

12th November 2004

Manager – Energy Market Reform Team
National Energy Market Branch
Department of Industry, Tourism and Resources
GPO Box 9839
Canberra ACT 2601

Submission by e-mail to: MCEMarketReform@industry.gov.au

Dear Sir / Madam,

Re: Regional Structure Review Consultation Paper

Snowy Hydro Limited (Snowy Hydro) strongly supports CRA's findings and draft report. CRA's recommendations as a package are sound and they offer a well-balanced proposal to address the known and significant deficiencies with the market regional boundaries as currently defined, the current ineffective code regional boundary change process and resulting unnecessary dispatch and general market inefficiencies.

Snowy Hydro strongly advocates that the MCE responds to the policy framework offered by CRA in an expedient and decisive manner. In summary we believe that:

1. CRA's findings offer a good holistic package. The package presented is a complete policy framework from which the market can evolve. The key recommendations (stringent regional boundary change criteria and long lead times, NEMMCO to continue to use option 4, and introduction of CSP/CSCs) will only work as a holistic package. With a partial implementation (through inappropriate selection of key recommendations), the economic value of the recommendations will be significantly diminished and more harm than good may result.
2. Any ongoing delays with respect to resolving the current regional boundary issues (and the implementation of the CSP/CSC) increases market risks and places further barriers to an efficiently operating market. It should be noted that the regional boundary review process has been stalled for the last 5 years. Any further delays will increasingly lead to:
 - Ongoing dispatch in-efficiencies (real economic losses);
 - Investment uncertainty and increased risk;
 - Higher costs to end use customers.

In addition, further future policy/principle consultations/reviews relating to these areas will risk signaling market regulatory failure, with resultant perverse market flow on effects.

3. The Jurisdictions have a rigorous and robust policy framework as a result of the exhaustive CRA study into regional boundary criteria and processes to manage network congestion. Accordingly Snowy Hydro recommends that MCE endorse the proposal as the policy framework in this reform area that is to apply to the market. Clear guidance and policy direction needs to be given to the AEMC to develop the detail (through appropriate industry consultation) and implement the CRA recommendations as soon as possible. Failure for the MCE to endorse as an appropriate policy framework will risk a complete re-run of the current consultation by the AEMC in the future and will leave the current market failings needlessly persisting into the future.

CSP/CSC

Snowy Hydro believes that the CSP/CSC proposal offers a number of major advantages over existing dispatch arrangements. Firstly, the CSP/CSC proposal ensures that generators face correct economic price signals at the margins for material intra-regional constraints. This eliminates the current perverse incentives for constrained on and constrained off generators to offer bids that decrease overall market efficiency and resultant lack of competitive disciplines on other generators. Secondly, the CSP/CSC proposal would significantly remove the requirement for disruptive intervention actions by NEMMCO to maintain system security. Finally, the CSP/CSC proposal will eliminate negative settlement residues caused predominantly from generator offers at times of material transmission intra-regional constraint and thereby firm up inter-regional settlement residues. This ultimately provides contracting certainty and thus increases inter-regional trade for the benefit of customers.

Another major advantage of the CSP/CSC is that it can be "removed" (i.e. no sunk costs of implementing) if the analysis on which it was justified proves to be incorrect or not as significant. This is a key advantage over actual new transmission upgrades/investments in order to alleviate transitory transmission constraints.

Any CSP/CSC implementation can be justified on net economic gain and it can be shown that it is not merely an economic transfer from one participant to another.

For the effective implementation of the CSP/CSC, both positive and negative CSP/CSCs are required otherwise there would be no neutrality in participant incentives.

The current proposal for the application of the Regulatory Test to include competition benefits implies that the need to take CSP/CSC arrangements into account in conducting the Regulatory Test.

Transmission access allocation (eg allocation of CSCs) remains a key issue for resolution. Allocation of the CSCs can be performed on a multitude of ways and the CSP/CSC proposal does not preclude any option, including allocation of rights on the same basis as the current implicit regional property rights. It is recommended that the MCE provide guidance to the AEMC to resolve this issue through industry consultation in a defined and timely timeframe including consideration of issue of grandfathering of rights. A clear and well defined timeframe for the consultation process is very important to ensure market inefficiencies are addressed as soon as possible.

