



Australian Energy Market Commission

Draft Rule Determination

**National Electricity Amendment (Cost
Recovery of Localised Regulation Services)
Rule 2007**

Rule Proponents
National Generators Forum

17 May 2007

Signed: 

John Tamblyn
Chairman
For and on behalf of
Australian Energy Market Commission

Commissioners
Tamblyn
Carver
Woodward

Inquiries

The Australian Energy Market Commission
PO Box H166
Australia Square NSW 1215

E: aemc@aemc.gov.au

T: (02) 8296 7800

F: (02) 8296 7899

Citation

AEMC 2007, Cost Recovery of Localised Regulation Services, Draft Rule Determination, 17 May 2007, Sydney

About the AEMC

The Council of Australian Governments, through its Ministerial Council on energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

Contents

Contents	iii
Summary	iv
1 NGF Rule proposal	1
1.1 Summary of the Rule change proposal	1
1.2 Context of the Proposed Rule.....	1
2 Draft Rule determination.....	5
2.1 Commission's power to make the draft Rule Determination.....	5
2.2 NEMMCO FCAS Review	7
2.3 Consultation process	8
3 Commission's analysis of the Proposed Rule	9
3.1 Regional cost recovery	9
3.2 Abolition of the Derogation.....	11
3.3 NEMMCO FCAS review.....	12
3.4 Analysis of the draft Rule	14
3.5 Implementation and timing of the Proposed Rule.....	15
3.6 Miscellaneous amendments	16
4 Differences between the Proposed Rule and the draft Rule	17

Summary

On 7 September 2006, the National Generator's Forum (NGF) lodged a proposal with the Australian Energy Market Commission (Commission) to amend the National Electricity Rules (Rules) to provide for cost recovery of localised regulation frequency control ancillary services (FCAS) on a regional basis.

The Commission notes that the services that the FCAS referred to in the NGF Rule change proposal are formally described as market ancillary services (MAS).

^a However, to maintain consistency between this draft Rule Determination, the NGF Rule change proposal and the submissions, the Commission will refer to them as FCAS.

The Proposed Rule has three main components:

- Apportionment of the cost of regulation FCAS amongst the region(s) that require the regulation FCAS in a trading interval;
- Within the region(s) that require regulation FCAS in a trading interval, apportionment of the regulation FCAS costs between the individual market participants who contribute to, or alleviate, the need for the regulation FCAS; and
- A procedure for determining the contribution factor of individual market participants for the purpose of apportioning individual liability for the costs of regulation FCAS.

Presently, the participant derogation in Part 11 of Chapter 8A of the Rules (Derogation) provides for localised cost recovery of regulation services in Tasmania. The NGF Rule change proposal notes that, if adopted, the Proposed Rule removes the need for the Derogation which, in any case, is due to expire on 31 December 2008.

The Commission published the Rule change proposal in accordance with s 95 of the National Electricity Law (NEL) and called for submissions from interested parties to be lodged by 22 February 2007. The Commission received submissions from TRUenergy, Flinders Power and NEMMCO.

The Commission has considered the Proposed Rule and the matters raised in the submissions, including any overlap between the Rule change proposal and NEMMCO's review of the operation and effectiveness of the FCAS markets which is currently underway.

For the reasons set out in Chapter 2 of this draft Rule Determination, the Commission is satisfied that the NGF's Proposed Rule would promote the National Electricity Market objective (NEM Objective) and satisfy the Rule making test. Therefore, in this draft Rule Determination, the Commission has determined to approve the proposed

^a See clause 3.11.2 of the Rules.

Rule change, (subject to some minor modifications) and in accordance with s 99 of the NEL, makes this draft Rule Determination and draft Rule.

The Commission invites submissions on this draft Rule Determination by **29 June 2007**. Submissions may be sent electronically to submissions@aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box H166
Australia Square NSW 1215
Fax: 02 8296 7899

All submissions should be prepared and lodged in accordance with the Commission's *Guidelines for making written submissions on Rule change proposals* which is available at the Commission's website at www.aemc.gov.au.

In accordance with s 101 of the NEL, any interested person or body may request that the Commission hold a pre-determination hearing in relation to the draft Rule Determination. Any request must be made in writing and must be received by the Commission by no later than **24 May 2007**.

This page has been intentionally left blank

1 NGF Rule proposal

On 7 September 2006, the National Generator's Forum (NGF) lodged a proposal with the Australian Energy Market Commission (Commission) to amend the National Electricity Rules (Rules) to require the costs of regulation frequency control ancillary services (FCAS) requirements to be recovered on a regional basis.

