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Dear John

MANAGEMENT OF NEGATIVE SETTLEMENT RESIDUES IN THE SNOWY REGION

Macquarie Generation considers that the NEM derogation proposed by NEMMCO and a group of southern NEM generators, *Management of Negative Settlement Residues in the Snowy Region, November 2005*, offers only a limited 'work-around' procedure that fails to address the causes of inefficient dispatch and counter-price flows in and around the Snowy Region.

In addition to numerous reviews, the Derogation proposal is one of many temporary and partial fixes that have been trialled or suggested for the Snowy Region in recent years:

- NEMMCO's *Management of Network Limitations within the Snowy Region and constraint formulation in the NEM – Interim Actions, July 2003*, introduced an Option 4 constraint formulation for the Snowy Region and set out procedures for managing negative residues that might result from on the Vic-Snowy interconnector if any option 4 constraint bound in the Snowy Region;
- NEMMCO proposed reorienting Option 4 constraints from Murray to Dederang should it forecast negative residue accumulation for the Vic to Snowy directional interconnector. After consulting with market participants, NEMMCO decided not to pursue this approach in September 2005;
- Snowy Hydro derogation for a trial of a partial form the constraint support pricing and contracting regime (CSC/CSP regime) for the Tumut nodes commenced on 1 October 2005 and will expire at the end of July 2007;
- Snowy Hydro Rule lodged a Rule change proposal seeking to reallocate Murray generation nodes to the Victorian Region and Tumut generation Nodes to the NSW Region, and the abolition of the Snowy Region – currently under AEMC review.

Any proposed change to the market rules can create uncertainty for participants and can alter incentives in ways not contemplated in the original proposal. This is one of the main reasons that Macquarie Generation lodged a Rule change proposal with the AEMC on 6 February 2006 detailing a permanent and robust solution to the unique problems created by intra-regional congestion in and around the Snowy Region (see: www.aemc.gov.au). The Rule change proposes the establishment of separate regions for Northern Victoria and South-west NSW and the abolition of the existing Snowy Region.

This proposed realignment of regional boundaries addresses the underlying causes of inefficient dispatch and counter-price flows in this part of the NEM. The proposal would:

- explicitly price the significant points of transmission congestion in this part of the NEM, namely: Murray to Tumut; Tumut to Canberra/Yass; Thomastown to Eildon/Kiewa; Murray to Thomastown; and, Ballarat to Bendigo.
- minimise, and possibly eliminate, loop flow effects in and around the Snowy network;
- reduce, and possibly eliminate, the likelihood of counter-price flows in this part of the NEM, thereby increasing the ‘firmness’ of settlement residue auctions units. This would improve the value of these units, making them a more effective tool for participants to manage inter-regional trading risks. At the same time, it would reduce the need for the NEMMCO to devise artificial solutions to minimise the incidence of negative residues; and
- include all generation centres in constraint equations, thus allowing the system operator to accurately control dispatch from all generation units.

The introduction of a regional or zonal market structure that removes intra-regional loop flow congestion points would resolve the problem that the proposed Derogation is attempting to address. Macquarie Generation considers that, under the proposed reconfiguration of the Snowy region, counter-price flows would only occur in limited circumstances involving multiple contingency events. NEMMCO could manage any such negative residues by placing limits on interconnector flows. This situation would occur infrequently and the consequent efficiency effects would be insignificant relative to the present case.

Macquarie Generation has asked the AEMC to consider the proposed realignment of regional boundaries as part of its current NEM-wide reviews of congestion management and regional boundary arrangements. Macquarie Generation considers that the AEMC should implement a boundary realignment around the Snowy network from mid 2007 when the current Snowy CSC/CSP trial expires. This would finally settle the regulatory uncertainty and industry debate over partial fixes for the one part of the NEM where transmission investment does not offer a practical solution to network congestion.

Yours sincerely



RUSSELL SKELTON
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