



17 November 2022

Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2000

By electronic lodgment: www.aemc.gov.au

ERC0290 – Operational Security Mechanism: Draft Rule Determination

Alinta Energy welcomes the opportunity to respond to the Commission's draft determination on its more preferable rule change on the Operational Security Mechanism.

Alinta Energy, as an active investor in energy markets across Australia with an owned and contracted generation portfolio of more than 3,000MW and over 1 million electricity and gas customers takes a strong interest in the development of an OSM and its effectiveness in supporting the provision of optimised system security services.

The proposed OSM has the objective of efficiently valuing security services without distorting markets for energy and ancillary services and to deliver all services (traded energy and ancillaries and procured security services) at least cost.

We acknowledge that technical difficulties and potential limitations of engineering knowledge at the present time have led the Commission to initially adopt a non-market ancillary services approach to procurement of security services. Real time unbundling and trading and thus valuation of such services should remain the goal of the OSM as it evolves over time.

Alinta Energy agrees that the proposed OSM is preferable to a "do nothing" approach which would increasingly rely on directions from the Australian Energy Market Operator to address power system security, which may extend to National Electricity Market jurisdictions outside of South Australia. Directions lack transparency and do not provide signals to investors in new entrant plant to assist in the provision of security services. While we appreciate the urgency to address existing gaps, the OSM needs to be implemented in a way that builds confidence for participants and clearly sets out the pathway to a market ancillary service model to value unbundled services to support system security.

We are concerned with the pay as bid approach to compensate market participants active in the OSM. Different market participants will be incentivised to bid and commit (or decommit) in a range of ways depending on their asset location, its technology, the contracts the plant supports with counterparties under a pay as bid OSM. Synchronous generators already committed but not participating in the OSM are still providing system security services. Some may be encouraged to decommit to receive enablement costs and the variable component of their bid. The uncertainty inherent in pay as bid approaches may lead to unintended

consequences and Alinta Energy would urge the AEMC and AEMO to examine alternatives, including a single clearing price to resolve this concern.

A related issue is the make whole payment approach where revenue received by an OSM participant is a function of their fixed enablement costs (which may be zero), the OSM variable bid less the spot market revenue for the block that the participant's OSM services and bids were active. This may encourage OSM bids that are higher than they need to be to manage the risks associated with the portfolio position taken by the OSM participant and the opportunity costs of foregone spot market revenue as discussed by the Commission on page 65 of the draft determination.

The make whole and pay as bid design features add considerably to the uncertainty of the OSM's operation and will undermine the principle of the OSM not distorting the energy or FCAS markets. Alinta Energy would encourage the Commission and AEMO to consult further on the bid and payment design features of the OSM to avoid unintended consequences that may result in higher costs for consumers in the medium term.

In relation to market power concerns, while we understand there is a risk of concentration in the OSM market, we do not believe significant regulatory oversight is necessary in the early stages. Market monitoring by the Australian Energy Regulator should be sufficient initially – price control and heavier oversight may have a significant impact on the willingness for eligible resources to participate in the OSM.

Alinta Energy supports both the scheduling of contracted security services and network support arrangements and the voluntary nature of the OSM.

A review of the OSM by the AEMC to assess if it is achieving its objectives should occur no later than late 2027, rather than begin in 2029. While Alinta Energy recognises that the AEMC has the power to conduct reviews into the operation and effectiveness of the Rules or any matter relating to the Rules, we would strongly recommend that the rule include an explicit obligation to undertake this review and to explicitly set out the factors that the AEMC must consider, including, but not limited to whether further unbundling of system security services should occur.

We make comment on individual elements of the draft determination below.

We would welcome further discussion of this response with the Commission. Please contact David Calder (David.Calder@alintaenergy.com.au) in the first instance.

Yours sincerely



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1. Overall design

The draft decision sets out the key design features of the OSM in chapter 3. As discussed above, the pay as bid approach for eligible and active participants scheduled under the OSM presents difficulties in relation to risk management (weighing contractual positions for eligible market participants considering a willingness to commit) and optimising OSM bids with the spot and ancillary services markets.

The review of the OSM after four years (2029) should be brought forward. While we support continued review, expansion of engineering knowledge and improvement of the OSM, the goal of moving to unbundled markets for security services should remain its purpose, rather than the OSM becoming the status quo.

2. Scheduled security services and the objective function of the OSM

Alinta Energy supports the inclusion of further unbundled system security services in the OSM as engineering knowledge develops.

