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ERARING ENERGY VIEWS ON SNOWY BOUNDARY CHANGE ISSUES CURRENTLY UNDER CONSULTATION

Eraring Energy wishes to thank the AEMC for the opportunity to comment on three separate but related consultation papers on Snowy region boundary issues. These three papers are :

- Draft Determination on Abolition of Snowy Region (AEMC)
- Congestion Pricing and Negative Residue Management Arrangements for the Snowy Region (Southern Generators)
- Split Snowy Region (Macquarie Generation)

Eraring Energy believes that the Split Snowy Region proposal (Split Region Option) gives the best solution to address the issues in the Snowy region and does not support any other solution.

Eraring Energy noted that significant analysis on the Split Region option has been carried out by the AEMC in preparation of the draft determination. According to the draft determination, the Split Region proposal would deliver higher economic efficiency, correct pricing outcomes for Murray/Tumut generation and production cost savings. More importantly, Eraring Energy concludes that the Split Region option would deliver a better inter-regional contracting regime.

On the basis of the facts in the draft determination, Eraring Energy believes that Split Region option is superior to the abolition of Snowy region.

The rule change proposed by Southern Generators to continue the existing Congestion Pricing and Negative Residue Management Arrangements is not preferred. Eraring Energy understands that the existing arrangements are temporary measures until a suitable boundary change is implemented.

Eraring Energy believes that a boundary change is absolutely necessary to address the issues in the Snowy region.

The attached submission outlines the reasons behind Eraring Energy's conclusion.

If you have further questions on any matters raised in this submission, please contact Mr Methsiri Aratchige on 02 8268 4235.



Peter Jackson
Managing Director
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Attachment

Eraring Energy have interpreted the analysis as outlined in the AEMC draft rule determination and believes that the Split Region option is the "best option" for number of decision criterion used by the AEMC.

1. Economic Efficiency of Dispatch

The AEMC have concluded that compared to the Business As Usual case, the Snowy Hydro proposal should enable more free-flowing interconnection and support more competitive bidding strategies across the NEM, leading to more efficient dispatch¹.

However, the AEMC does not explicitly state that it is better than the Split Region Option. Eraring Energy does not believe that the AEMC has demonstrated that the Snowy Hydro proposal is a better option than the Split Region Option in relation to the economic efficiency of dispatch.

Eraring Energy believes that the Split Region Option would achieve better economic efficiency than the Snowy Hydro proposal in the following areas.

1.1 Correct Pricing Outcomes

According to the Split Region Option, both Murray and Tumut generation would be exposed to their shadow nodal prices. As such, it is clear that both Murray and Tumut generation would be exposed to "correct" pricing under the Split Region Option whereas the Snowy Hydro proposal would undermine this correct pricing outcome.

Eraring Energy believes the Split Region Option would produce more economically efficient pricing outcomes for both Murray and Tumut generators than the Snowy Hydro proposal.

1.2 Maintaining Headroom and Bidding below cost

Maintaining headroom (or economic withholding) and bidding below costs are detrimental to economic efficiency. Under certain circumstances, Snowy has an incentive to adopt either one or both of the above strategies.

With the Snowy Hydro proposal, it is less likely that Snowy would maintain headroom when the Murray -Tumut cutset is binding in the northward direction. However, Snowy can also bid below cost under certain circumstances as Snowy is not exposed to its nodal shadow prices under the Snowy Hydro proposal. Therefore, total reduction in economic efficiency would be based on both of the above activities under many scenarios.

It is Eraring Energy's view that the AEMC have given more weight to the maintaining headroom issue than the bidding below cost issue. However, there is no detailed analysis in the draft determination to ascertain that

¹ Page 47, Section 5.1.4 of Draft Rule Determination

maintaining head room is any more detrimental than bidding below cost in relation to economic efficiency.

Eraring Energy does not believe that it has been demonstrated that the Snowy Hydro proposal is the best option in this regard.