This Chapter summarises the NGF's Rule change proposal and discusses the matters that the Proposed Rule seeks to address.

1.1 Summary of the Rule change proposal

The key elements of the NGF's Rule change proposal are:

- Apportionment of the cost of regulation FCAS among the region(s) that require the regulation FCAS in a trading interval;
- Within the region(s) that require regulation FCAS in a trading interval, apportionment of the regulation FCAS costs between the individual market participants who contribute to, or alleviate, the need for the regulation FCAS; and
- A procedure for determining the contribution factor of individual market participants for the purpose of apportioning individual liability for the costs of regulation FCAS.

To give effect to the proposal, the Proposed Rule suggests amendments to clauses 3.15.6A(h), (i), (j) and (k) of the Rules. The process and the drafting of the suggested amendments draws on the process for regionalisation of contingency FCAS, and on the drafting of the existing contingency FCAS Rule (Rule 3.15.6A(g)).¹ The Proposed Rule also includes consequential amendments necessary for its effective implementation, the most notable of which is the deletion of the derogation contained in Part 11 of Chapter 8A of the Rules.

1.2 Context of the Proposed Rule

The NGF Rule change proposal refers to frequency control ancillary services, or FCAS. The Commission notes that the services that are commonly referred to as FCAS are formally referred to in the Rules as market ancillary services (MAS).² However, to maintain consistency between this draft Rule Determination, the NGF Rule change proposal and the submissions, the Commission will refer to them as FCAS.

FCAS enables NEMMCO to control the frequency of the power system and ensure the system meets the frequency standards prescribed by the Reliability Panel. There

¹ NGF Rule change proposal, 7 September 2006, p. 2.

² See clause 3.11.2 of the Rules.

are eight types of FCAS, which can be grouped into two categories: six types of contingency FCAS and two types of regulation FCAS.

Contingency FCAS (comprising *fast*, *slow* and *delayed*, each having a *raise* and *lower* service) are used to restore the prescribed frequency of the power system after a major disturbance, such as the unplanned outage of a large generator or a random failure in the transmission network. Major disturbances of this kind are rare.

Regulation FCAS (*raise* and *lower*) are used to control minor variations in frequency around the Australian standard of 50Hz. Minor variations occur continually, and are typically the result of forecasting errors or generators not meeting their dispatch targets. Regulation FCAS are dispatched at five minute intervals to account for these continuous frequency variations.

When NEMMCO determines the quantity of regulation and/or contingency FCAS in accordance with the dispatch algorithm, NEMMCO must determine the required quantity that:

- May be sourced from any region within the NEM, which is known as a “global market ancillary service requirement”;³ and
- Must only be sourced from one or more nominated regions, which is known as a “local market ancillary service requirement”.⁴

Local market ancillary service requirements, or local FCAS requirements, are required in abnormal circumstances where only local market participants have the technical capability to provide FCAS. This is most often the case when a region becomes isolated – or “islanded” – due to planned and/or forced outages of transmission elements.

Currently, there is a disparity between the way that local regulation FCAS requirements are paid for compared to local contingency FCAS requirements. The Issues Paper published by NEMMCO as part of its FCAS Review summarises the current cost recovery mechanism for each requirement:⁵

“Whenever local contingency FCAS requirements are set, the costs of those local contingency requirements are recovered solely from market participants within the local region or regions. This is on the basis that only the local market participants benefit from the local FCAS requirements, and that only the local market participants can influence the local FCAS prices. ...

Whenever local regulation FCAS requirements are set in Tasmania, the costs of those local requirements are recovered solely from Tasmanian participants under a participant derogation in the Rules. ... Whenever local regulation FCAS requirements are set on the mainland, the costs of those local regulation

³ Clause 3.8.1(e2) of the Rules.

⁴ *Id.*

⁵ NEMMCO, *FCAS Review Issues Paper*, December 2006, pp. 29-30.

requirements are recovered from all mainland participants, i.e., including from participants who are outside the region(s) in which the local requirement is set.”

The impact of the existing cost recovery mechanism for local regulation FCAS requirements on market participants is most clearly observed where a region is islanded from the remainder of the NEM. As the NGF Rule change proposal explains:⁶

“Thus at that time [that Tasmania announced it would join the NEM before the completion of the Basslink interconnector] the cost of FCAS regulation services was being recovered on a NEM wide basis without any recognition that a part or parts of the NEM may have a local requirement such as may occur when a region becomes islanded away. Under such circumstances the islanded part may have extremely high FCAS regulation supply costs however the cost recovery would be from all parts of the NEM based on specific causer pay factors for generators and a common causer pays factor for most consumers. ...

