



**Submission to National Electricity Amendment:**

**Causer Pays for Ancillary Services to Control  
the Tasmanian Frequency**

Project Reference Code: ERC0082

13 March 2009

## Introduction

Aurora Energy Pty Ltd appreciates this opportunity to comment on the *Causer Pays for Ancillary Services to Control the Tasmanian Frequency* rule change proposal 2009 ('the rule change proposal') under which Hydro Tasmania seeks to modify the settlement of local frequency control Market Ancillary Services in the Tasmanian jurisdiction of the National Electricity Market through a Participant Derogation.

In 2008, the Australian Energy Market Commission (the Commission) Reliability Panel completed its Comprehensive Review of the Tasmanian Frequency Operating Standards. The outcomes of that Review may lead to an increased requirement for some types of frequency control ancillary services (FCAS) in Tasmania.

The current rule change proposal from Hydro Tasmania is that the increased costs of these Market Ancillary Services should be recovered from those generators that could not have met the Tasmanian Frequency Operating Standards that applied prior to the Reliability Panel's review in 2008.

## Aurora Energy

Aurora Energy (Aurora) is a Tasmanian Government-owned electricity distribution and retail company formed in July 1998 pursuant to the Electricity Companies Act and incorporated under the Corporations Law. Aurora also recently completed the purchase of the Tamar Valley Power Station project under an agreement with the Tasmanian Government. The interests of the new owner of that development, Aurora subsidiary 'Aurora Energy Tamar Valley Pty Ltd' are represented in a separate submission under the Australian Energy Market Commission's consultation process.

The primary focus of this submission is the rule change proposal's potential impact on Aurora's functions as a retail market participant.

## General comments & key messages

Overall, Aurora believes that this rule change proposal would result in outcomes that do not progress the National Electricity Objective (NEO) and in fact run counter to it. If the proposed change were enacted, the National Market would see:

- no material benefit;
- the creation of impediments to the development of competition in power generation;
- an inconsistent application of the 'Causer Pays' principle; and
- unnecessary added complexity in the rules and management of the NEM.

On these grounds Aurora as a national market customer and consumer representative opposes the rule change proposal and recommends that no derogation be made.

## **National Electricity Objective and materiality**

To justify alteration of the existing national market arrangements the Commission requires that a shortcoming in the National Electricity Rules or a clear benefit to the NEO be identified as the 'issue to be addressed by the proposed rule'.

The NEO is to promote efficient investment, operation and use of electricity services for the long-term interests of consumers of electricity. Page 11 of the rule change proposal document notes that the issue to be addressed is a wealth transfer between classes of generators. As such, the issue being addressed does not justify a change to the National Electricity Rules.

As a market customer and consumer representative Aurora sees no material net benefit from the proposed rule change with respect to electricity quality, reliability, security of supply, or electricity price, especially in the long term. The rule change proposal itself acknowledges that "In the present case, Hydro Tasmania does not consider that the proposed rule change raises issues of security, reliability and safety of the power system" and "Finally we do not expect that electricity retailers or final consumers will be materially affected by whether the rule change proceeds".

Hydro Tasmania, the proponent of the rule change submits two arguments to describe a perceived problem with the existing NEM arrangement and to support a preferred solution that would promote the NEO. These arguments are:

1. that the change would promote good regulatory practice; and
2. that the change would promote dynamic efficiency

Aurora submits that neither of these arguments can be proven to show a material net benefit to the NEO, whether directly or indirectly. Further discussion supporting this position is presented in the following sections.

## **Perceptions of regulatory predictability through Causer Pays**

The proponent asserts that the rule change proposal will reinforce participants' perceptions of regulatory predictability through the application of the Causer Pays Principle. Aurora submits that this statement is not proven to be correct and that it does not represent a quantifiable material contribution to the NEO.

### Perceptions of regulatory predictability

As a market participant, Aurora's experience is that the introduction and removal of jurisdictional derogations by their nature create perceptions of regulatory unpredictability compared to the uniform application of rules across the National Electricity Market.

