Macquarie Generation

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Australian Energy Regulator
GPO Box 520J
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Attention: Market impact incentives

Email: AERInquiry@aer.gov.au

Dear Regulator

SERVICE TARGET PERFORMANCE INCENTIVE SCHEME

Macquarie Generation supports the introduction of the proposed incentive model (option 5) outlined in the AER's Issues Paper, *Developing Incentives based on the Market Impact of Transmission Congestion*, released in June 2007.

Macquarie Generation agrees that the proposed *marginal cost of constraints – outage notification* option should, if calibrated appropriately, improve the incentive for transmission network service providers to schedule network outages at times that are less likely to have a significant impact on the market. The proposal has a number of strengths:

- Focuses on network congestion caused by outages – the one area of congestion under the direct control of TNSPs;
- Encourages TNSPs to schedule network outages so as to avoid high demand periods and focuses on those network outages that have a material impact on the market – should not affect the timing of outage work on non-critical parts of the transmission system.
- Encourages TNSPs to plan ahead and give market participants significant notice of major outage works.

Notification weighting

Macquarie Generation agrees that the proposed incentive scheme should discourage TNSPs from scheduling outages at short notice. While TNSPs should face incentives to plan outages to critical network elements during low demand periods, they should not be heavily penalised for proceeding with outages that were scheduled with significant notice.

Generators respond to outage plans in a number of ways:

1. *by varying their financial contract position.* Outage plans will influence the timing and volume of forward contracts that a generator is willing to sell. Cancelling and rescheduling outages at short notice can impose significant financial costs on generators if they are not able to match their physical production levels with their contract positions. Generators are more likely to provide risk management products to retailers and other intermediaries if they have a high degree of confidence that the TNSP will follow their outage plans, particularly those scheduled many months in advance.
2. *by coordinating plant maintenance downtime with planned network outages.* It is expensive and often impractical to move a unit outage if a network outage is cancelled with little notice. A low cost generator that is not able to reschedule its maintenance work would be unavailable during the period of the unit outage and may be constrained from participating in the wholesale market during the period of the rescheduled network outage.

Macquarie Generation proposes the following notification weightings for the incentive mechanism (table 1). The weightings are designed to discourage outage scheduling at short notice – the highest weightings are given to outages that take place with less than seven day's notice. Historically, it is these short notice outages that tend to have the highest financial impact for participants.

While TNSPs would be heavily penalised for scheduling outages at short notice that then have a significant market impact, the proposed weightings still provide a financial incentive to move planned outages from periods with a high market impact to periods with a low or no market impact. For instance, a weighting of 10 (or 2% of the maximum penalty) applies for outages planned with only a week's notice provided the outage does not increase spot prices by more than $10/MWh.

Table 1: Proposed reward outage notification weightings

	< 24 hrs	1-3 days	3-7 days	1 week – 1 mth	1 mth – 3 mths	3 mth – 6 mths	6 mth – 12 mth	> 12 mths
>$10/MWh	500	200	150	100	50	30	10	5
<$10/MWh	50	20	15	10	5	3	2	1

Macquarie Generation considers that the AER should not penalise TNSPs for outages that are rescheduled because of system security or system reliability reasons.

Over booking of outages

Any scheme that penalises TNSPs for scheduling outages at short notice and rewards TNSPs for informing the market well in advance may create an incentive to "over book" outages – a potential form of gaming. A TNSP may schedule a greater number of longer outages than it reasonably needs. The TNSP could then cancel those outages that may have a significant market impact when it has better information on likely market conditions. The TNSP is not penalised because the outages that do proceed were notified in advance. This greater frequency of cancelled outages makes it difficult for the generation sector to plan maintenance work and agree forward contracts.

For an incentive mechanism to work it needs to be reasonably simple and transparent for all participants. Macquarie Generation supports the incentive mechanism in the form proposed by the AER. One way of discouraging possible over scheduling of outages is to monitor and report on the number and timing of outage cancellations each year for each TNSP. The AER may need to modify the mechanism or withhold incentive payments if the number of cancellations increases significantly.

Periodic review

The proposed incentive mechanism has a number of arbitrary features – the notification weightings, the market impact threshold, the size of the financial reward and penalty. It is difficult to know in advance how such a scheme may influence TNSP behaviour. Hopefully it will better align TNSP planning schedules with those critical hours in the market where it is necessary to maximise network availability. However, there may be unintended consequences or the scheme may not be provide sufficient incentive to drive better planning practices. The AER should commit to review the incentive mechanism after two or three years of operation.

Summary

Macquarie Generation agrees with the comments made in the National Generators Forum submission in support of the option 5 proposal. This brief submission emphasises the need for a relatively high degree of certainty in the planning schedules of the TNSPs to facilitate efficient production and maintenance planning by generators. Macquarie Generation's proposed outage notification weightings would achieve this goal while still providing an incentive for TNSPs to consider market impacts as part of their long and short term planning processes.

Yours faithfully

RUSSELL SKELTON
MANAGER MARKETING & TRADING

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