission>

Dear Ms Collyer

**Stanwell Corporation Limited Response to
Draft Rule Determination – Operational Security Mechanism**

Stanwell Corporation Limited (Stanwell) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) *Draft Rule Determination – National Electricity Amendment (Operational Security Mechanism) Rule 2022* (the Draft Determination).

Stanwell is a major provider of electricity to Queensland, the National Electricity Market (NEM) and large energy users throughout Australia. We own and operate two coal-fired power stations, providing reliable and affordable energy, with a pipeline of proposed renewable generation and storage technologies to reduce our emissions intensity and create future opportunities for our people and communities.

This submission contains the views of Stanwell in relation to the Draft Determination and should not be construed as being indicative or representative of Queensland Government policy.

Support for further development of the OSM

Many of the essential system services (ESS) that support the stable and reliable operation of the NEM, such as system strength and inertia, are presently provided by thermal synchronous generators as intrinsic by-products of this generation technology. However, the intrinsic provision of these services will diminish over time as the market transitions to higher levels of variable renewable energy (VRE), creating technical challenges for the Australian Energy Market Operator (AEMO).

In this context, the Energy Security Board (ESB)¹ and the market bodies² have endorsed the unbundling of ESS so that they can be individually and explicitly valued, priced and scheduled through market-based mechanisms. These prices will provide necessary investment and scarcity signals for market participants to ensure the future delivery of required ESS at the most efficient cost to customers.

Stanwell has consistently expressed its strong support for these reforms in previous submissions to the ESB³ and the AEMC⁴, emphasising the need for these “missing markets” to be developed and implemented as a priority. This includes supporting the development of an inertia spot market as proposed under the Australian Energy Council’s (AEC) rule change request, currently under consideration by the AEMC.

Stanwell recognises that there are challenges to unbundling ESS products and developing individual market solutions for their valuing and procurement, and that the OSM provides an interim solution while this work continues. While the procurement of system security services collectively in advance using a framework such as the OSM will be less efficient than purchasing individual services through spot markets co-optimised in real time, Stanwell believes that it is a reasonable interim solution to provide at least an initial recognition of the value of ESS and start providing some investment signal to potential new service providers. Accordingly, Stanwell supports the continued development of the OSM.

However, we are firmly of the view that AEMC should undertake significantly more work to provide stakeholders, including existing market participants, greater clarity as to how the mechanism will operate. It is Stanwell’s view that this needs to be done before finalisation of the Rule.

As the process currently stands, much of the core work that will underpin the final design of the OSM has not been completed, including critical first steps such as defining the services that will be delivered through the mechanism and how providers will be accredited. The Draft Determination identifies that much of the work will be subsequently developed by AEMO and set out in procedures and guidelines. Stanwell believes that it is neither practical nor appropriate to leave these key matters to be resolved after a final determination is made.

Service Definitions

The constituents of system stability, the relationships among them, and the specification of the services to be valued and procured are central to the OSM framework. It is difficult to understand why this matter has not been settled before the Draft Determination was published.

¹ ESB 2021, *Post-2025 Market Design: Final Advice to Ministers*, Part A.

² AEMC 2022, *Operational Security Mechanism*, Draft Rule Determination.

³ Stanwell Corporation Limited 2021, *Submission to Post 2025 Market Design Consultation Paper* and Stanwell Corporation Limited 2021, *Submission to Post-2025 Market Design Options- A Paper for Consultation*.

⁴ Stanwell Corporation Limited 2022, *ERC0339 – Efficient Provision of Inertia: Essential system services and inertia in the NEM*.

We are aware that AEMO is undertaking significant work on how to operate the NEM at 100 percent instantaneous penetration of renewables through its 2022 Engineering Roadmap. As part of this work, Stanwell understands that AEMO is advancing its thinking and understanding of the system services that are required for the power system technical operating envelope under high-VRE generation scenarios. This work should be closely linked to the development of the OSM, and more explicitly referenced in the AEMC's consultation.

Stanwell urges the AEMC and AEMO to prioritise this fundamental work. Further delay in identifying and defining the system security services to be delivered and which of those will be delivered through the OSM will ultimately hinder the timely accreditation of OSM participants for the services they are able and willing to provide. It will also impede investment decision-making as prospective asset owners need to have clarity as to which services they can obtain a revenue stream from to justify their investment in new technologies.

Given that system security obligations are split across AEMO and transmission network providers, these entities should be closely involved in the identifying and defining these services.

Continued unbundling of ESS and development of spot markets

As noted above, we support the development of the OSM as an interim solution for the delivery of ESS while work to unbundle those services and develop spot market solutions for their delivery continues. Notwithstanding this, it is important that the transition to individual spot market continues over time. As services are procured and delivered through the OSM, there is a risk that the motivation for further regulatory reform could diminish. Our concern is that the OSM ultimately increases the risk that the development of more efficient unbundled spot markets is unnecessarily delayed.

We are already seeing some resistance on the part of the AEMC and AEMO to proactively advance the development of a spot market for inertia with the "wait and see" suggested approach for developing that market in the Essential Systems Services and Inertia in the NEM joint discussion paper.⁵ In our submission to that paper, Stanwell emphasised⁶ the need for the AEMC to swiftly progress the AEC's proposed rule change to establish a market for the provision of inertia services, rather than risk rushing development of a solution when an actual shortfall becomes imminent. Accordingly, Stanwell is strongly of the view that the AEMC should continue to progress the AEC inertia market rule change request, independent of the development of the OSM.