The argument put forward to propose a rule change cites reluctance from potential new entrants to invest in the NEM because there may be costs arising from regulatory decisions similar to the revision of Tasmanian frequency standards, and that the Tasmanian standards might be tightened in the future. This is unrealistic given that the Commission has not signalled any intent to further tighten the frequency tolerances in Tasmania or any other NEM Region. A comprehensive review of the Tasmanian standards has been undertaken and should be allowed to stand on its own merits.

In contradiction of its own argument about the impact of unexpected regulatory risk on investments, the rule proposal would have the currently committed Tamar Valley Power Station investment and any future development exposed to a regulatory rule change that imposes additional costs on them that they are unable to control. Aurora submits that the precedent of an incumbent dominant generator being permitted to

use a regulatory derogation that creates a competitive disadvantage for a sole new entrant competitor would be more damaging to perceptions of regulatory unpredictability than the current arrangement.

The Rule change proposal would also risk setting a precedent for a number of other actions around "causer pays" allocation of costs. Aurora Energy would be concerned about a precedent for change in the FCAS market arrangements that resulted in further costs being allocated directly to consumers of electricity.

#### Causer Pays principle

Aurora supports the principle of 'causer pays' as a reasonable and equitable tenet in the market. However, it is a principle that should be applied with care and impartiality.

The application of the causer pays principle to justify this rule change proposal is not consistent with its application by the AEMC in other contexts, including cost allocation of regulation FCAS in the NEM. The costs of Regulation FCAS for example are allocated to the market participant class that can be identified as causing a type of frequency deviation, whether it was a sudden drop in load or generation – requiring lower or raise regulation respectively.

The rule change proposal advocates charging one type of generation technology (currently one market participant) the costs of all the FCAS required in the Tasmanian region beyond that which would have been required under the historical frequency operating standard, including where it is not the causer.

FCAS requirements in Tasmania are set by a number of factors apart from the contingency size of dispatched generators and loads, and the required frequency standard. Factors such as inertia, network contingencies under normal and outage conditions, and rate of change of frequency are taken into account by NEMMCO in setting the amount of FCAS required. Although these factors can increase the requirement for FCAS, they are not used in allocating costs to causers of FCAS. At present the costs are allocated only to dispatched generators and loads, not to all the causers (e.g. wind generators, Basslink interconnector, generators connected via radial transmission lines, hydro generator outages and transmission outages). In order to be complete, the application of Causer Pays would need to cover all causes of additional FCAS, potentially setting a precedent for major change in the NEM.

Aurora submits that additional FCAS requirements in excess of the level required under the historical standard in Tasmania can be caused by the activities of a number of different market participants.

A new generator is not the sole causer of an incremental rise in FCAS requirement.

An appropriate causer pays mechanism would not, for example, impose increased costs on an established efficient thermal generator alone as a future wind generator, that pays for no FCAS under the proposed rule change, may increase the FCAS needs due to its impact on system inertia. This situation would occur under the proposed rule change.

At present FCAS costs are allocated only to generators and loads that are dispatched at the time of the requirement, however, under the rule change proposal FCAS costs could be charged to an efficient thermal generator even when it is not dispatched, which is a significant departure from NEM arrangements.

NOTE: By a strict definition of cause and effect, new and future generators did not 'cause' the modification of the Tasmanian frequency standards. The Tasmanian Frequency Standards were reviewed in 2008 on a schedule originally determined as part of the Commission's Comprehensive Reliability Review of May 2006, at a point when Tasmania had just entered the NEM and Basslink was unproven operationally.

The driver of this review was standardisation across the national market – to investigate the potential for aligning Tasmania’s standard more closely with the rest of the market<sup>1</sup>. The review was not undertaken in order to accommodate new efficient thermal generators, although the inability of thermal generation plant to comply with the standard was a compelling argument in support of bringing frequency tolerances closer to the national standard, despite increasing FCAS requirements.

The Proposal document blurs the distinction between a ‘beneficiary’ and a ‘causer’. It also sees the efficient thermal generator as the sole beneficiary of the revised Frequency Operating Standards. This is a misconception of the primary argument that justified the change, which stated that the customer is the beneficiary in the long term, because of increased competition in wholesale energy.

