

9th February 2016

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submission lodged online at: www.aemc.gov.au

Project Number: ERC0187

Dear Mr Pierce

Compliance with dispatch instructions Rule 2015 – Draft Determination

Snowy Hydro is disagrees with the Draft Determination. We believe there is clearly a problem with the current arrangements where strict compliance is required for compliance with dispatch instructions. As highlighted in our Rule change proposal it is impossible for scheduled generators to exactly meet dispatch targets, which exposes Scheduled Generators to enforcement at the discretion of the AER. It is only the exercise of the AER’s discretion (upon which there are no particular constraints) which prevents generators from being penalised for every dispatch interval in which they do not exactly generate the target output. This is an unsatisfactory situation, since the AER is not bound by own its own compliance policies and can modify or give new meaning to its stated position at any time.

Material Regulatory Risk Remains

As outlined in our Rule change, this strict compliance regime is economically sub-optimal and not required as there already exists strong commercial incentives to comply with dispatch instructions.

Based on previous AER guidance, AEMO’s non-conformance procedure under 3.8.23 which recognises departures from dispatch targets are part of normal system operation, and the Commission’s own Draft Determination¹, it is highlighted that all NEM institutions envisage variations of some degree from dispatch instructions. It is therefore inconsistent for the Rules under 4.9.8(a) to impose a “must comply” strict (exact) obligation on Scheduled Participants, which legally implies exactly meeting dispatch targets.

The adverse consequence of the current strict compliance regime is to impose unnecessary regulatory risk on Scheduled Participants. This regulatory risk results in inefficient generation plant operations in order to minimise the risk of being in breach of the black letter requirement of Rules

¹ AEMC, Draft Determination – Compliance with Dispatch Instructions, page 17. The AEMC states, “The Commission acknowledges that exact compliance with dispatch instructions may not always be possible due to the physical realities of operating generators. For example, the variability in the fuel to energy conversion process and accuracy of metering equipment causes fluctuations in a generator’s output.”

clause 4.9.8(a). Ultimately the Rules clause 4.9.8(a) is inconsistent with the National Electricity Objective.

The AEMC's Draft Determination ruling was premised on the AER not exercising its discretion to pursue minor "technical breaches" of 4.9.8(a). For instance, the AEMC states²:

The small number of AER enforcement actions relative to the number of "technical breaches" appears to show an approach that is consistent with the AER's stated approach.

However, the AEMC has missed the fact the AER in its recent published statement of approach³ to enforcing this Rules provision has opened the risk of breaching 4.9.8(a) for minor "technical" departures from dispatch instructions. For instance, the AER has removed the following key paragraph which was present in its 2006 guidance⁴:

While Registered Participants must endeavour to comply with dispatch instructions, the AER recognises that exact compliance with dispatch instructions in every dispatch interval is a physical impossibility. **Accordingly, the AER does not intend to pursue a breach of clause 4.9.8(a) with respect to minor departures from dispatch instructions that occur despite the best endeavours of a Registered Participant to comply** (emphasis added).

As highlighted above the AER has removed from its guidance the concept of "best endeavours of a Registered Participant to comply." Hence the AER's current stated approach may have changed from its past approach where it has only issued three infringement notices and instituted one legal proceeding for a breach of clause 4.9.8(a). In other words, past enforcement activity may not be a legitimate indicator of future enforcement activity. There is clearly an increase in the regulatory risk that the AER may pursue minor technical breaches of dispatch targets thereby imposing unnecessary risk and costs on Scheduled Participants.

Compliance Cost and Analysis

In the Rule change proposal Snowy Hydro outlined compliance costs related to minimising the regulatory risk of being in breach of the current exact compliance obligation to comply with dispatch instructions. For a Scheduled Generator like Snowy Hydro clause 4.9.8(a) mandates a dramatic reduction of energy conversion efficiency (from the renewable potential energy of the stored water) which increases costs as multiple machines are run at less efficient turbine efficiency points in order to minimise the risk of breaching the relevant Rule. A 5 to 10% loss of energy conversion efficiency is plausible and would come at an economic dead loss of the order of \$10 to \$20 million per annum across the Snowy Hydro Electric Scheme.

To minimise the regulatory risk of being pursued by the AER for a breach of 4.9.8(a), Snowy Hydro has had to adopt a 'good practice' measure of self-reporting material dispatch deviations (this is not a requirement under the Rules). In the past, there would be no formal AER response or an email noting receipt. To highlight our view that the AER enforcement approach has changed in recent times, submission of these notifications has been followed by a request for a teleconference and a

² AEMC, Draft Determination – Compliance with Dispatch Instructions, page 19.

