

Loy Yang Marketing Management Company Pty. Ltd.

AGL Hydro Pty. Ltd.

International Power (Hazelwood, Synergen, Pelican Point and Loy Yang B)

TRUenergy Pty. Ltd.

Flinders Power

Hydro Tasmania

15 March, 2007

Dr John Tamblyn
Chairman AEMC
Level 16,
1 Margaret St,
SYDNEY NSW 2000

By [email: submissions@aemc.gov.au](mailto:submissions@aemc.gov.au)

Dear Dr Tamblyn

RULE CHANGE REQUEST: MOVE SNOWY CSP/CSC TRIAL INTO CHAPTER 3

Please find attached a Rule change proposal from the above listed group of NEM generators, known as the "Southern Generators".

This proposed Rule change has the effect of moving parts of the Participant (NEMMCO) Derogation Chapter 8A Part 8 from paragraph (e) onwards¹ including sections related to the management of negative residues² into Chapter 3 of the Rules and making the Rule terminate only upon a regional boundary change.

Our reasons for submitting this Rule change proposal are:

- modelling undertaken on our behalf by ROAM Consulting, to support our submission to the Draft Determination- Abolition of the Snowy Region, indicates that the current arrangements (ie the CSP/CSC trial and the Southern generators Rule change) furthers the National Electricity Market objective better than the proposals being considered by

¹ commonly referred to as "the snowy trial"

² commonly referred to as "the southern generators' variation"

the Commission in its Draft National Electricity Amendment (Abolition of Snowy Region) Rule 2007, and

- that the Commission has indicated that it is unable to consider the current arrangements as an alternative to the Snowy Region abolition because the current arrangements are enabled only by a time limited derogation.

This Rule change proposal provides an opportunity for the current arrangements to be considered as an alternative permanent proposal in seeking to maximise the market objective.

Yours faithfully,



ROGER OAKLEY

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(on behalf of the participants listed)

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Manager Energy Policy & Regulation
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SOUTHERN GENERATOR PROPOSED RULE CHANGE:

"MOVE SNOWY TRIAL INTO CHAPTER 3"

Background to the Rule Change

Since NEM start, the Snowy pricing region has encompassed the Murray and Tumut groups of generators, with Murray as the pricing node. Intra-regional constraints binding between Murray and Tumut had the consequence of materially mis-pricing Tumut and also resulting in counter price flows in the Snowy region at times of high interregional flows when constraints bind.

Initially, as the NEMMCO settlement system had no means of funding counter-price flows, Chapter 8A Part 8(c) was implemented as a temporary arrangement to provide NEMMCO with the means to manage negative settlement residues in the Snowy region by constraint re-orientation or by "clamping".

Subsequently, following proposals by Snowy Hydro Ltd to NECA in July, 2005, Chapter 8A Part 8 was expanded to include a mechanism for more accurately pricing Tumut generation. This was in the form of a "Congestion Management Pricing and Contract" or "CSP/CSC" scheme and was consistent with MCE policy. This mechanism has been implemented by NEMMCO but will expire during 2007 or 2008³.

Also in 2005, the "Southern Generators"⁴ recognised that positive and negative settlement residues on the Snowy regions' interconnectors are a natural outcome of the accurate pricing of the Murray group of generators in the presence of loop flows. Consequently clamping or re-orientation to limit negative settlement residues leads to inefficient market outcomes. Thus the Southern Generators proposed a resolution to that issue with a Rule change that allowed the negative residue accumulation on the loop to be offset by the associated positive accumulation.

This issue is quite independent of the issue of Tumut mis-pricing, but was proposed, for convenience, as a variation to the Chapter 8A part 8 CSP/CSC trial Rule clauses and was made a Rule by the AEMC in November, 2006.

In the Southern Generators' opinion, both mechanisms have been shown to function well in practice, delivering benefits to the market.

In 2006 the Commission also received proposals for changes to the Snowy regional boundary, from Snowy Hydro and Macquarie Generation. Each proponent claimed that the National Electricity Market Objectives ("NEMO") were furthered primarily due to the accurate pricing of the Murray to Tumut constraints and the resolution of negative settlement residues associated with the loop flow. As the Southern Generators noted in their initial submission, each of these matters has already been adequately dealt with in our view by the Chapter 8A Part 8 derogation.

