

17 October 2006

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box H166
Australia Square NSW 1215

Dear John

**National Electricity Rules – Request for Non-controversial participant derogation
Extension of Recovery of Localised FCAS Regulation Services in Tasmania**

NEMMCO requests the Australian Energy Market Commission (Commission) to extend a Participant derogation as a non-controversial Rule change under sections 91 and 96 of the *National Electricity Law* (NEL). The Rule change seeks to extend current arrangements for the localised cost recovery of regulation Frequency Control Ancillary Services (FCAS) in Tasmania.

Extending the derogation will allow expiry of the derogation to be coordinated with related Rule change and review processes in a way that minimises changes to the regulatory arrangements for recovery of FCAS costs in the longer term.

A description of the proposed rule, statement of the issues concerning the existing rules, how the proposed Rule addresses those issues consistent with the NEM objective is contained in the Addendum. A draft of the proposed Rule is also in the Addendum.

NEMMCO would be pleased if you could have these matters considered by the Commission. For further details, please do not hesitate to contact John Colquhoun on (03) 9648 8784.

Yours sincerely


Brian Spalding
Chief Operating Officer

Enc.

1. Introduction

Part 11 of Chapter 8A of the National Electricity Rules (Rules) requires NEMMCO to recover the local cost of regulation frequency control ancillary service (FCAS) in Tasmania from participants in Tasmania. The derogation expires on 31 December 2006.

NEMMCO is aware that the Commission has received a request for a Rule from the National Generators' Forum (NGF) that broadens local cost recovery of regulation FCAS. NEMMCO also has an obligation under clause 3.1.4(a1)(2) & (3) of the Rules to undertake a review of FCAS arrangements.

NEMMCO believes it would be beneficial to extend the expiry of the participant derogation until after the completion of the Rule change and review processes.

2. Background

Regulation FCAS is used for real-time frequency control and is automatically and remotely controlled by NEMMCO. It can be either supplied locally (from within a region) or from other regions depending on the available transfer capability on interconnectors.

Before Basslink, Tasmania was electrically isolated from other NEM regions and all regulation FCAS was provided locally. The NGF then proposed an interim arrangement that allowed for local cost recovery of regulation FCAS in Tasmania until a permanent arrangement was implemented. The derogation became part of the National Electricity Code (Code) in March 2005.

The NGF also proposed a Code change that applied local cost recovery more broadly. Because of the imminent restructure of the NEM governance and institutions, the Code change was not progressed at the time. The NGF's current Rule proposal effectively reinitiates the earlier Code change request.

With Basslink installed, Tasmania's regulation FCAS can be provided from other regions subject to the capability of Basslink. This is limited by:

- whether the actual Basslink flow is within its deadband¹ of operation;
- the headroom between the actual Basslink flow and the deadband; and
- the headroom between the actual Basslink flow and its upper and lower limits.

As long as Basslink is able to transfer regulation FCAS, the services and the recovery of costs of those services can be shared between Tasmania and the mainland. When sharing of regulation FCAS is limited by Basslink capability, then some requirements are provided in Tasmania and the mainland and the derogation allows their costs to be recovered locally.

NEMMCO's review of FCAS examines the effectiveness and operation of the spot market for FCAS and is required to be completed within 12 months of commencement of the review, currently planned for December 2006. The NEMMCO review and any required Rule changes should be complete before December 2008.

¹ Basslink cannot operate for transfers less than 50 MW between Tasmania and Victoria.

3. Addressing the Issues

The following section addresses the issues with the current Rule that would be addressed by the proposed Rule change, a description of the proposed Rule and how the proposed Rule would contribute to the NEM objective.

3.1 Statement of issues concerning the Rules and how the proposed Rule addresses the issues

The derogation expires on 31 December 2006. Given the Commission is considering the NGF's proposed Rule change and NEMMCO will further review FCAS arrangements, the expiry of the participant derogation may lead to several changes to the Rules in the short term, creating regulatory uncertainty for participants and unnecessary compliance costs incurred for changes.

