AUSTRALIAN ENERGY REGULATOR

GPO Box 520
Melbourne VIC 3001
Telephone: (03) 9290 1444
Facsimile: (03) 9663 3699
www.aer.gov.au

6 September 2010

Scott Stacey
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Lodged electronically via www.aemc.gov.au

Dear Scott,

Rule change proposal – Network Support and Control Ancillary Services (NSCAS)

We welcome the opportunity to respond to the Commission's consultation on the National Electricity Amendment (Network Support and Control Ancillary Services) Rule 2010.

The Australian Energy Regulator (AER) monitors the National Electricity Market (NEM) and is responsible for compliance with and enforcement of the National Electricity Law and Rules. The AER is also responsible for the economic regulation of electricity transmission and distribution services. These roles mean that we are well placed to comment on AEMO's proposed changes to the current arrangements for NSCAS planning and procurement.

This submission sets out our high level support for the proposed Rule change, and provides some comments on how the AER's regulatory activities would interact with the proposal to allow transmission network service providers (TNSPs) to participate in non-market ancillary services tenders.

We support AEMO's proposed amendments to the Rules surrounding NSCAS. In particular, we support:

- AEMO's proposed role in identifying the required level of NSCAS and developing preferred options as part of its national transmission planner function
- the proposed changes to AEMO's non-market ancillary services tender process, which will allow network service providers to submit tenders for these services, and
- the proposal to adopt a general principle of "beneficiary" or "causer" pays for the provision of these services.

We consider that the proposed Rule change will ensure that the planning framework is nationally focussed and enhance network capability across the NEM. Allowing TNSPs to participate in AEMO's tender processes should also promote competition and lower costs for these services.

The proposed Rule change allows AEMO, in its role as national transmission planner, to develop preferred options for meeting an identified NSCAS need. AEMO is financially neutral between non-network and network-based solutions and accordingly its proposed solutions are likely to be efficient.

Under AEMO's Rule Change Proposal, TNSPs will be able to compete against Registered Participants in AEMO's tender process. We consider that the change promotes efficient outcomes because it permits AEMO to consider a broader range of options for meeting a given NSCAS need. In some cases, the introduction of competitive pressure on NSCAS providers has the potential to significantly reduce costs.

We note that the National Generator's Forum (NGF) has identified a number of issues that concern the relationship between the tender process and the TNSPs' regulated activities. These include the risk of "moral hazard" (where TNSPs defer efficient investment with a view to receiving higher unregulated returns via an AEMO tender) and the risk of "double dipping" by TNSPs.

With regard to these issues, the AER notes that under the proposal AEMO will only procure NSCAS in the event that a TNSP fails to meet an identified NSCAS requirement for an 18 month period. TNSPs have an incentive to invest in their network through the assurance of returns at the weighted average cost of capital (WACC). TNSPs would risk foregoing their regulated returns if they chose to not invest and instead to participate in a tender that they may not win.

Further, the AER will be monitoring any discrepancies between the projects undertaken by TNSPs and those recommended in the National Transmission Network Development Plan (NTNDP). AEMO proposes to publish details of its NSCAS contracts, which will enable the AER to determine whether TNSPs are displaying the behaviour envisaged by the NGF. If a TNSP were to engage in such activities, the AER would carefully consider whether the TNSP was complying with its responsibilities and obligations with regard to power system security.

The AER acknowledges that there is potential for a TNSP to "double dip". However, this could only occur in limited circumstances, and the TNSP would only receive higher returns (that is, the return on and of capital on the difference between forecast and actual capital expenditure) for the remainder of the regulatory control period. After this time the TNSP's actual capital expenditure only on prescribed transmission services is rolled into its asset base in accordance with the National Electricity Rules. For the reasons set out above, we question whether there is material risk of such behaviour.

Please contact Mark Wilson on (08) 8213 3419 if you have any queries in regard to any of the matters raised in this letter.

Yours sincerely,

Michelle Groves
Chief Executive Officer