

Date: 13th March, 2009

Mr John Tamblyn
Chairman
Australian Energy Marketing Commission (AEMC)
Level 5, 201 Elizabeth Street
SYDNEY NSW 2000

Email: submissions@aemc.gov.au

Dear Sir,

Project ERC0082 – Proposed National Electricity Amendment (Causer Pays for Ancillary Services to Control the Tasmanian Frequency) Rule 2009

Gunns Limited appreciates the opportunity to provide its comments to the AEMC on the important factors that need to be considered in the consultation process of the Rule change proposal that has been submitted by Hydro Tasmania.

Gunns opposes the proposed Rule change on the grounds that it is inequitable, will restrict prospective entrants into the Tasmanian market and will essentially only benefit the organisation that is proposing the change, while penalising its potential competitors. We believe that this is contrary to the National Electricity Objective. We also suggest Hydro Tasmania is incorrect in assigning the cause of the increase in ancillary services to new generators.

Background

Gunns Limited (Gunns) is developing a 213MW (at 0.85 pf) cogeneration power station at Bell Bay in northern Tasmania in conjunction with its Pulp Mill project. The current plan is to connect the power station to Transend's electricity network at 220kV, approximately 5 km from the nearby George Town Substation.

Gunns requires the power station to be registered by NEMMCO to allow connection and dispatch into the National Electricity Market (NEM).

Basis of "Old" Frequency Standard

The Frequency Operating Standard for Tasmania was developed by Hydro Tasmania or its predecessors long before Tasmania joined the NEM, and its design reflected the capabilities of the hydro-electric generation and

transmission system in the State. The generation and transmission systems were owned and run as a monopoly by this State owned organisation.

We presume that the Standard reflected a balance between cost and a reliability target that was set by the owners.

The current wind farm generators were built by Hydro Tasmania, which ensured that its Frequency Standard was met.

Reviews of the Frequency Standard after joining the NEM maintained the status quo as there were no potential competitors at the time, and the generation capacity in Tasmania was still virtually 100% owned and run by Hydro Tasmania.

Against a background of low water storages and a reliance on Basslink to make up the shortfall, the Standard was revised in the 2008 review to make it more possible to connect modern generators, particularly steam and combined cycle turbines, and thus to open competition within the state. The "cause" of the current requirement for a "small increase in the FCAS requirements, particularly those for R6" (as stated in the frequency review final report), then is not the connection of one or more efficient new generators, but the necessary decision to modify the inefficient and anti-competitive Old Standard.

Hydro Tasmania Proposal

This section of the submission addresses specific points raised in the Hydro Tasmania proposal. The paragraph numbers correspond to the numbers in the proposal.

3.1 Background

The proposal selectively quotes the alternative methods that could be used to recover additional FCAS outlined on page 26 of the Reliability Panel's final report. It does not include the Panel's description of the difficulties that it saw in implementing either method. Gunns shares the view that either method would be difficult to introduce (even if it could be justified).

3.2 Form of the Proposed Rule

A 15 year sunset clause is proposed, on the basis that Tasmania will not need another thermal power station within that time. This implies that further competition, that has the potential to reduce customer prices during this period, should be discouraged.

3.3 Substance of the Proposed Rule

The proposed Rule is inequitable, and would appear to be extremely difficult (and costly) for NEMMCO to administer. It is applied to the increase in FCAS

required because of the change in the frequency standard, which must be separated from any increase or decrease in FCAS due to other causes, such as machine inertia, load, outages and the quantity of wind generation connected. This means that for every billing period, the FCAS required will need to be calculated both for the current Standard and the Old Standard, and the difference billed.

The generators that would be subject to the terms of the Rule would be charged whether or not they were connected or were supplying power. They would also be charged even if they, like the Gunn's generator, did not benefit from the change in the Frequency Standard, or met the Old Standard's access requirements for frequencies below the normal operating range and thus did not add to any requirement for raise FCAS.

5. Achievement of the National Electricity Objective (NEO)

We do not believe that the proposed changes meet the National Electricity Objective.

In Clause 5.1 the proponent claims that the change promotes good regulatory practice, but the proposed change, itself, is designed to transfer costs to new market entrants. Connection of any new generators would benefit those already liable under the Rule change. This does not create any certainty for new participants, and does not encourage further investment.

Further on regulatory practice:

- Is it good regulatory practice to attempt to split FCAS costs into "old" and "new"?
- Is it good regulatory practice to apply certain rules to one part of the national market and not the rest?
- Is it good regulatory practice to apply certain costs to new entrants into a market, whether they can be justified or not?

We suggest that, for all of the above, this is not the case.

There is also nothing to prevent further Rule changes, which would be a far greater source of regulatory uncertainty.

Investment decisions are made after consideration of all factors, most of which are not fixed. FCAS costs, both at the time of installation and after, are a variable, and depend to a far greater degree on system conditions than on the changes brought about by alterations to the Frequency Standard.

Economic efficiency is discussed in Clause 5.2. In this section of the proposal the proponent states that the proposed Rule change will create incentives to

invest in lower-efficiency plant or to delay investment as long as possible to ensure maximum return.

Both results of the proposal would tend to lead to increased electricity charges to consumers due to higher cost of production in new plants or continuing lack of competition.

Neither of these would appear to be in the best interests of the customers, and therefore do not meet the National Electricity Objective.

In Section 6 of the proposal it is stated:

“Finally, we do not expect that the electricity retailers or final customers will be materially affected by whether the Rule change proceeds.”

Surely this is in clear conflict with the statement in Section 5 – viz:

“ ... proposed Rule change may lead to the efficient deferral of commissioning datesThis is because expected wholesale prices and revenues would be higher,”

Moreover the expectation for higher wholesale prices is in conflict with the important NEO objective to minimise costs to customers.

Conclusions

The proposed Rule change is inequitable, as it does not target the “causers” of the increase in FCAS requirement, but most likely new entrants into the Tasmanian market. Indeed the cause is not new entrants but the fact that the old standard was significantly out of line with that required for a modern multi generator type system such as that found on mainland Australia and in most developed countries around the world.

The proposed change also:

- Attempts to reduce Regulatory Risk by imposing additional costs on new generators without significantly reducing the overall investment risk profile.
- Will discourage investment due to the potential extra operating cost, reducing competition and thus reducing the potential for lower costs to consumers.
- Could encourage investment in less than optimal technology to meet an outdated Standard, reducing the potential for low-cost operation.

With the push for more renewable energy sources such as wind power, which generally does not provide system inertia, lack of investment in larger steam

and combined cycle generators will lead to a requirement for more FCAS. Anything that prevents or discourages investment in high inertia efficient machines is likely to lead to difficulties with system control and higher prices to consumers. This is contrary to the NEO and must be resisted.

If you have any questions on this submission, please contact Pieter Blom on (03)6335 5455 or 0409 024 416, or Neville Smith on (03)6355 5429.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Les Baker', with a stylized, cursive script.

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