



Ref: ERC0140

7 November 2013

Attention: Elizabeth Ross
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Ms Ross

Draft Determination: Negative offers from scheduled network service providers

The NGF is pleased to have this opportunity to respond to the Draft Determination on negative offers from scheduled network service providers (SNSPs).

The NGF is the national industry association representing private and government owned electricity generators. NGF members operate all generation technologies, including coal-fired plant, gas-fired plant, solar, hydroelectric plant and wind farms. Members have businesses in all States and Territories.

We are glad the AEMC was cognisant to the main issues raised by the NGF in its response to the consultation paper. We considered the issues were related to whether generators could also own transmission (SNSPs in this instance) and whether there is too great a concentration of generation in an exporting region. Given we considered these issues the responsibility of legislators and competition regulators we are glad the Commission has not exercised its Rule making powers to address any perceived inequity. The Commission has rightly recognised that this would be dealing in transfers between participants, rather than increases in efficiency.

The NGF supports this aspect of the Commission's Draft Determination

As to the preferable Rule change put forward by the Commission, the NGF is confused by some of the language in the Draft Determination. The Draft Determination suggests that generators can offer prices at the maximum cap and minimum floor prices as allowed by the Reliability Settings. **This is not accurate.** Under 3.8.6(c) generators are required to offer loading and off-loading prices no more or less than the price cap or floor price multiplied by the relevant *intra-regional loss factor* at the *Scheduled Generator's transmission network connection point*. The offered price at the connection point is not the floor price of $-\$1,000/\text{MWh}$, but a value that includes the marginal loss factor. **The $-\$1,000/\text{MWh}$ price is at the RRN.** However, the draft determination does recognise this issue correctly in Appendix B in section B.2.1. This area is extremely complex due to the interaction of the energy balance equations and the loss factors.

The preferable Rule change amends clause 3.8.6A(i), after "*market price cap*" insert "or be less than the *market floor price*". This does not include reference to the *intra-regional loss factor* in the same way as generators. Importantly 3.8.6A identifies the way offers from SNSPs are considered and shows that SNSPs' MLFs are applied to connection point prices which determine whether the SNSP is dispatched. If the difference in loss adjusted prices at each connection point is greater than the offer, the SNSP will be dispatched.

The NGF believes that 3.8.6A (f) and (h) which identify the prices at each connection point and the revenue it will earn, means that NEMDE values this energy from SNSP at the connection point at RRP x (MLF x MW). This calculation appears equivalent to the treatment of generators, although this assumption is not clear. We request the AEMC confirm in its Final Determination that this is correct and therefore SNSPs offers do not need to be restricted to the floor price multiplied by the *intra-regional loss factor* at the connection point in the manner of generators (with this being the stated intention of the Draft Determination's preferable Rule).

The NGF is supportive of the consideration by the Commission that in effect a SNSP is equivalent to a load in the exporting region at its respective connection point and a generator in the importing region at its respective connection point and therefore should be able to actively trade on the spot market on an equal basis with generators and scheduled loads. The NGF agrees with these statements. The NGF is therefore concerned, that the Commission and its consultant then restricted themselves to considering how generators (and scheduled loads) bids could be altered to replicate the bids received from a SNSP, an equally valid consideration could have been to consider how a SNSP's bid could replicate a generators bid and therefore place generators and SNSP's on a neutral or level playing field

Overall the NGF understands the reasons for the AEMC's decision and accepts it but encourages the Commission to provide a better explanation for the reasons behind its decisions in its final determination.

The Commission has highlighted potential ways to improve the efficiency of dispatch by either modelling generators losses in NEMDE or using a full network model. Either approach may result in dynamic loss factors being applied in real time, in dispatch (which is ex-post), rather than static loss factors in advance, (ex-ante).

The NGF has previously engaged with the Commission in the Transmission Frameworks Review on the development of dispatch and pricing. The NGF has highlighted the need for regional approximations in pricing to allow a homogenous pooling of buyers and sellers in order to facilitate the efficient development of financial markets. We have previously stated that such approximations may result in some productive inefficiency that is more than compensated by the productive, allocative and dynamic efficiency gains of promoting an efficient commodity exchange.

With regards to changing the allocation of losses we request the Commission question whether it is worthwhile moving to more "accurate" calculations of MLFs in real time. The allocation of MLFs to volumes in real time may change generators settlement by +/- 15%¹ so a gross difference of 30% could occur in settlement. For the Market Participant trying to determine their forward derivative position, real time variances in cash settlement, based on something the generator cannot control (the level of transmission losses) would not be helpful. The logical response of Market Participants to any additional Spot market / cashflow risk would be to reduce their contract exposure in the derivatives market, which may reduce overall efficiency.

¹ As shown by P31 of the SW Advisory and ACIL Tasman report for the Snowy Generator

The NGF is worried by the AEMC's undue focus on the potential benefits of the Optional Firm Access (OFA) model, developed as part of the Transmission Frameworks Review (TFR). It seems premature to us to suggest that the OFA model could address the issues raised in this Rule change proposal, particularly as the current proposal has extensive grandfathering. In addition, the Standing Council of Energy and Resources (SCER) is still to make a decision on whether or not it supports the model. The AEMC recognises more detailed work is necessary on the feasibility of the OFA model before making a decision on its implementation. Until there is greater clarity around the practical design of OFA, we consider there is insufficient information available to determine its benefits, particularly in this specific case.

There appears to be a theme developing with regards to proposals, such as a full network model and the Commission's proposal of optional firm access:

- incremental benefit of changing the Rules is low and the effort or complexity required is very high;
- costs of changing the Rules are largely related to unintended consequences that are hard to quantify (and therefore not quantified);
- solutions are found without properly identifying or quantifying the problem;
- theoretical constructs are applied without regard to the physical imperfections of the market and participant incentives;
- consultants (including AEMO) specialising in dispatch have a myopic view as to how power markets should be designed and tend to discount incremental effort, ignore unintended consequences and zealously assume complex new Rules will work as intended; and
- Market Participants are wary of unintended consequences and hence oppose proposals.

In the Transmission Frameworks Review the Commission sided with Consultants and AEMO, largely ignoring the view of interested stakeholders such as the NGF. Given this, we respectfully request that any proposal to change NEMDE, such as including a full network model for losses includes the following:

- detailed identification, analysis and quantification of the problem;
- development of potential solutions for the problem;
- rigorous quantification of the costs as well as the benefits;
- evaluation of unintended consequences; and
- critical assessment of whether the proposal will work as intended .

If you have any queries, please contact David Scott on 07 3854 7440.

Yours sincerely



Tim Reardon
Executive Director, NGF