



Australian Energy Market Commission

Rule Determination

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

Rule Proponent
NEMMCO

7 December 2006

Signed:

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Chairman
For and on behalf of
Australian Energy Market Commission

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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 market. 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.

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Abbreviations

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
Code	National Electricity Code
Commission	see AEMC
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
Rules	National Electricity Rules

Summary

The Australian Energy Market Commission (Commission) makes this Rule determination and accompanying Rule under section 102 of the National Electricity Law (NEL). On 17 October 2006, the National Energy Market Management Company (NEMMCO) submitted a Rule change proposal to the Commission to extend the participant derogation in Part 11 of Chapter 8A of the Rules to the new expiry date of 31 December 2008. The derogation provides for arrangements for the recovery of localised costs of regulation services in Tasmania, and expires on 31 December 2006. NEMMCO requested that the Rule change be considered by the Commission as non-controversial to allow the rule change process to be expedited.

Regulation services are one of a number of market ancillary services managed by NEMMCO. A regulation service is the activity of providing real-time frequency control for the power system within the National Energy Market (NEM). There is no 'regional boundary' for regulation services when interconnection is operating within its normal range. The Rules provide for cost recovery for regulation services (clause 3.15.6A(a)) differently compared with the provisions for cost recovery for other market ancillary services. For regulation services, cost recovery is determined for the NEM taken as a whole, without distinguishing between regions.

The existing derogation replaces clause 3.15.6A(a) for regulation services only, and requires NEMMCO to determine cost recovery for this service on a regional basis, similar to the other types of market ancillary services, and then determine the specific costs for the Tasmanian region, with the balance of the costs being averaged for all other regions combined.

The Commission determined on 31 October 2006 to commence the Rule change process for the NEMMCO proposal. A notice to expedite the Rule making process under sections 95 and 96 was published by the Commission on 2 November 2006. Interested parties were invited to make any objections in writing by 16 November 2006 and to provide written submissions by 4 December 2006. The Commission received one objection on the question of expedition and two submissions with comments on the objection. There were no submissions on the making of the Rule.

The Commission considered the proposed Rule change and found that the expiry of the participant derogation would be inappropriate because generators are relying on the extension to the participant derogation to allow a limitation with the existing permanent right located in Chapter 3 of the Rules to be resolved. The Commission accepts that it will be in the best interests of investors and consumers to allow sufficient time for a consensus on a suitable solution to be developed. This view acknowledges the current consideration being given by the Commission to a Rule change proposal submitted by the National Generators Forum, that addresses this issue.

Based on this finding, the Commission has decided to make the Rule. This extends the current participant derogation in Part 11 of Chapter 8A of the Rules to 31 December 2008, on the ground that the proposed Rule is unlikely to have a significant effect on the NEM and is therefore non-controversial.

The Commission also analysed the objection and the submissions on it. However, it was decided to proceed with the making of the Rule.

The Commission is satisfied that the Rule is likely to contribute to the NEM objective, and that it therefore satisfies the Rule Making Test.

This Rule determination sets out the Commission's reasons for making the Rule, in accordance with the requirements of the NEL.

1. NEMMCO's Rule Proposal

On 17 October 2006, NEMMCO submitted a Rule change request to the Commission to extend the Participant derogation in Part 11 of Chapter 8A of the Rules to the new expiry date of 31 December 2008. The derogation provides for arrangements for the recovery of localised costs of regulation services in Tasmania, and currently expires on 31 December 2006. NEMMCO submitted the proposal as requested by the NGF on behalf of the generator class of participants, who are the subject of the participant derogation.

NEMMCO proposed that clause 8A Part 11(d) be changed as follows:

- (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 permit the regional recovery of *regulation services* costs will become effective.

NEMMCO requested that the Rule change be treated as a non-controversial Rule change, and therefore subject to an expedited process.

2. Background

Regulation services is one of a number¹ of market ancillary services managed by NEMMCO. Regulation service is the activity of providing real-time frequency control for the power system. There is no 'regional boundary' for regulation services where interconnection is operating within its normal range. For example, a generator in the Queensland region can provide regulation services for all other regions of the national market if the power system conditions are right. However, if the regional interconnector is not in service, or not operating within its normal range, then regulation services will need to be separately introduced on either side of the interconnector.

