

Dr John Tamblyn
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Dear Dr Tamblyn

SYSTEM RESTART ANCILLARY SERVICES

Macquarie Generation welcomes and supports the Australian Energy Market Commission's findings in its Draft Rule Determination – *System Restart Ancillary Services and Pricing Under Market Suspension, December 2005*.

The key conclusion in the Commission's determination is its endorsement of the benefits of an open, market-based approach to the procurement of restart services and its recognition of the potential for regulatory failure under the cost-based model proposed by NEMMCO.

Macquarie Generation's earlier submission to the Commission argued that the NEMMCO proposal would effectively make NEMMCO and the dispute resolution advisor responsible for the economic regulation of system restart ancillary services. Various clauses in the proposal made references to 'efficiently incurred long run incremental costs' and remuneration that is 'sufficient, but not more than sufficient'. The proposal also allowed for NEMMCO to directly tender for facilities to provide restart services following an unsuccessful tender process.

The Corporation argued that such an approach is inconsistent with the notion that generation in the NEM is a contestable activity that provides opportunities for participants to respond to price signals. While it is the case that regulation is instituted under the Rules to limit economic rents in the provision of transmission and distribution services, such centralised controls were explicitly not considered for constraining the returns of market generators or retailers.

In its report to the Commission, Firecone observed that NEMMCO's main concern related to the price it pays for system restart ancillary services in a thin market rather than to the loss of economic efficiency, for example by procuring the restart services from inefficient providers or procuring the wrong amount of service. Firecone concluded that NEMMCO had not provided any evidence that the scale of any inefficiency is sufficient to justify the introduction of a cost based pricing regime.¹ The Corporation believes that in the absence of such evidence or compelling reasoning, the design of NEM rules for wholesale generation should favour arrangements that promote market mechanisms and minimise barriers to competition.

¹ Firecone, *Proposed NEMMCO Rule for System Restart Ancillary Services*, Final Report, December 2005, p.19.

In terms of inefficiencies associated with a model that relies on the threat of regulation, the Commission's determination provides a good summary of potential sources:

A quasi-regulatory approach risks distorting investment decisions, removing incentives for participants to take part in future tender processes, and has significant costs. In the Commission's view, while in theory a quasi-regulatory approach may offer the potential for productive and allocative efficiency, in practice such a process will involve significant risks and costs and has the potential to impede entry investment and the development of competitive provision of SRAS. (p.46)

Macquarie Generation considers that the AEMC's draft determination applies a robust framework for assessing the relative merits of the various procurement models, institutional arrangements and procedural arrangements. The result is a well-balanced and well-researched report. The Commission addressed the major issues raised in our submission and provided adequate reasoning in responding to those concerns.

It is particularly pleasing that the AEMC has given sufficient weight to the dynamic efficiency benefits that should arise from allowing market signals to guide generator investment decisions in a contestable market. The report provides market participants with confidence that the AEMC will approach its rule-making responsibilities in a way that tends towards light-handed regulatory approaches that support market models.

It is also positive to note that the Commission engaged independent economic advice on the fundamental issue of the degree of contestability in the restart service market and incorporated that expert advice in the redesign of the tendering arrangements.

Macquarie Generation believes that the onus should be on NEMMCO or other interested parties to demonstrate that there are prohibitive barriers to entry or other sources of market failure in the provision of restart services that would justify a fundamental shift in the approach adopted by the Commission in its draft determination.

Yours faithfully



RUSSELL SKELTON
MANAGER MARKETING & TRADING

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