Regional boundary change criteria

Snowy Hydro supports the proposed stringent regional boundary change criteria provided that the whole CRA package of recommendations is implemented as a package. Otherwise the criteria must be radically changed.

We note that the proposed 200MW minimum load for a region criterion should only apply to a 'radial' supplied load region, and not as a general criterion.

The total transaction and implementation costs for a specific CSP/CSC location is extremely low. Accordingly, Snowy Hydro recommends the CSP/CSC implementation process be triggered by NEMMCO whenever constraints cost exceed \$10,000 (i.e. the same threshold that NEMMCO use to implement negative SRA accumulation truncation under its current policy).

A 3-year notification period (following a yearly review) of a change in regional boundaries and a 5-year period in which region(s) are locked in is an appropriate approach. This Snowy Hydro support is conditional upon there being an expedient mechanism for the implementation of a CSP/CSC arrangement for significant constraints as they arise. Alternatively there needs to be an expeditious fix to the current very significant regional boundary problems that exist with the Snowy Region. These problems have been persistent

for a number of years and have impacted significantly on both system security and market efficiency.

Other General Observations

The CRA report rightfully identifies that dispatch and pricing can be (and perhaps should be) decoupled. The dispatch model must represent the underlying electrical network in order to correctly manage loading. A direct physical representation is ultimately the simplest and most transparent arrangement. This is a completely separate issue to pricing and settlement.

The draft CRA report has not addressed the very critical related issue of loop flow effects (and resultant 'efficient' counter-price flows between market regions). Snowy Hydro recommends that this be addressed in the final CRA report. A simple mechanism to address the issue is to require the regional reference node within the market region to be specifically excluded from being on the 'side' of a loop (as opposed to a 'Y' point). This should be required to be considered as part of the regional boundary criteria.

Current situation unsustainable

The current constraint formulation using option 4 with SRA truncation is the best currently available in the absence of CSP/CSC implementation. Never the less it is very problematic. Continuing to use Option 4 and negative SRA truncation without implementing CSP/CSC is unsustainable and is effectively untested.

Simply maintaining the status quo will continue to result in economic losses, inappropriate incentives, and higher risks to Participants, and ultimately higher costs to customers. By definition negative SRA truncation signals means no inter-regional trade is occurring (an outcome which is against market objectives).

Due to the ongoing significant problems with the existing Snowy Region definition, failure to either expeditiously fix the region definition or proceed with broader reforms will have significant consequences to the broader market. Under the current arrangements the following are very real potential outcomes (that would be prevented by the CSP/CSC applied to relevant Snowy region constraints):

- Tumut generation is "removed" from market competition even though there is a tight supply-demand balance in NSW;
- Significantly reduced certainty of summer reserves for Victoria and South Australia due to perverse artificial incentives on Murray generation, which may significantly increase the risk of load shedding of end use customers. (Ironically, NEMMCO has announced low reserve levels in these states for this summer).

These current perverse outcomes are not just wealth transfers. Such outcomes will inevitably create uncertainty and additional risk premiums for NEM participants and will inevitably result in increased real economic losses for the NEM.

Snowy Hydro strongly advocates an expeditious implementation of the CSP/CSC arrangements or alternatively an expeditious fix to the current Snowy Region boundary definition.

Conclusion and Recommendations

In conclusion, Snowy Hydro strongly advocates that the MCE endorse the CRA recommendations as a holistic package from which to “jump start” the stalled and necessary market reforms relating to constraint management, regional boundary changes and transmission investment. The CRA recommendations offer a robust policy framework from which the MCE can endorse and then arrange for implementation of much needed reform in these problem areas.

The status quo arrangements in these areas are unsustainable. More radical potential solutions such as full nodal pricing (for generators) will have very significant market disruptions, significant undesirable financial market impacts and is not supported by industry participants. The CRA proposed solution is the only known workable and pragmatic way forward.

Snowy Hydro appreciates the opportunity to provide input into this consultation. To discuss any issue related to this submission I can be contacted on (02) 9278 1885.

Yours sincerely,

Roger Whitby
Executive Officer Trading