In the Rules, the cost recovery provision for regulation service is drafted differently to the cost recovery provisions for the other market ancillary services. Clause 3.15.6A(h) provides for the calculation of an ancillary service trading amount for each Market Generator or Market Customer in accordance with their need for regulation services. The cost recovery calculation is determined from a whole of NEM approach and does not distinguish between regional conditions. That is, for regulation services, the cost recovery principle was approached from a national perspective from the commencement of the NEM. This principle was acceptable whilst the NEM consisted of mainland regions interconnected via AC² transmission circuits. However, with the introduction of a DC³ interconnector between the Victorian and Tasmanian regions, this whole of NEM approach needed to be reconsidered.

The Tasmanian interconnector is able to pass through regulation services when the interconnector is operating within a 'normal' range, but is not able to pass through regulation services at all other times. When Tasmania commenced operating as a NEM region, this constraint was recognised and captured in a participant derogation in Chapter 8A for all generators in the NEM. The derogation simply replaces clause

¹ The other market ancillary services are: fast service (raise and lower), slow service (raise and lower), delayed service (raise and lower).

² Alternating Current

³ Direct Current

3.15.6A(a) for regulation services only, and requires NEMMCO to determine cost recovery for this service on a regional basis, similar to the other types of market ancillary services, and then to determine the specific costs for the Tasmanian region, and the balance of the costs for all other regions combined.

The National Generators Forum, in summarising the background to the derogation, advised⁴ that all other FCAS⁵ services are presently recovered on a regional basis, following extensive regulatory discussion during a NECA⁶ Code change in 2003. Regulation was not transferred to a regional basis only because its recovery is more complex and price separation in the NEM at that time was rare. The effort of formulating such a mechanism was not seen as justifiable. With the introduction of Tasmania, price separation between Tasmania and the remaining NEM regions is much more common. The Tasmanian derogation was installed in lieu of a general solution as an interim measure. A general solution has now been proposed by the National Generators Forum but is expected to take in the order of 12 months to finalise, given the time required to consult upon and finalise the rule change, and the subsequent changes that will be necessary to NEMMCO's information technology processes. The Commission therefore believes that the extension of the interim derogation is both necessary and consistent with previous and future directions and the NEM objective.

3. Rule determination

The Commission has determined in accordance with section 102 of the NEL to make the attached Rule as set out in this Rule determination. The Rule is the proposed Rule put forward by the proponent, which amends the existing Rule by a variation to the termination date of the derogation.

On 31 October 2006, under section 94 of the NEL, the Commission determined to commence initial consultation on this proposal by publishing a notice under section 95 and 96 of the NEL for a non-controversial Rule change. The notice was published on 2 November 2006. The Rule change proposal was open for public consultation for four weeks, with submissions closing on 4 December 2006. Interested parties were required to advise the Commission in writing by 16 November of an objection to expediting the making of the Rule as a non-controversial Rule change.

One party objected to the Commission expediting the Rule change. On 15 November 2006, the Commission invited interested parties to comment on the objection by 24 November 2006 in order for the Commission to obtain views on and assess the factual basis of the objection. Two parties submitted comments on the objection. The Commission's analysis of the objection is provided in Section 3.4 of this Rule determination.

No party made a submission in regard to the content of the proposed Rule change.

This Rule determination sets out the Commission's reasons for making the Rule. The Commission has taken into account:

1. the Commission's powers under the NEL to make the Rule;

⁴ In its comments to the objection, dated 24 November 2006

⁵ Frequency Control Ancillary Services, a term used by industry to mean 'market ancillary services'

⁶ The National Electricity Code Administrator

2. the proponent's Rule change proposal including the proposed Rule;
3. objections for expediting the making of the Rule;
4. submissions received on the objection to the making of the Rule;
5. relevant MCE statements of policy principles; and
6. the Commission's analysis as to the ways in which the Rule will or is likely to contribute to the achievement of the NEM objective so that it satisfies the statutory Rule making test.

3.1 The Commission's power to make the Rule

The Commission is satisfied that the Rule proposed by NEMMCO falls within the subject matters for which the Commission may make Rules, as set out in section 34 of the NEL and in Schedule 1 to the NEL.

The Rule satisfies the criteria of section 34 of the NEL as it relates to the operation of the NEM and the activities of persons participating in the NEM.

In addition, the Rule relates specifically to matters which the Commission may make Rules that are provided for in clause 36 of Schedule 1 of the NEL where:

- clause 36 relates to any other matter or thing that is the subject of, or is of a kind dealt with by, a provision of the Code as in operation and effect immediately before commencement of section 12 of the NEL.

