

22nd February 2010

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Sent electronically to: submissions@aemc.gov.au
Project Reference code: REL0034

Dear Dr Tamblyn,

Submission to: Reliability Standard and Settings Review (Draft Report)

Snowy Hydro Limited appreciates the opportunity to comment on this important review. Snowy Hydro supports the Reliability Panel's recommendations on maintaining the existing reliability standard and its definition. We believe to date the evidence suggests that there has been sufficient generation investment and demand side response to meet the reliability standard and therefore see no need to change the standard or its current settings.

On balance we believe there is insufficient evidence to increase the Maximum Price Cap (MPC) to \$16,000 in financial years 2012/13 and 2013/14. An assessment of proposed new generation plant in the 2009 Electricity Statement of Opportunity (ESOO) and the increasing responsiveness of demand load to high spot prices suggest that the current levels of the MPC are sufficiently high to signal new investments to meet the reliability standard in the near future.

We believe the CPT should remain at 15 times the level of the MPC. Our analysis suggests that modifying the CPT to a smaller ratio of the MPC (ie. less than 15 times) would significantly increase trading days that are subjected to the Administered Price Cap.

Is there sufficient evidence to increase MPC?

It is important to note that the modelling results are an input into consideration of a change to the Reliability Settings. The other key inputs which are much more difficult to model but equally as important in the decision making process include:

1. Risk considerations for Retailers and Generators;
2. Actual evidence of market response to existing CPT settings (ie. generation investment and demand side response);
3. Impact of prudential requirements; and
4. Impact on competition in the market.

All the above factors are clearly canvassed in the NGF submission and hence we will not cover these any further.

The energy only market since its inception in 1998 has delivered gradual generation development to ensure that the Minimum Reserve Level (MRL) and the Unserved Energy (USE) have in large been met.

We recognise that this is a historical analysis and that the past may not adequately represent the future environment with on-going regulatory uncertainty. However, a quick scan of the Electricity Statement of Opportunity shows an abundance of proposed new generation.

From the 2009 Electricity Statement of Opportunity we approximate that in Calendar year 2009 there was approximately 840 MW of peak demand growth¹ in the 50% probability of exceedance NEM wide maximum demand scenario. For this same period there was approximately 2500MW of committed generation. This suggests more than sufficient new generation investment to meet peak demand growth.

The above analysis was re-affirmed by Roam Consulting at the Forum on 12/2/10 who showed that all Regions in the NEM had sufficient capacity to meet the MRL in the relevant 2012/13 and 2013/14 time periods with the exception of South Australia which required 50MW of additional generation in 2013/14.

With a relatively small reserve shortfall which has been sufficiently signalled to the market well ahead of time, we question the need to increase the MPC to \$16,000 to induce 50MW of additional generation in SA. The reserve shortfall could otherwise be met by alternative and arguably more cost efficient mechanisms such as:

- Reserve Trader arrangements;
- Inducing more Demand Side Response (DSP);
- Interconnector augmentations; and
- Incremental generation upgrades.

It appears that the Roam modelling results are suggesting increasing the MPC to maintain the reliability standard. However, the modelling results are very subjective and rely on a number of key inputs which may significantly modify the findings. These include:

1. The peakiness of the demand curve. This peakiness may be reduced by DSP which to date has been very conservatively reported by NIEIR and AEMO. This is a very important consideration given that “at the MPC recommended by this report some DSP may provide a lower cost alternative²”.

We note that a NGF member has provided analysis to suggest that demand is getting peakier but the duration of the peaks are longer. Thereby OCGT has in fact more hours of running time to recoup costs. Hence the MPC does not need to be as high to recover the OCGT's cost.

2. Capital costs of generation plant is dependent on many factors including the exchange rate. The ACIL Tasman report uses an exchange rate of 75 cents which we believe is very low and conservative. The rate should be in the high 80's to reflect the resilience and strength of the Australian economy. A higher exchange rate would offset higher input costs for new generation plant.

¹ 2009 Electricity Statement of Opportunity, page 3-21, the 50% POE NEM-wide winter maximum demand is projected to grow at 2% on average, in summer it was 2.4%. We have used 2.4% growth with the maximum demand at 35,000 MW to calculate the 840 MW peak demand growth.

