

20th April 2009

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Sent electronically to: submissions@aemc.gov.au
Project Reference code: ERC0075

Dear Sir / Madam,

**Submission to: Contingency Administered Price Cap Following a
Physical Trigger Event – Draft Rule Determination**

Snowy Hydro strongly supports the AEMC Draft Determination. We believe there is no evidence of market failure that warrants the adoption of the NGF proposed rule change. Further, Snowy Hydro believes that the proposal does not meet the market rules objective test and its implementation would instead result in significant distortions and increased costs to the spot market.

As highlighted by the Commission and a number of submissions to the proposed rule the 'unmanageable' financial risk that the NGF proposal has alleged needs managing can satisfactorily be managed through a number of ways such as contract force majeure provisions, co-insurance, and/or through more prudent risk management. The use of these mechanisms does not lead to distorted pricing signals, increased risk to system security, and would not intervene in the function of the market.

The following sections empathise and summarise the key concerns we have with the NGF proposal that support the Commissions Draft Determination.

What is the market failure the NGF proposal is addressing?

What is the market failure the NGF proposal is proposing to address? In our view there has been no market failure as the market has satisfactorily cleared when these non credible contingency events have occurred in the NEM and indeed there is no evidence that the cited risks are 'unmanageable'.

We note that to date there has been no Insurance Providers offering products to manage the risk the NGF proposal is supposed to address and no co-insurance arrangements to perform a similar function. This supports our view that there is no market failure with the current arrangements and the NGF proposal is an attempt to obtain "free" market insurance for base-load generation.

Snowy Hydro supports the Commissions assessment that price signals would be distorted when the CAPP is triggered. This would distort the optimal mix of generation plant and reduce the availability of demand side response. These distortions are inefficient and will ultimately increase the cost of energy to end-consumers.

NEMMCO liability

Snowy Hydro supports the AEMC finding that NEMMCO's primary focus during these non credible contingency events is to operate the system in a secure state. The complexity of the NGF CAPP proposal means the triggering of the CAPP can not be automated. This means NEMMCO's focus would incorrectly be directed towards assessing whether or not to trigger the CAPP. We agree with the AEMC's assessment that this additional requirement of NEMMCO is unwarranted in a time of system stress and would increase the likelihood of NEMMCO operational errors.

The potential for NEMMCO errors are: triggering the CAPP when the trigger was unwarranted or alternatively not triggering the CAPP when NEMMCO should have. Regardless of whether the CAPP is triggered there would be additional diversion of focus from managing system security. Snowy Hydro highlights when the CAPP is not properly administered that there would be strong grounds for Market Participants to claim compensation for NEMMCO's incorrect interpretation of the CAPP trigger procedures.

The NGF proposal does not address substantive liability issues for the potential of incorrectly applying the CAPP. For instance, does NEMMCO carry liability for incorrectly triggering the CAPP? Who will ultimately fund this liability? And given the complexity of the proposal what is the cost of potential disputes? These issues are not trivial and would result in resources and costs to NEMMCO and Markets Participants. Ultimately, end-customers would pay for these costs through increase wholesale and retail prices.

Further to the above and as highlighted by the Commission, the application of the CAPP would reduce the availability of peaking generation and demand side response thereby increasing the likelihood that NEMMCO would need to resort to directions to restore the supply and demand balance. The costs of these directions and/or the claim for compensation due to an administered price period are borne by market customers. We agree with the AEMC's assessment that the risk capital that market customers must then hold to cover these costs would inefficiently put upward pressure on retail electricity prices.

Summary

In summary, the NGF proposal fails to meet the NEM objective and fails to even meet the first five fundamental design principles in the NEM rules.

The NGF proposal if implemented would:

- Distort investment signals and lead to sub-optimal mix of generation plant;
- Reduce incentives for peaking generators and demand side response to participate in a non credible contingency event. This would not only reduce market efficiency but would threaten system security;
- Increase the likelihood of participants seeking compensation due to the application of the CAPP and/or due to being directed; and
- Place NEMMCO in a difficult situation at a time when the Operators focus should be on maintaining system security.

For the reasons outlined in this submission Snowy Hydro believes the NGF proposal does not meet the NEM objective. We strongly endorse the Commissions Draft Determination to reject the Rule change proposal.



Snowy Hydro appreciates the opportunity to respond to this consultation. Please contact Kevin Ly, Manager Market Development and Strategy on (02) 9278 1862 if you would like to discuss any issue associated with this submission.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Roger Whitby', is written over a light blue rectangular background.

Roger Whitby
Executive Officer, Trading

