Hydro Tasmania

17 October 2017

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

Dear Mr Pierce

Five Minute Settlement - Draft Determination (ERC0201)

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

Hydro Tasmania strongly opposes the proposed rule change as there is no evidence that it meets the National Electricity Objective. It is clear that a comprehensive cost benefit analysis providing justification for the rule change has not been undertaken.

Hydro Tasmania does not consider that such a significant and fundamental rule change should be made without there being a detailed cost benefit assessment that clearly demonstrates the rule change will provide net benefits for consumers. It is clear, from various sources including AEMC's own analysis, that the costs to customers from the proposed rule change will increase1, from:

- Very high costs of implementing this rule change across the market
- Increase in cap prices
- Increase in ancillary services costs
- Increase in system support payments
- Increase in costs from generators running inefficiently
- Increase in costs due to unexpected market disruption

There is no clear evidence presented of the benefits of this proposed rule change. The AEMC's acknowledgement2 that there is lack of clarity in how the market would respond to five minute settlement (used as the basis for why a cost benefit analysis was not carried out) is in itself a clear indication of the need to better understand market impacts before proceeding.

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[1] Section 4.2.2 - http://www.aemc.gov.au/getattachment/0eb01d4d-2c31-4f53-a32a-77d36726cb18/Draft-determination.aspx
[2] Section 7.3.1 - http://www.aemc.gov.au/getattachment/0eb01d4d-2c31-4f53-a32a-77d36726cb18/Draft-determination.aspx

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Hydro Tasmania notes that there are several reviews and rule change proposals currently being considered by the AEMC:

- The *Reliability Frameworks Review* is assessing the suitability of market mechanisms such as a Generator Reliability Obligation and Day-ahead Markets. The details of these mechanisms are largely unknown. Committing to a five-minute settlement prior to thorough consideration of these mechanisms may result in sub-optimal outcomes for the NEM.
- The *Inertia Ancillary Service Market* rule change is currently under review. The outcome of this proposed rule change process will have significant implications for the financial viability of existing and proposed generators. Hydro Tasmania believes the implementation of the five-minute settlement rule should not be progressed until the impacts of inertia ancillary services market are well understood.
- The *Frequency Control Frameworks Review* is also currently under review.

Recommendations made through the Finkel Review will likely address several issues used as rationale for this rule change. Deliberation of five minute settlements should be considered in the context of all these integrated market reforms.

As discussed in previous submissions we believe there could be a material negative impact on the market from the following affects:

- The issue of spot market price volatility introduced by generator behaviour was raised as an original justification for the proposed rule change. As noted in the draft determination, the good faith bidding provisions have played a significant role in minimising perceived generator instigated price volatility. This has been a valuable addition to current market arrangements. Additional revisions to rebidding processes could reduce price volatility without causing significant adverse impacts upon market participants and consumers. Hydro Tasmania encourages the AEMC to consider lower cost and less complex (lower risk) alternatives to address spot market price volatility in preference to implementing the proposed rule.
- Cap contracts play an integral role in the operation of the National Electricity Market (NEM). Independent analysis[3] forecast that five minute settlement would likely result in cap contract liquidity being materially reduced as a result of existing generators having a limited ability to physically back contracts under five minute settlement. An inability to respond to market fluctuations will likely impact the financial viability of some generators, which may see retirement of plant prior to the end of their economic life. This would cause a greater shortfall in capacity than that expected, increased FCAS requirements thus increasing the need for investment in new flexible, dispatchable generation.
- As noted in the draft determination, incumbent generators are expected to reduce their cap contract commitments due to an inability to 'defend' cap contracts under five minute settlements. To mitigate risk under future and existing cap contracts, generators may need

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[3] Analysis provided by Energy Edge, Seed Advisory and Marsden Jacobs.

to operate assets inefficiently to allow response to market fluctuations. This inefficient operation and the increased use and cost of inputs will be factored into all pricing aspects of the NEM and could result in higher prices for consumers.

- Hydro Tasmania is concerned that the forecast reduction in cap contracts will have a detrimental impact to the competitive functioning of the market. This would be expected to disproportionately impact second-tier retailers, who will be limited in their ability to back retail contracts and provide low-cost services to consumers.
- Hydro Tasmania believes that there is insufficient evidence that system support payments will adequately incentivise the sustained operation of existing peaking generators, or the development of new peaking generation in the NEM. If the incentives are insufficient, existing generators, or proposed developments, may become financially unviable and will likely withdraw from the market. Conversely, if system support payments are considered sufficient, this will likely come at significant cost to customers. Hydro Tasmania believes it would be ill-timed to implement the proposed rule change until the incentives of system support payments are visible to existing and prospective market participants.

Hydro Tasmania does not support implementing the proposed rule change until the uncertainties regarding market risks and benefits are adequately quantified across the entire NEM. Delaying implementation of five minute settlements will allow greater consideration of potential alternatives to achieve the objectives that the proposed rule is seeking to address. Further, this will allow the proposed rule to be thoroughly considered in the context of the current market reforms and processes.

To this extent, Hydro Tasmania believes that the existing 30 minute settlement period should not be changed, and a more prudent approach would be to establish a monitoring regime to assess the future suitability of conditions for five minute settlement.

Hydro Tasmania is open to discuss the issues outlined in our submission with the Commission. Please contact Prajit Parameswar if you have any questions or would like to discuss further (Prajit.parameswar@hydro.com.au (03) 6230 5612)

Yours sincerely

Gerard Flack

Director Wholesale Energy Services