3.2 Submissions received

The Commission received submissions in regard to expediting the Rule change and the making of the Rule, as follows:

Submission on expediting the Rule change:

- Aurora Energy Pty Ltd (Aurora Energy), who lodged a written objection;
- The National Generator Forum, which provided comments on the objection; and
- The National Electricity Market Management Company, which provided comments on the objection.

These submissions are assessed in Section 3.4 of this Rule determination.

3.3 Relevant MCE statements of policy principles

The NEL requires the Commission to have regard to any MCE statements of policy principles in applying the Rule Making test. The Commission notes that currently, there are no specific MCE statements of policy principles that directly relate to market ancillary services.

3.4 Matters arising from consultation and the Commission's analysis

In the course of the public consultation period for this proposed Rule change, the Commission received an objection from Aurora Energy to the expedition of the Rule. To assist with the Commission's consideration of this objection, submissions on the expedition were requested by the Commission. Two submissions were received following this request, from NEMMCO and the National Generators Forum. No other submissions were received during the public consultation process.

In this section, the analysis of the objection is considered in greater detail.

3.4.1 Issues relating to expediting the making of the Rule

Aurora Energy stated in its objection to the expedition of the Rule that:

The justification for this derogation was as a transitional arrangement between Tasmania joining the NEM on 29 May 2005, and the physical connection of Basslink scheduled for the 30 April 2006. As this has now occurred the derogation should be allowed to expire on 31 December 2006...the extension of this derogation is unnecessary and on this basis, would be classified as controversial.

...any proposed rule change in the future is part and parcel of the normal NEM environment. Therefore the degree of regulatory uncertainty is no greater than what would normally be expected as part of any NER Rule change process.

The current arrangements do provide a more accurate locational signal as to the costs of providing regulation FCAS in Tasmania than the alternate, where regulation services are averaged across the entire NEM. However, there is no justification for the Tasmanian region to be treated differently to any other region of the NEM where locational pricing signals are not provided.

The principle that parties that bear the cost of regulation services are those that have the possibility of influencing the requirement for the service is fine as an idealistic view. The reality is however that market customers who pay the bulk of the regulation service...have limited ability to influence requirement levels and in fact have no control over price.

The removal of this derogation and the averaging of regulation costs across the entire NEM would not result in a material impact to market participants.

NEMMCO stated in its comment on the objection that:

NEMMCO's purpose in proposing the derogation was to maintain the current arrangements while debate on the issue was underway elsewhere...We believe that the main points raised by Aurora would be better dealt with in those forums.

The core benefit from extending the derogation is to ensure regulatory certainty for the market and avoid additional costs from changing cost recovery arrangements...NEMMCO has completed software changes to settle the market but has deferred changes to the calculation of "causer pays" factors for the recovery of regulation FCAS until the future of the derogation is decided.

The National Generators Forum indicated in its comment on objection that:

...the NGF has submitted a rule change proposal to enable local cost recovery of regulation services in line with the current methodology to recover contingency service costs. The reason for extension of the existing derogation is to allow

transitional arrangements to continue until the completion of the proposed rule change.

The current arrangements do provide [a] more accurate locational signal for the provision of regulation services in Tasmania than the alternate where cost of regulation services is averaged across [the] entire NEM. This fact has been agreed by Aurora Energy.

While price separation for regulation services is possible between mainland regions, it is more likely between Tasmania and the mainland due to limitations on transport of the service via Basslink. Hence the retention of the derogation will deal with the most likely issues while a more general solution is under consideration.

As Basslink is a single cable, there is a high possibility that Tasmania may disconnect from [the] Mainland due to unforeseen circumstances. As such, prices of Tasmanian regulation services could be very high due to tight demand/supply. In this situation, only Tasmanian providers can influence regulation prices. Therefore, local cost recovery is essential.

...extension of this derogation is essential to protect Mainland participants in case of material price differential for regulation services between Tasmania and the Mainland...Under such conditions, mainland participants could be exposed to significant costs over which they have no control or from which they get no benefit. Such an outcome would represent a significant inefficiency. On this basis we believed expiry of the current derogation is a move away from the market objective.

In summary, the NGF does not agree with Aurora Energy's objection...If Aurora was correct and the derogation had little effect, it would do no harm. On the other hand, if their assertion is wrong, the extension of the derogation will have a desirable effect. In this way, extending the derogation until the NGF Rule change can be fully considered is the low risk alternative.

