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

10 February 2006

Dear Dr Tamblyn,

RE: DRAFT RULE DETERMINATION ON SYSTEM RESTART ANCILLARY SERVICES

The National Generators Forum (NGF) welcomes the opportunity to comment on the draft Rule determination for System Restart Ancillary Services.

Firstly, it must be said that the revised Rules covering System Restart Ancillary Services ("SRAS") developed by the AEMC are a vast improvement over the previous proposals and go a long way to satisfying our key concerns.

Further, the NGF believes that the draft Rules would contribute to the achievement of the National Electricity Market (NEM) objective.

Some of the major improvements are listed below:

1. Recognition of potential competitiveness of SRAS market;
2. Rejection of NEMMCO's proposed interventionist approach;
3. Defining objectives of the SRAS;
4. Enhancing the role of the Reliability Panel for setting standards;
5. Provision of standard dispute resolution procedures;
6. Reducing NEMMCO discretion;
7. Provision of long term bilateral contracts;
8. Removal of the regional cost recovery.

The NGF believes that the draft Rules would encourage providers to offer services and potential providers would have proper incentive to join the market.

Therefore, in summary the NGF supports the draft Rules determined by the AEMC. Detailed comments on the draft determination are attached to this letter.

One matter however, that the NGF does not support is the AEMC's determination for the cost recovery mechanism for SRAS. As stated in our previous submission, it is the NGF's view that 100% of SRAS cost should be borne by the market customers. Our attached submission elaborates further on this viewpoint.

If you have any questions in relation to this proposal, please contact the undersigned.

Yours faithfully

John Boshier
Executive Director

NGF RESPONSE TO AEMC DRAFT DETERMINATION ON SYSTEM RESTART ANCILLARY SERVICES

1. Recognition of potential competitiveness of SRAS market

With regard to the competitiveness of market, the Firecone report indicated that although the SRAS market is limited there are steps which could be taken to increase the depth of competition. Firecone further stated that the market based approach is most likely to work towards the objective of the National Electricity Market (NEM).

The NGF fully supports this view and as such relevant Rule changes are supported.

2. Rejection of NEMMCO's proposed interventionist approach

NEMMCO attempted to adopt a heavy handed regulatory approach in securing SRAS. NEMMCO have further included a number of guidelines to assess reasonable terms and conditions in their proposed quasi-regulatory approach. As stated in the Firecone report¹ conclusion,

*We consider that a market based procurement of SRAS services without a residual threat of regulation is most likely to work towards the objective of the national electricity market Competitive procurement should result in SRAS being procured from the most efficient provider. Whilst this may lead to some over-pricing, an adequate case has **not been made** that the extent of the over-pricing is sufficient to justify the imposition of a cost based pricing requirement. Moreover, no consideration has been given to the likelihood of regulatory error when effectively regulating prices in such a small market, to the direct transaction costs of regulation and to the wider impacts of what will be in practice regulatory powers into what is otherwise a competitive market (emphasis added).*

Further as highlighted by Firecone²,

they [NEMMCO] have provided no conclusive evidence that prices are currently inefficient, no demonstration that the scale of any inefficiency is sufficient to justify the introduction of a cost based pricing regime, and no evidence that such an approach can be implemented effectively and will lead to better overall outcomes in the procurement of SRAS services.

The NGF is pleased that NEMMCO's quasi-regulatory mechanism has been rejected by the AEMC and the removal of such interventionist measures would certainly encourage more participants to offer SRAS services thus further opening up the market.

With respect to NCAS, the NGF supports AEMC's conclusion that the procurement of NCAS through a competitive tendering process should be maintained, and that NEMMCO's proposals for assessing reasonable terms and conditions for NCAS offers should be removed.

¹ Firecone, Review for AEMC of the Proposed NEMMCO Rule for SRAS, page 20

² Firecone, Review for AEMC of the Proposed NEMMCO Rule for SRAS, page 19

3. Defining objectives of the SRAS

The NGF fully agrees with the AEMC's suggested objectives for the SRAS. NEMMCO's proposed definitions relate only to the procurement aspect but AEMC's modified objective correctly addresses the overall objective of SRAS which is to, "minimise the expected economic costs of a major supply disruption, taking into account the cost of supplying SRAS³". The AEMC SRAS objective is entirely consistent with the NEM objective.

