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Australian Energy Market Commission (AEMC)

Via website: https://www.aemc.gov.au/contact-us/lodge-submission

Optimising Contingency Size in Dispatch and Allocating Contingency FCAS

Alinta Energy welcomes the opportunity to provide feedback on the AEMC's consultation paper which combines the "Optimising contingency size in dispatch" and "Allocating contingency FCAS costs" rule change requests.

Key points:

- **We do not support the proposed changes to contingency reserve cost allocation and treatment of contingency size in dispatch.**
- **We consider that the proposed changes would not deliver benefits that outweigh their costs and would introduce risks to market integrity.**

Question 1: Is there a substantive problem or evidence of an emerging one?

Do you consider that the current allocation of contingency FCAS costs leads to a material loss of market efficiency?

No, the existing allocation method for contingency FCAS costs already incentivises large loads/generators to curtail their demand/generation when contingency FCAS prices are high.

As the AEMC's consultation paper observes, contingency FCAS costs are typically low but can rise sharply in a tail-risk situations like separation events.

During these events, generators and large loads already face strong commercial signals to decommit or curtail under the current allocation method: participants' dispatch and settlement exposure rises materially as prices spike, which drives behavioural change without additional complexity. In these circumstances, a runway allocation method would only marginally increase incentives for larger participants to do what they are already likely to be doing.

Also, as identified by the paper, outside of these events, contingency FCAS prices are low (and are tending lower with fast frequency response and investment in batteries). During these periods, there would be no incentive (and no efficiency benefit) to curtail load or generation regardless of the allocation method. In these cases, the benefit a generator is delivering in terms of lower energy costs, or the benefit a load is deriving from consuming energy would outweigh the benefit of their curtailment in terms of reductions in contingency FCAS costs.

We also add that the proponent implies that the current method leads to a loss of efficiency because during high cost FCAS events, and where there is a lack of contingency FCAS capacity, "smaller generators" reduce their output and withdraw their FCAS capacity. The proponent argues that the allocation method would ameliorate this situation because the smaller generators' FCAS costs would be "greatly reduced", allowing them to continue operating, and put downward pressure on energy prices.[1] We disagree with this logic:

- During high FCAS cost events, if smaller generators are curtailing their output or increasing their prices, larger generators would be curtailing as well. Where larger generators curtail, smaller generators will no longer be as small in comparison and so under the runway method, their FCAS costs would not be "greatly reduced".

- The energy price and FCAS cost impacts of larger generators curtailing would likely be at least as material as the impacts of smaller generators curtailing.

- This situation assumes the requirement is driven by a generator contingency. However, as recognised by the AEMC, high FCAS costs tend to arise with network contingencies. The recent instance of extreme contingency FCAS cost outlined in the paper occurred where the Heywood interconnect became a large contingency. In similar cases, using the runway method to curtail larger generators would not reduce the contingency reserve requirement and would therefore not reduce contingency reserve costs.

- Contingency FCAS supply is increasingly provided batteries which do not need to produce energy to provide contingency FCAS and can therefore provide contingency FCAS supply in the high FCAS cost scenario outlined by the proponent. This reduces the potential benefit envisaged by the proponent that stems from smaller generators not withdrawing their FCAS supply.

Finally, the runway method would be materially harder for participants to forecast and compute ex-ante compared with the status quo. A unit's liability in any interval would be highly sensitive to the dispatch of other participants (i.e. who will be a larger credible contingency), making exposure path-dependent and amplifying volatility compared with proportional energy-based recovery. Consequently, misestimation would be more likely, and this could lead to inefficient operational or energy pricing decisions.

To what extent do AEMO's current practices already address the periods of greatest concern to the proponent and thereby reduce the materiality of the issue?

As outlined above, we consider the current allocation method already avoids efficiency issues. When FCAS costs are high, under the current allocation method, loads and generators have strong incentives to curtail, and where these loads and generators are the largest contingencies, this removes the need for AEMO to intervene with the optimisation method proposed by the rule change proponent.

We also consider that AEMO's current contingency optimisation criteria minimises any material efficiency issues (to the extent practicable) that could arise with large contingencies causing high contingency FCAS costs. As noted by the paper, high contingency costs tend to arise with separation events and or network contingency situations where there is a large amount of generation at risk or there is a scarcity of FCAS (such as in island conditions), and in these cases AEMO will already determine whether moving generating units at risk to the

[1] Grid Energy, *Efficiency Improvements in Contingency Frequency Control Ancillary Services (FCAS) Cost Allocation*, p.7.

LHS of the constraint equation is appropriate, taking into account considerations such as the risk of power system security violations due to the FCAS requirement exceeding the FCAS availability.

Question 2: Will contingency size optimisation address the issue raised by the proponent?

Do you consider that contingency size co-optimisation will address the issue identified by the proponent?

As noted above, we do not consider there is a material issue to be addressed, and therefore do not consider that there are material benefits in introducing further contingency size optimisation beyond AEMO's current practices.

Are there other factors or solutions that should be considered?

No comment.

Do you have any views on how to manage the potential risks to market integrity?

How should the limits on contingency size optimisation issues be expressed to avoid market integrity risks?

We are concerned that the proposals could impact on liquidity and we do not see any clear solutions to the market integrity issues associated with the proposal.

Question 3: Will runway contingency FCAS cost allocation address the issues identified by the proponent?