NEMMCO proposes that the duration of the derogation be sufficiently long to allow the completion of these two processes, without being excessively long should the Commission decide against an alternative arrangement.

The existing derogation provides more accurate locational signals as to the cost of providing regulation FCAS in Tasmania than the alternative where FCAS costs are averaged across the entire NEM. The derogation itself contemplates that the arrangement would be replaced by a different locational pricing arrangement (see paragraph (d) of the derogation), and it is likely that allowing the derogation to expire will result in a less efficient cost recovery arrangement in Tasmania, if only for a short period.

By extending the derogation, the proposal will minimise regulatory uncertainty for NEM participant and avoid operating with a less efficient arrangement while a longer term solution is developed.

3.2 Description of proposed Rule

The proposed Rule would extend the latest expiry date of the derogation contained in Chapter 8A – Participant derogation, Part 11 until 31 December 2008 (see Addendum B).

3.3 How the proposed Rule is likely to contribute to the achievement of the national electricity market objective

The proposed Rule will contribute to the objective in two ways – through good regulatory practice and through efficient pricing signals in the short term that are consistent with the longer-term development of the NEM.

Good Regulatory Practice

NEMMCO has sought guidance from previous Commission determinations including:

- the Reliability Safety Net extension;
- Extension of inter-regional settlement agreements.

NEMMCO notes that the extension of both the Reliability Safety Net ² and inter-regional settlement agreements ³ promote certainty in the NEM by continuing existing arrangements while final arrangements are developed. Similarly, extending the interim arrangements for recovery of local FCAS costs in Tasmania will also promote certainty and therefore avoid increased costs by removing the need to change the arrangement twice in the short term.

Efficient Locational Pricing Signals

The Commission will be considering the merits of regional cost recovery of regulation FCAS across constrained interconnectors as part of the NGF's Rule change proposal.

However, maintaining the local recovery arrangement in favour of averaging costs of all regulation FCAS across the NEM will contribute to the NEM objective by:

- improving efficient use of FCAS either side of a constrained Basslink through a better pricing signal to consumers of FCAS; and
- being more likely to be aligned with the long term arrangement determined by the Commission from the NGF Rule change proposal or NEMMCO's FCAS review.

4. Other considerations

The following section addresses the Commission's power to make this Rule change proposal and the rationale for considering this Rule change as a non-controversial and urgent Rule change.

4.1 Power to make the Rule

NEMMCO believes the Commission has the power to make the requested Rule change under s.34(1)(c) of the NEL. It also falls within the head of power in clause 34 of Schedule 1 of the NEL relating to the payment of money (including the payment of interest) for the settlement of transactions for electricity or services purchased or supplied through the wholesale exchange operated and administered by NEMMCO, which is given effect by s.34(2) of the NEL.

4.2 Non-controversial Rule

NEMMCO believes this Rule change is non-controversial because:

- the proposed extension is a continuation of the current interim arrangements in the NEM and that the interim arrangements is still applicable because the processes to identify a permanent arrangement are underway;
- regardless of further reviews or Rules changes the participant derogation would still expire by December 2008;

² AEMC 2006, *Reliability Safety Net extension*, Final Rule Determination, 11 May 2006, Sydney [6].

³ AEMC 2006, *Extension of Inter-regional Settlements Agreement*, Final Rule Determination, 13 July 2006, Sydney [7].

- the NGF has indicated its support for extending the interim arrangement and requested NEMMCO to put forward this Rule change, as under the National Electricity Law changes to a participant derogation that modifies NEMMCO's functions must be requested by NEMMCO.

5. Recommended Rule Change

8A. Participant Derogations

Part 11 - Transitional Arrangement for Market Ancillary Services for Tasmanian Entry

- (d) This *participant derogation* expires on the earlier of 31 December ~~2006~~2008 and the time specified in a *market* notice whereby NEMMCO declares that changes to its *market* systems to implement *Rules* changes that permits the regional recovery of regulation services costs will become effective.