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ERC0282 consultation paper – Application of compensation in relation to AEMO interventions

AGL Energy (**AGL**) welcomes the opportunity to comment on the Australian Energy Market Commission's (**AEMC**) consultation on the application of compensation in relation to Australian Energy Market Operator (**AEMO**) interventions.

AGL is one of Australia's leading integrated energy companies and the largest ASX listed owner, operator and developer of renewable generation. Our diverse power generation portfolio includes base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources. AGL is also a significant retailer of energy and provides energy solutions to over 3.6 million customers in New South Wales, Victoria, Queensland, Western Australia and South Australia.

The AEMC is consulting on a proposal from AEMO to establish that affected participants are only eligible for compensation in connection with intervention events that trigger intervention pricing under the revised "regional reference node test" (**RRN test**). This proposal is intended to complement the AEMC's draft rule determination (**ERC0253**) to remove intervention pricing where the reason for the intervention is to obtain a service where a dispatch price is not currently set through the National Electricity Market (**NEM**) dispatch process.

AGL supports the need for a robust intervention framework to minimise the impact of intervention events on market signals and outcomes, particularly to end consumers. However, as stated in our submission to ERC0253 we fundamentally disagree with the conclusions reached by the AEMC in that process, and therefore do not support the current proposal from AEMO. We have considered several elements discussed in Chapter 2 of the consultation paper.

2.2 When should affected participant compensation be paid?

The AEMC refers to South Australia as an example where certain combinations of synchronous generators must be online in order to maintain minimum levels of system strength. The AEMC explains that as the NEM dispatch engine (**NEMDE**) cannot formulate these combinations as a constraint, AEMO issues directions to achieve the necessary generation mix. The AEMC notes that no compensation would be payable when participants' dispatch targets change because of constraints being imposed by NEMDE and queries why participants affected by intervention events are treated differently to participants affected by constraints under the normal dispatch of the system.

This question was raised and answered in the Intervention Pricing Working Group (**IPWG**). The IPWG's view was that when an AEMO direction, meeting the RRN test, injects energy into the market resulting in a distortion of price then compensation should be paid to affected participants. This directed energy often



occurs when demand is low and wind output is high, resulting in low energy prices, which are typically below the operating costs of gas-powered generators.

The directions scenario is quite different to that of participants with a commercial incentive to remain online, reacting to targets affected by physical network constraints in a market, rather than a market distorted through the addition of energy directed on by AEMO. We note that AEMO can control the effect/quantum of the market distortion by the generation configuration it chooses to direct to manage system strength.

In our view, the AEMC's query is both circular and problematic. It is not the potential complexity of a constraint that results in the AEMO requirement to direct. It is that generators have responded to market signals in accordance with market design and are not available to be constrained on by the dispatch process. The AEMC has focused on AEMO's "choice of tool" but ignored the ability of market participants to respond to the tool used by AEMO, i.e. constraints or directions.

To support its position, the AEMC refers to an example where no compensation was payable to a participant who was directed to reduce output in order to restore the power system to a secure state. The AEMC links this to the appropriateness of compensating affected participants who are constrained due to NEMDE optimisation following a direction.

We consider that the Mortlake direction example used by the AEMC demonstrates that there is no need for AEMO's proposed rule to be made at all. In the example, the direction did not meet the RRN test and therefore intervention pricing was not applied. This outcome would be enshrined in the National Electricity Rules should ERC0253 be finalised in accordance with the AEMC draft determination.

AGL has been unable to come up with a scenario where affected participants would receive compensation when intervention pricing did not apply. We would appreciate the AEMC or AEMO pointing to an example of this if it has occurred. In the absence of any such occurrence, we query whether this rule proposal meets the National Electricity Objective in terms of costs to consumers.

Further to this, to AGL's knowledge, AEMO has never suggested that a second set of counterfactual targets was required when the RRN test was not satisfied and intervention pricing not triggered. AGL supports the view that counterfactual targets are not required when intervention pricing is not triggered.