In the event of high FCAS regulation supply costs in Tasmania then the cost would be mainly recovered from mainland participants including generators who had FCAS regulation capability available but could not use it to offset their cost obligations. Conversely, any high FCAS regulation supply costs on the mainland would be recovered in part from Tasmanian participants.”

While the NGF provided this analysis in the context of the background to the introduction of the Derogation, it acknowledges that there is “the possibility of other regions or parts thereof becoming separated into an island thus requiring a more general solution”.⁷

To address concerns about inequitable recovery of local regulation FCAS requirements and to overcome difficulties in amending the then National Electricity Code, the Australian Competition and Consumer Commission (ACCC) approved a participant derogation on 9 March 2005.⁸ The Derogation, which requires NEMMCO to recover Tasmania’s local regulation FCAS requirements from Tasmanian market participants was to expire on 31 December 2006 but was extended by the AEMC until 31 December 2008.⁹

The Commission understands that the primary objective of the Proposed Rule, therefore, is two-fold:

⁶ NGF Rule change proposal, 7 September 2006, p. 2.

⁷ *Id.*

⁸ Australian Competition and Consumer Commission, *Applications for Authorisation: Amendments to the National Electricity Code: Tasmanian Ancillary Services – Chapter 8 Derogation – Determination*, 9 March 2005.

⁹ *National Electricity Amendment (Extension of Cost Recovery of Regulation Services in Tasmania) Rule 2006 No.20.*

- To replace the Derogation with a permanent solution; and
- To implement a NEM-wide solution that enables the cost of local regulation FCAS requirements to be recovered from those markets participants who had both the capacity and the ability to mitigate their liability at the time the requirements were required.

Using the cost recovery mechanism that currently applies to local contingency FCAS requirements as a starting point, the NGF Rule change proposal:¹⁰

- Requires the cost of the local regulation FCAS requirements to be apportioned between regions or sets of regions;
- Modifies the existing methodology for calculating causer-pays factors to take account of the apportionment of cost between regions or sets of regions; and
- Requires the causer-pays factors (as modified) to be used to divide the cost between participants within the region or set of regions.

The NGF Rule change proposal submits that the Proposed Rule has the following advantages:

- “It is able to deal with both partial and total localisation of services (note that partial localisation of regulation service is a common occurrence across Basslink);
- The localisation of cost allocation is driven by the localisation of the NEMMCO FCAS regulation supply requirement, thus avoiding problems of definition;
- It carries across to the regulation services an established process used for all other market ancillary services, giving advantages in both consistency and implementation cost;
- Both the settlement processes and the proposed rule changes are simple extensions from the existing Rules”.

The Commission’s analysis of the Proposed Rule and the submissions made during the first round of public consultation is set out in Chapter 2.

¹⁰ NGF Rule change proposal, 7 September 2006, p. 3.

2 Draft Rule determination

The Commission has determined, in accordance with s 99 of the NEL, to make the Proposed Rule subject to certain minor amendments to ensure consistency in the use of terms defined in the Rules and to correct typographical errors. A draft of the Rule to be made (draft Rule) is attached to this draft Rule Determination at Attachment A.

This draft Rule Determination sets out the Commission's reasons for making the draft Rule. In making its decision, the Commission has taken into account:

- The Commission's powers under the NEL to make the draft Rule;
- The NGF's Rule change proposal and proposed Rule;
- The submissions received during the first round of public consultation;
- The scope and timing of NEMMCO's review of the operation and effectiveness of the FCAS markets, including NEMMCO's FCAS Review Draft Report; and
- The Commission's analysis as to the ways in which the draft Rule will or is likely to contribute to the promotion of the NEM Objective so that it satisfies the statutory Rule making test.

This Chapter sets out the Commission's powers to make the draft Rule, and the effect of the draft Rule.

2.1 Commission's power to make the draft Rule Determination

The Commission has considered the subject matter of the Rule change proposal submitted by the NGF and is satisfied that it falls within the scope of the Commission's Rule making powers as set out in s 34 and Schedule 1 of the NEL. Specifically, the Proposed Rule is a Rule that is for, or with respect to:

- The operation of the national electricity market; and
- The operation of the national electricity system for the purposes of the safety, security and reliability of that system; and
- The activities of persons participating in the national electricity market or involved in the operation of the national electricity system.

The Proposed Rule also falls within the matters referred to in Item 7 (The setting of prices for electricity and services through the wholesale exchange) and Item 8 (The methodology and formulae to be applied in setting prices referred to in Item 7) of Schedule 1.

