22 May 2008

Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By Email: submissions@aemc.gov.au

Dear Dr Tamblyn

Proposed Rule change: Determination of Spot Prices

In responding to the Rule change proposal by the Australian Energy Regular (AER), the National Generators Forum (NGF) wishes to stress at the outset that we are strongly supportive of a change to this aspect of the Rules.

We agree with the AER that the current provisions in clause 3.9.2(e)(1)(ii) and clause 3.9.2(f):
- Are difficult for NEMMCO to apply, and
- Have been wrongly applied on several occasions, and
- Have consequently had serious adverse effects on market participants

If the change proposed by the AER was the only way of amending the current provision, the NGF would support the proposal. However in this submission we are proposing an improvement to the AER proposal. We believe this change will make an even greater contribution to the NEM objective than can be achieved by implementing the AER proposal.

The basis for this belief is that our amendment has been developed to satisfy the following specific objectives, each of which we believe contributes towards the NEM objective:

- The dispatch price should be set to VoLL when there is insufficient supply to meet all (non-scheduled) demand while maintaining a secure operating state (since this contributes to the market signals that are important for supply reliability), but
- The dispatch price should NOT be set to VoLL if there is unused generation availability that could be used to supply un-met demand while maintaining a secure operating state (to avoid imposing unmanageable risks on participants), and

- The setting of dispatch price to VoLL should depend solely on the conditions of supply/demand balance, and not on the history that led to that state (to ensure consistent and predictable pricing principles).

The AER proposal does not meet the latter two objectives. In relation to these objectives we note that our amendment:

o avoids the risk of imposing unmanageable risks on generators when load is shed and there is unused generation capacity in the NEM.

This risk arises from the financial interaction between a generator's forward market and spot market sales when a generators dispatch is curtailed. Because risk mitigation through the forward markets is not feasible for events of this nature they are best addressed through the Rules. The reduction of unmanageable risk for generators leads to lower investment costs in the NEM and ultimately to lower prices for consumers.

o ensures "scarcity" pricing will apply with independence from participant offers, and hence provide greater certainty as to outcomes.

We note that the AER considers that under its proposal, "scarcity" pricing will apply when load that has been shed is not able to be restored. The AER based this expectation on historical analysis that indicates that generator offers have generally included some component prices at or near VoLL. However, this analysis fails to consider the impacts of constraint equations and NEMMCO directions, both of which can have large price suppression impacts.

As our objectives indicate, we support "scarcity" pricing in such cases, but contend that the Rules should not rely on participant offers to have a particular form in order to procure this outcome (which we agree is desirable).

Increased certainty in market outcomes reduces risk for participants and hence leads to lower prices for consumers.

The drafting of this provision is designed to cope with the most common form of supply scarcity: namely where surplus supply is available at one or more remote locations, but cannot supply the relevant load due to network limitations. Hence the reference to a secure operating state in the re-drafted 3.9.2 (e)(1)(ii). This preserves the principle that a supply shortfall should trigger a capacity scarcity signal, regardless of the circumstances that lead to that shortfall.

In developing an amendment to satisfy the above objectives, we have also been mindful of the concern expressed by the AER in relation to imposing additional workload on NEMMCO at a time of system disturbance. In response to this concern we have chosen a criterion for NEMMCO decision making that depends on an assessment that NEMMCO needs to carry out as part of a load restoration process, irrespective of its use as a trigger for the setting of VoLL. We have also drafted the provision so that in the case of uncertainty by NEMMCO, no action is required.

We have attached a table which compares this amendment with both the current Rules and the AER proposal, and a draft of our Rule changes (marked up against the current Rules) in Appendix A.

If you have any questions in relation to this submission, please feel free to contact me in the first instance on 02 6243 5120.

Yours sincerely
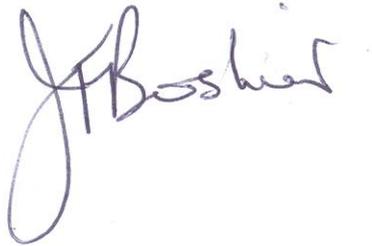
John Boshier
Executive Director

Comparison of current Rules and Rule change proposals

Circumstance	NEMMCO action on load restoration	VoLL price application		
		Current Rules	**AER proposal**	**NGF amendment**
Load shed and not in secure operating state	No restoration	Should not be applied, but has proved uncertain in practice	Should not be applied	Should not be applied
NEMMCO determine that load restoration will not lead to departure from secure operating state	Some load restored to supply	Should not be applied, but has proved uncertain in practice	Should not be applied	Should not be applied
NEMMCO determine that load restoration would lead to departure from secure operating state	No restoration	Should be applied, subject to time delay, but has proved uncertain in practice	Should not be applied	**Should be applied**

If sufficient surplus generation exists, however NEMMCO for other reasons is uncertain whether load restoration will lead to departure from a secure operating state, it would be expected that no further load restoration would occur and VoLL should not be applied (as per the AER proposal).

APPENDIX A
RULE CHANGE REQUEST – DETERMINATION OF SPOT PRICES
TEXT OF PROPOSED ALTERATIVE AMENDMENTS
As proposed by the NGF

1. Amend clause 3.9.2(e) as follows:

(e) Notwithstanding clauses 3.9.2(c) or (d), for any *dispatch interval* if:

> (1) the *dispatch price* for that *dispatch interval* has not already been calculated and published by the *central dispatch* process and *NEMMCO* reasonably determines that the *central dispatch* process may determine that:

>> (i) all *load* in a *region* could not otherwise be supplied and *NEMMCO* issues instructions that are current for that *dispatch interval* to *Network Service Providers* or *Market Participants* to shed *load*; or

>> (ii) in the case where *interruptible load* has been shed in a region due to a contingency event, and some *load* remains without supply, NEMMCO determines that no restoration of that *load* should occur in the *dispatch interval* because restoration would lead to a departure from a *secure operating state*,

>> then, *NEMMCO* must set the *dispatch price* at that *region's regional reference node* to equal *VoLL*;

> (2) *NEMMCO* has declared a *dispatch interval* to be an *intervention price dispatch interval* under clause 3.9.3(a), then subject to clauses 3.9.3(a2) and 3.9.3(a3) *NEMMCO* must set the *dispatch price* in accordance with clause 3.9.3; and

> (3) **[Deleted]**

> (4) an *administered price period* in accordance with rule 3.14 applies, then *NEMMCO* must limit the *dispatch price* in accordance with clause 3.14.2(d1).

2. Delete clause 3.9.2(f).

(f) If *interruptible load* is shed as a result of a *contingency event* and *NEMMCO* has not set the *dispatch price* to equal *VoLL* pursuant to clause 3.9.2(e)(1)(i), *NEMMCO* must not set the *dispatch price* to *VoLL* pursuant to clause 3.9.2(e)(1)(ii) prior to the commencement of the third *dispatch interval* following the restoration of the *power system* to a *secure operating state* and the restoration of the *frequency* of the *power system* to the normal band of the *frequency operating standards*.