4. Enhancing the role of the Reliability Panel for setting Standards etc

There were number of ambiguous terms such as primary and secondary services which were not properly defined. The NGF is supportive of the enhanced role assigned to the Reliability Panel.

The Reliability Panel, as an independent body consisting of representatives from various participants, is placed in the best position to determine guidelines/definitions for system restart standards, primary/secondary services, sub-network boundaries etc. This would result in better definition of the SRAS requirement to be provided to meet the reliability standard. Also the use of the Reliability Panel to set standards separates the function of determining the standards from the implementation of those standards. As stated by the AEMC this removes any potential conflict of interest and provides service providers with greater confidence in the integrity of the tendering process. An independently set standard also removes any bias by any Jurisdiction to set a higher standard than what is technically required.

5. Provision of standard dispute resolution procedures

As indicated in the previous submission, the NGF is of the view that all participants should have equal access to same dispute resolution procedures provided under the Chapter 8 of the Rules. The NGF is pleased to note that the AEMC endorsed the NGF's view.

This would certainly place all participants including NEMMCO on equal footing when it comes to disputes. This is an essential feature of a well designed market and this would encourage more participation of potential SRAS providers.

In its draft determination the AEMC states that⁴,

The standard dispute resolution procedure should apply, subject to a provision that unreasonable terms and conditions in tenders should not grounds for dispute.

The NGF highlights that it could not find such a provision in the draft rule. The NGF requests that this provision be included in the final rule.

6. Reducing NEMMCO discretion

Under the proposed Rules, NEMMCO has unnecessary discretionary power on a number of matters. For example, NEMMCO proposed that the determination of sub-network

³ AEMC Draft Rule Determination, page 12

⁴ *ibid*, page 31

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boundaries should not be subject to Rule consultation process arguing that participants with commercial interests should not be party to the consultation. However, the AEMC has rejected that argument and the NGF supports the AEMC's view as every market participant must have equal access to information and the decision making process.

The NGF is of the view that a better outcome for the entire market could be achieved by requiring NEMMCO to follow the Rule consultation procedure for their determinations.

Also, it is appropriate that all parts of system restart standards are determined by the Reliability Panel rather than one section by the Panel and the rest by NEMMCO. This will ensure clarity and consistency in definitions while providing NEMMCO some discretion to address practical issues. The NGF supports the AEMC determination that the Reliability Panel set all relevant system restart standards.

7. Provision of long term bilateral contracts

The AEMC has recommended a long term bilateral contracts provisions for the SRAS. It is certainly a very good improvement to SRAS market and the NGF is fully supportive of this draft Rule.

However, according to the draft Rule clause 3.11.5 (m) (1), NEMMCO has the discretion to determine whether a bilateral contract would provide better value for money than that of the service available through tendering process.

The NGF is concerned that draft Rule 3.11.5(m) allows NEMMCO at its discretion to bypass the competitive tendering process and process with a bilateral negotiating process. The NGF believes that it is consistent with the clear intent of the proposed new rules that a competitive tender process be the preferred process for selection of SRAS services. The NGF considers the rules and the NMAS tender guidelines should express a preference for a competitive tender process and set out the circumstances in which NEMMCO could elect to proceed with a bilateral contracting process, for example around the determination of "better value for money".

As a sidepoint, it appears the reference in draft Rule 3.11.5(a) to Rule 3.115(n) should instead be a reference to Rule 3.11.5(m).

8. Cost Recovery for SRAS

The NGF believes the AEMC has improved NEMMCO proposals regarding cost recovery.

8.1 Regionalisation

The AEMC have highlighted the benefits of a smeared system of cost recovery versus regional recovery. These benefits included; simplicity, removal of issues that may arise from regional versus sub-network boundaries, and the use restart services from other sub electrical networks. Further the AEMC have concluded that the benefits of regional recovery of SRAS do not outweigh the costs. The NGF argued that any generator levy should be recovered on an equalised NEM-wide basis and thus we support the AEMC's draft decision in this regard.