2.1.1 The Rule making test and the NEM Objective

The Rule making test set out in s 88 of the NEL requires the Commission to be satisfied that a Rule that it proposes to make will, or is likely to, contribute to the

achievement of the NEM Objective. The NEM Objective, which is set out in s 7 of the NEL, provides:

“The national electricity market objective is to promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system.”

The NGF submits that its Proposed Rule “will ensure that the parties that bear the cost of regulation services are those that have the possibility of influencing that requirement for service.”¹¹ In order to satisfy itself for the purposes of s 88, the Commission has undertaken its own analysis of whether the Proposed Rule will, or is likely to, contribute to the achievement of the NEM Objective.

The Commission considers it likely that benefits will flow to the NEM from the Proposed Rule. Firstly, it will promote consistency in the way that FCAS services are recovered across the NEM and across different forms of FCAS. Currently, the Rules permit the costs of localised contingency FCAS to be recovered from market participants on a regional basis. With the exception of Tasmania due to the Derogation, the costs of localised regulation FCAS are recovered from participants across the NEM with the effect that market participants may be required to contribute to costs incurred other than by reason of their conduct. The Commission has not been able to identify a sound operational or policy rationale for maintaining the divergence in the current approaches and therefore considers it is appropriate that the discrepancy be addressed. Further, the Commission considers that improving the correlation between the contribution of a market participant to frequency deviations and the cost of localised regulation services will promote more effective and efficient use of the power system, and provide clearer investment signals to existing and potential market participants.

The Proposed Rule also eliminates the need for the Derogation. As noted above, the Derogation was always intended to operate as a temporary measure until a NEM-wide solution could be developed and implemented. The Commission considers that amending the Rules in the way proposed by the Proposed Rule accords with the policy objective that existed at the time the FCAS market was introduced.

Further, the continued operation of the Derogation prolongs the differences between Tasmania and the mainland in relation to the mechanisms by which the costs of local regulation FCAS are recovered. Given the intention of the energy market reforms to reduce the instances of jurisdictional-specific regulation, removing the Derogation in favour of a NEM-wide approach will assist to promote regulatory consistency and efficient use of the system.

The Commission has applied the Rule making test to the draft Rule and is satisfied that the draft Rule is likely to promote the NEM Objective. Chapter 3 of this draft Rule Determination sets out the Commission’s analysis of the issues raised by the

¹¹ NGF Rule change proposal, 7 September 2006, p.3.

Rule change proposal and the submissions, and how the Rule change proposal satisfies the NEM Objective and the statutory Rule making test.

2.2 NEMMCO FCAS Review

NEMMCO is required under the Rules to undertake a review of the operation and effectiveness of the spot market for ancillary services market, and recommend any improvements.¹² The Rules require NEMMCO, in conducting the review, to consider:

- Simplification of the FCAS markets;
- Better determination of FCAS requirements; and
- The introduction of an FCAS usage market.

NEMMCO released an Issues Paper in mid-December 2006, setting the scope of the review and calling for submissions from interested market participants. Submissions were required by 23 February 2007.

The Issues Paper anticipated that the draft report would be released on 20 April 2007. The Commission considered that NEMMCO's draft report was likely to be relevant to the Commission's analysis of the NGF Rule change proposal and submissions received during first round consultation. The Commission was therefore satisfied that it was in the public interest to extend the period of time for making the draft Rule Determination and on 19 April 2007 it issued a notice under s 107 of the NEL.

NEMMCO's Issues Paper indicated that one of the matters to be considered as part of the review was whether "regional recovery of regulation FCAS costs [should] be introduced to all regions of the NEM".¹³

NEMMCO published its draft report on 3 May 2007. Its draft conclusion on this issue is that:¹⁴

"The costs of local regulation FCAS requirements should be regionally recovered, subject to a final decision on the appropriate causer pays factors to use. Resolution of this issue would be best managed through the AEMC Rule change process already underway."

NEMMCO's final report and recommendations are due in July 2007, with Rule changes arising out of its recommendations (if any) to be submitted to the AEMC by the end of October.

¹² National Electricity Rules, clauses 3.1.4(a1)(2) and (3).

¹³ NEMMCO, *FCAS Review Issues Paper*, December 2006, p. 35.

¹⁴ *Ibid.*, p. 37.

2.3 Consultation process

On 21 December 2006, the Commission published a notice under s 95 of the NEL commencing initial consultation on the NGF Rule change proposal. Interested parties were invited to provide submissions by 22 February 2007.

The Commission received a submission from:

- TRUenergy;
- Flinders Power; and
- NEMMCO.

On 5 April 2007, the Commission also issued a notice under s 107 of the NEL extending the time for making this draft Rule Determination.

