

**Loy Yang Marketing Management Company Pty. Ltd.**

**AGL Hydro Pty. Ltd.**

**International Power (Hazelwood, Synergen, Pelican Point, Loy Yang B and Valley Power)**

**TRUenergy Pty. Ltd.**

**NRG Flinders Pty. Ltd.**

**Hydro Tasmania**

7<sup>th</sup> September 2006

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Australian Energy Market Commission  
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**Proposed National Electricity Amendment (Management of negative settlement residues by re-orientation) Rule 2006 and draft National Electricity Amendment (Management of negative settlement residues in the Snowy region) Rule 2006**

This further submission by the "Southern Generators" is in response to the Snowy Hydro submission to the Commission dated 5<sup>th</sup> September 2006 and the associated presentation.

Despite the further submissions made by Snowy Hydro since the publication of the draft determination by the Commission nothing has fundamentally changed that should cause the Commission to vary their decision.

In their recent submissions Snowy Hydro has:

- identified an environmental impact on their business which they would be expected to manage as part of their normal business operations,
- detailed their concerns regarding a potential security of supply issue in Victoria which has been assessed by NEMMCO as not being a significant degradation in reserves for 2006/07 and in addition NEMMCO, now that they are aware of the issue, has identified a process to address reserve shortfalls if they should eventuate,
- claimed that customers would be worse off under the Rule change which is totally inconsistent with the modeling work undertaken by the Commission.

As stated in our previous response the claims made by Snowy Hydro are not credible.

Snowy Hydro is an independent business and (like all other businesses including all generators in the NEM), is responsible for managing all the risks faced by their business. These risks can be wide ranging and may include high or low water levels, drought, floods, plant limitations and failures, the impact of pool and market prices and environmental constraints as well as the consequences of their risk management decisions.

The problem identified by Snowy Hydro arises not from the efficient market signals which arise from the Southern generators proposal but either from:

- plant limitations in the Snowy hydro region principally their inability to spill water at Geehi which has previously been hidden by the mis-pricing that has occurred in the Snowy region, or
- decisions to implement a risk management strategy which is inappropriate in the current drought conditions.

Management of both issues is clearly the responsibility of Snowy Hydro.

Whether or not the strategy outlined by Snowy Hydro is a rational response to managing the risks they face, (and we don't believe it is for the reasons detailed in the attachment to this letter) it is entirely a Snowy Hydro decision. NEMMCO is aware of the issue and will respond in the short term to supply reliability issues should they eventuate. In the medium to long term, the market will respond to the consequential price signals.

Snowy Hydro is however proposing that their internal operational problems should be mitigated by enshrining a process of market intervention by NEMMCO which has been demonstrated by the Commission to be inefficient and which has been shown to have a distortionary impact on the NEM as a whole. This solution to the issues faced by the Snowy Hydro business is clearly inconsistent with the market objective.

Application of efficient price signals will drive Snowy Hydro to develop appropriate risk management strategies that will deliver efficient market outcomes to the benefit of consumers.

We provide in the attachment comments on the risk management strategy proposed by Snowy Hydro which suggest that the risks identified are overstated as is the threat to Victorian supply.

If you wish to discuss any aspect of this submission, please contact Ben Skinner on 03 8628 1280.

Yours faithfully

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**Attachment to the letter to the AEMC from the “Southern Generators” dated 7<sup>th</sup> September 2006**

**Proposed National Electricity Amendment (Management of negative settlement residues by re-orientation) Rule 2006 and draft National Electricity Amendment (Management of negative settlement residues in the Snowy Region) Rule 2006**

The Rule Proponents (known jointly as the Southern Generators) have considered –

- The letter to AEMC from NEMMCO dated 5 September 2006,
- The Letter to AEMC from Snowy Hydro dated 5<sup>th</sup> September 2006, and
- The available material from the Snowy Hydro presentation to AEMC on 5<sup>th</sup> September.

We wish to comment on several of the matters raised.

Considering first the letter from NEMMCO, we are generally in agreement with the views put. Given the NEMMCO role in system security and their role as market operator, it is to be expected that they need to be conservative in their assessment and neutral in their language. We therefore take the view that NEMMCO has gone as far as could be expected in dismissing the concerns raised by Snowy Hydro.

We see the core of the Snowy Hydro argument as their claim that they would operate the Geehi storage at low levels, even if Victorian supply reliability was under threat and hence they had an expectation of market opportunities. They are also, by implication, claiming that they would operate this way regardless of weather conditions, rather than in response to a credible chance of rain.

We have considered the data presented by Snowy Hydro and we do not believe it supports their proposition that this purported policy is a rational commercial strategy for Snowy.

Their argument relies on the coincidence of two low probability events, congestion of the Snowy intra-regional constraint with northward flow, and high inflows to Geehi reservoir making Murray generation necessary to avoid spill.

