NATIONAL GENERATORS FORUM

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Chairman
Australian Energy Markets Commission
PO Box A2449
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Dear Dr Tamblyn

Proposal of a National Electricity Rule: "Physical Market Cap Trigger"

Please find enclosed a formal proposal by the National Generators Forum (NGF) for the making of a new National Electricity Rule. This Rule Change proposal is consistent with the Commission's guidelines. The NGF is not seeking a "fast track" process on this occasion.

Snowy Hydro and Tasmania Hydro advise that, for their own reasons, they do not support this proposal from the NGF.

The NGF was motivated to develop this rule change following discussions of the impacts of the Victorian power disruption of 16 January 2007 and similar events. These discussions have included NEMMCO and the AER, whom we support in their related efforts to improve market operation. Activities those organisations have undertaken include:

- Improving the process of reclassification of credible contingency events, including a rule change proposed by the AER and presently under consultation. This is intended to reduce the probability of such disruptions.
- A rule change proposal by the AER to alter the rules regarding the application of VoLL also presently under consultation. This is intended to simplify market pricing during a major disruption.
- A proposal by NEMMCO before the Reliability Panel to alter frequency standards during supply scarcity. This is intended to speed the restoration of customer supply following a major disruption.

Whilst these proposals may improve power system operation, the NGF recognises that power system disruptions that take the market outside its normal operating envelope will occur from time to time and they will still result in major market pricing and dispatch impacts. Our research into these events has shown that large wealth transfers can occur in very short periods and are essentially random. Generators, both winners and losers from these events, have neither caused nor had the capacity to mitigate the disruption. In our view these wealth transfers are not efficient and result in increased market participation risk.

This rule change does not represent the first time that a market risk mitigation mechanism triggered by a physical event has been postulated. At market start a force majeure concept existed, but this was excised by the Code Administrator as they were unable to define unambiguous and transparent triggers. A Cumulative Price Threshold (CPT) was created where risk mitigation is triggered by high prices, regardless of their cause. The CPT is set at an appropriately high level, equivalent to 7.5 hours of VoLL within a week. The NGF understands and supports the CPT concept, but notes that considerable wealth transfer can occur in the time between a major market disruption and the CPT trigger.

This proposal intends to limit that wealth transfer prior to the application of the CPT in particular defined circumstances. The NGF does not propose any changes to the CPT, and sees that mechanism continuing to set the extreme upper limit to market risk in the presence of our new mechanism, and covering circumstances not intended to be covered in this proposal.

The NGF considered at length the challenges in identifying a clear and appropriate physical trigger for a risk mitigation mechanism. From those discussions a concept emerged that had not previously been proposed: using the concept of a "Non-credible contingency event". This has immediate attractions:

- Such concepts are already defined in the rules and already trigger certain actions;
- These concepts are also used and understood in power system engineering;
- The events occur rarely, yet all power system disruptions in NEM history that have lead to large wealth transfers have experienced such an event in their initial moments;
- In an engineering context, the concepts are defined as a guide to planners as to what contingencies an efficient power system should be designed to withstand versus what should be ignored. It is therefore reasonable to conclude that wealth transfers associated with events in the latter category are not an essential feature of an efficient power system.

Contingency events can occur within transmission networks and within generators. The NGF was concerned that a risk mitigation mechanism that was triggered by an event caused by and contained wholly within a power station may be seen to reduce incentives to invest in generator reliability. These events have been excepted from the trigger.

To activate the mechanism, a material change to dispatch caused by the contingency must have also occurred. The mechanism itself is of the form of a price cap, modelled on the existing Administered Price Cap (APC). The mechanism concludes upon the conclusion of the material change to dispatch or 24 hours, whichever comes first.

A degree of operational decision making will unavoidably be required by the market operator to trigger and conclude this mechanism. We have therefore proposed that NEMMCO be required to develop and consult upon procedures that will minimise any judgement or arbitrariness.

The rule drafting to implement a new mechanism of this form is necessarily complex. We have conducted considerable due diligence upon the drafting and have attempted to fully explain it in the descriptive material. Nevertheless unexpected issues and confusions may arise and we would hope that the Commission's rule change process can constructively identify and deal with any such issues. The NGF is keen to clarify any details to your Commission and work through any issues that arise.

Finally, the NGF gratefully acknowledges the assistance of NEMMCO and AER staff in developing the concept and perusing the format of the proposed rules, and of Creative Energy Consulting for managing the preparation of this rule change.

For discussion please call me on (02) 6243 5120.

Yours sincerely,

John Boshier
Executive Director