³ AER Quarterly Compliance Report: January-March 2015.

⁴ AER, Compliance Bulletin – Complying with dispatch instructions, No.1 – December 2006, page 3.

number of questions seeking clarification. While no additional action has been taken, responding to these requests takes significant time and resources per notification.

Snowy Hydro notes that the Commission recognises this cost, for example⁵, “the Commission acknowledges that relaxing the standard for compliance with the rule may reduce the costs for some participants of complying with dispatch instructions”. However, the Commission states that⁶, “the current standard is likely to contribute to lower total system costs and therefore contribute to the NEO”. Snowy Hydro states the obvious that Scheduled Participants are in the best position to outline the compliance costs associated with endeavouring to exactly comply with dispatch instructions. We highlight that the AEMC has made a subjective assessment of compliance costs without countervailing analysis. Snowy Hydro therefore requests to see the AEMC’s analysis to underpin its assessment and conclusion on compliance costs.

The Rule 4.9.8(a) is Invalid

The fact is all Scheduled Generators will:

- a. regularly fail to achieve the particular/exact output specified in their dispatch instructions; and
- b. as a result, if clause 4.9.8(a) applies in accordance with its stated terms, regularly contravene a civil penalty provision in their ordinary day-to-day operations.

As demonstrated from our Rule change proposal in tables 1 and 2, it is virtually impossible for Scheduled Generators to exactly meet their dispatch targets and hence they are in effect at the mercy of the AER. It is only the exercise of the AER’s discretion (upon which there are no particular constraints) which prevents generators from being penalised for every dispatch interval in which they do not *exactly* generate the target output. This is an unsatisfactory situation, since the AER has absolute discretion and can modify or give new meaning to its stated position at any time.

In light of the above, we believe that clause 4.9.8(a) is invalid at law. That is, the sheer volume of ‘breaches’ of this provision by Scheduled Participants across the market leads to the ineluctable conclusion that clause 4.9.8(a) is, in administrative law terms, invalid on the basis that it is:

- 1) unreasonable; and
- 2) not reasonably proportionate to the subject matter the grant of the rule making power under s90 of the *National Electricity Law*.

Snowy Hydro remains of the view that clause 4.9.8(a) is deficient as it is legally invalid (and thus both susceptible to legal challenge and potentially uncertain in its enforcement).

In the alternative, if clause 4.9.8(a) does not require a Registered Participant to achieve the exact output specified in a dispatch instruction, it fails to communicate the obligation actually imposed by clause 4.9.8(a), and is accordingly invalid on the ground that it is uncertain.

⁵ AEMC, Draft Determination – Compliance with Dispatch Instructions, page 25.

⁶ AEMC, Draft Determination – Compliance with Dispatch Instructions, page 25.

Snowy Hydro is concerned that the Commission in its Draft Determination while acknowledging exactly meeting a dispatch instruction may not always be possible, does not amend 4.9.8(a) to reduce the risk of legal challenge on the validity of 4.9.8(a). This does not appear to be good regulatory practice to not address this matter in an orderly way rather than having it tested by the Courts. Any Court process would produce uncertainty and potentially disorderly behaviour and outcomes if Rules clause 4.9.8(a) is judged to be invalid.

Recommendations

The removal of the AER's guidance that they would not enforce 4.9.8(a) in an exact sense has increased regulatory risk for industry participants. Snowy Hydro advocates that the Final Determination to this Rule change proposal:

- 1) Considers amending 4.9.8(a) to reduce the risk of legal challenge in administrative law terms, on the validity of the Rule;
- 2) Considers reframing the "reasonable" endeavours to comply with dispatch instructions to a "best" endeavours obligation. This would in effect increase the standard of obligation to comply with dispatch instructions issued by AEMO; and
- 3) Require the AER to re-issue guidance on its enforcement framework to remove the regulatory risk from enforcement action for minor "technical" failures to comply with dispatch instructions.

Given the problems identified with the current Rule, an alternative construct of 4.9.8(a) is required. We believe on balance our proposed Rule change proposal appropriately trade-offs on the issues of: consistency between pricing and dispatch to ensure an efficient market, reduction in regulatory risk, reduction in compliance costs, and commercial incentives to comply with dispatch targets.

Snowy Hydro appreciates the opportunity to respond to the Draft Determination. Should you have any enquires to this submission contact me on kevin.ly@snowyhydro.com.au or on (02) 9278 1862.

Yours sincerely,



Kevin Ly

Head of Wholesale Regulation