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Mr John Pierce
Mr Neville Henderson
Dr Brian Spalding
Australian Energy Market Commission

Dear Commissioners

Lodged electronically: www.aemc.gov.au (ERC0224)

**AEMC 2017, Pricing during market suspension, Consultation Paper, 15 August 2017**

EnergyAustralia is one of Australia's largest energy companies with over 2.6 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion dollar energy generation portfolio across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market (NEM).

We welcome the opportunity to comment on the *Pricing during market suspension* rule change and are supportive of changes which ensure the most cost reflective pricing mechanism is adopted during market suspension.

**Facilitating a return to normal dispatch pricing**

During a market suspension AEMO has a series of pricing options available. Currently, AEMO must progress through this list sequentially which takes the market progressively further away from pricing that reflects existing market conditions. AEMO is prohibited from moving back up the list towards normal dispatch pricing until the market suspension is lifted.

We are supportive of AEMO's proposal to remove the current restrictions on returning to market pricing when central dispatch operations return to normal but a market suspension may still be in place. Allowing a return to market pricing will minimise uncertainty and prevent perverse pricing and dispatch outcomes in the market.

The NEM operates on the principle of promoting efficient electricity supply using market pricing. Maintaining artificial dispatch prices for extended periods creates market distortions and leads to poor outcomes for consumers as participants can be incentivised to bid perversely. Examples of aberrant bidding behaviours were witnessed during the market suspension in South Australia between 28 September and 11 October. During this market suspension, AEMO successfully returned to dispatching generators based on the economic merit order of bids, however, dispatch prices were still fixed at default prices rather than market clearing spot prices. Consequently, some generators were incentivised to bid to ensure they were dispatched and others bid 'unavailable' and waited to be directed.[1] As

[1] AEMO, Requests for Rules – Market Suspension, 25 July 2017, http://www.aemc.gov.au/Rule-Changes/Pricing-during-market-suspension

default pricing was not reflective of market conditions, this incentivised bidding behaviours that led to inefficient market outcomes. The market operates using a central dispatch system to ensure efficient pricing outcomes and normal operation of the market should be prioritised.

In addition, perverse market outcomes can arise from the application of price scaling in neighbouring regions during the market suspension. When electricity is flowing into the suspended region, upstream prices are capped to minimise negative settlement residues. Under this scenario, it is possible that during periods of tight reserve conditions the scaling of the default pricing mechanism could result in a disincentive for peaking generation to be dispatched as the price they receive may be lower than their marginal cost of production, which is essentially at odds with the design of the market. This could lead to supply shortfalls where further intervention in the market by AEMO, such as directions to generate, is required. While a review of the consequences of the price scaling process is not considered to be in scope of this rule change by AEMC and AEMO, we urge a review of the scaling mechanism to address these concerns.

**Maintaining availability of appropriate pricing options**

Due to complexity in assessing which pricing option to apply during market suspension, AEMO has proposed to remove the 'pre-dispatch' and 'neighbouring-region' pricing options. While we recognise that continuous assessment of the most appropriate pricing system is onerous for AEMO, there could be merit in retaining these mechanisms. For example, if the market is suspended during a period of high prices, pre-dispatch pricing is likely to more accurately reflect the cost of supply in the short term than default pricing (which is based on average prices in the weeks prior the suspension). Although unlikely to be used frequently, we can foresee situations where these methods would provide the most cost reflective pricing signals and would be the most appropriate to use. Given the cost to AEMO of continuously assessing the options, we are supportive of removing mandatory consideration of these options. However, we consider that there could be benefits in retaining these as options for AEMO to utilise where they provide the most suitable pricing method for the market conditions.

In conclusion, we support AEMO's objective to revise market suspension pricing mechanisms and processes to ensure that cost reflective pricing is used as much as possible. Allowing AEMO to return to dispatch pricing, once market dispatch is operating as normal, will alleviate the disconnect between pricing and dispatch outcomes. Removing any false price signals will remove the incentives for opportunistic bidding behaviours that compromise the integrity, and principles, of the NEM. A return to efficient dispatch pricing will ultimately lower the cost of supply, providing benefits to all customers.

If you would like to discuss this submission, please contact Georgina Snelling on (03) 8628 1126.

Regards

Melinda Green
Industry Regulation Leader