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Ms Katy Brady

Australian Energy Market Commission

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Dear Katy,

EPR0070 Investigation into intervention mechanisms and system strength in the NEM

AGL Energy (AGL) welcomes the opportunity to comment on the Australian Energy Market Commission (AEMC) investigation into intervention mechanisms and system strength in the National Electricity Market (NEM) Consultation Paper.

We note the Consultation Paper examines two rule change proposals from the Australian Energy Market Operator (AEMO) regarding the market intervention participant compensation threshold and the Regional Reference Node (RRN) Test following activation of the Reliability and Emergency Reserve Trader (RERT).

Our response to the rule change requests and the AEMC's consultation questions are set out below.

Intervention mechanisms in the NEM

As the Consultation Paper neatly summarises, the purpose of AEMO intervention is to maintain and/or restore the reliability and security of the NEM when regulatory processes or market responses have not produced the required outcome.

AEMO intervention in the market has increased in response to the challenges of an energy market in transition, along with some unprecedented weather events. AGL supports the need for a robust intervention framework in the NEM to minimise the impact of intervention events on market signals and outcomes.

AGL supports retaining the current priority afforded to RERT at times of supply scarcity, with no subsequent ranking set out in the National Electricity Rules (NER) for directions of instructions. Broadly speaking, AEMO intervention should aim to minimise costs to consumers and market impacts and retaining the existing ranking appears to support these aims. In particular, the AEMC has recently made a final rule on the Enhanced RERT, introducing a new principle in the NER that RERT costs should not exceed the average value of customer reliability (VCR) for the region it is being used. The AEMC expressed a view that the costs of emergency reserves should be less than the costs of involuntary load shedding, that is, instructions. AGL agrees with this view.

Regarding directions and instructions, in practice, AEMO is likely to issue directions for generation prior to issuing instructions for load shedding, but overall, we consider it is appropriate for AEMO to make such assessments as necessary rather than the NER specifying priority.

One final point to note on the question of priority is that the principles underlying AEMO intervention for both RERT and directions includes the aim of minimising the number of affected participants. In our view,

applying this principle will not necessarily lead to the lowest cost option being applied, however given AEMO has to make its decision to exercise the RERT at times when the power system is under stress, it is probably not appropriate for it to have to calculate the potential costs of RERT as compared to directions when a quick decision is required.

Intervention pricing

As noted above, when AEMO intervenes in the market, it must consider how to minimise market impact and the cost to end consumers. Counteractions could be an effective tool in minimising the impact of market directions, specifically by minimising the impact on interconnector flows and reducing the impact and number of affected participants in neighbouring regions. The Consultation Paper, in considering the efficacy of counteractions, asks whether it is better to utilise this is manual process, or to let NEMDE optimise the dispatch targets once a direction has been issued.

We appreciate that AEMO's current systems do not support automatic implementation of counteraction constraints, however AGL considers there is merit in examining whether NEMDE can be configured to optimise counteractions. We believe this could be done by region and would produce improved outcomes by reducing the effect of directed megawatts in the affected region whilst minimising the impact on interconnector flows and affected participants in neighbouring regions as mentioned earlier.

The Consultation Paper asks whether AEMO should implement intervention pricing when it counteracts a direction, given the purpose of the counteraction is to offset the direction. In asking this, the AEMC acknowledges that even when counteractions are applied, they do not necessarily offset the impact of the direction in practice.

Our view is that intervention pricing must be implemented, regardless of whether counteraction has been applied, until it can be demonstrated that real-time NEMDE counteraction dispatch can at all times eliminate the distortionary effects of directions on the market price. We also note that, even with real time NEMDE counteraction dispatch, there will still be periods where exact counteraction cannot be achieved due to the generation mix in service at that time, and there will be perverse price outcomes without intervention pricing.

The NER provide that when an AEMO intervention event occurs, AEMO must set the dispatch price and ancillary services price at the value which AEMO, in its reasonable opinion, considers would have applied in that region had the AEMO intervention event not occurred.

From this, it is clear the purpose of intervention pricing is to minimise market distortion resulting from the intervention. The act of issuing a manual counteraction, or direction, is itself a distortion of the market. Accordingly, intervention pricing should continue to apply.

The same logic applies when responding to the SW Advisory and Endgame Economics recommendation that intervention pricing apply only where there is scarcity of traded services, and not in the case of directions for system strength. We strongly reject this argument, on the basis that any AEMO intervention in the market is a distortion of it, regardless of the driver, that is, supply scarcity or system strength. The impact of such distortion is best mitigated through intervention pricing.

A further recommendation of SW Advisory and Endgame Economics is to set the dispatch price at the market price cap when the RERT is activated, similar to the framework applicable to involuntary load

shedding under AEMO instructions. Our view is that this approach would strip the RERT of a significant aspect of its purpose, which is to minimise financial impact.

For example, AEMO's report on the events of 24-25 January 2019 explains how the activation of the RERT on those dates precluded the need for more load shedding than that already called upon, at a saving of around $52 million. This outcome was clearly due, in part, to the fact that the spot price does not automatically hit the market price cap when RERT is activated as it does for load shedding.

