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Australian Energy Market Commission
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Submitted by email to aemc@aemc.gov.au

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Primary frequency response incentive arrangements

Snowy Hydro Limited welcomes the opportunity to comment on matters raised in the Directions Paper from the Australian Energy Market Commission (the Commission) on Primary frequency response incentive arrangements.

Snowy Hydro welcomes regulatory reforms that support the development to deliver essential system services through appropriate incentives in order to prepare the NEM for the future operating conditions. Instead the market has unfortunately been met with a heavy-handed mandatory primary frequency control rule which was imposed on market participants in order to obtain an outcome that could have improved through an enhanced market.

It is for this reason we remain disappointed that a permanent approach has been adopted in the case of mandatory primary frequency response (PFR) and that the Commission has proposed for it to remain enduring. Mandating PFR is more likely to result in a random effect on frequency performance and has not considered the long term impacts on future investment in PFR. In addition, the increase in the provision of PFR from generators will represent a cost in terms of wear and tear and efficiency with the mandatory proposal increasing the 'workload' on the remaining generators providing this service which in turn encourages these generators to stop providing the service. The suggestion that the generation plant suffers wear and tear due to excessive movement caused by governor response to frequency deviations should not be considered as the only cost on generators, it is only part of the cost that generators are faced with. This will be a cost on industry that will only appear through years of operating under this mandated approach and not in the short term as assessed through the consultant reports.

Reforms to the causer pays process

The Commission's work to improve the allocation of regulation FCAS costs to deliver improved valuation and pricing of plant behavior that impacts on power system Frequency is critical for generators in the short run.

The Directions Paper has attempted to solve the distortion from mandatory PFR. Under a mandatory PFR which requires a tight frequency performance, the plant is required to have to do more work and the proposed payments have considered efficient incentives for this work through the reformed causer pays.

Any proposal that is compared to a market-based arrangement will be inefficient, however the Commission's arrangements in the revised rule that support frequency performance payments transactions refined by investigations and analysis undertaken by IES Consulting are welcome. The approach to maintain the link to the market price for regulation services is sensible as it will simplify the Frequency performance payment transactions, relative to the draft rule

In the long-term, should the Commission seek to continue to promote the efficient operation, use and investment of primary frequency control then there is a clear need for market arrangements to incentivise the provision of sufficient resources required.

The Review of the frequency operating standard 2022 Issues Paper notes that AEMO acknowledges during future operating conditions the level of Primary Frequency Response (PFR)

provided by generating resources under the mandatory arrangements may reduce and that additional arrangements may be required to deliver sufficient levels of frequency responsiveness to control power system frequency. The solution to these problems is not 'more of the same', but rather the creation of a fair value compensation mechanism.

Frequency stability is not simply a technical parameter of generation assets, it is a service and will only be provided by the market if sustainable compensation arrangements exist. The mandatory PFR, will only lead to the market relying on existing capacity with no investment in new technologies to provide PFR or for existing capacity to provide more on that what is required on the current mandatory PFR settings. A diminishing share of the generation fleet will be required to shoulder an increasing burden of frequency stability without adequate compensation. The current arrangements both on mandating PFR and providing double-causer pays are not long term efficient arrangements for the NEM.

If the market is not effectively remunerating providers of primary frequency response through a market and maintaining the sunset date for Mandatory primary frequency response in the future, as initially proposed by market operator, then the right investment will not be in place in the future for the NEM. There is a misled belief that markets can be formed just in time. This is not the case and AEMO and the NEM do not want to rely until existing assets' wear and tear impacts become significant that they are seeking to find more short term fixes.

Transparency - New reporting obligations for AEMO and the AER

Snowy Hydro supports any change that would support the principle of transparency and would provide relevant information to market participants and stakeholders to assess the effectiveness and efficiency of the frequency control frameworks over time. This is critical so market participants can make informed and efficient investment and operational decisions.

The new reporting obligations for AEMO and the AER in relation to the levels of aggregate frequency responsiveness in the power system should focus on the value of providing the service, by displaying both the benefits and costs associated with providing the service. A focus only on the costs of frequency performance payments would unlikely provide the complete picture for the market.

Market is the only long-term solution

The Commission's acknowledgment of the need for incentives is critical however the work undertaken by the ESB to specify and value essential system services through efficiently procured market-based procurement in the long term should not be derailed by maintaining mandatory reforms, which involves, in essence, running critical assets to the ground causing long term issues in the NEM both on cost and supply of generators. The Post 2025 Market Design clearly highlighted the glaring omission in the current NEM design, being an absence of an explicit reward for several essential system services.

The continued use of the mandatory PFR requirement however is likely to distort other FCAS markets if they are undervalued. The removal of the original mandatory PFR rule incorporating a three-year sunset should be reconsidered by the Commission as it is clear that the mandatory PFR arrangements are distorting the existing Frequency Control Ancillary Services (FCAS) markets. This goes against all the work being undertaken on the ESB Post 2025 Market Design work.

Instead we are likely to have PFR performing the majority of frequency control post credible contingencies, for which paid and voluntary FCAS contingency markets are intended to entirely manage. This will deter participants in those FCAS markets from investing more to provide these assets, meaning the value in the market is unlikely to reach the efficient level that would appropriately compensate for the delivery of these services. The mandatory arrangements will only lead to the market relying on existing capacity with no investment in new technologies to

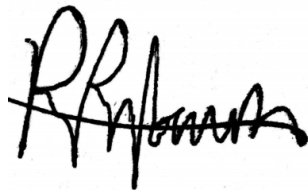


provide PFR or for existing capacity to provide more on that what is required on the current mandatory PFR settings.

As noted in our previous submission to the Commission, the GHD advice has already clearly flagged *"beyond 2030 with expected technological changes in the power system"* it will be *"challenging the effectiveness of the mandatory PFR arrangement."* Waiting to form a market post 2030 is too late. Given the transformation underway, not all services required for the efficient, secure and reliable operation of the changing system are being valued or appropriately procured, a key theme of the Post 2025 Market Design. Rule changes such as the Mandatory Primary Frequency Control Ancillary Services (FCAS) rule change incentive arrangements are inadequate for the long term efficient operation of the NEM.

Snowy Hydro appreciates the opportunity to respond to the Commission on the Directions Paper on Primary frequency response incentive arrangements and any questions about this submission should be addressed to panos.priftakis@snowyhydro.com.au.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'P. Priftakis', with a horizontal line drawn through the middle of the signature.

Panos Priftakis
Head of Wholesale Regulation
Snowy Hydro

