

25th February 2011

Mr John Pierce
Chairman
Australian Energy Market Commission

Submission lodged online at: www.aemc.gov.au
Project Number: ERC0108

Dear Mr Pierce

Submission to Network Support and Control Ancillary Service Rule Draft Determination

Executive Summary

Snowy Hydro appreciates the opportunity to respond to the Draft Rule Determination on Network Support and Control Ancillary Services (NSCAS).

Snowy Hydro believes TNSPs have very strong incentives to invest in network assets which provide NSCAS to meet their required jurisdictional standards and obligations. The Draft Rule will mandate TNSPs as the sole entity to procure NSCAS for market benefits. This raises a number of serious concerns for Snowy Hydro and other generators in the NEM.

Firstly, Snowy Hydro believes TNSPs are not adequately equipped or have the necessary Spot market experience to assess market benefits from the dispatch of NSCAS in the Spot market.

Secondly, by placing this function with TNSPs there is a real risk that the most efficient mix of network services is not procured by TNSPs because they may not understand the risk factors Service Providers face on the pricing of their network services.

Finally, the TNSP is not an independent third party in this process. TNSPs have a commercial interest in expanding their Regulatory Asset Base. The mechanism by which they will assess NSCAS offers from other Market Participants is through the RIT-T. The inputs assumed in the RIT-T will be critical factors in achieving an efficient outcome under the proposed new arrangements. Snowy Hydro's concern is that these inputs are biased towards their own network solutions.

Under the existing Rules the procurement and dispatch of NSCAS for market benefits has been performed adequately by AEMO. Snowy Hydro accepts that enhancing Spot market benefits is a subset of overall market benefits. However, enhancing the Spot market has a very important and material component of market benefits since Spot market outcomes have a major influence on the Contract market through forward contract prices and liquidity.

It is therefore argued that under the proposed new arrangements that appropriate weight / importance is placed on enhancing Spot market outcomes as a key component of overall market benefits. Given the importance of NSCAS to an efficient NEM and the skill set required to procure and dispatch NSCAS to enhance Spot market trade, we believe it is appropriate that AEMO **retain** the accountability and responsibility for planning and procurement of network services that deliver market benefits.

However, if the AEMC continues with the Draft Ruling that TNSPs have sole responsibility for providing NSCAS which solely deliver market benefits then Snowy Hydro believes there must be:

- an adequate transitional period for TNSPs to demonstrate that they have the necessary expertise to assess and quantify market benefits that are delivered by dispatching NSCAS in the Spot market;
- the TNSPs and AEMO must address a number of material transitional issues to ensure that the change-over of responsibilities from AEMO to TNSPs is likely to increase overall market efficiency; and
- specific Rule obligations on TNSPs and AEMO are required to ensure NSCAS are procured and dispatched where there are market benefits.

Snowy Hydro believes there needs to be at least an **18 to 24 month** transitional period to address the above implementation / transition issues prior to the commencement of the Rule change. At the expiry of this period there needs to be an independent assessment that TNSPs are adequately prepared for this transition.

Finally, the appropriate measure of success in these new arrangements is whether TNSPs have duplicated assets to provide NSCAS where there already exists other Service Providers who can provide this service. Snowy Hydro believes that under the proposed new arrangements TNSPs should only invest in NSCAS when there are **insufficient** services available from other Service Providers. That is, if the process by which TNSPs procure network services is open, transparent, and unbiased then rationally other Service Providers would shadow price their own service offering to the cost of network assets that must be procured by TSNPs through their Regulated Asset Base in the absence of alternative services by other Service Providers.

It therefore follows that the AER must apply close scrutiny to any TNSP investment in NSCAS where there exist alternative Service Providers that could have provided the network service. There must be detailed assessment of whether in fact the TNSPs have procured the most efficient type/mix of NSCAS. If the TNSPs could have sourced NSCAS from a more cost effective Service Provider then Snowy Hydro strongly believes that the network asset procured by the TNSP must be excluded from the TNSPs Regulatory Asset Base.