3 Commission’s analysis of the Proposed Rule

The Commission received a submission on the Rule change proposal at the first round of consultation from:

- TRUenergy;
- Flinders Power; and
- NEMMCO.

This Chapter addresses the issues raised in submissions made in response to the Proposed Rule and sets out the Commission’s analysis and its reasons for its draft decision.

3.1 Regional cost recovery

As detailed in Chapter 1 of this draft Rule Determination, the NGF’s Proposed Rule removes the Derogation allowing local regulation FCAS costs to be recovered in Tasmania and implements a NEM-wide process requiring the cost of regulation FCAS to be recovered on a regional basis.

The submissions received during the first round of consultation were broadly supportive of the Proposed Rule. TRUenergy observed:¹⁵

“It was the intention shortly after the creation of FCAS markets in 2001 that all services, including regulation, should move towards regionalised recovery where regionalised requirements exist. This was driven by the advantages listed in the proposal and by its potential to facilitate secondary markets in the various services.

It is now appropriate for regulation services to be brought into line with the contingency services and for a single generic solution to be proposed rather than a ‘Tasmania only’ approach.”

NEMMCO also expressed support for the principles behind the NGF’s Rule change proposal.¹⁶

Flinders Power considered that while the Rule change proposal was not without merit, it was preferable not to proceed with the Rule change proposal at this time.¹⁷ Flinders Power’s concerns were that introducing regional recovery for regulation FCAS would:

¹⁵ TRUenergy, 16 February 2007, p. 1.

¹⁶ NEMMCO, 22 February 2007, p. 1.

¹⁷ Flinders Power, 21 February 2007, p. 2.

- Allow the distortions caused by the lag in the current regulation FCAS cost apportionment arrangements to persist, thereby continuing to allow generators to escape their portion of the costs by varying output; and
- Exacerbate the differences between the commercial drivers for contingency FCAS compared to regulation FCAS.

Flinders Power and NEMMCO also noted that NEMMCO is currently undertaking a review of the operation and effectiveness of the spot market for ancillary services, and on the potential for future implementation of a usage market for these services.¹⁸

The Commission addresses each of these matters below.

3.1.1 Distortionary effects of NEM-wide regional recovery

Flinders Power submits that the current mechanism to apportion the cost of regulation FCAS does not allow costs to be reflected in “real time”.¹⁹ Rather, there is a delay of up to seven weeks from the date the data used to calculate causer pays factors is first collected, to the date the causer pays factors based on that data are applied.

Flinders Power submits that the first consequence of this delay is that low output plant can “inefficiently escape their portion of costs purely through the variability of their output patterns.”²⁰ Using the example of a peaking generator, Flinders Power submitted that a market participant may operate with unfavourable deviations during one period and to manage out the financial effects of those deviations in the subsequent period.

The Commission notes the matters raised by Flinders Power’s analysis. However, it also notes that the ability for a generator to engage in such conduct stems predominantly from the current arrangements that govern the calculation and application of the causer pays factors which are not the subject of the current Rule change proposal. Accordingly, the Commission has determined that the draft Rule will not amend the principles that NEMMCO is currently required to take into account in preparing a procedure for determining causer pays factors.

3.1.2 Adjustment of the ‘causer pays’ factors

The NGF’s Rule change proposal notes that the Proposed Rule requires “a slight modification to the causer pays calculation” in clause 3.15.6A(h) to enable regional recovery. NEMMCO noted that:²¹

18 *Ibid.*, and NEMMCO, 22 February 2007, p. 1.

19 Flinders Power, 21 February 2007, p. 1.

20 *Ibid.*

21 NEMMCO, 22 February 2007, p. 1.

“scaling up the existing causer pays factors is a pragmatic and sufficiently accurate approach to regional recovery of regulation FCAS in the event of regional islanding.”

Based on the Commission’s acceptance of regional recovery of regulation FCAS at a policy level, the Commission understands the need for amendments to implement it. However, the Commission has amended the drafting proposed by the NGF to ensure consistency with the remainder of the Rules.

Flinders Power submits that until cost recovery for regulation FCAS can move closer to a real time cost recovery arrangement, implementing regional cost recovery will exacerbate the distortions of the current scheme.²²

As noted above, the Commission considers that issues regarding the current arrangements for calculating causer pays factors are not the subject of the current Rule change proposal. Accordingly, for the reasons set out at section 3.1.1 above, the Commission has determined the draft Rule will not amend the principles that NEMMCO is currently required to take into account in preparing a procedure for determining causer pays factors.