Stanwell notes that the AEMC proposes to conduct four-yearly reviews of the OSM to monitor its performance and opportunities for unbundling to ensure that the mechanism remains fit-for-purpose in the long-run. This review, which the AEMC Reliability Panel may be well-placed to conduct, should reflect an ongoing commitment and provide a clear

⁵ Australian Energy Market Commission and Australian Energy Market Operator 2022, *Essential Systems Services and Inertia in the NEM*, p. 20.

⁶ Stanwell Corporation Limited 2021, *Submission to Essential System Services and Inertia in the NEM*.

pathway to the development of those individual markets. It should also continue to provide market participants with certainty, and not result in changes that affect the economic viability of their future participation.

Further, we would strongly encourage the AEMC to work with AEMO and stakeholders to develop a clear pathway to the unbundling of ESS markets that would form the basis for the reviews of the OSM and ESS as proposed in the Draft Determination. This would provide further assurance to market participants and investors of the commitment on the part of the market bodies to the development of system service spot markets wherever possible.

Compensation eligibility

Under the existing asset-based definition of system security services, it appears that generators receiving revenue from the energy market will be ineligible for OSM payments for any security services provided. Stanwell considers that this approach is short-sighted and may result in unintended adverse consequences for both the OSM and the energy market.

This approach appears to consider that all ESS provided are inseparable from the provision of energy, including the level of service provision. While the services to be procured under the OSM have not yet been defined, Stanwell considers that both incumbent and new entrant service providers are likely to have some level of control over the provision of ESS which should be compensable.

Even if a service is inseparable from the provision of energy, it is not clear that it should not be valued by the OSM. If it is priced such that it displaces a more expensive separable provider, this service has a value to customers. If it is priced such that a separable provider is cheaper the inseparable service could simply not be dispatched and receive no compensation, even if it is ultimately provided. The latter case would also mean that the non-dispatched provider would not be obligated to provide the service if energy market conditions changed after the OSM run and it was not ultimately dispatched for energy.

Alternatively, if the OSM was designed such that inseparable services could not be bid, and were simply assumed to be provided when a generator is online, the true value of system security services would become obscured, diminishing the price signal for those services to current providers as well as potential investors. It is also not clear whether the assumed service would impose compliance obligations equivalent to a service being paid for, particularly if energy market conditions changed such that the assumed energy dispatch no longer occurred.

Moreover, if an OSM market was chronically undersupplied or primarily supplied by sources inseparable from energy provision there may be times when the value of the ESS is greater than the value of the energy. This has been observed in South Australia in relation to synchronous generators who have had to be directed on at low energy prices in order to provide grid stability. There is no ability for providers to factor the value of these services into their energy bid as apparently assumed in the draft OSM design.

Market power

In the absence of any comprehensive analysis, the AEMC has foreshadowed the potential for market power to be exercised in the OSM. To this extent, it has proposed a role for the Australian Energy Regulator (AER) to manage any competitive issues that it may identify.

While supporting proportionate regulatory oversight, Stanwell considers that the ESS markets being developed are likely to be procuring very small volumes relative to the energy market. As such they are likely to either be swamped by suppliers or have extremely limited suppliers (like system restart ancillary services). In either case, complex, expensive oversight mechanisms are likely to be unnecessary.

The proposed regime provides the AER with the power to determine and enforce an efficient price as a regulatory remedy. It is important that the Rules clarify the meaning of this concept in the context of a competitive market that incentivises the entry of new service providers by signalling revenue opportunities.

In the short term, Stanwell considers that a more light-handed market monitoring approach is warranted as information on actual participation levels and generator behaviour in the market for security services becomes available for the first time, providing for the merits of an alternative regulatory approach to be assessed on an evidence-basis.

Development timeframe

The AEMC is proposing that the OSM will commence on 1 October 2025. This will require key processes to be developed and communicated well in advance to provide market participants and other stakeholders with sufficient time to prepare and register. There remains much to be done, and the timeframe to enable this may not be reasonable.

Working backwards, for the AER to complete its initial comprehensive market power review by 1 July 2025, it would seem likely that at least an initial tranche of providers would have to have completed their registration process by late 2024. Optimistically then, the accreditation process for market participants will need to have been finalised by mid-2024, if not earlier. In turn, the accreditation process cannot commence in earnest until services are defined and unbundled, and many of the detailed operational parameters and procedures have been established and documented in guidelines.

To the extent that many of these matters will need to be subject to stakeholder consultation, this would suggest that a significant amount of detailed work on the OSM will need to be conducted and finalised by early 2024. However, the indicative timing of these milestones are all predicated on the assumption that the AEMC makes a final determination on the OSM rule change during the first quarter of 2023. If further consultation on the rule change is necessary, the commencement date for the OSM will need to be commensurately later.

Conclusion

As VRE's share of dispatched energy grows and thermal generators retire, the importance of incentivising new reliable sources of system security services is critical. To this end, Stanwell supports the development of the OSM as an interim measure. Spot markets, co-optimised with the delivery of energy and FCAS, provide the most efficient investment signals, and accordingly the existence of the OSM should not unnecessarily distract the AEMC and AEMO from their evolution, where possible.

The foreshadowed timeframe for development of the OSM is tight. Given many key pieces of work that will influence the ultimate design of the mechanism are yet to be progressed, including the definition of services to be procured, consideration should be given to both expediting that work and extending this timeframe sufficiently to get the decision-making right, rather than rushing the process.

Stanwell welcomes the opportunity to further discuss the matters outlined in this submission. Please refer any questions to Steve Williams, Market Regulations Senior Advisor, on 0409870998, or email at Stephen.Williams@stanwell.com.

Yours sincerely



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