Are TNSPs Equipped to Procure NSCAS for Markets Benefits?

The Draft Rule Determination states¹ that “TNSPs have sole responsibility for providing NSCAS which solely deliver market benefits.”

Snowy Hydro believes that enhancing Spot market trade through the use of NSCAS is a major component of the overall market benefits. Network services currently contracted by AEMO have been used to support inter-regional flows. A reduction in inter-regional flows is a major risk under the proposed new arrangements. Such an adverse outcome would disrupt the contract markets and ultimately increase consumer prices.

Snowy Hydro reasoning for this concern is that TNSPs are not equipped or have the necessary Spot market experience to make an informed assessment of procuring NSCAS which delivers market benefits from enhancing Spot market trade. It must be noted that the NEM clears in the 5 minute timeframe. The decision to enable NSCAS is effectively done in real time. Snowy Hydro believes TNSPs simply don't have the detailed Spot market/central dispatch knowledge to perform this cost/benefit assessment.

¹ AEMC Draft Rule Determination, page 11

Snowy Hydro notes that the RIT-T has sufficient flexibility for TNSPs to avoid having to assess market benefit from “enhancing Spot market trade”. TNSP’s have also struggled with applying the Market Benefits section of the new RIT-T. Therefore it is expected that TNSPs will have an even more difficult task of assessing market benefits of network services which enhance Spot market trade in the dispatch (5 minute) time frame.

Snowy Hydro advocates that it is appropriate that the accountability and responsibility for planning and procurement of network services that deliver market benefits continue to reside with AEMO.

If however the AEMC persist with their Draft Ruling that TNSPs have sole responsibility for providing NSCAS which solely deliver market benefits then TNSP’s must demonstrate they have the capability and infrastructure to perform this function through an open and transparent consultation with all interested stakeholders. This consultation would include guidelines on how they will assess Spot markets benefits as a sub-set of overall market benefits and articulate what infrastructure they have in place to perform this analysis. Snowy Hydro envisages all Market Participants and AEMO would be interested in this consultation.

AEMO and TNSPs must have a clear understanding of how and when these procured network services would be dispatched. A potential complicating factor is that TNSPs procure and therefore fund the costs of NSCAS that deliver market benefits whereas AEMO has to dispatch these services through the central dispatch. There needs to be a clear Rules obligation to ensure that this interaction between TNSPs and AEMO would not decrease overall efficiency in the procurement and dispatch of NSCAS for market benefits.

Summary of Implementation Concerns

As highlighted above, implementation of the proposed arrangements and the interaction between TNSPs and AEMO is of critical importance to ensure an efficient outcome in the long term interest of consumers.

Similar implementation concerns are also relevant with AEMO’s potential involvement in the procurement process for system security and reliability.

The following is a non exhaustive list of key implementation / transition issues that must be addressed by either or both AEMO and TNSPs prior to the commencement of this Rule change:

- TNSPs demonstrating sufficient expertise to assess market benefits from enhancing Spot market trade. The TNSPs must conduct an open and transparent consultation process providing all interested Stakeholders with the opportunity to critique whether TNSPs have adequate systems and processes in place to perform this function that is currently done by AEMO;
- Tendering guidelines for non-registered Participants;
- AEMO and TNSPs to sought out tender provisions and outline how they plan to assess tenders on a competitively neutral basis; and
- AEMO to establish Regional Benefits calculations.

As outlined above there remain a number of material implementation issues for both TNSPs and AEMO to address. Snowy Hydro therefore believes there needs to be at least an **18 to 24 month** transitional period to address these implementation issues prior to the commencement of the Rule change. Given the importance of network services to the secure

and efficient operation of the NEM, serious consideration should be given to an independent assessment/audit that the end of this transition period to ascertain whether TNSPs are adequately prepared for this new role.

Specific Rules Obligations Required

The Draft Rule Determination requires TNSPs to provide NSCAS for market benefit. However, the Draft new Rules do not explicitly require TNSPs to provide NSCAS for market benefit.

There is also no specific Rule obligation for AEMO to dispatch NSCAS procured by TNSPs where there are net market benefits.