3.2 Abolition of the Derogation

Presently, Part 11 of Chapter 8A of the Rules contains a derogation that provides for the transitional arrangement for market ancillary service for Tasmanian entry into the NEM (the Derogation). The Derogation replaces clause 3.15.6A(a) for regulation services only. It requires NEMMCO to determine cost recovery for regulation services on a regional basis, similar to the other types of market ancillary services, and then determine the costs for the Tasmanian region, with the balance of costs being averaged for all other regions combined.

The Derogation was due to expire on 31 December 2006 but was extended in late 2006 until 31 December 2008 in response to a Rule change proposal from NEMMCO.²³

Although the NGF’s Rule change proposal was received prior to the extension of the Derogation, its observations regarding the need for a permanent solution remain relevant:²⁴

“... there is a need to implement a permanent solution for Tasmanian islanding. Further there is the possibility of other regions or parts thereof becoming separated into an island (due to planned and/or forced outages of transmission elements) thus requiring a more general solution. In addition it is now apparent that limitations on the operation of BassLink necessitate a local

²² Flinders Power, 21 February 2007, p. 1.

²³ The Derogation was extended on 7 December 2006. Further information about NEMMCO’s Rule change proposal and the consultation process followed by the Commission is available from the Commission’s website at www.aemc.gov.au.

²⁴ NGF Rule change proposal, 7 September 2006, p. 2.

requirement for FCAS regulation services under some power transfer conditions.”

TRUenergy expressed support for the abolition of the Derogation for the reason that the Derogation was only ever intended as a short-term solution.²⁵

“While contingency services had regionalised recovery implemented shortly thereafter, regulation services were initially overlooked as their incidence of separation was lower and their resolution more complex. However the entry of Tasmania necessitated an urgent response and so the current ‘Tasmania only’ derogation was implemented.”

The Commission has considered the policy rationale underlying the introduction of the Derogation. The Commission is satisfied that the Derogation was intended to apply temporarily and that subsequent steps were to be taken to identify and implement a permanent solution. Further, the Commission is satisfied that the draft Rule provides a practical resolution of the issues.

The Commission considers that it is also appropriate to address the broader discrepancy between the mechanisms for, on the one hand, recovering the costs of local contingency FCAS requirements and, on the other, recovering the costs of local regulation FCAS requirements.

Therefore, the Commission has decided that the Derogation shall be removed by the draft Rule. However, the Commission notes that it may be necessary to extend the Derogation beyond 31 December 2008 as a transitional measure depending on the time required by NEMMCO to implement systems changes required by the adoption of the Proposed Rule. This is a matter the Commission will review before making a final Rule Determination on the Proposed Rule.

3.3 NEMMCO FCAS review

NEMMCO is required under the Rules to undertake a review of the operation and effectiveness of the spot market for ancillary services market, and recommend any improvements.²⁶ The Rules require NEMMCO, in conducting the review, to consider:

- Simplification of the FCAS markets;
- Better determination of FCAS requirements; and
- The introduction of an FCAS usage market.

NEMMCO’s Issues Paper foreshadowed a number of potential changes that are likely to improve the operation of the FCAS markets. NEMMCO sought

²⁵ TRUenergy, 16 February 2007, p. 1.

²⁶ National Electricity Rules, clauses 3.1.4(a1)(2) and (3).

submissions²⁷ on the appropriateness of the potential changes, and called for other possible changes that may be suitable. In relation to the regional recovery of regulation FCAS costs, the Issues Paper stated:²⁸

“The costs from local contingency FCAS requirements are covered regionally, on the basis that only local market participants are the beneficiaries of the local FCAS requirements, and only local market participants are able to influence the local FCAS price. This principle has been applied temporarily to Tasmanian regulation FCAS costs. However, the principle has not yet been extended to the recover of regulation FCAS in general.”

In its submission on the NGF Rule change proposal, NEMMCO noted:²⁹

“... the regional recovery of regulation FCAS costs is a likely prerequisite for any co-optimisation of regulation and delayed FCAS. The potential co-optimisation of regulation and delayed FCAS is currently being considered as part of NEMMCO’s review of the FCAS markets, as well as being the subject of a current Hydro Tasmania Rule change proposal.”

Flinders Power also observed that the matters sought to be addressed by the NGF’s Rule change proposal were the subject of NEMMCO’s FCAS market review. In its first round submission, Flinders Power stated:³⁰

“It is also noted that a broad review of the operation of the FCAS markets in the NEM is currently underway, being undertaken by NEMMCO. This review might potentially result in a number of changes to current FCAS arrangements, including service requirements, market operation, and cost recovery arrangements. It is expected that any Rule change proposals which emerge from this review would be presented to the AEMC by the end of September 2007.