The objective function of maximising the value of trade through the co-optimisation of scheduled security services alongside existing energy and ancillary services markets is appropriate, but again, the pay as bid and keep whole approach to committing resources into the OSM schedule and recovering costs may have unintended consequences from a risk management perspective. Prospective, eligible OSM participant's individual portfolios may inhibit participation, or encourage OSM bids that incorporate significant risk premiums.

3. Eligibility and offers

We support the voluntary nature of OSM participation, which includes the establishment of systems and processes to engage with AEMO as the OSM scheduler. We also support excluding regulated assets of network service providers in the OSM as the Commission notes on page 35 of the draft determination to avoid consumers paying twice for the same service (through network charges and allocated OSM settlement costs).

We agree with the Commission in section 5.2.1 of the draft determination that longer term contracting would be administratively burdensome and would serve the real-time or near-time price and scarcity objectives of the OSM.

Allowing a fixed and variable component in OSM bids would produce more efficient outcomes as discussed in section 5.2.2 of the draft determination and recognises the different fixed costs facing potential providers of security services into the OSM.

4. Market Power

Alinta Energy supports a light-handed approach to determining the impact of market power in any region or system configuration supporting the secure technical operating envelope. Annual reviews by the Australian Energy Regulator would seem appropriate; however the rules should define what an efficient price is, rather than left to fluid and potentially changing interpretation over time.

We support a flexible approach to regulation in this area. Similar market power considerations do not routinely feature in the energy or FCAS markets and there should be a precondition to demonstrate the need and value of regulation before any market power oversight is applied.

To the extent that some participants can exercise market power, the barriers to entry to compete this away are not likely to be high in the medium term as participants have access to

a range of technology solutions that can provide system security (BESS, synchronous condensers, new entrant gas plant).

5. OSM timing and scheduling arrangements

Alinta Energy agrees that OSM rebids up to gate closure would provide confidence to AEMO in the availability of security services and provide flexibility for OSM participants to respond to iterations of the OSM schedules produced.

6. Participant revenue and cost recovery

The approach to participant revenue set out in section 8.1 of the draft determination and the principle of making the OSM participant whole (between revenue earned in the energy market) and from its OSM bids meets the principles and objectives set out by the Commission. However, the mechanism is unable to account for individual OSM participant portfolios in the contract market and the uncertainty associated with spot market revenue that may be foregone if a market participant commits to the OSM.

Alinta Energy believes further consideration of the interaction between energy, ancillary services (FCAS) and OSM markets is required to ensure maximum participation without significant risk premiums being factored into OSM bids.

We agree that broad coverage of the benefits of OSM supports cost recovery from market participants generally and that regional benefits may manifest that would justify varied allocation of cost recovery and aligns with existing approaches for ancillary services.

We support the alignment of settlement of OSM payments with energy and ancillary services markets.

7. Interaction with planning timeframe

We agree that allowing contracts for system strength to participate in the OSM builds links between the planning and operational timeframes and that this participation should take place in a neutral manner relative to other OSM participant technologies.

8. OSM transparency and governance

The OSM should be reviewed earlier than 2029 as proposed in the draft determination (four years from its commencement date). There is likely to be material changes in the physical market, the impact of thermal plant retirement and improvements in the understanding of system security and the feasibility of unbundling system security services over this period. The objective of the OSM should not be static and a NMAS model a goal in itself, but needs to reflect a commitment to move to a MAS-based model over time.

As discussed above, the final rule for the OSM should include an explicit requirement for the AEMC to undertake a review, ideally no later than after two years of implementation (late 2027).

9. Implementation timing and costs

We understand that AEMO's estimates of the implementation costs of the OSM are relatively modest given the nature of the proposed change to systems and operation of the market, notwithstanding the bands of uncertainty set out in the draft decision of ± 40 per cent. It is unclear what individual market participant costs will be if they intend to participate in the OSM, but there will be indirect costs (and benefits) on all participants as a result of its implementation (market customers, impacts on energy and FCAS markets from the OSM feedback loop etc.).

Given the practical operation and mechanics of the OSM are not fully understood at this stage, we are concerned that the Commission intends to make its Final Determination and rule at the end of this year. Acknowledging the rule changes that led to the more preferable rule in the draft determination were lodged in 2019 and 2020 (by Hydro Tasmania and Delta Electricity respectively), we firmly believe the pay as bid and make whole provisions require further analysis before the rule is made. As such, we recommend an extension of making the final rule until at least 31 March 2023.

10. Interaction of the OSM with other system security elements

Alinta Energy supports the emphasis on flexibility in the OSM design, operation and amendment. One indicator of its effectiveness will be any measurable reduction in the number of AEMO directions, noting that its purpose is not to replace the directions framework. We support the complimentary nature of the proposed OSM with other system security reforms.