One of the key objectives of the proposed Rule was to clarify roles between AEMO and TNSPs in the procurement and dispatch of NSCAS. However, it remains unclear how TNSPs who procure NSCAS for market benefits would effectively co-ordinate with AEMO whose role would be to dispatch NSCAS where there are net market benefits. Hence, a Rule obligation is required on both AEMO and TNSPs to co-ordinate the procurement and dispatch of NSCAS where there are market benefits.

Snowy Hydro believes at least three explicit Rules obligations are required to clarify roles and meet the objective of the Rule change proposal:

1. A Rule obligation for TNSPs to procure NSCAS which solely deliver market benefits;
2. A Rule obligation for AEMO to dispatch NSCAS procured by TNSPs where there are net market benefits; and
3. An obligation for TNSPs and AEMO to co-ordinate with each other to ensure NSCAS is procured and dispatched where there are net market benefits.

Other Important Considerations

Snowy Hydro wants to highlight two very important considerations with this Rule change proposal.

Firstly, the issue of who pays for these services and the mechanism by which the costs are paid is expected to have a major influence on which type of services are procured. The cost of NSCAS procured by TNSPs would be recovered by transmission network charges to their customers and expensed in the current year that it is procured. The costs of these network services have been volatile and TNSP customers are concerned with the volatility and variability of transmission charges.

In contrast, if TNSPs invest in meet a NSCAS need through their own regulated investment, the cost recovery of this asset would be a charge that is amortised over the economic life of the network asset. This charge would be a lot smoother and more predictable than a service provided by other competitive Service Providers. Hence, TNSPs may favour their own capital investment in preference to services offered by Market Participants whose cost would be more variable and unpredictable.

Secondly, services contracted by AEMO have been targeted at supporting inter-regional flows. These interconnectors are at the jurisdictional boundaries of adjacent state TNSPs. Hence, there would need to be heightened level of co-ordination between adjacent TNSPs to assess market benefits that are derived by increased inter-regional flows from one jurisdiction to the adjoining jurisdiction. Co-ordination between different Jurisdictions would

be more complex than determining requirements within the individual TNSPs own jurisdiction with the result being less NSCAS is procured than is optimal. This risk has not been considered in this Rule change or Draft Rule Determination.

These two important issues further highlight the importance of an adequate transitional period to ensure that appropriate processes are in place to deliver the most competitive outcome for consumers.

Conclusion

Snowy Hydro believes TNSPs are not adequately equipped to assess market benefits from the dispatch of NSCAS in real time in the Spot market. To ensure that these proposed new arrangements are workable then there must be an adequate transitional period for TNSPs to demonstrate that they have the necessary expertise to assess and quantify market benefits that are delivered by dispatching NSCAS in the Spot market.

Given the materiality of implementation / transition issues there needs to be at least an **18 to 24 month** transitional period prior to the commencement of this Rule change.

Further to this, the Rules must have specific Rule obligations on TNSPs and AEMO to procure and dispatch NSCAS where there are market benefits.

Snowy Hydro believes that under the proposed new arrangements TNSPs should only invest in NSCAS when there are insufficient services available from other Service Providers. That is, if the process by which TNSPs procure services is open, transparent, and unbiased then rationally other Service Providers would shadow price their own service offering to the cost of network assets that must be procured by TNSPs through their Regulated Asset Base in the absence of alternative Service Providers.

It therefore follows that the AER must apply close scrutiny to any TNSP investment in NSCAS. Where there exist alternative Service Providers that could have provided the NSCAS there must be detailed assessment of whether in fact the TNSPs have procured the most efficient type/mix of NSCAS. If the TNSPs could have sourced NSCAS from a more cost effective Service Provider then Snowy Hydro strongly believes that the network asset procured by the TNSP must be excluded from the TNSPs Regulatory Asset Base.

Snowy Hydro appreciates the opportunity to respond to this Draft Rule Determination. Please contact me on (02) 9278 1862 if you would like to discuss any issue associated with this submission.

Yours sincerely,

Kevin Ly
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