2.4 Commission's views in the final report and related draft determinations

The AEMC refers to its draft determination for the RRN test rule change request, where it determined that intervention pricing should only apply in circumstances where the intervention is to obtain a service that is traded in the market. In the AEMC's words, intervention pricing should apply where "there is a relevant price signal to preserve." Our submission to ERC0253 details AGL's disagreement with this view.

AGL's view diverges from the AEMC's in considering where market distortion lies. AGL considers that the intervention pricing run applied when AEMO issues a direction, corrects the distortion caused by the directed units' place in the bid stack. The AEMC takes the view that applying intervention pricing in such instances causes distortion by providing false investment signals for energy, when it is not energy that the market needs.

In short, our view is the intervention price is a more accurate representation of the energy price. The intervention price reflects fundamental supply and demand rather than the price distorted by the minimum generation operations of directed power stations.



In South Australia, the quantum of the market distortion caused by AEMO directions has been significant. In September 2019, directed participant energy was as high as 36 per cent of South Australian regional demand. This amount of energy being pushed out of the bid stack through AEMO intervention is simply too large to be ignored. The directed generation cannot simply be discounted through a minimising term such as “by-product”.

In our view we consider that the AEMC’s attempted simplification of its proposed intervention reforms do not capture what the proposed reforms are likely to do to the NEM in terms of distorted outcomes.

2.4.2 Infeasible dispatch targets

The AEMC has considered the operational rationality of NEMDE’s intervention pricing run and determined that the counterfactual represents an infeasible situation that would not play out given AEMO’s system security obligations. Accordingly, the AEMC does not consider that prices received by participants should be determined on this infeasible basis.

AGL agrees that the dispatch targets in the intervention pricing run would operationally risk system security, however the economic rationale behind the counterfactual must be considered alongside the operational result. The provision of one non-traded, directed service should not distort the market price signal of the primary traded service, energy or frequency control ancillary services (**FCAS**).

The term “infeasible” is potentially misleading as there are examples where the system has been in an unsecure state, including significant periods prior to system strength analysis, and no AEMO reports through such periods have ever described the dispatch targets in those cases as “infeasible”.

2.4.3 Ability to optimise affected participant compensation

The AEMC has determined that participants are able to optimise the amount of affected participant compensation they receive because the intervention pricing run is a dynamic process which produces notional dispatch targets every five minutes and is available to the market.

AGL would welcome analysis that shows that participants have actively optimised affected participant compensation through rebidding activities. Whilst intervention prices are published every five minutes, generators are unlikely to know whether they will be eligible for compensation in most cases until after the trading interval has concluded due to the \$5 000 threshold per trading interval.

Further, other provisions of the National Electricity Rules are directly targeted at bidding behaviour, to ensure participants have a genuine intention to honour bids, offers, and rebids. All industry participants would expect that concerns regarding market manipulation would be dealt with under this existing framework.

In conclusion we reiterate the position in our response to ERC0253 that the current rule proposal along with the AEMC’s related draft determinations represent the strict application of theoretical economic principles resulting in adverse market outcomes.

The AEMC is attempting to address short term price concerns without addressing or considering the underlying issue that certain increasingly scarce services are not “valued” under current market arrangements. The ongoing delay in the AEMC’s review of system strength and other services, along with the AEMC’s decision to excise that review from its consideration of the interventions framework is a disappointing outcome. We urge the AEMC to delay making its final rules on interventions until it has



completed a review of system strength and other services and consulted on those review findings with stakeholders.

Looking to the longer term, we must all consider the interplay of current market reforms with the proposed Coordination of Generation and Transmission Infrastructure reforms. The AEMC's proposed access model discussion paper acknowledges the importance of system security services, including system strength, and their relationship to transmission reforms. In our view, these same forward-looking links have not been drawn in the present NEM intervention framework review.

If you have any queries about this submission, please contact Liz Gharghori on (03) 8633 6723 or lgharghori@agl.com.au.

Yours sincerely,

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