1.3 Production Cost Savings

Quantitative modelling has been performed by the AEMC to estimate the cost savings from the Split Region Option and the Snowy Hydro proposal compared with the Business As Usual case. The following table summarises the difference in cost savings using the Split Region Option and the Snowy Hydro proposal².

Financial Year	Cost Savings using Split Region Option LESS Cost Savings using Snowy Hydro proposal	
	Contract Low	Contract High
2007/08	-\$0.07m	\$1.39m
2008/09	\$1.01m	\$1.61m
2009/10	-\$0.16m	-\$0.36m
Total	+\$0.78m	+\$2.64m

According to the above table, the Split Region option would give greater cost savings over the three years in both the contract low and contract high scenarios.

Eraring Energy believes that the Split Region Option is more effective in achieving production cost savings than the Snowy Hydro proposal.

2. Inter-regional Contracting

The AEMC have concluded that the Snowy Hydro proposal is likely to lead to a material reduction in the risk of inter-regional contracting in the NEM compared to the Business As Usual case³.

However, the AEMC have not explicitly stated that it is better than the Split Region Option. Eraring Energy does not believe that the AEMC has demonstrated that the Snowy Hydro proposal is a better option than the Split Region Option in relation to inter-regional contracting issues.

Eraring Energy believes that the Split Region Option is superior to the Snowy Hydro proposal in addressing inter-regional contracting issues based on the issues outlined below.

2.1 Rationale for Inter-regional Contracting

Inter-regional contracting is undertaken by a variety of participants and occurs for a variety of reasons, namely:

² Figure A.7 of Appendix 1 in the AEMC Draft Rule Determination

³ Page 61, section 5.3.4, Draft Rule Determination

- Traders taking a view on the spot price outcomes of a particular region, either in isolation or in relation to other regions
- Traders taking a view on the contract market developments in a particular region, either in isolation or in relation to other regions
- Participants hedging exposures in a particular region

Any changes to regions/boundaries will affect participant's views on both contract market and spot price outcomes and on the effectiveness or otherwise of instruments used to effect trading or hedging strategies.

This will affect the pricing of instruments and the types of instruments used, but will not necessarily restrict the level of inter-regional contracting and may indeed enhance the level of inter-regional contracting for reasons outlined below.

2.2 Negative Settlement Residues

Negative settlement residues naturally reduce the firmness of Settlements Residue Auction (SRA) units which are commonly used as a risk management instrument for hedging inter-regional risk. Therefore, lower negative residues would enhance the effectiveness of SRA units and thus reduce inter-regional risk.

Negative residues are a by-product of counter priced flows. According to the conceptual analysis undertaken by the AEMC, both the Snowy Hydro proposal and the Split Region Option may result in counter priced flows. However, it appears that there is less likelihood of counter priced flows in the Split Region Option.

Eraring Energy believes that the Split Region option is superior to the Snowy Hydro proposal in terms of reducing the likelihood of negative settlements residues occurring.

2.3 Inter-regional Price Separation

The analysis undertaken by the AEMC shows that the Split Region option results in significantly lower levels of inter-regional price separation between NSW and Vic compared to the Snowy Hydro proposal⁴.

Eraring Energy believes that the Split Region Option is superior to the Snowy Hydro proposal in reducing overall levels and instances of inter-regional price separation leading to a reduction of risk from inter-regional contracting.

2.4 Trading over number of regions

One of the major arguments put forward by the AEMC is that contracting across a number of regions would lead to increased complexities, reduction of liquidity, higher transaction costs and higher execution risks of acquiring multiple sets of SRA units.

⁴ Page 60, figure 5.15, Draft Rule Determination

Eraring Energy manages a significant amount of sold Victorian contracts inherited from Pacific Power. As such, Eraring Energy has a significant amount of experience with inter-regional contracting activities. It is Eraring's experience that inter-regional contracting over multiple regions is manageable as long as suitable mechanisms such as linked bidding facilities in Settlements Residue Auctions are available.