The Commission's consideration and reasoning:

The Commission has considered the issues raised by Aurora in its objection to the expedition of the proposed Rule, and the further submission received in response to the objection and has decided to proceed with the expedition of the proposed Rule. The Commission's reasons for this decision are.

- (i) Aurora Energy has asserted that "the removal of the derogation and the averaging of regulation costs across the entire NEM would not result in a material impact to market participants". Aurora Energy did not, however, provide the Commission with the details of its analysis in support of this statement. The Commission notes that the National Generators Forum believes that Aurora Energy is only correct in limited circumstances, where "regulation price difference[s] between Tasmania and [the] Mainland is not material". The Commission is of the view that the National Generators Forum's qualification of Aurora Energy's statement is relevant, because the Commission believes that there is likely to be price differentials across the BassLink interconnector, potentially resulting in market impacts in the absence of the derogation, or an alternative approach in the Rules;
- (ii) The NEMMCO proposal to extend the participant derogation for another 24 months is a short term extension to provide sufficient time for all parties affected by the existing participant derogation to adequately consider resolving the nature

of the permanent right⁷, and to make the necessary software changes to support that permanent right. Whilst the Commission considers that this matter should be resolved at the earliest opportunity, the diverse views evident from this Rule change consultation warrant the derogation to be extended for a further period. On balance, the Commission considers that an extension of the derogation for a period of 24 months would be a reasonable period for all parties to participate in reaching a permanent solution; and

- (iii) The Commission notes that the objection to expediting the making of the Rule seeks to retain the limited cost transparency and efficiency that is available from the existing permanent right. The Commission does not readily accept that a derogation should naturally expire if in doing so it places an obvious limitation on the operation of the market, and there is evidence that elsewhere parties are actively seeking to find a solution to remove that limitation.

Accordingly, the Commission has decided to expedite the making of the Rule.

3.4.2 Analysis on the making of the Rule

From the points identified in section 3.4.1, the Commission considers that the expiry of the participant derogation would be inappropriate because generators are relying on the extension to the participant derogation to provide sufficient time to consider a more permanent arrangement to be developed and implemented.

The Commission accepts that it will be in the best interests of investors and consumers to allow sufficient time for a suitable solution to be developed. This view acknowledges the current consideration being given by the Commission to a Rule change proposal submitted by the NGF that addresses this issue.

Accordingly, the Commission has approved the extension of the derogation under Chapter 8A, Part 11 of the Rules as requested by NEMMCO.

3.5 Assessment of the Rule: the Rule Making Test and the NEM objective

The Rule Making Test requires the Commission to be satisfied that a Rule that it proposes to make will contribute to the NEM objective. The NEM objective is defined in section 7 of the NEL.

The test requires the Commission to consider the implications of the proposed new Rule, for the efficient investment in, and efficient use of these electricity services, in respect of specified elements which impact on the long term interests of consumers of electricity. The Commission has applied the Rule Making Test to NEMMCO's proposal and found that it satisfies the Rule making test.

The Commission has tested these various changes and has assessed that incorporating the NEMMCO proposal into the Rules will, or is likely to, contribute to the NEM objective in the following ways:

- Ancillary services provide essential electrical support to the operation of the power system. The transparent and efficient settlement of ancillary service costs

⁷ Separately, the Commission received a proposal from the National Generators Forum dated 4 September 2006 requesting that a Rule be made to accommodate the local cost recovery process for regulation services in a manner similar to the way it is managed for the other market ancillary services.

will encourage investor innovation in ancillary services delivery leading to higher quality and lower costs for consumers;

- The Commission accepts the view that the current participant derogation is more cost transparent and efficient than the permanent right currently available in the Rules. The extension of the derogation will provide additional time to enable proponents to consider alternate ways to improving the transparency and efficiency of the existing permanent right;
- The Commission has received a proposal from the NGF to improve the transparency and efficiency of the existing permanent right. The Rule change consultation period for the NGF proposal will not be finalised until mid 2007, beyond the date of the expiry of the current participant derogation; and
- The Commission considers that it is in the interest of investors and consumers for the current arrangements to be maintained for a further transitional period to allow time for adequate consideration of the NGF proposal. The Commission notes that if the NGF proposal was successful, the participant derogation would be terminated at the time the new Rule was made.

Based on the Commission's analysis, the assessment of the objection to expediting the making of the Rule, and the suggestions from interested parties, the Commission is of the view that the Rule to be made satisfies the Rule Making Test.

Attachment 1: Rule to be made