In its Draft Rule Determination accepting the Snowy Hydro regional boundary proposal to abandon the Snowy region, the Commission did not consider the

³ The Commission has indicated that it will extend the arrangement until the earlier of June 2008 or a Snowy regional boundary change.

⁴ Despite a number of organisational re-structures, the "Southern Generators" have substantively remained the same group throughout as the proponents of this Rule change.

current arrangements to be a relevant counterfactual, although it did concede that these arrangements were effective⁵.

In discounting the current regime, the Commission has considered as an alternative only those arrangements that were in place prior to October 2005, noting in its draft determination:

"The Commission's current view is that in these circumstances, the existing interim means of pricing the congestion (i.e. Tumut CSP/CSC Trial) is not be (sic) an appropriate long-term solution compared to a region boundary change"⁶

The reasoning for the above view is unclear in the draft determination however at the recent consultative forum the Commission noted:

"as the trial is a trial and modified in a time-limited manner through a derogation, we did not regard what is currently the status quo as in a legal and regulatory sense the appropriate base case."⁷

It would appear that the Commission has decided that the current arrangements may not be considered as a relevant counterfactual because of the method used for its implementation.

The Southern Generators' believe that the current arrangements have been successfully implemented and ought to be included in any assessment of future Snowy region developments. In order to allow for consideration of the current arrangements as a relevant counterfactual, the Southern Generators propose that those arrangements become a permanent Rule.

Proposed Rule Change

The proposal is effectively a simple transfer of the arrangements that bring about the Snowy trial and the Southern Generators' variation from the Chapter 8 derogation section into Chapter 3 in the main body of the Rules.

The sunset provision has been deleted; however we have proposed a paragraph to enable the arrangements to fall away should a change to the Snowy regional boundary render these unnecessary (see the explanation of this Rule Change (page 8)).

How the Rule Change furthers the NEM Objective

The Southern Generators' have engaged ROAM Consulting to emulate the approach used by Frontier Economics to model the market efficiency gains attributed to the various proposals. The results are largely consistent with respect to those options modelled by Frontier; however ROAM expanded their exercise to include the current arrangements. In terms of efficiency of dispatch, the ranking of the alternative arrangements modelled by ROAM, from best to worst is:

1. Current arrangements with the CSP/CSC trial and the Southern Generators' variation;
2. Snowy Hydro Ltd. Proposal, the Snowy region abolition⁸;

⁵ Pg vi Draft Rule determination-Snowy abolition

⁶ Pg 26 Draft Rule Determination-Snowy region abolition

⁷ Pg 8 Snowy region abolition forum transcript

3. Split region option with Murray region node at Dederang as considered by the Commission⁹;
4. "Business As Usual" (i.e. pre 2005 arrangements) as modelled by the Commission;

Further, as the current arrangements are already in place, there would be no cost of implementation for NEMMCO and the market participants, whereas the cost of implementation of all the other alternatives is likely to be significant and may outweigh their respective benefits.

Thus, if the Commission were also to consider that the current arrangements best meet the market objectives this could be achieved by simply embedding those arrangements into a non-temporary part of the Rules.

Further quantitative and qualitative evidence as to why the current arrangements are superior to any of the other proposals is presented in the Southern Generators' submission to Draft Rule - Snowy Region Abolition and the attached modeling report by ROAM Consulting.

Consideration against Commission decision criteria

The Commission has published a list of seven decision criteria to use when assessing a proposal against the NEM Objective. We address these in turn with respect to our Rule change:

The likely effect of the proposal on the economic efficiency of dispatch – being the minimisation of the resource costs of dispatch to meet load;

The ROAM analysis shows that greater economic efficiency of dispatch is likely to be achieved with the current arrangements over those currently being considered as part of the Snowy Region Rule change draft determination.

The likely pricing outcomes (and participant responses) - in that pricing outcomes may have implications for allocative and dynamic efficiency in the future;

The ROAM analysis incorporates pricing impacts and considers the pricing outcomes. These are generally superior in terms of efficiency implications than the other proposals.¹⁰

The likely effect of the proposal on inter-regional trading and risk management which may affect the competitiveness of the market and allocative and dynamic efficiency in the future;

Trading is occurring across the Snowy region in the current arrangements and because clamping has been eliminated, most participants describe the present settlement residues as "firmer" than those being considered by the Commission as the "business as usual" case

⁸ This ranking has been established on the basis of preliminary modeling by ROAM Consulting and may change when final modeling results are available.