In practice, hedging inter-regional exposures under any of the proposals analysed or indeed Business As Usual is a complex, uncertain science. The complexity and uncertainty is driven by many factors including:

- market dispatch dynamics
- market participant bidding behaviour
- contract trading sentiment
- other externalities (eg bushfires, drought etc)

Under Business As Usual case, inter-regional contracting can be affected in one of two major ways. One is the direct buying from or the selling into, the region concerned and the second one is using SRA units between the regions.

For example, if a NSW participant wants a hedge in Victoria, the NSW participant could purchase a contract directly from a Victorian generator. Regardless of the number of regions in between, the ability to sell by the Victorian generator does not change. The risk that the Victorian generator is exposed to is the same.

In terms of purchasing SRA units, participants can already bid for multiple links at one time. For example, if a participant wants a hedge between QLD and SA, the participant is able to submit one bid for all 4 links (i.e. QLD to NSW, NSW to Snowy, Snowy to Vic and Vic to SA). This SRA bidding facility was introduced primarily to enhance inter-regional trading. Therefore, there should not be additional transaction risks in acquiring SRA units to hedge inter-regional exposures under any of the proposals as compared to the Business As Usual case.

Eraring Energy does not believe that the AEMC has demonstrated that the Snowy Hydro proposal is a better option than the Split Region Option in relation to the ability to contract over multiple regions and does not agree with the AEMC's view that trading across a larger number of regions is more difficult than trading across a smaller number of regions⁵.

2.5 Transparency of Information

It is considered extremely important and an essential feature of a well functioning market that there is full and equitable information flows available to all market participants.

⁵ Page 61, Draft Rule Determination

Under Business As Usual case, information about power flows/limitations across the Tumut-Murray transmission cutset is opaque to the majority of the market and is tightly held by Snowy Hydro.

Under the Snowy Hydro proposal, information about prices and power flows/limitations across the Tumut-Murray transmission cutset would be much more transparent as it would be an explicit interconnector.

However, this benefit would be negated by the reduction in information about prices and power flows/limitations across the existing Snowy/Victoria and Snowy/NSW interconnectors as compared to the Business As Usual case.

Under the Split Region option, the information about prices and power flows/limitations across all of these three transmission cutsets would be much more transparent.

The increased data and transparency of the Split Region option will lead to better pricing and risk management for inter-regional trading between the NSW and Victorian nodes.

3. Abolition of existing boundaries Vs Robustness

The incident that occurred on 16 January 2007 in Victoria highlights the importance of a boundary south of Murray. On that day, if Murray were in the Victorian region as proposed in the Snowy Hydro proposal, Murray would have received VoLL prices without supplying the Victorian customers who did not have sufficient supply. This incident reinforces the requirement of a regional boundary south of Murray.

There is no guarantee that transmission cutsets belong to the existing boundaries (NSW/Snowy and Snowy/Vic) will not be constrained for significant periods in future. In that case, if the Snowy proposal is adopted then there is a possibility that those boundaries would need to be re-introduced. This would certainly be an unnecessary market disruption.

Eraring Energy raises the issue of robustness and validity of the abolition of the existing boundaries.

5. Restrictions on Snowy Hydro procurement of SRA units

Eraring Energy agrees with the AEMC's view that the existing restrictions on Snowy Hydro would need to continue with the new boundary structure if the Snowy Hydro proposal were to be implemented. Snowy Hydro should not be entitled to purchase any units in the proposed NSW/Victoria interconnector in either direction.

6. Conclusion

Eraring Energy believes that the AEMC has not demonstrated that the Snowy Hydro proposal is a better option than the Split Region Option in relation to many of the key decision criteria used by the AEMC. Instead, Eraring Energy believes that the facts in the draft determination favour the Split Region proposal.

Therefore, Eraring Energy recommends that Split Snowy Region proposal should be implemented without continuing existing band-aids such as constraint support payment mechanisms.