

12th October 2007

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box H166
Australia Square NSW 1215

Submission sent electronically to:
submissions@aemc.gov.au

Dear Dr Tamblyn,

**Submission to - Draft Rule Determinations –
Split Snowy Region and Congestion Pricing and Negative Residue Management
Arrangements for the Snowy Region**

Snowy Hydro supports the Commission's Draft Determinations on the Split Snowy Region and Congestion Pricing and Negative Residue Management Arrangements for the Snowy Region (SGen) rule proposals.

We believe that the Commission has taken an appropriate integrated approach to assessing the competing alternatives to address congestion in the Snowy Region. The Snowy Region Abolition addresses a legacy congestion issue and thus establishes a robust starting point for a congestion management regime that may apply in the future. The Snowy Region Abolition also ensures an appropriate starting point for the MCE's region boundary change framework. In summary, we note that the Abolition proposal sits well with and is an important part of the overall direction that the Commission has proposed on the Congestion Management Review, the MCE proposed process for a region change, and the Commission's approach to transmission planning, revenue and pricing.

The Snowy Region congestion problem is a clear example of material and enduring congestion where a region boundary change is the appropriate response. We strongly agree with the Commission that addressing the Snowy Region congestion problem through the implementation on the Snowy Region Abolition has removed any perception of regulatory risk of not appropriately responding to such a material and enduring congestion problem.

We note that the Commission has taken an appropriate game theoretic modelling approach to assess these competing proposals. This approach correctly considers commercial incentives on Participant behaviour in response to a Rule change. In contrast, we note modelling undertaken by some Participants to assess the competing proposals are inappropriate and not relevant as these models do not use game theory based modelling and hence do not accurately consider commercial incentives or behaviour.

We believe the Snowy Region Abolition rule proposal is superior then these competing alternatives on all of the Commissions assessment criteria.

We agree with the Commission that the modelling outputs are an important part of decision making but not necessarily the primary consideration in assessing the competing proposals. We however note that the results of the modelling confirm our view that Abolition proposal would result in superior market outcomes than in comparison to the other competing alternatives.

On dispatch efficiency the Commission has verified that the Abolition proposal results in the most efficient dispatch outcomes. This is due in part to more efficient incentives on Snowy Hydro generation not to withhold plant. These inefficient incentives on Snowy Hydro plant remain in both the competing alternatives as there are strong incentives to maintain headroom. Consistent with our submission to the Snowy Region Abolition draft determination we believe that the differences in dispatch efficiency benefits from the competing rule proposals are immaterial when compared to the impact of the competing alternatives to the Contracts market.

On inter-regional trading and risk management the Abolition proposal reduces basis risk on Snowy Hydro and thus would encourage Snowy Hydro to offer more competitive contracts. This would result in more competitive contract prices and with flow on benefits to the liquidity of the hedge markets and inter-regional trade. Since there is a close relationship between the contract and spot markets more competitive outcomes in the contract market should have wider benefits to customers in the Spot market.

On pricing outcomes the Abolition proposal results in more competitive prices as the proposal creates the strongest incentives for all generators to bid in a more competitive way. This assertion has been confirmed by the Commissions modelling which showed that the Abolition proposal results in more consistently lower Spot prices than the competing alternatives. We agree with the Commissions finding that, “the Abolition proposal most effectively promotes wholesale prices that reflect the efficient costs of production, and therefore allocative efficiency¹.”

With respect to good regulatory practice, Snowy Hydro supports the Commissions conclusion that the Abolition proposal best promotes the principles of good regulatory practice as the solution is transparent, would result in predictable market operations, and is a proportionate response to the identified problem. In comparison the Split Snowy Region inappropriately pre-empts possible future responses to any potential congestion that may arise north of Tumut and South of Murray. Hence it is not a proportionate response when compared to the Abolition proposal. Further, the SGen proposal would result in a permanent retention of an interim trial. This would pre-empt developments arising from the Congestion Management Review and is not a proportionate response to a material and enduring problem.

With respect to long term implications and consistency with public policy settings, the Abolition proposal would increase competition in both the contract and spot markets and thus promote allocative and dynamic efficiency in the NEM in the long term. Consumers would benefit from these efficiency improvements. Snowy Hydro also strongly supports the Commission’s finding that the, “Abolition proposal is the most consistent with the policy settings as set out by the MCE when compared to the alternatives².”

In summary, the Abolition proposal addresses a material and enduring legacy congestion problem that has been recognised by all market Participants. The Abolition proposal is consistent with the NEM region designed market, is more transparent and less complex in

¹ AEMC 2007, Abolition of Snowy Region, Rule Determination, 30 August 2007, Sydney, page 23.

² Ibid, page 26.

comparison to the alternative proposals. The proposal would result in the most efficient dispatch outcomes, increases competition in both the contract and spot markets, and therefore result in more competitive outcomes.

Snowy Hydro appreciates the opportunity to comment on the Draft Determinations on the alternative proposals for the Snowy Region. We strongly support the Commissions finding that the Abolition proposal best meets the NEM objective, and therefore the Split Snowy Region and SGen rule proposals should be rejected in their respective Final Determinations. Please contact me on (02) 9278 1885 if you would like to discuss the issues outlined in this submission.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Roger Whitby', is written over a light blue rectangular background.

Roger Whitby
Executive Officer, Trading