Whilst the current Rule change proposal is not without merit, Flinders Power believes in view of the current distortions, it would be preferable not to proceed with this change at this time, and to await the outcomes of the FCAS review before implementing changes to the current cost recovery arrangements.”

As noted above, NEMMCO released its draft report on 3 May 2007.³¹ With respect to local recovery of regulation FCAS, NEMMCO said:

“To make things clear for the AEMC consultation, this report favours extending the regional cost recovery principle to regulation FCAS costs, subject to the resolution of the appropriate causer pays factors to be used. NEMMCO

²⁷ The period for making submissions closed on 23 February 2007.

²⁸ NEMMCO, *FCAS Review Issues Paper*, December 2006, p. 3.

²⁹ NEMMCO, 22 February 2007, p. 1.

³⁰ Flinders Power, 21 February 2007, p. 2.

³¹ NEMMCO, *FCAS Review Draft Report*, May 2007, p. [xx]. A copy of the report is available from the NEMMCO website at http://www.nemmco.com.au/ancillary_services/160-0313.pdf.

considers it appropriate to maintain a ‘placemaker’ in the FCAS review for the regional recovery of regulation FCAS costs, but agrees with the NGF and Stanwell that the issue can be adequately resolved through the AMEC Rule change process already underway.”

On the basis of the clear exposition of NEMMCO’s position, the Commission does not consider it is appropriate to defer consideration of the NGF’s Rule change proposal until after the conclusion of the FCAS Review. Accordingly, the Commission proposes to make the draft Rule in the form annexed to this draft Rule Determination.

3.4 Analysis of the draft Rule

The Commission has assessed the drafting of the Proposed Rule against the Derogation and clauses 3.15.6A(f) and (g) of the Rules, which provide for local recovery of FCAS contingency costs. Based on its understanding of the NGF’s objectives in putting forward the Proposed Rule and the operation of the Rules and the Derogation, the Commission has made several amendments to the Proposed Rule. To assist interested stakeholders during the second round consultation process, this section of the draft Rule Determination outlines the nature of, and rationale for, the drafting amendments made by the Commission.

The purpose of clauses 3.15.6A(h) and (i) of the draft Rule is to enable the costs of regulation FCAS to be recovered on a regional basis throughout the NEM. To ensure the clauses in the draft Rule do not unnecessarily or unintentionally alter the process that currently applies in Tasmania, the Commission has assessed the draft Rule against the Derogation.

Sub-paragraphs (1) and (2) of clause 3.15.6A(h) of the draft Rule mirror paragraphs (1) and (2) of the Derogation. The allocation mechanisms contained in paragraphs (3) and (4) of the Derogation have been adapted to facilitate NEM-wide recovery of the costs of regulation FCAS and are set out in clause 3.15.6A(h)(3) of the draft Rule. As set out in the NGF’s Proposed Rule, clause 3.15.6A(h)(3) uses “customer energy” to determine the quantity of energy being consumed in each region. The Commission considers this is a straightforward means of measuring energy consumption and stresses that it does not apportion regulation FCAS costs to market customers. Further, the Commission considers that using customer energy as a measure will achieve the objective of enabling regional recovery of regulation FCAS costs, and therefore accepts the approach proposed by the NGF as appropriate.

The formulae contained in clause 3.15.6A(i) of the draft Rule are substantially similar to those contained in paragraphs (3) and (4) of the Derogation and in clauses 3.15.6A(h) and (i) of the current Rules. In order to facilitate NEM-wide regional recovery, the draft Rule contains modified definitions of the inputs to the formulae.

Paragraph (5) of the Derogation is not replicated in the draft Rule because it will become redundant once the Rule commences.

The draft Rule also amends clauses 3.15.6A(j) and (k) of the current Rules. The insertion of sub-paragraph (j)(2) clarifies that NEMMCO is subject to a positive obligation to determine causer pays factors for regulation FCAS on a regional basis.

To guide NEMMCO in developing a procedure for determining causer pays factors, the draft Rule inserts new principles that NEMMCO must take into account at subparagraphs (3) and (6) of clause 3.15.6A(k). The inclusion of these principles is to ensure that matters specific to the regional recovery of the cost of regulation FCAS are addressed in NEMMCO's procedure.

The new clauses for insertion into Chapter 11 of the Rules introduce savings and transitional measures designed to ensure that the actions taken by NEMMCO prior to the Rule commencing for the purposes of implementing the Rule are valid.

