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

Dear Dr Tamblyn

AURORA ENERGY OBJECTION TO EXTENDING FCAS DEROGATION

The National Generator Forum (NGF) wishes to thank the AEMC for the opportunity to make comments on the above subject. NGF does not agree with Aurora Energy's views and requests the AEMC to extend the FCAS derogation until the completion of the Review.

As you are aware, 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 services costs. The reason for extension of the existing derogation is to allow transitional arrangements to continue until the completion of the proposed rule change. Therefore, this is simply a temporary measure.

NGF wishes to make the following points in response to Aurora Energy's submission.

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

2. 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.

3. As BassLink is a single cable, there is a high possibility that Tasmania may disconnect from Mainland due to unforseen 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.

4. 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 <u>if regulation price difference between Tasmania and Mainland is not material</u>. (The statement made by Aurora Energy should be qualified by the words underlined.)

5. However, extension of this derogation is essential to protect Mainland participants in case of material price differential for regulation services between Tasmania and Mainland. Note that the price difference can be as high as $10000/MWh. 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 believe expiry of the current derogation is a move away from the market objective.

6. All other FCAS services are presently recovered on a regional basis, following extensive regulatory discussions during a NECA 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. Thus the effort of formulating such a mechanism was not seen as justifiable. With the introduction of Tasmania, price separation is much more common, so an interim Tasmanian derogation was installed in lieu of a general solution. A general solution has now been formulated but will take over 12 months to progress through the rule change and NEMMCO IT processes. Therefore the extension of the interim derogation is both necessary and consistent with previous and future direction.

In summary, the NGF does not agree with Aurora Energy's objection and therefore requests the AEMC to extend the derogation until the completion of the review of the NGF rule change proposal for cost recovery of regulation services.

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.

If you have any further questions, please contact Methsiri Aratchige on 02 8268 4235.

Yours faithfully,

John Boshier
<u>Executive Director</u>