The NGF supported jurisdictionally based customer recovery where there is discretion for localised variations to a national standard. We note that the AEMC has removed this

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discretion and emphasised the role of the Reliability Panel in setting the criteria for selecting sub-networks. The NGF is satisfied that these changes should result in a consistent national standard and therefore the NGF supports the AEMC's decision to also levy customers on an equalised NEM-wide basis.

Although the NGF concurs with the AEMC's final decision, it rejects as invalid the argument put forward by the AEMC that regionalised recovery would pressure suppliers to lower their tenders in the interest of lowering their levy exposure⁵. The only appropriate price pressure on tenderers should be competitive selling pressure, not the indirect cost that results incidentally by also contributing to its cost. Indeed where this pressure exists, it would distort the SRAS market. E.g. large generators (and therefore large contributors) might be incentivised to offer services below the efficient cost. Indeed, the NGF suggests this may represent an argument that generators should not fund any SRAS costs.

8.2 Generator/Customer Split

The NGF is disappointed the AEMC considers the existing 50/50 customer/generator split appropriate:

*The commission notes that both generators and market customers benefit from the provision of a restart service. However, it is difficult to quantify the benefit that any individual party will gain from the provision of the service. Not only will this rely on the value that the participant places on the lost load avoided, but also the participant's assessment of the likelihood of the system service needing to be used.*⁶

The NGF makes several points in response:

- Electricity is a low cost input to virtually all commercial and industrial processes driving economic growth underpinning Australia's international competitiveness.
- The benefit of SRAS is the ability to promptly restore the power system following a black system in one or more locations. If NEMMCO acquired less, or in the extreme, none at all, the restoration would eventually occur but over a much longer time period with disastrous impacts upon the economy and the community.
- The community and the economy greatly benefit from prompt restoration, and the existing standards are created with a view to a reasonable trade off of this economic benefit against the cost of having multiple start sources available.
- During a black system and its restoration, the market pricing system is suspended, and prices in affected regions are set at the scheduled suspension price: i.e. the 90th percentile of historical prices, likely to be in the order of \$35/MWh. As this will be of similar magnitude to the strike prices of wholesale contracts, it ensures there are no significant financial transactions resulting from the event.
- Network Service Providers will suffer a loss of revenue for the period of the restoration due to the loss of energy transacted, typically \$20/MWh for transmission and \$40/MWh for distribution.

⁵ AEMC Draft Rule Determination , page 35

⁶ AEMC Draft Rule Determination, page 36

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- Generators also suffer a loss of revenue due to loss of output, partially offset by fuel saving. Black system events experienced overseas have been shown to be unrelated to high demand conditions, therefore the expected revenue opportunity lost would be about average spot prices less fuel. Thus we would expect a loss to generators in the order of \$20/MWh.
- Market Customers blacked out will however suffer a significantly greater economic loss which is indicated by their Value of Customer Reliability. This is at least the VoLL price cap, \$10,000/MWh, and more likely a higher number, around \$30,000/MWh⁷.

In fact, quantifying the relative benefit from SRAS upon participant classes is straightforward and points clearly to placing all but a negligible proportion upon Market Customers.

The NGF sees no relevance in the participant's assessment of the likelihood of the service being used. The volume of SRAS will be determined by the Reliability Panel, and the quality of providers determined by NEMMCO and its procedures. Individual participants' assessments have no bearing or relevance to these matters.

In any case, the generator levy results in an increase in the production cost of all generators. This results in a commensurate increase in energy price and thus market customers are indirectly paying the generator levy via their energy costs. Clearly, no efficiency benefits are obtained by applying cost recovery to generators (in the same way Network Service Providers are currently excluded). Collecting the entire levy directly from market customers on an energy consumption basis would be simpler, and would be consistent with recovering these costs in the least distortionary manner.

⁷ See VENCORP study of the Value of Customer Reliability, 2004.