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Australian Energy Market Commission
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Sydney South NSW 1235

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Inertia Ancillary Service Market - Consultation Paper

Snowy Hydro Limited welcomes the opportunity to comment on the Inertia Ancillary Service Market - Consultation Paper.

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.

Snowy Hydro strongly advocates for the establishment of new markets to provide the necessary pricing signals for complementary services such as inertia and fast frequency response.

We highlight that forward electricity markets are in backwardation where future forward electricity contracts are cheaper than near dated forward contracts. This is despite the fact that there is likely to be at least 5000 MW of new renewable generation to be built by the end of 2020. What this observations says is that the collective consensus of all Market Participants and Financial Intermediaries is that the NEM should revert to lower electricity prices. The key message here is that regulatory changes to the NEM should be done in a considered and evidenced based manner without the urge for short term responses/policies which in the long run are contrary to the long term interest of consumers.

Market based solutions

Synchronous inertia slows down the rate of change of frequency and is an important component to ensuring a secure system. As synchronous generation retires, there is limited ability for renewable asynchronous generation to take its place and provide the necessary inertia.

Snowy Hydro disagrees with the AEMC's decision to allow TNSPs to provide the minimum threshold level of inertia. We highlight that a market based mechanism would encourage competition in the provision of inertia, provide an incentive for innovation to occur, and hence is demonstrably more efficient than a regulated solution through TNSPs. We highlight the

AEMC's key principle, "that competition and market signals generally lead to better outcomes than centralised planning, since they are more flexible to changing conditions and to consumers' needs¹." This key principle should guide the AEMC's decision making on this rule change.

Interaction with Settlement Residue Auction

Snowy Hydro is very concerned with one of the proposals to pay interregional settlement residue funds (IRSR) to inertia providers as a result of RoCoF constraints on interconnectors.

With the changing generation mix in the NEM, conventional synchronous generators are running less or being retired as evidenced by the recent closures of Northern and Hazelwood power stations. As this trends continues, Market Participants access to hedging contracts are likely to decrease.

The Settlement Residue Auction (SRA) units will increase in importance to allow Market Participants to underwrite and/or sell forward contracts across NEM regions.

As stated by the AEMC²,

The Commission sought evidence on whether the current design of auctions allows market participants to use the units to hedge risks that arise from operating in interconnected regions. Stakeholder submissions confirmed that despite not providing firm hedges, units are indeed being used to support inter-regional hedging.

Any proposal that decreases the firmness of SRA units would have the unintended consequence of reducing participation in the SRA auction and therefore reducing inter-regional trade. Uncertainty in the firmness of SRA units would increase and act to deter inter-regional trade.

Further to this the absence of a separate inertia market will add unnecessary complexity into a generators energy market offers.

We also strongly agree with the AEMC's assessment of the deficiencies³ that would limit the effectiveness of the SRA market sourcing approach. These deficiencies are summarised below:

¹ AEMC, Inertia Ancillary Service Market, Consultation Paper, page 16.

² AEMC, Secondary trading of settlement residue distribution units, Draft Determination, page 17.

³ AEMC, Inertia Ancillary Service Market, Consultation Paper, page 19

- The potential to reduce the effectiveness of SRA units as a means of hedging inter-regional spot price risk.
- The proposed funding approach using IRSRs would not address intra-regional RoCoF constraints.
- The proposed approach is not co-optimised across separate services in the NEM.

For the reasons outlined above Snowy Hydro strongly does not support the proposed market sourcing approach through the IRRS funds.

Alternative methods of payment for Inertia

The three alternative methods of funding inertia payments are much less distortionary and worthy of further consideration.

Snowy Hydro considers that the second option of using SRA proceeds and recovering any additional required funds from TNSPs is the least distortionary and most appropriate option.

Conclusion

In conclusion, Snowy Hydro supports a market-based mechanisms for the provision of all inertia. We believe the introduction of a minimum level of inertia is an artificial and unwarranted construct. We have serious concerns about providing inertia payments through the inter-regional settlement residues and highlight that the AEMC's proposal only addresses inter-regional constraints. Our overall preference is for the AEMC to undertake a thorough and comprehensive review of the existing Frequency Control Ancillary Service (FCAS) markets and properly consider co-optimisation of all ancillary services including intra and inter-regional inertia constraints.

Snowy Hydro appreciates the opportunity to participate in this consultation process. For further clarification on our submission, contact me on kevin.ly@snowyhydro.com.au.

Yours sincerely



Kevin Ly
Head of Wholesale Regulation