### **Economic Efficiency**

Hydro Tasmania presents the argument that the rule change proposal would promote dynamic efficiency through exposing new generators to additional costs that they impose on the market thereby causing deferral of timing of new generators (page 10), and that this would result in lower prices (page 9 of the proposal document). Dynamic efficiency in this case refers to maximising the net benefits of capital investment and retirement decisions.

As discussed in the section above, new generators do not impose the additional costs; the costs are a result of aligning the Tasmanian Frequency Operating Standards more closely with the rest of the NEM in the long-term interests of consumers. Under these standards, new thermal generators are not the only causers of additional FCAS costs but the rule change proposal would have them exposed to the additional costs imposed on the FCAS market by all other entities.

Aurora submits that the existing market arrangements are satisfactory. The allocation of FCAS does not cause new plants to be developed inefficiently late, or result in the ‘wrong type of capacity or in the wrong location leading to inefficiently high consumer costs’. There is not sufficient evidence to believe that the rule change proposed would have a material impact on the timing or merit order of new generation plants.

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<sup>1</sup> The Panel: ...proposes to consider the opportunities for further alignment of the Tasmanian frequency standards with the NEM standards in an additional review to commence within approximately twelve months.

### **Barrier to Competitive Entry**

Tasmanian consumers would benefit from an efficient competitive market in both wholesale energy and FCAS in Tasmania. Aurora submits that the rule change proposal is counter to this objective, and thus counter to long-term customer benefit.

The wider band of frequency tolerances in the existing Tasmanian Frequency Operating Standards is a historical anomaly inconsistent with the rest of the market. The Tasmanian standards varied from the rest of the NEM because hydro generation, which dominates the Tasmanian system, is capable of riding through a wider range of frequency disturbances. The other existing scheduled generator, Bell Bay thermal power station is licensed to connect non-compliantly.

The main benefit for consumers promised by the revision of the frequency standards was the removal of a unique Tasmanian barrier to investment in what is proving to be the least cost generation technology for the next two decades.

Primarily, the proposed 'Causer Pays' rule change if enacted would re-impose material impediments to the development of new efficient thermal generation plant in Tasmania, stifling competition in power generation in the Region leading to net outcomes that are not in the long-term interests of consumers of electricity. The new standard has been determined by a comprehensive review process to be the appropriate standard for Tasmania. The historical standard was a barrier to low cost efficient generation that has been removed. This rule change would replace one barrier with another barrier.

Any new prospective generator already has a significant disincentive to locate in Tasmania due to the generator contingency size limit imposed by the Tasmanian frequency standard review, without any additional raise and lower FCAS costs being assigned to it. This is clearly to the disadvantage of Tasmanian consumers and the development of a competitive market in Tasmania.

### **Other Market Principles**

Causer Pays is only one principle that is generally accepted in the NEM. Aurora argues that the proposed rule change is counter to other generally accepted tenets of the market, such as the prudent use of market power, contestability, simplicity, harmonisation, and removal of barriers to market entry. For example, the proposed rule change will lead to increased complexity in the market. It will require the AEMO to undertake additional calculation activity for no net gain and a new market participant derogation will be introduced to the market.

## Conclusion

In this submission Aurora has argued against the acceptance of the rule change proposal based on its lack of relevance to the NEO. Supporting this argument Aurora has noted that:

- there is no problem for the market to be addressing;
- arguments related to 'dynamic efficiency' and 'perceptions of regulatory unpredictability' are insubstantial;
- the Comprehensive Review and determination of revised Tasmanian Frequency standards should stand on its own merits;
- the benefits of the new standards accrue to electricity consumers, not just the new generator;
- proposed application of the Causer Pays principle is inconsistent;
- the proposed rule change would be anti-competitive; and
- the proposed rule change would deliver unnecessary complexity.

Therefore, Aurora submits that the proposed rule change is not justified.

Representatives from Aurora Energy are available should you require any further support to this submission.

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Aurora Energy

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