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Australian Energy Market Commission
Level 15, 60 Castlereagh Street
Sydney NSW 2000

Submitted electronically

Draft Rule Determination – Improving Compensation Frameworks (ERC0425)

Snowy Hydro Limited welcomes the opportunity to comment on the AEMC's draft rule determination for *Improving Compensation Frameworks*.

Snowy Hydro commends the AEMC for progressing the recommendations from the 2024 Review into Electricity Compensation Frameworks into draft rules, in particular the following proposals:

- Allowing opportunity cost compensation to be claimed in directions, administered pricing and market suspension frameworks. The current approach, under which opportunity costs can be claimed for some types of market intervention but not others, is arbitrary and inconsistent. This change will also support the growing role of storage and fuel-constrained generation to manage variable renewable energy sources.

- Evaluating administered pricing compensation on a per-unit and per-trading interval basis rather than aggregate portfolio netting. The current approach undermines opportunity cost compensation, because profitable and loss making intervals on the same day must be netted-off before a compensation claim can be established. Assessing claims at the individual unit and trading interval level restores market incentives to stay online during intervention events.

- Consolidation of claims administration under AEMO with independent expert assessment for opportunity cost claims. The bifurcated process during the June 2022 energy crisis created administrative delay and uncertainty. Furthermore, given the economic complexity of calculating "what-if" counterfactual scenarios for energy storage, we support the engagement of an independent expert for all opportunity cost claims.

The Compensation Process Should Formally Recognise Contracts

Snowy Hydro recommends a further change in how cost opportunity costs are assessed, by formally acknowledging the role of forward contract positions. In particular, the rules and Compensation Guidelines should be amended such that a generator's forward contracting obligations, including the cost to defend those positions from a finite fuel resource, are recognised when assessing opportunity cost.

Snowy Hydro's 2022 Compensation Claim

Snowy Hydro highlighted the deficiencies in the AEMC's application of its Compensation Guidelines during the assessment of its June 2022 Administered Price Period compensation claim. In that determination, the AEMC rejected Snowy Hydro's market-based opportunity cost calculation on the basis it was not 'transparent, repeatable and generalisable', and instead applied a backward-looking Volume-Weighted Average Price (VWAP).

As Snowy Hydro highlighted at the time, assuming that the contracts market does not exist and does not impact spot market opportunities is divorced from the reality of operating in the NEM. Wholesale spot prices cannot be separated from forward contract positions:

- Generators never make dispatch decisions in isolation from their contractual hedge book. A generator will bid assets below SRMC if the combined spot and hedge revenue defends its sold contract position, to avoid exposure to undefended contract payouts.

- When an energy-constrained generator (such as hydro) is forced to generate during a price limit event, it depletes scarce water reserved to defend forward contract positions in subsequent high-demand periods. In Snowy Hydro's case, the premature loss of water, previously earmarked to defend its contracts, forced reliance on expensive thermal assets. The cost of running a thermal plant to defend its hedge book is a direct, verifiable opportunity cost that arose from the event.

- Relying on VWAPs or other backward-looking metrics does not reflect the opportunity cost of fuel-constrained plant, which sits at the top of the bid stack and shadow-prices marginal thermal peaking generation.

AEMC asserted, in respect of Snowy Hydro's 2022 claim, that recognising contract positions was "not contemplated in the Guidelines". However, as Snowy Hydro noted, nothing in the rules or the Guidelines excluded their consideration.

In any case, opportunity cost is fundamentally a forward-looking metric that can never be accurately captured by VWAP. Neither can the calculation of a given generator's opportunity cost ever be "transparent, repeatable, and generalisable" in the sense that it will always depend on the circumstances specific to that generator: its asset portfolio, generation opportunities, fuel reserves and contract book. While it may be thought to improve the administrative efficiency of assessing compensation claims, it is not the correct criteria.

If the AEMC genuinely wants to maintain the incentive to supply, it must acknowledge that opportunity cost must be calculated by reference to the particular opportunities and constraints faced by each generator at the time of the event.

The rules and Compensation Guidelines should, therefore, be updated on this basis to recognise the role of contracts. In particular, the draft rules should require the AEMC to update the Compensation Guidelines such that:

1. Forward contracting obligations and hedge book commitments form a legitimate baseline for evaluating alternative opportunities.

2. The verified cost incurred by a participant to defend forward contract positions (including downstream fuel consumption or spot re-hedging) following fuel depletion during an intervention event constitutes an eligible market-based opportunity cost.

About Snowy Hydro

Snowy Hydro Limited is a producer, supplier, trader and retailer of energy in the National Electricity Market and a leading provider of risk management financial hedge contracts. We are an integrated energy company with more than 6,000MW of on-demand generation 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.