

19 February 2015

Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Provided by direct lodgment

**National Electricity Amendment (System Restart  
Ancillary Services) Rule 2014  
Reference: ERC0168**

The Major Energy Users (MEU) has reviewed with interest the AEMC draft more preferable rule made in response to the two proposed rule changes, one submitted by AEMO and another by a group of generators regarding the System Restart Ancillary Services (SRAS). The MEU was involved in the discussions on SRAS undertaken by AEMO in 2013 which led to the proposed rule from AEMO.

Overall, there are a number of important changes that are proposed as part of the draft preferred rule and the MEU supports these. However, the MEU has concerns about other aspects of the proposed changes and makes the following observations where the AEMC appears not to have fully appreciated the concerns of consumers.

The MEU makes the following comments regarding SRAS and the AEMC discussion in its draft preferred rule.

- The MEU agrees that the concept of SRAS is to provide a service that would allow a region to restart if it were "black" and there was no ability for supplies from adjacent regions to assist in a restart (eg if its interconnectors with other regions are out of service or incapable of providing supply to a region that is "black" such as DC links).
- The AEMC more preferable rule requires that each region has to have its own indigenous black start generation. The MEU considers that the circumstance of a region going "black" without there being an interconnector in operation is so remote that there has to be a careful examination of the annual prices allowed as the current arrangements require SRAS charges to be unlimited. In this regard, it is important to note that these charges accumulate over time and, as black starts are so unusual, the overall costs to the market incurred could be very large relative to the costs incurred in the provision of the service. Such an outcome would not be efficient as is required by the National Electricity Objective (NEO).

**2-3 Parkhaven Court, Healesville, Victoria, 3777**

**ABN 71 278 859 567**

**Ph: (03) 5962 3225, Fx (03) 5962 3237, email [davidheadberry@bigpond.com](mailto:davidheadberry@bigpond.com)**

- There are only some generators within a region that can provide the black start capability needed when a regional system restart is required. This means there is limited competition in the provision of the SRAS service and those generators will seek to maximise their prices using their market power. The AEMO proposed rule recognises this reality but the AEMC draft preferred rule, after addressing the issue, allows this exercise of market power to remain unchecked.
- In regard to competition, the MEU notes from table C.1 that in terms of the ability to provide SRAS Hydro Tasmania (HT) has a monopoly position in the Tasmanian market (its HHI<sup>1</sup> is 10,000) and Queensland and South Australia SRAS markets have very high HHI ratings at 5,000 and 3750 respectively, classing these two regions as "highly concentrated" in terms of SRAS. All the other regions rated as "moderately concentrated". The AEMC comments that the SRAS markets are "relatively concentrated" which is a gross understatement and this understatement negatively affected how the AEMC addressed its more preferable rule; low competition means prices can be well above costs involved leading to unnecessarily high charges. The AEMC provides a view that generators without black start capability might seek to develop this capacity (and so improve competition for SRAS) but the MEU considers that assuming this imposes an unacceptable risk on consumers as the MEU views the probability of this occurring very low otherwise generators would have acted already to provide SRAS.
- The AEMC makes reference to the charges for SRAS as a proportion of the overall market costs and observes that the SRAS charges were an average \$0.28/MWh across the NEM (page 91). The AEMC uses this observation to implicitly support its view that the issue is of a low order concern, that there is enough competition to ensure low prices into the future and that controls are not required to prevent further increases.

However, the AEMC fails to assess the cost in each region. For example the charge for SRAS in Tasmania for 2012/13 was \$1.04/MWh<sup>2</sup>, nearly four times the average charge, and there is every reason to consider that prices might go higher to reflect the lack of competition in that region. With the low levels of competition identified in other regions, this concern could well extend beyond just Tasmania.

- AEMO has observed that SRAS prices are increasing and this is what triggered the AEMO concern about the SRAS process. The MEU also notes that the SRAS payments for Tasmania in 2012/13 were by far the highest in the NEM on any comparative basis<sup>3</sup> (see figure 3.1) although the same figure 3.1 shows that Tasmania contributes the smallest amount to the NEM wide SRAS charges.

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<sup>1</sup> Herfindahl–Hirschman Index

<sup>2</sup> Derived from the costs for Tasmania detailed in figure 3.1 of \$10.2m and the total consumption in Tasmania in 2011/12 of 9.8 TWh

<sup>3</sup> Such as electricity demand, electricity consumption and connected customers

Tasmania is the smallest region in the NEM<sup>4</sup> and HT is the monopoly generator in the region as well as having a generation mix very appropriate for providing SRAS. This raises the concern as to why HT prices for SRAS services are so high. The MEU sees that there are three factors that drive this outcome:

1. HT has a monopoly on the provision of services in the region allowing it to effectively price what it likes for the service
  2. Generators only pay 50% of the charges for the service so if there was only one generator in the region there is an incentive to overstate the prices because 50% of the price will be paid by someone else
  3. The current mechanism for paying for SRAS is effectively socialised across the NEM so a generator in one region (such as Tasmania) can overcharge for the provision of SRAS in the full knowledge that only a proportion of the costs will be recovered from that region.
- Of these three issues, the AEMC draft preferred rule fully addresses only one - point three through its change on regional cost reflectivity. The concept of regional cost reflectivity is supported by the MEU and that costs incurred for the provision of a service should be borne by those receiving the benefit of the service.
  - The second point issue (sharing costs between generators and consumers) whilst the draft preferred rule reflects that both generators and consumers benefit from SRAS, it also permits generators (especially where there is limited or no competition) to transfer excessive prices for the provision of SRAS to consumers and to other generators.