Ultimately, we consider that the current arrangements for the application of intervention pricing should be retained.

The RRN test

The Consultation Paper considers the AEMO request to apply the RRN test to RERT activation in the same way it is applied to directions, on the basis that preserving a scarcity price signal is not appropriate when a direction is given for plant at a specific location to resolve a local issue. AGL does not have a strong view on this matter, other than to reiterate the underlying principle that intervention pricing is applied to preserve market signals by minimising the distortion caused by market intervention.

We consider it would be extremely unusual for the RERT to be activated in any circumstance where the RRN test would not be met, had the test been applied. In other words, it is unlikely that the RERT would be activated to resolve a local issue where the RRN test would not be met. Therefore, in practice, the fact that the NER do not currently require the RRN test to be met, is unlikely to be impacting price outcomes.

Regarding the specific wording of the AEMO rule change proposal, AGL agrees with the AEMC that there are concerns with specifying directions for 'energy' and 'market ancillary services' when the existing test does not. AGL's view is that the test should not be redrafted in this way given the unclear definitions of these terms that would lead to the test excluding certain types of directions, such as those for system strength. As stated above, we do not consider that the application of intervention pricing should be impacted by the driver of the intervention event.

The compensation framework

AGL is largely happy with the application of the NER compensation framework, except for the compensation threshold that prevents compensation claims of less than $5000 per trading interval. The application of this threshold in a heightened 'directions' environment has meant that significant costs have been unable to be recovered. Accordingly, we strongly support the AEMO rule proposal to instead apply this threshold per intervention event. We accept that should the rule be made, it may be appropriate to raise the $5000 threshold to a higher set amount.

The Consultation Paper explains the difference between directed and affected participant compensation, with the former compensated at the 90th percentile price with a safety net for costs incurred, and the latter compensated to put them in the position they would have been in but for the intervention event. The AEMC asks whether affected participants should be compensated at all, given there is no right to dispatch and constrained off generators are not compensated during normal system operation. Restating the principle outlined above in our views on intervention pricing, the purpose of intervention pricing, including compensation, is to mitigate the distortion caused by market intervention, regardless of the cause of that intervention. Accordingly, affected participants should and must be compensated.

Focusing on directions, the AEMC questions the appropriateness of the 90th percentile price approach to compensation, indicating that it incentivises participants to await direction. Using South Australian (SA) system strength as an example, we disagree with the view that the 90th percentile price is an incentive for SA gas generators to await direction. We note that the benefit of the 90th percentile price, relative to short run marginal costs, is significantly less now than at market start, primarily due to a significant increase in fuel cost. Also, an SA generator committing uneconomically, without a direction, not only risks receiving negative prices for its generation, but also for its entire regional portfolio, which may be comprised of significant megawatts of renewable generation.

There are also other underlying a decision whether to bid generation into the market and at what level, and a generator has the right to manage its portfolio with respect to the factors important to it. For example, a generator may wish to conserve fuel during period where dispatch is uneconomical and can bid itself as unavailable. Should AEMO determine that the generator be directed on at the time that the generator would prefer not to be, that generator has a right to be compensated following AEMO's direction. In our view, this is not a perverse outcome, but simply a fair one that is mostly reflected in the current rules, with the exception noted above of the $5000 threshold.

AGL is unaware of the origins of the 90th percentile price framework but considers it has produced fair and appropriate outcomes and does not require amendment. Per participant costs have previously been considered as an alternative, but we would suggest not taking this path, as determining the per participant costs is a difficult exercise that will not necessarily produce an accurate result, or agreement between AEMO and the participant.

Finally, the AEMC has asked whether details of compensation paid, and the identities of compensated participants should be published, suggesting that this information would be useful in determining the efficiency of bidding practices. AGL does not consider that publication of this information is necessary, given the NER and AEMO Guidelines set out precisely how compensation is calculated. Further, the bidding practices of generators are governed by the NER and competition laws, and subject rigorous scrutiny by both the Australian Energy Regulator and Australian Competition and Consumer Commission. In our view, the work of these agencies is sufficient to monitor generator behaviour.

Minimum levels of system strength and inertia

The AEMC is investigating whether the system strength and inertia frameworks are appropriately addressing system strength and inertia shortfalls, with a view to limit the need for directions and the subsequent application of intervention pricing. The AEMC has asked whether there are interim measures that can be applied to address system strength issues while longer term network solutions are implemented.

Whatever measures are selected to provide necessary services to the market, the key factor is that these services must be valued and compensated appropriately. AGL supports the introduction of an appropriate incentive framework for services including system strength, inertia, voltage support, and frequency control. We appreciate that the AEMC is proposing to look at this as part of its future work program and look forward to engaging further on these issues.

If you have any queries about this submission, please contact Liz Gharghori on (03) 8633 6723 or lgharghori@agl.com.au.

Yours sincerely,

Chris Streets

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