16 February 2006

John Tamblyn, Chairman
Australian Energy Market Commission
Level 16, 1 Margaret Street
Sydney NSW 2000

By email: submissions@aemc.gov.au

Dear John,

**MANAGEMENT OF NEGATIVE SETTLEMENT RESIDUES IN THE SNOWY REGION**

Origin appreciates this opportunity to make a submission to the above consultation and to provide some comments on Loy Yang Marketing Management Company (LYMMCO) and others' proposal for addressing negative settlement residues in the Snowy region.

As a retailer we have a strong interest in trading and competing widely across the National Electricity Market (NEM) and as such are strongly supportive of measures which minimise interregional risks. Counter price flows across regions appear to us inconsistent with principles of efficient trade and indeed inconsistent with the underlying basis for creating a regionalised market in the first place, which is to allow energy to flow from low cost regions to higher cost regions, or to allow energy to flow from regions with excess supply to those suffering shortage. Counter price flows reflect the fact that this key principle of interregional trade has been undermined. Relatedly, the accumulation of negative residues which arises from counter price flows also devalues the financial instruments which assist in managing the risk of trading between regions, and thus deter such trade.

Origin therefore considers that both on a principled and practical level counter price flows between regions should be avoided. However, the key problem with current NEMMCO practice of constraining negative residues is that while it addresses the symptoms of the problem it fails to address its causes and, as a consequence, creates other distortions. NEMMCO currently manages negative residues in the Snowy Region by capping exports out of Victoria; however, this unfortunately interferes with what was previously an efficient dispatch. That is, with constraint impacts and loop flows taken into account the effect of reducing Victorian output and increasing Murray output increases overall dispatch costs. As well as interfering with dispatch the manner of intervention can also create significant volatility in prices at Murray due to the imprecise nature of the flow capping process. This creates uncertainty in the minds of participants as to the likely impacts of the NEMMCO intervention on the market and thus also can be considered to deter efficient trade.

Origin would therefore be amenable to an alternative approach which avoids the need for NEMMCO to intervene in the market, yet also addresses counter price flows and its consequences. The LYMMCO proposal has *prima facie* merit in this regard; by using positive residues on a nearby interconnector as an offset against the negative residues on the VIC- Snowy the issue is dealt with at a practical level and without, apparently, significant transfers of wealth.


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Our concern, however, is that the interregional counter price flow remains and therefore the issue has not been addressed at its root. This measure appears, not unlike the NEMMCO intervention itself, to be another ad hoc attempt to address the symptoms of a problem rather than its underlying cause.

The cause in this particular case essentially arises from the existence of an inappropriate region. That is, in a regionalised market (as opposed to a nodal market) spot prices should reflect significant demand as well as supply, which the Snowy region price clearly does not. For example, when the constraint between Murray and Tumut binds in a northerly direction cheap energy from Victoria is attempting to traverse the Snowy region to meet demand in NSW. The regional structure and subsequent pricing should reflect this important point.

The removal of the Snowy region would confer a number of substantive benefits in this regard, arguably beyond those which might be achieved by the LYMMCO proposal:

First, redrawing the boundary along the constraint means it is efficiently priced and thereby removes the counter price flow at its source while also obviating the need for the current CSP/CSC arrangement. We consider this provides a simpler and more transparent resolution to the Snowy constraint issue than the combined CSP/CSC and LYMMCO proposal. There is a place for CSP/CSC arrangements provided they are not used to address what are better defined as interregional constraints.

Second, and consistent with the underlying principles of a regional market, we also consider that there are substantial competition and trading benefits associated with having greater liquidity around regional reference nodes. A regional node at Murray in the absence of significant other load or generation in that region provides Murray with substantive influence over its own nodal price. Moving Tumut into NSW and Murray into Victoria would mitigate this influence (it would be more difficult for Murray to influence the level of the Victorian price than its own local price) and would also mean that significant additional generation in each of those states now observes the same price signal. This will improve the consistency between pricing and dispatch and enhance generator competition and the liquidity of trade around these nodes. It is unclear to us that the LYMMCO proposal would create equally such significant long term benefits for consumers.

If you wish to discuss any of these matters further please do not hesitate to call Con van Kemenade on 8345 5278

Yours Sincerely

Michael Hayes
Manager, Portfolio Strategy & Regulation