⁹ The efficiency difference as estimated by ROAM between the Snowy Hydro proposal and Split Region option in the final modelling results is likely to be small.

¹⁰ This conclusion has been established on the basis of preliminary modeling by ROAM Consulting and may change when final modeling results are available.

in the Snowy region draft determination. Making the current arrangements available for Commission consideration in that determination would assist in the development of the optimal trading and risk management environment. In our presentation at the recent Forum, we demonstrated that in terms of firming interregional settlement residues, given that there are three major constraints between Melbourne and Sydney, three notional inter-connectors are better than two, and two is better than one. For this reason we would expect that the firmness of the inter-regional settlement residues for the current arrangements would be better than those under the Snowy Region abolition.

The likely effect of the proposal on power system security, supply reliability, and technical factors;

We believe this criterion is unaffected by the proposal.

Whether the proposal is consistent with good regulatory practice;

We believe that good regulatory practice decision making in this situation, ie making a regional boundary change through a Rule change process, involves determining the best decision from a finite, but appropriate range of options. As the current arrangements are actually in force at the present time, have operational experience and are in our view successful, it would seem that good regulatory practice ought to allow for the consideration of such arrangements. A Rule change that permits its consideration is therefore consistent with good practice.

It is also suggested that good regulatory practice should produce decision making which results in minimal disruption to the operation of the market. For example, it is noted that the proposed date for the abolition of the Snowy region has resulted in the cancellation of the auction of future Snowy units through the SRA process, with implications for inter-regional trading in the NEM. The present proposal would allow the continuation of SRA process on the current basis, and again release these units to the market.

The likely long-term implications of the proposal and consistency with public policy;

The Southern Generators believe that transferring Part 8 into Chapter 3 would not inhibit future development of the NEM's congestion regime. While the provisions will have the force of a full Rule, the National Electricity Rules remain subject to amendment at any time. Were other mechanisms to be proposed out of, say, the AEMC's congestion management review, then this Rule change would not inhibit these or for that matter any other reviews which may result in future Rule changes. A Snowy regional boundary change automatically terminates the current arrangement. (Please refer also to the section on MCE Policy considerations on the next page).

The likely timing of the proposal and any issues associated with implementation of the proposal.

As this proposed Rule change is administrative only, there are no implementation issues.

Regarding timing, this Rule change proposal needs to be considered in parallel with the Snowy region final Rule determination (see Appropriate Context for considering the Rule Change below).

MCE Policy Considerations

The Southern Generators' consider that extending the current arrangements is also most consistent with MCE policy. This policy is supportive of congestion management techniques but very conservative with respect to regional boundary change, ie regional boundary change is a last resort. We note that:

"The MCE therefore proposed a 'staged approach' to managing congestion in the NEM, beginning with a congestion management regime, consideration of investment solutions and finally, a region boundary change."¹¹

In our view what is presently in place with respect to the Murray and Tumut constraints is a well functioning congestion management regime. The Southern Generators agree that investment solutions may not be readily available for this constraint, nor in the foreseeable future for at least the Snowy to Victoria constraint. However given the success of the current arrangements neither investment solutions, nor implementation of a regional boundary change, appear to be necessary.

In its draft determination, the Commission claimed it was unable to consider the MCE's most preferred option (congestion management) and as investment was unlikely it therefore had no choice but to recommend a boundary change, the MCE's least preferred option. Our objective in submitting this Rule change proposal is to assist the Commission in overcoming this difficulty by allowing consideration of the current arrangements.

Furthermore, the MCE stated in its Regional Boundary change proposal that:

"The boundary change process should enable sufficient lead times to address commercial and economic consideration in relation to a change in the regional boundary",¹² and

"The region change would come into effect three years after the final determination"¹³.

In our view, this proposed Rule change from the Southern Generators would also assist the Commission in avoiding a regional boundary change that would not comply within this policy of providing sufficient lead time.

Our Rule change is therefore intended to enable the Commission to more fully implement MCE policy with respect to implementation priorities and notification timing.