This impact on consumers can be typified by using the Tasmanian example. Charges are to be shared 50/50 between generators and consumers. In 2012/13 HT charged \$10.2m for SRAS and, on the basis of 50% being paid by generators, HT would pay \$5.1m but electricity consumers would contribute \$5.1m, so HT would be \$5.1m better off. The only control on the continued escalation of the price is either regulation of some sort or ensuring there is significant competition.

The AEMC approach - assuming competition applies and costs should be regionalised with generators and consumers sharing equally the costs incurred - will result in increased charges for Tasmanian consumers and possibly will lead to consumer harm in other regions as well. This highlights that there needs to be some control on what generators can charge for SRAS and this is totally lacking in the draft preferred rule.

- The issue of insufficient competition - point 1 - (especially in Tasmania and to a lesser extent in Queensland and SA) is only partially addressed, and even then, in a peripheral way by allowing some freedoms to AEMO in how they address SRAS pricing.

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<sup>4</sup> In terms of area, connected customers, electricity demand and electricity consumption

As the SRAS must be sourced from within a region, this allows the exercise of market power if there is insufficient competition in the provision of SRAS. This aspect applies most critically in Tasmania but also (to a lesser extent) in Queensland and South Australia where competition is limited.

The likelihood of a region going “black” and having no interconnection to help restart is very small, yet the annual charges to restart a region are significant compared to the likelihood of their need and have increased significantly in recent years. The cause of the increase is unlikely been due to increased costs but more from low competition for SRAS. An additional driver of increased prices is that all generators are facing low prices in the market more generally, squeezing their profitability. So an unlimited ability to get more revenue through excessive SRAS prices is an opportunity to improve profitability.

There is insufficient regional competition to ensure that Tasmanian (but also Queensland and SA) SRAS pricing will reflect the lowest costs possible. The MEU notes that AEMO had proposed that it have the power to impose arbitration to address the issue of insufficient competition to get acceptable prices. Whilst the MEU accepts that arbitration would probably not have achieved this outcome, the AEMC draft preferred rule does not address the very real concern that HT (or the generators in Queensland and SA) could use their market power to set unacceptably high prices for the provision of the service; the AEMC appears to assume that competition will keep SRAS costs low yet this expectation is unlikely to be realised, especially now with low generator profitability.

- At the very centre of the issue of SRAS, is how the System Restart Standard (SRS) is set and the recovery times required after a region goes black. The cost of a system restart is related to the time permitted for the restart and extent (% of load) for recovery after a region goes "black". As SRAS is based on a region being isolated and being "black" is a very low probability event, the charges for the SRAS need to be put into context; there is a need to balance the costs incurred on an annual basis against the likelihood of a major failure of the system. The MEU considers that the timeframe for a region restart must be assessed in terms of the likelihood of it occurring, the value consumers have placed on reliability (eg the value of customer reliability - VCR) and the charges that will be incurred between black start events. As the AEMC has not carried out this assessment as part of the draft preferred rule, the MEU considers that the preferred rule should require a full investigation as to what the SRS should be before setting the rules on how AEMO is to implement the SRAS.

The MEU is aware that the SRS imposes a requirement that 40% of the regional load must be returned within 4 hours. The standard is intended as a target timeframe for AEMO and is an integral part of the establishing of contracts for SRAS provision.

The important issue is that there is no limit on the overall charge that AEMO can incur in establishing its contracts with generators to achieve this target. As AEMO is a price taker in regard to the SRAS, it means that AEMO cannot apply any controls on the prices that are offered and must accept whatever

prices are offered until it considers that the target can be met. This is not in accordance with the concept of customer reliability where there is, through the VCR, a limit on what consumers are willing to pay for reliability> although a system restart is a subset of reliability, there is no limit placed on what AEMO must pay for meeting the SRS. The SRS must be structured in terms of VCR and a limit put on the amount that AEMO can be permitted to commit for the provision of SRAS.

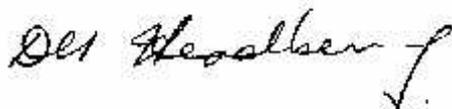
The MEU considers that an essential part of the SRAS rule change process has to reassess the SRS recognising that the probability of a black start being required without interconnector assistance is extremely remote and the amount to which AEMO must contract for services to enable system restarts. Perhaps the SRS can be restated in terms of what is possible with regard to setting a cap on SRAS costs based on the VCR.

Overall the MEU considers that addressing the issue by combining a number of different approaches might result in driving down these burgeoning SRAS costs to more sensible levels. The MEU considers that:

1. AEMO has to be provided with some ability to obviate the market power some generators have in the provision of SRAS services in their region. The peripheral changes made in the draft preferred rule do not provide sufficient controls on prices for SRAS, especially where there is significant market power.
2. Increasing a generator's share of the costs of SRAS (perhaps in proportion to the level of competition) or imposing commercial obligations on those generators which are beneficiaries of the recovery after a network goes "black" could reduce the incentive to over-price the provision of SRAS
3. There needs to be a cap on the overall costs that AEMO can accept for the provision of SRAS
4. Some relaxation of the standard to reflect reality is necessary to address what is really a remote possibility, particularly with reference to the value consumers have placed on reliability

These thoughts reflect a consumer view on the issue. Should you wish to discuss these observations or related aspects, please contact the undersigned.

Yours sincerely



David Headberry  
Public Officer