Do you consider that runway contingency FCAS cost allocation will address the issue identified by the proponent?

As noted above, we do not consider there is a material issue to be addressed and therefore do not consider that there are material benefits in runway cost allocation.

Are there other factors or solutions that should be considered by the Commission when considering this?

We consider that the AEMC should not take it as read that the runway method will necessarily represent an improvement in terms of causer-pays and equity principles, especially noting that high contingency FCAS costs are typically driven by network events, and in these cases large generators (or non-network loads) would be unfairly penalised under the runway method. Further, some large generators may be providing services that are not services that are not rewarded under the current framework, including inertia and system strength. Where these services are crucial to system security and reliability, for example, during minimum system load events, the runway method could dramatically increase the cost of generators providing these services, even where they have reduced their output as much as practicable.

We also consider that runway method may put pressure on energy costs where larger generators attempt to price in their contingency FCAS cost exposure into their variable costs of generation.

Are you aware of any issues associated with the practicality of applying runway pricing to large loads?

As mentioned above, we consider that the runway method increases the complexity and uncertainty of participants predicting and therefore changing their behaviour based on their contingency FCAS costs.

We are also unclear on how AEMO sets its contingency FCAS requirements and to what extent this would align with those penalised under a runway method.

Question 4: Do stakeholders consider the two rule changes to be complementary?

Do you consider contingency size co-optimisation and runway FCAS cost allocation to be complementary mechanisms that work together or substitute mechanisms which aim to achieve the same outcomes via different methods?

We consider these proposals are substitutional rather than complementary. Any potential benefit of each would be undermined by the other. For example, there is less potential FCAS cost reduction benefit in attempting to increase incentives for large loads and generators to curtail if AEMO would intervene regardless as proposed under the optimisation rule change request.

What is your understanding of the interactions between these two mechanisms, should they be implemented together?

Question 5: Do stakeholders agree with the benefits identified from contingency size optimisation and runway FCAS cost allocation?

No, as outlined above, we consider that these proposals would not deliver benefits that would outweigh their costs:

- High FCAS costs are typically driven by network events which would not be captured by the proposal, and in these circumstances AEMO may already intervene to reduce contingency size under their current criteria, and runway cost allocation would be ineffectual on networks.

- During high network cost events, participants already have strong incentives to reduce their output/load under the current allocation method.

- Outside of these events, contingency FCAS costs are low and declining with increasing levels of battery storage capacity, further reducing any potential benefit of the rule changes.

- Noting that the runway method may make contingency costs more extreme an unpredictable in the limited circumstances where FCAS costs are high, there is a higher risk of misestimation, and participants may be more conservative in how they price in these costs or as to whether they decide to generate/consume.

- As outlined in response to question 1, we perceive flaws in the logic outlining how the rule change would improve efficiency during high cost FCAS events.

Do you agree that participant bidding is likely to change, given the runway cost allocation to achieve the benefits identified by the proponent?

We do not consider that bidding would change in beneficial ways, noting that participants already have strong incentives to reduce their output or load when contingency FCAS costs

are high under the current method.

Noting that the runway method may make contingency costs more extreme an unpredictable in the limited circumstances where FCAS costs are high, there is a higher risk of misestimation, and participants may be more conservative in how they price in these costs or as to whether they decide to generate/consume.

Do you agree that contingency size optimisation will enhance market efficiency as identified by the proponent?

No, per our response to question 2.

Question 6: What are your views on the costs, benefits, and risks of the proposed solution?

Do you agree with the costs and benefits of the package of proposed rule changes as put forward by the proponent?

No, as addressed in response to questions 1, 2, 3 and 5.

Do you have any insights on how the costs and benefits of the proposal may change given the transitioning power system?

We expect that these costs will continue to decline with increasing battery storage capacity in the NEM and with increasing levels of interconnection, reducing the risk of separation events causing high contingency FCAS costs.

Do you consider the market integrity risks identified by the proponent in respect of contingency size optimisation to be material and how should these be managed should the rule be made?

Yes, we consider that the market integrity risks identified would be material and we have not identified any resolutions.

Question 7: Assessment framework Do you agree with the proposed assessment criteria?

Are there additional criteria that the Commission should consider or criteria included here that are not relevant?

We agree with the proposed assessment criteria.

We anticipate that the proposed changes are complicated and putting aside our views that there is no case for change, any potential benefit they would deliver would rely on forecast behavioral changes. Given this uncertainty and complexity, if these rule change requests are to be progressed further it should be to a stage of careful analysis of costs and benefits. Only where costs are well understood and benefits are clear and sufficiently certain should these rule changes be implemented

Finally, there should be scrutiny of whether the runway method aligns with how AEMO sets contingency FCAS requirements and the risk that the runway method results in participants paying more where they are not a primary causer of contingency of FCAS requirements, for example, where network contingencies set the requirement.

We recommend the inclusion of DNSPs into the fee structures

Considering the growing involvement of DNSPs in AEMO's activities and outputs, excluding these participants from the fee structures would conflict with AEMO's fee structure principles. In our response to AEMO's Consultation Paper, we outlined two key sub-clauses within

Thank you for your consideration of Alinta Energy's submission. If you would like to discuss this further, please get in touch with me at Oscar.carlberg@alintanergy.com.au.

Yours sincerely,

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