Appropriate context for considering the Rule change

Our Rule change proposal is, necessarily, purely administrative in nature in that it simply transfers words from one chapter of the Rules to another. We understand it may be controversial and have not sought an expedited Rule change except to the extent noted below.

From a process perspective, this Rule change can only be sensibly considered within the context of the draft Rule determination for the Snowy region abolition. It is suggested that the final determination can now include the current arrangements as a counterfactual on the basis that these may well become a genuine alternative through this Rule change. Further, upon

¹¹ Pg 66, Draft Rule-snowy region abolition

¹² Pg 5, MCE proposal for regional boundary change criteria

¹³ Ibid Pg 7

considering the merits of the current arrangements through that process, the Commission will be able to readily rule upon our proposal.

Explanation of Rule Change

Chapter 8A Part 8 of the Rules is a NEMMCO sponsored participant derogation with several parts:

- (a) and (b) remove any uncertainty that NEMMCO's implementation of the fully optimised form of constraints is inconsistent with parts of Chapter 3;
- (c) removes any doubt that NEMMCO's clamping of negative residues is inconsistent with parts of Chapter 3;
- (c1) exempt makes an exception of NEMMCO's obligation to clamp Snowy region negative residues;
- (e) sunsets the entire derogation at a date which may be "otherwise determined by the AEMC"¹⁴;
- all other parts bring about the CSP/CSC trial and the Southern Generators' variation.

The Southern Generators proposal is to transfer the parts of the derogation relevant to the CSP/CSC trial and the Southern Generators' variation into Chapter 3 for the following reasons.

In relation to Parts (a), (b) and (c), we understand that NEMMCO intends to keep its current practices with respect to fully optimised constraints and negative residue clamping and that in its view this derogation is not essential to those practices. It is believed that NEMMCO does not intend to request extension of these provisions.

Part (c1) is not essential as these practices also do not obligate the clamping of negative residues where an alternative mechanism exists.

Parts (e)(1) and (3) are the derogation sunset provisions and therefore are not included as part of the proposed permanent arrangements.

Part (e) (2) also terminated the derogation upon "the first regional boundary review by the AEMC". Termination upon regional boundary changes is also unnecessary unless the change subdivides the group of nodes affected by the proposed arrangements. Thus, we have replaced (e)(2) with a new paragraph that disables the arrangements in the case where a change occurs and the relevant nodes are not all in the same region.

The Southern Generators are therefore mainly concerned with transferring matters pertaining to the last dot point into the main body of the Rules.

In the event that this Rule change is approved, it would be sensible to delete the equivalent text from Chapter 8A Part 8 upon implementation of our proposal into Chapter 3. As Chapter 8A Part 8 is a NEMMCO derogation, we understand the Southern Generators are unable to propose a variation to it without NEMMCO's concurrence; we have not sought that from NEMMCO. We suggest to the Commission that it may:

- leave the duplicate text in BA Part 8, with the sunset provisions as it in no way contradicts our change;

¹⁴ Presently indicated as the earlier of snowy regional boundary change or 30 June 2008 by the AEMC (See draft determination 14 Dec 2006)

- remove the text unilaterally from 8A Part 8; or
- seek NEMMCO's approval to the deletion, which we believe it will be very likely to provide.

We have proposed inserting the text into a new Chapter 3 clause, 3.15.6B which is at the end of the normal settlements procedures.

We propose only one new paragraph: 3.15.6B(a) that makes the necessary connection of the CSP/CSC trial to the existing Snowy regional definition. This is because the Snowy region is not defined in the Rules and therefore it is impossible to make a permanent Rule implementing a congestion management mechanism without clarifying to what region boundaries the Rule applies to.

Draft Rule to be made

1. Create a new Chapter 3 clause: "3.15.6B **Snowy Region Congestion Management**";
2. Insert paragraph:

"3.15.6B(a) This clause 3.15.6B must have no effect if the network nodes referred to in 3.15.6B(b) are not all encompassed in a single region."
3. To simplify this Rule change, keep 3.15.6B (b) to (e) blank.
4. 3.15.6B (f) to be transcribed from 8A part 8 (f) except remove the words "developed pursuant to clause (b)".
5. Transcribe all paragraphs from 8A part 8 (g) through to (p) to the equivalent numbered paragraphs in 3.15.6B.