² Roam Consulting, Reliability Standard and Settings Review, 15 January 2010, page 26 of 27.

3. The analysis ignores the contracts market. Investors react when contract prices increase and not to the potential for 6 hours of MPC which may or may not occur.
4. Other assumptions such as forced outage rates and bidding assumptions especially with respect to contract levels could substantially change the model results.

In summary, the result of the market modelling is an input to the decision making process. Other key factors such as the observed level of generation investment and DSP should arguably be given more weight in the decision making process.

Relationship of CPT to MPC

CPT is a risk management tool that is linked to Spot prices. We believe the level of 15 times is about right given that the CPT has only been triggered a few times.

There has been some debate amongst NGF members on whether the MPC could increase and at the same time reduce the CPT. The logic behind this idea is that the higher MPC allows an OCGT to recover costs while the reduced CPT reduces the risk to Participants of sustained high prices.

With the current MPC of \$10,000 / MWh, an Administered Price Cap (APC) is applicable for a Trading Interval if the previous 336 trading intervals for a Region exceeds the CPT of \$150,000.


Snowy Hydro has done some analysis to look at the affect of reducing CPT to different ratio.

This analysis uses historical Spot price data for the past two calender years starting from 01/01/2008.

During this period there were 27 days where an APC was declared (5 instances of varying length):

- In SA, from 17/3/08-18/3/08, 29/1/09-6/2/09 and 13/11/09-17/11/09
- In TAS from 16/6/09-18/6/09
- In VIC from 29/1/09-5/2/09.

If the CPT had been halved to \$75,000 then we calculate there would have been 125 days when an APC would have been declared (13 instances of varying length):

- In NSW, 31/10/08-7/11/08, 20/11/09-27/11/09 and 8/12/09-14/12/09
 - In QLD, 22/2/08-29/2/08
 - In SA, 10/1/08-17/1/08, 18/2/08-25/2/08, 6/3/08-20/3/08, 13/1/09-20/1/09, 29/1/09-7/2/09, 11/11/09-26/11/09, 11/1/10-18/1/10
 - In TAS, 12/6/09-23/6/09
 - In VIC, 29/1/09-6/2/09.
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The analysis clearly demonstrates that reducing the CPT by half significantly increases the occurrence of administered price periods. The increase is the order of over 450%. The analysis suggests that halving the CPT would have resulted in over 17% of all trading days in the last two years having at least one Region in an administered price cap.

The analysis demonstrates that a reduction in the CPT by reducing its ratio to the MPC while maintaining the current level of the MPC or increasing the MPC would increase the occurrence of administered price periods. In our opinion this would send the wrong signal to the investors that the market is short of generation and is too risky. It may also inappropriately signal to Governments to advocate for more generation when in fact the supply/demand balance is satisfactory.

Market Floor Price

We note that the Roam Report considers that there is no justification for recommending any change to the Market Floor Price (MFP). Snowy Hydro supports this recommendation. We believe that the MFP needs to be sufficiently negative to differentiate between all different generation technologies and their minimum operating levels. The current level of -1000/MWh is sufficiently negative to fulfil this role.

We suggest that any recommendation to change the current level of the MFP should be accompanied by detailed analysis to ensure that there is a clear and unambiguous economic case to make such as change.



Summary

In summary, the National Electricity Market is working and the evidence suggests that to date there have been sufficient generation investment and demand side response to meet the reliability standard.

All the available evidence suggests the market will continue to meet or exceed the reliability standard with the current levels of MPC and CPT. We therefore don't see a need and there is insufficient evidence to increase the Maximum Price Cap to \$16,000 in financial years 2012/13 and 2013/14.

In fact increasing the MPC in these relevant years may create unintended problems such as increased costs in managing risks, create an additional cost barrier for new entrants, and reduce overall competition in the market.

We believe the CPT should remain at 15 times the level of the MPC. Our analysis suggests that modifying the CPT to a smaller ratio of the MPC (ie. less than 15 times) would significantly increase trading days that are subjected to the Administered Price Cap and would thereby send the wrong signals to stakeholders about the sustainability of the market.

Snowy Hydro appreciates the opportunity to respond to this consultation. Please contact Kevin Ly, Manager Market Development & 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