**Snowy network congestion**

On page 55 of your commission’s draft rule determination the incidence of congestion of northward flow is shown as ranging from 5 to 15 hours per month. We note as a matter of practical system operation that these hours will not be contiguous, but rather occur on several days for up to a few hours (generally less than 5) on any day.

In addition to this low incidence, we also note that the circumstances that lead to such congestion do not generally occur without warning, and hence the possible incidence of such congestion can be seen and action taken by participants, including Snowy Hydro, to avoid its consequences.

We also note that congestion on these Snowy lines will not occur without some Snowy energy input at Murray, because the northward flow from Victoria is limited to about 1100 MW, while 1300 MW is required to constrain the intra-regional limit.

### **Snowy forced generation**

Snowy Hydro have emphasised the extreme inflow condition of 3.9 GL in a single day.

This needs to be put in the context of the ability of the Murray stations to utilise such inflows.

At full output the Murray stations use 3.9 GL in less than 5 hours.

If Murray generation was limited to 200 MW (ie 1300 less 1100) to avoid congestion for 5 hours (an extreme case) and were similarly limited to an average of 600 MW over the remainder of its run time, the 3.9 GL inflow for 24 hours would be used in only 11 hours.

We also note that Snowy Hydro has another alternative for managing Geehi inflows that they have not disclosed in their submission. This is the diversion of Geehi inflows to Jindabyne. This involves some cost to Snowy in later pumping the water back to Geehi, but allows this to be done at a time when the net value of the water in generation, after pumping costs, is high.

Of the 3.9 GL per day quoted by Snowy Hydro, up to about half could be managed in this way.

This would significantly reduce the need for forced generation at the time of the inflows, below the amount assumed in our analysis above.

We also note that the normal storage level range quoted by Snowy Hydro, of 60% to 80 % already allows for the short term storage of all, or at least a major part of the 3.9 GL extreme day inflow postulated, hence raising further questions about the need for the strategy threatened by Snowy Hydro.

### **We conclude**

On the basis of information from AEMC and Snowy Hydro, we conclude that in the unlikely event of high Geehi inflows coinciding with a market need for high northerly flows through Snowy, Snowy Hydro could, with a little foresight, manage their forced generation to avoid network congestion

We therefore believe that Snowy Hydro's commercial interest will be served by holding their normal water level in Geehi when Victorian supply reliability is under threat, rather than making good their threat of low storage levels to prepare for this very unlikely coincidence. Furthermore, on the basis of their information, we believe that they could manage such an unlikely coincidence even if it occurred.

### **Purported effect on customers**

In their 8<sup>th</sup> slide, Snowy Hydro attribute "loss to customer" amounts to the proposal under consideration. We believe these claims to be wildly inaccurate and unjustified.

We note that –

- If Snowy Hydro's interpretation of changes in hedge market movement were correct, an increase in the Victorian price and a reduction in the NSW price

would be expected. In fact both prices rose indicating that other explanations underlie the observed changes,

- The prices at the Victorian and NSW regional reference nodes show convergence, as should be expected in a functioning national market, and
- The volumes used to define the “loss” are not stated, and the volumes implied by Snowy Hydro’s numbers are wildly in excess of any likely traded volumes in Victoria for the period depicted. Mark-to-market numbers are purely accounting numbers and not, by their nature, associated with loss to customers.

In any event these movements to the forward curve could be attributed to a number of factors such as recent strong underlying pool prices, forecasts by the Bureau of Meteorology of an el nino effect, the prevailing drought in Tasmania, and recent high spot gas prices. Markets move up and down, there is no guarantee that the current increase will remain.

### **Snowy’s “discussion on problem”**

The second slide used by Snowy Hydro sets out four points under a heading of “discussion on problem”. We will repeat these points below and respond briefly to each.

#### **Ø LYMMCO’s (Southern Generator’s) proposal removes 1200 MW of Murray Generation**

Our proposal does not limit the use of the full 1500 MW (approx.) of Murray generation in the market. Even if, evidently contrary to their own interests, Snowy held low levels in Geehi, most of this generation would remain available for brief periods and can thus support peak loads.

#### **Ø Problem has been significantly worsened by Eucumbene storage level**

We appreciate that the drought will limit Snowy Hydro’s participation in the energy market. However, their ability to derive revenue from brief periods of high value is not greatly impacted.

We do not accept that distorting the market pricing in their favour would form an appropriate method of financial support to compensate for the drought.

#### **Ø Summer reliability threat has only crystallised at end of August**

We appreciate that the deficit of actual inflows below expected inflows has emerged gradually over time. However, the evidence from Snowy does not support the view that this is a material threat to reliability of supply.

Our view in this is supported by the letter from NEMMCO.

#### **Ø NEMMCO is not practically able to manage the risk**

We believe that NEMMCO’s letter indicates that they can manage the risks portrayed by Snowy Hydro. We support the NEMMCO view in this.