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Dr John Tamblyn
Chairman
Australian Energy Market Commission
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Dear Dr Tamblyn

AEMC Reliability Panel - Consultation on the Panel's review of the frequency operating standards for Tasmania

Introduction

The NGF believes that as a matter of principle, the technical parameters that underpin the physical operation of the market must be set at a level that balances the secure and reliable operation of the system with the economically efficient operation of the market.

In addition, the interests of a seamless and integrated market are best met when the operational standards are applied in a consistent manner across the market, subject to economic and technical feasibility, and applied in a technologically neutral manner across all plant types and supply sources.

We consider, however, that the costs that result from changing the system standard should be applied to those that required or directly benefit from the change. In addition the principle of grandfathering for existing investments, to respect the physical capability that the plant was originally designed to achieve at the time of commissioning, should be applied. Existing plant is capable of meeting the current Tasmanian standard and should not therefore be penalised if a tighter, more costly standard is now applied.

This submission identifies from the NGF view the relevant and important economic factors that the Panel should consider when assessing any changes to the standards, taking into account the new entrant in Tasmania.

1 Economic analysis of changing the frequency standards

The first two principles above suggest that the Tasmanian frequency operating standards should progressively move toward the mainland standards if it is economically efficient – more simply, provided the costs of doing so are exceeded by the benefits.

Alinta, a new entrant generator in Tasmania, states that the benefits of tightening the standards will include improved quality of the power supply for participants and consumers and increased competition through facilitation of new entry, leading to lower prices for consumers.

In addition, there may be improvements in long term security and reliability benefits through improved plant mix and greater fuel diversity in Tasmania including reduced reliance on hydro-electric sources and imports.

The NGF notes that the extent to which lower prices will eventuate in practice will depend on the competitive market structure in Tasmania. We do not see the Panel's primary role as assessing the benefits of competition. In this case, however, it will be necessary to do so to identify some of the benefits of the change. This will need to be done with some care since, any efforts made towards aligning the Tasmanian frequency standards with international or mainland standards should also take into account any impact on the local market structure, new entrants, the imposition of costs or restrictions on incumbents, and on competitive outcomes.

This requires that the Reliability Panel undertake a thorough assessment of the potential costs of tightening the standards, to ensure they are set at a level which maximises the net benefits to consumers over the long term, consistent with the National Electricity Objective.

In the NGF view, given the above, the RP will need to determine the least cost approach to defining the frequency standards taking into account;

- direct costs[1] of altering existing systems to accommodate any tighter frequency standards such as the cost of implementing technical changes and purchase of additional control systems or plant and equipment, and
- indirect or hidden costs that may result such as the impact on existing commercial arrangements and the requirement to provide additional service (such as FCAS) or the provision of "non standard" solutions on affected incumbents. These are of concern as the new entrant has capacity in excess of the plant currently installed, and hence will require additional ancillary service in some circumstances. The changes can impact on current arrangements, other participants and hence competitive outcomes.

2 Provision of services to meet system standards

[1] In considering the potential costs involved, a number of factors need to be assessed over the short and long-term. These include:

- Impacts on the requirement for and supply of FCAS in Tasmania;
- Consideration of whether there is a commercial incentive for any investment in new sources of FCAS (because Basslink can transport FCAS from the mainland most of the time, it is hard to recover the costs of such an investment);
- Impacts on the operation and import capability of Basslink;
- Operational impacts, including under-frequency load shedding priorities, over-frequency tripping arrangements and system management implications;

As a separate but related issue, service provision deserves particular consideration by the Reliability Panel, given that under the market Rules a participant that causes increased requirements does not bear the cost of that increase in all circumstances.

In the absence of market signals on this matter, it falls to the Reliability Panel to consider the related costs and benefits.

The NGF notes that the current arrangements for the provision of some services by participants under connection agreements to support the system standard, are expected to be provided free of charge by generators or are generally considered to be a common good and the costs for providing additional FCAS or other services are smeared across all participants - both generators and retailers.

This means that at the time an investment decision is made there is no mechanism to ensure that the least cost approach to meeting the reliability standards is selected by the new entrant.

For example in Tasmania, it is not clear whether or not the current approach of installing standard plant and incurring the cost of modifying the frequency standards[2] or installing non standard plant specifically selected to meet the existing reliability standards is the least cost approach for consumers.

The NGF is not saying the investment decision is not the least cost, only that the current arrangements for paying for and funding services to meet system standards does not necessarily ensure the least cost approach is considered as part of the investment decision.

The NGF is of the view that wherever possible the provision of these services should be provided on a competitive fee for service basis. These services can be a scarce resource, as may be the case in Tasmania, and provision on a competitive basis would support the development of additional resource where required at least cost. This would support the objective of ensuring the lowest cost delivered energy to consumers.

In principle, new entrants should install plant or procure the services required to ensure their plant can operate within the standards existing at the time of connection without harming incumbents. This will mean that the new entrant considers all the location specific costs and is incentivised to select the overall least cost investment option to ensure the lowest cost delivered energy to consumers consistent with the NEM objective. However, it is recognised that funding arrangements (such as cost recovery for FCAS provision) are beyond the scope of the present consultation.

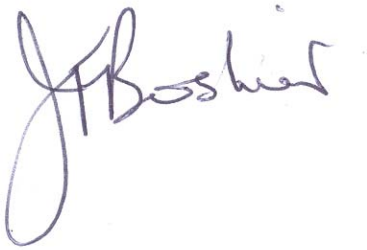
Ultimately, setting the Tasmanian frequency standard at an efficient level involves a trade off between the potential benefits such as increased competition and market entry, and the costs involved in moving to and maintaining tighter standards. Alternative means of overcoming the technical obstacles to new plant connection may also be available, such as the adoption of more flexible generator performance standards for frequency.

In conclusion, the NGF considers that the Panel should ensure that all potential benefits and any indirect or hidden costs and impacts of changed arrangements are fully considered in the evaluation process, and all viable alternatives considered.

If you have any questions, please contact the undersigned on 02 6243 5120.

[2] This may be reasonable in part in that once the initial costs have been made to establish tighter frequency standards the entry of new standard plant into Tasmania will be facilitated (at no or only an incremental cost), as demand grows.

Yours faithfully



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