

Date: 18<sup>th</sup> June, 2009

The Chairman  
Australian Energy Marketing Commission  
Level 5, 201 Elizabeth Street  
SYDNEY NSW 2000

Dear Sir,

**Reference ERC 0082/2**  
**Observations on additional information from Hydro Tasmania**

Thank you for the opportunity to comment on the additional submissions by Hydro Tasmania in support of its proposed Rule change labelled "Causer Pays for Ancillary Services in Tasmania".

Hydro Tasmania has now submitted two supplements to its original submission, changing the process but not the intent, which appears to be a "wealth transfer from the TVPS..." (Clause 6 of 23<sup>rd</sup> December submission). We take this opportunity to reiterate our opposition to the proposed rule change and confirm that the thrust of our submission of 13<sup>th</sup> March 2009 still stands.

That said, the following refers to Hydro Tasmania's proposed changes to its original submission.

Issues in the subsequent submissions that will affect Gunns' proposal to connect its steam turbine generator to the Tasmanian grid are:

1. The revised sunset clause (Clause 5.3 and 5.4 of 20<sup>th</sup> March submission).
2. "Any generator is able to manage their FCAS costs" (Clause 3.2 of 20<sup>th</sup> March submission).
3. "Should TVPS pay for FCAS when it is not running" (Clause 3.1 of 20<sup>th</sup> March submission).
4. The change to the proposal to only consider fast raise FCAS. (13<sup>th</sup> May submission)
5. The effect of machine inertia on the FCAS requirement.

These issues are considered in more detail below.

1. The revised sunset clause appears to indicate that the derogation would terminate at the time the Gunns generator (or similar) is commissioned

(or ready to commission, depending on which part of the paragraph you read).

In introducing this change Hydro Tasmania is, in effect, confirming the inequity of its proposed rule as:

- If the rule were valid in the first instance, why should it change with the advent of another generator? Has the perceived problem disappeared?
- If there were a sound rationale for the first new generator that could not comply with the old standards to pay, then it should follow that subsequent generators that also could not comply should also share in the additional FCAS costs.
- It introduces an uncertainty in how long the “so called” causer pays for the additional FCAS costs. Under the Hydro Tasmania proposal this could potentially vary from 1 to 15 years. This represents a huge potential variation in the financial impost outcomes on Tamar Valley Power Station. Clearly, not all of these outcomes can be equitable and, if this is so, the application of the proposed rule is flawed.

These potential inequitable imposts ultimately arise as a consequence of an incorrect premise in the first instance, namely that the cause of the problem is the new generator. It is not. The cause is the fact that the old standard was significantly out of line with that required for a modern multi-generator system such as that found on mainland Australia and in most developed countries around the world. The AEMC recognised this and scheduled this latest review long before the Tamar Valley Power Station was planned.

If the Rule change was applied, the additional income that Hydro Tasmania hopes to gain could cease within the next few years rather than the 15 years that it anticipated in its original submission. We wonder then what other ways it will seek to recover its perceived losses. This, in itself, introduces a level of uncertainty for subsequent participants.

2. Hydro Tasmania states in its first Supplementary Submission that “Any generator is able to manage their FCAS costs.” This may apply in an effective market situation, but it is obviously not the case where there is only one supplier.

Hydro Tasmania, being the only registered supplier of FCAS in Tasmania, has demonstrated its ability to manipulate the FCAS market to its benefit. For example, in the three weeks from 29<sup>th</sup> March, 2009 the average cost of FCAS in Tasmania was \$10.47 million per week, while the average weekly FCAS cost for the remainder of the NEM was \$228,000 (AER Weekly Market Analyses – 29<sup>th</sup> March-18<sup>th</sup> April). The average weekly FCAS cost in Tasmania in the 4 weeks before this period was \$41,400, and in the 4 weeks after this period was approximately \$69,300.

Hydro Tasmania is also the only recipient of FCAS revenue in Tasmania, so the FCAS price would have had little effect (other than to Roaring Forties, which is partly owned by them), but it may not have been a coincidence that the period of high FCAS charges coincided with the time that the new Tamar Valley Power

Station was attempting to commence commercial operation – a process that was stopped as the FCAS costs they had to pay were greater than the revenue they received from the spot market.

3. Hydro Tasmania is now requesting, through this rule change, to transfer income from new registered generators even when they are not connected or, in Gunns case, even while it is acting as a consumer. This is certainly not an example of a Generator having control of its costs.

Gunns is concerned that, as a future competitor of Hydro Tasmania, it will be presented with similar conditions to those that Tamar Valley Power Station is now facing, especially if it could be faced with unknown and possibly extreme costs even, if this rule change were approved, when its generator is not connected to the Tasmanian grid.

4. The proposal appears to have changed from applying to all additional FCAS required due to the application of the new frequency standard, to applying to only fast raise FCAS. The subsequent letter from NEMMCO indicates that they believe this to be the case, but does this mean that any new generator that could have met the existing standard for low frequency excursions would not be liable under the proposed rule change?
5. We understand that NEMMCO has already taken steps to include the effect on the system of the machine with the highest inertia in the State when calculating FCAS requirements, so the inclusion of this in the Rule change proposal should not be necessary. When connected, the Gunns steam turbine generator will have the highest inertia in Tasmania, but this would only be included in FCAS calculations when it was connected.

Hydro Tasmania has included proposed wording for the Derogation, but after the 2<sup>nd</sup> supplementary submission it is no longer complete, as it doesn't include any of the changes proposed in their first supplementary Submission. This means that we are no longer sure of the scope of the proposed change on which we are commenting.

If all the changes that have been proposed are incorporated, it appears that the rule change is aimed purely at one competitor, as the proposed change may expire when the next machine is commissioned. The next machine is likely to be the Gunns' steam turbine.

**Is this Rule Change necessary, particularly to achieve the National Electricity Objective?**

Gunns' previous submission has stated that it considers that this proposed Rule change is contrary to the stated objectives of the National Electricity Law. This remains the company's position.

Recent events have confirmed our opinion that the proposed rule change is also unnecessary. Hydro Tasmania has the ability within the present rules to recover any reasonable additional costs that it believes it incurs, through the normal FCAS market processes. There is, however, a fine line between cost recovery and profiteering or anti-competitive behavior, the latter of which are potentially open to the dominant player in markets such as that currently prevailing in Tasmania.

Significantly, the target of this rule change (Tamar Valley Power Station) is in effect the only major entity that would be required to outlay FCAS payments under the present rules, as any payments that Hydro Tasmania and Roaring Forties are required to make are returned to Hydro Tasmania as the provider. It has not escaped our notice that the target of this rule change is also the first competitor to Hydro Tasmania since its inception some 100 years ago. As a potential additional competitor to Hydro Tasmania, Gunns seeks a level playing field. The proposed Rule change achieves the opposite.

If you wish to discuss any of the matters raised above, please contact Pieter Blom on 03 6335 5455 or 0409 024 416, or Neville Smith on 03 6335 5429.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Les Baker', written in a cursive style.

**Les Baker**  
**General Manager – Bell Bay Pulp Mill Project**  
**Executive Director – Gunns Plantations**