3.5 Implementation and timing of the Proposed Rule

3.5.1 Implementation

In its first round submission, NEMMCO's raised concerns regarding the lead time required to implement the changes required by the NGF's Rule change proposal if the proposed abolition of the Snowy region proceed. While NEMMCO's development cycle typically takes about 9 months (including 3 months to develop functional requirements and 6 months to develop, test and implement software), NEMMCO is of the view that the development cycle may be under particular pressure if the proposed abolition of the Snowy region proceed. NEMMCO noted that it could "provide firmer comments on the timeframes once a draft determination is published."³²

The Commission is aware of the impact that other Rule changes, including any rule change proposals relating to the Snowy region or arising from the FCAS Review, can have on the timing for system development. Notwithstanding any uncertainty surrounding future system requirements, the Commission does not consider it appropriate to delay the making of a draft Rule Determination on the NGF Rule change proposal until the final outcomes of the Snowy region boundary change proposal are known.

The Commission is of the view that the scale, or number, of the modifications that will be required by the proposal under the conditions outlined by NEMMCO should not, at this stage, influence the decision to implement the proposal. The Commission will remain mindful of NEMMCO's development cycle and the pressures placed upon it when making its final Rule Determination. The Commission has also taken into consideration NEMMCO's view, as expressed in the FCAS Review Draft Report, that the issue of local cost recovery of regulation FCAS is best addressed through the Rule change proposal put forward by the NGF.³³

The Commission will undertake further consultation with NEMMCO concerning the timelines that NEMMCO expects may be required to implement the draft Rule.

³² NEMMCO, 22 February 2007, pp. 1-2.

³³ NEMMCO, *FCAS Review Draft Report*, May 2007, p. 37.

3.5.2 Timing of commencement

As discussed above, the Derogation will cease to apply on 31 December 2008. On the basis of NEMMCO's 9 month development cycle, the Commission proposes that the Rule will take effect no later than 1 January 2009.

A commencement date later than this will require arrangements to deal with the expiry of the Derogation. The Commission has identified two options to address this eventuality. The first is for NEMMCO to submit a Rule change proposal requesting that the Derogation be extended. The second option, which is noted in the draft Rule, is for the Rule to commence in two stages. The first part of the Rule would replicate the terms of the Derogation, and this would commence by 1 January 2009 and apply until Part 2 of the Rule commences. Part 2 would contain the provisions that enable NEM-wide localised cost recovery of regulation FCAS; that is, the majority of the draft Rule. Part 2 would commence on a specified date that is later than 1 January 2009, taking into account the timeframes for implementation.

To ensure NEMMCO can ready itself for the commencement date, it is important to ensure that the Rule includes appropriate savings and transitional arrangements. At a minimum, these arrangements would need to ensure that:

- NEMMCO is able to review and make appropriate changes to FCAS formulae and procedures prior to the commencement of the Rule; and
- Relevant work undertaken by NEMMCO, or any other market participant, prior to the commencement of the Rule is recognised when the Rule commences.

The Commission seeks feedback from interested stakeholders on the appropriateness of the proposed commencement date, and on the savings and transitional provisions.

3.6 Miscellaneous amendments

In the course of evaluating the Proposed Rule, the Commission noted that clauses 3.15.6A(f) and 3.15.6A(g) of the Rules refer to "local requirements" or "local ancillary service requirements" in italics, indicating that these terms are defined in the Rules. It appears that the use of such terms as defined terms is an error and the appropriate term to use in these clauses is "local market ancillary service requirements". Accordingly, the draft Rule makes this amendment.

4 Differences between the Proposed Rule and the draft Rule

The Commission has largely adopted the drafting of the Proposed Rule subject to some minor modifications and enhancements.

The key differences between the Proposed Rule and the draft Rule are that the draft Rule:

- Amends clause 3.9.2A to remove the references to regulating raise service and regulating lower service;
- Amends clause 3.15.6A(h)(1) to require the allocation under clause 3.15.6A(a) to be undertaken for each of the regulating raise services and regulating lower services (rather than “or”);
- Deletes the words “requirement” and “requirements” from the definitions of the terms used in the formulae in clauses 3.15.6A(i)(1) and (2);
- Inserts new principles at sub-paragraphs (3) and (5) of clause 3.15.6A(k), thereby providing additional guidance to NEMMCO in the development of its procedure for determining causer pays factors; and
- Italicises the words “region” and “regions” to reflect that they are a defined term in the Rules (clauses 3.15.6A(k)(3) and (6);
- Provides for transitional and savings provisions;

The draft Rule also makes minor editorial amendments to the Proposed Rule.

The draft Rule also amends clauses 3.15.6A(f) and 3.15.6A(g) refer to “local market ancillary requirements”.

This page has been intentionally left blank