18 May 2017

John Pierce
Chairman
Australian Energy Market Commission (AEMC)
PO Box A2449
SYDNEY SOUTH NSW 1235

By online submission

Dear Mr Pierce

Five minute settlement rule change – Directions Paper (ERC0201)

Hydro Tasmania appreciates the opportunity to provide comment on the AEMC's Directions Paper for the proposed five minute settlement rule change.

Hydro Tasmania is of the strong opinion that, in accordance with the National Electricity Objective, the case to justify the proposed rule change has not been adequately made. Hydro Tasmania strongly believes that the five minute rule change should not proceed due to the serious issues and risks that it creates for technical and market design aspects as follows:

- The 30 minute trading interval basis is fundamental and embedded in all aspects of the market[1]. A move to a smaller resolution than the existing 30 minute Trading Interval increases volatility and minimises generators' ability to physically deliver energy to react. This will cause a breakdown between the physical dispatch delivery response and financial interdependency of the market.
- The proposed rule will undermine power system security through limiting the incentives for some synchronous generators, that cannot respond within a five minute period, to respond to price 'spikes' at all. The reduction in incentives is likely to result in generators withdrawing supply, which will be a negative outcome for the market at a time when concerted efforts are being made to address system security and reliability.
- As the Energy Edge analysis illustrates, five minute settlement would likely result in cap contract liquidity being materially reduced; this is a consequence of existing generators having a limited ability to physically back contracts under five minute settlement.
    - Hydro Tasmania is highly concerned with this potential outcome as contract liquidity is already a significant issue in the National Electricity Market (NEM), which has been exacerbated by recent generator closures.
    - Any further reduction in liquidity will be extremely detrimental to the competitive functioning of the market particularly for second tier retailers.
    - Hydro Tasmania believes that a change to a five minute settlement will destroy the ability of some generators to supply and deliver against cap

[1] This includes market aspects such as systems, contracts, settlements, finance & risk functions, dispatch, analysis, optimisation and performance

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contracts resulting in a serious loss of efficiency for hedging within the market.

- The proposed rule would have impacts on many long term contracts and agreements, affecting both derivative contracts and off-market contracts and agreements. Close consideration needs to be given to financial arrangements that have already been entered into that make reference to 'Trading Intervals' within the NEM. A move to five minute settlement would be extremely disruptive for these contracts which would have a material financial impact for participants to such agreements.

- The issue of spot market price volatility introduced by generator behaviour was raised as an original justification for the proposed rule change. It should be noted that much of this concern has been addressed by other mechanisms, including in particular the change to the good faith rebidding provisions. The rule change proposal, however, does not appear to adequately consider that the introduction of a change to the settlement period to 5 minutes, along with the increase in new technologies, may itself change spot market price volatility. With a 5 minute settlement period and potential new entrant technologies with fast response times, but with potentially little visibility to the market, it will be more difficult for market participants with traditional technologies to plan and operate efficiently. This could, along with regulatory uncertainty, continue to exacerbate investment uncertainty in generation supply when it is most needed.

- There would be significant costs and risks associated with updating systems (primarily settlement and metering systems) to handle the rule change. While once-off in nature, it will be a material cost. The need to update systems for all participants would also raise material implementation risks. This would be factored into consumer pricing; this needs to be clearly understood and compared against other perceived consumer benefits.

Hydro Tasmania recognises that the AEMC is considering this rule change at a time of significant transition in the electricity sector with the challenges of a transforming market and of reducing sectoral emissions. While Hydro Tasmania supports approaches to increase the penetration of low and zero emission technologies, we believe that the costs and uncertainties of this rule change will materially exceed the perceived benefits. This rule change will cause a breakdown between the physical dispatch delivery response and financial interdependency of the market. To this extent, Hydro Tasmania believes that the existing 30 minute settlement period is a fundamental basis for all wholesale market participants and must not be changed.

Hydro Tasmania is open to discuss the issues outlined in our submission with the Commission. Please contact John Cooper if you have any questions or would like to discuss further (john.cooper@hydro.com.au) (03) 6230 5313)

Yours sincerely

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