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Mr Ian Woodward,
Chairman Reliability Panel,
Australian Energy Market Commission,
PO Box A2449,
Sydney South NSW 1235

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By email: submissions@aemc.gov.au

Dear Mr Woodward,

Causer Pays for Ancillary Services to Control the Tasmanian frequency

Thank you for the opportunity for the NGF to make a submission on the rule change proposal. This submission covers the following issues:

- **Support for cost recovery mechanisms**: this rule passes costs to the causer
- **Good Regulatory Practice**: the reduction of regulatory risk on incumbents and the associated improved investment climate
- **Market Signals for FCAS**: The benefits from encouraging TVPS to provide more FCAS
- **Sunset Duration**: Support for the 15 years derogation

These issues are covered in detail below.

Aurora Energy Tamar Valley (AETV) is expected to soon become a member of NGF and so were consulted on this submission. They do not support the NGF position.

Support for cost recovery mechanisms

NGF considers that the costs that result from changing the system frequency standard should be applied to those that required or directly benefit from the change. Existing plant is capable of meeting the current Tasmanian standard and should not therefore be penalised if a tighter, more costly standard is now applied.

In our original submission to the AEMC in their request for stakeholder comments, the NGF noted that:

> *We consider, however, that the costs that result from changing the system standard should be applied to those that required or directly benefit from the change. In addition the principle of grandfathering for existing investments, to respect the physical capability that the plant was originally designed to achieve at the time of commissioning, should be applied.*

Whilst the contingency limit will partially address the problem, the incumbent generators will still be penalised for the tighter standard. Whilst customers will also be subject to higher FCAS costs, the Reliability Panel has determined that these costs are more than offset by the cheaper energy from more efficient plant. We note that in section 4.5 of its Final Decision the Reliability Panel has recognised this issue and made helpful suggestions in relation to addressing this issue.

We recognise that the issue of protecting investments from costs derived from regulatory change is a cornerstone in developing confidence in the investment climate in the NEM. This is particularly important at this time, when the industry is changing due to the impact of a carbon constrained world and major new investments will be required. We look to the AEMC to provide support for any initiative in this area.

Good Regulatory Practice

The NGF submits that the proposed Rule change is consistent with the promotion of good regulatory practice. Although the Rule change proposal will not – and is not intended to – lead to fewer or less responsive regulatory decisions, it will reinforce participants' perceptions of regulatory predictability through the consistent application of the 'causer pays' principle. This is a principle that the AEMC has applied in other contexts, such as its review of transmission pricing. It is also the principle embodied within the cost allocation regime for FCAS more generally.

A fundamental aspect of good regulatory practice is the minimisation of actual or perceived regulatory risk. As noted by the MCE, a critical factor in promoting the long-term interests of consumers is to ensure efficient investment in electricity infrastructure. Increased actual or perceived regulatory risk undermines the incentives to efficiently invest in electricity infrastructure, and as such is not consistent with the NEO. Consequently, the impact of administrative rule changes on either actual or perceived regulatory risk is an important consideration in promoting the NEO.

One of the key implications of the proposed Rule change is that it ensures that a party making an investment today is not forced to bear costs imposed by future regulatory changes resulting from a subsequent new entrant. In the present situation, the Rule change would mean that Hydro Tasmania and Roaring 40's would not bear the additional FCAS costs arising from a decision of the Panel to change Tasmanian frequency standards in response to the commissioning of the CCGT Tamar Valley Power Station (TVPS).

While existing generation investments are obviously sunk in this regard and cannot change their investments from this decision, going forward, proponents of new generation, load and transmission projects in Tasmania and elsewhere will be more reluctant to invest in the NEM if they perceive a significant risk that they may be required to bear costs arising from decisions of a similar nature. This is especially relevant given that there may be further tightening of the Tasmanian frequency standards in the future – potential new entrants will be concerned that any future changes to the standards will impose additional costs on them that they cannot control, and hence adversely impact the value of their investments. In this particular instance, the case for change is stronger due to the significant costs which the new entrant causes on the existing generators.

In this regard, the proposed Rule change reinforces the ‘causer pays’ principle, which should improve investor confidence in the integrity of the NEM regulatory framework. Compared to the absence of the proposed Rule change, the result should be a more favourable investment climate, a lower cost of capital of investment, and ultimately greater productive efficiency as future load can be served at a lower cost.

By adopting this Rule Proposal, the AEMC will have reaffirmed the principle that investors will not be faced with costs arising from regulatory decisions made in response to later investments.

Market Signals for FCAS

As a separate but related issue, service provision deserves particular consideration given that under the market Rules a participant that causes increased requirements does not bear the cost of that increase in all circumstances. The NGF notes that the current arrangements for the provision of some services to support the system standard by participants, under connection agreements, the services are expected to be provided free of charge by generators or are generally considered to be a common good. The costs for providing additional FCAS or other services are smeared across all participants - both generators and retailers.

This means that at the time an investment decision is made there is no mechanism to ensure that the least cost approach to meeting the reliability standards is selected by the new entrant. For example in Tasmania, it is not clear whether or not the current approach of installing standard plant and incurring the cost of modifying the frequency standards or installing non-standard plant specifically selected to meet the existing reliability standards is the least cost approach for consumers.

These services can be a scarce resource, as may well be the case in Tasmania, and provision on a competitive basis would support the development of additional resource where required at least cost. This would support the objective of ensuring the lowest cost delivered energy to consumers.

In principle, new entrants should install plant or procure the services required to ensure their plant can operate within the standards existing at the time of connection without harming incumbents. This will mean that the new entrant considers all the location specific costs and is incentivised to select the overall least cost investment option to ensure the lowest cost delivered energy to consumers consistent with the NEM objective. In this case, implementation of the rule will encourage TVPS to provide the additional FCAS which they have caused in Tasmania which is a good outcome for the market and customers.

NGF believes that this rule change implements this principle for the unique circumstances which have arisen in Tasmania.

Sunset Duration

Hydro Tasmania has proposed a sunset of 15 years to this derogation. NGF supports this approach. The derogation should cover the period up to the commissioning of major new thermal plant when the FCAS shortage would be relieved (in part by the significant additional inertia provided). Tasmania has a very low load growth and a strong dependence on 5 major customers. The recent global financial crisis makes load growth predictions now look very optimistic. New thermal plant is likely to be delayed by new wind developments as well. In the light of these factors and the potential over supply (when TVPS is commissioned), we believe that 15 years is a realistic duration.

For any queries on this submission, please contact the undersigned on 02-62435120.

Yours sincerely,

JF Boshier

John Boshier
<u>Executive Director</u>