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Your Ref: ERC0290 & ERC0306
Contact Officer: Chris Ridings
Contact Phone: 08 8213 3487
Date: 22 October 2021

Ms Anna Collyer
Chair - Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Ms Collyer,

Capacity commitment mechanism and synchronous services markets – Directions paper

The Australian Energy Regulator (**AER**) welcomes the opportunity to comment on the Australian Energy Market Commission's (**AEMC**) *Capacity commitment mechanism and synchronous services markets directions paper*. This directions paper aims to further consider options for valuing, procuring, and scheduling essential system services as initially developed by the Energy Security Board (**ESB**) as part of the Post-2025 Market Design.

As the power system rapidly transitions from one mostly supplied by large, dispatchable synchronous generators to dispersed, variable inverter-based resources (**IBR**) there is a need to unbundle a range of services which have historically been provided as a by-product of synchronous generation. Identifying and valuing these services is required to encourage investment in technologies which can provide these services, and the ability to schedule these resources is required for the Australian Energy Market Operator (**AEMO**) to maintain a secure technical operating envelope.

Defining the need

A key part of reforming existing frameworks requires establishing the need. As part of defining the need for reform, the directions paper states that '*AEMO is increasingly having to make operational decisions, such as directing on generators, to maintain system security*'¹. We note that the vast majority of these directions are in South Australia arising from system strength shortcomings that were identified and addressed through previous system strength reforms. Additionally, similar gaps in other regions have been addressed quickly, and at low cost. The directions paper makes the implicit assumption that these recent reforms will not be sufficient to reduce the frequency or distortionary effect of AEMO directions to maintain system security in other NEM jurisdictions.²

We understand that AEMO undertake a range of deterministic analyses to determine the system configurations under which the power system is stable. However, as it is not always possible to determine the physical characteristics being supplied by individual units as part

¹ AEMC, Capacity commitment mechanism and synchronous services markets – directions paper, p. 31

² AEMC, Efficient management of system strength on the power system,
<https://www.aemc.gov.au/rule-changes/efficient-management-system-strength-power-system>

of this analysis, AEMO conclude that maintaining power system security requires dispatch conditions to fall within a set of pre-determined configurations.

The system services market or procurement framework considered here is proposed to require these configurations to decrease reliance on market interventions (a highly distortionary last resort measure). However, for the reasons above, it is important that the AEMC carefully examines whether there is a need for this procurement framework in the operational timeframe. While this procurement framework could be implemented now to address a future concern, we consider any cost benefit analysis of implementation take into account:

1. The frequency (historical and forecast) of occurrence: how close have self-committed configurations been to the pre-determined minimum configurations, and how is this expected to change in the near future, and;
2. The system security impact of a discrepancy between self-committed configurations and pre-determined minimum configurations: noting the system strength procurement process, establishment of bilateral contracts and the market interventions framework exists as backstops to ensure power system stability.

The AER remains open to the need for a scheduling mechanism (like the UCS) for system services such as system strength. AEMO have progressed a significant amount of work in this regard, such as through the Engineering Framework³. However, we consider that the costs of introducing another backstop mechanism such as a system services market be commensurate with the long-term need.

Unbundling services

We support the recommendations of the ESB that it is important to identify and unbundle the provision of system services from energy. We consider that use of the UCS for scheduling these unbundled services (such as system strength) represents an opportunity to create efficient market signals for investment in the needs of the power system.

We therefore consider that if the UCS is designed to schedule units to meet pre-determined system configurations, it would be highly desirable for this to be accompanied by a review framework to increase transparency to facilitate transitioning to the full unbundling of services. This will ensure the power system is moving toward a technology-neutral approach to meeting requirements. This will also allay concerns around market distortions that could arise from the requirement to have a specific unit directed for services, consistent with the objectives of AEMO's Engineering Framework.

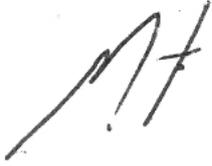
Market power concerns

The procurement of services in the operational timeframe also raises the possibility for persistent abuse of market power by certain generators where a particular unit identifies that it is in the unique position to supply a service. This could emerge when it is the common factor in enabling a pre-determined secure configuration of units. While the publication of certain information is necessary to ensuring that participants make efficient commitment decisions, we consider that the type of information needs to be carefully considered to mitigate potential market power concerns. Market power concerns can be mitigated by the AEMC considering circumstances where information is needed to allow participants to produce price forecasts that helpfully inform bidding behaviour, against other situations where certain information may facilitate anti-competitive bidding.

³ AEMO, Engineering Framework, <https://aemo.com.au/en/initiatives/major-programs/engineering-framework>

We thank the AEMC for the opportunity to submit on this process. If you have any questions about our submission, please contact Chris Ridings on 08 8213 3487.

Yours sincerely,

A handwritten signature in black ink, appearing to be the initials 'MF' with a stylized flourish.

Mark Feather
General Manager, Policy & Performance
Australian Energy Regulator