



Johnston Kaye

From: BARLOW Darren (Ergon) [darren.barlow@ergon.com.au]
Sent: Friday, 6 October 2000 3:53 PM
To: 'tjrp@accc.gov.au'; 'kaye.johnston@accc.gov.au'
Subject: NRF Submission on Ancillary Services Market



ACCC - Submission on
Ancillary...

Kaye and Louis,

Please find attached a copy of the NRF submission on the ancillary services code changes. As U will appreciate this topic is very complex technically and as such I am really not sure that we understand all of the issues. I would like to arrange a mutually convenient time to meet with U in Canberra to discuss this submission together with the issues floating around behind it (ie the comments on prudentials, etc). I will contact U late next week to arrange.

< .CCC - Submission on Ancillary Services Interim Market arrangements.doc >>

Regards,

Darren Barlow
Manager Regulation
ERGON ENERGY
Phone: 07 3228 8116
Mobile: 0419 727 462
Fax: 07 3228 8255
Post: PO Box 107 Albert Street
BRISBANE Q 4002
Email: darren.barlow@ergon.com.au
Web: <http://www.ergon.com.au>

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6 October 2000



Mr Paul Bilyk
Acting General Manager
Regulatory Affairs – Electricity
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2602

Our ref: R-00-229

Dear Mr Bilyk,

NATIONAL ELECTRICITY CODE CHANGES – ANCILLARY SERVICES

We refer to the request for submissions on the proposed "*National Electricity Code Changes – Ancillary Services*" (Code Changes) submitted by the Code Change Panel to the Australian Competition and Consumer Commission (ACCC) for approval.

We thank you for the opportunity to provide comment and we ask that you accept this letter and the attached document as the National Retailers' Forum (NRF) submission on the Code Changes and supporting material. The NRF is an independent organisation whose members operate as Retailers of electricity throughout the National Electricity Market.

The Code changes proposed by the National Electricity Administrator Limited are complex and touch upon almost all areas of the existing Code. The technical nature of ancillary services themselves, let alone the design of a market for their trading, are difficult to fully understand without a sound appreciation of the underlying services and their characteristics. Retailers are not, by their very nature, technical experts in ancillary services and this has caused significant concern when trying to understand and interpret the true impact of the proposed Code changes. We believe it would be useful if "plain English" were encouraged in all Code change proposal. We believe that technical jargon and the resultant information bias may impact adversely upon the quality of responses made, and the ability of many parties to adequately understand and communicate their thoughts to the ACCC therefore discouraging participation in the ACCC's consultation process.

The following NRF members jointly support this submission:

1. ACTEW Energy Pty Ltd
2. Advance Energy
3. AGL (incl AGL South Australia)
4. Energex Retail Pty Ltd
5. Energy Australia
6. Ergon Energy
7. Great Southern Energy
8. Integral Energy
9. Origin Energy
10. Powercor Australia

11. Australian Inland Energy

12. United Energy

Please feel free to contact me on (07) 3228 8116 as the NRF Coordinator on this matter should you have any queries.

Yours faithfully,

Darren Barlow
Manager Regulation
Strategic Business Development Group

NATIONAL RETAILERS FORUM

**SUBMISSION ON PROPOSED
NATIONAL ELECTRICITY
CODE CHANGES –
ANCILLARY SERVICES**

1.0 INTRODUCTION

We refer to the request for submissions on the proposed "*National Electricity Code Changes – Ancillary Services*" ('Code Changes') submitted by the Code Change Panel ('the CCP') to the Australian Competition and Consumer Commission ('ACCC') for approval.

We thank you for the opportunity to provide comment and we ask that you accept this letter and the attached document as the National Retailers' Forum ('NRF') submission on the Code Changes and supporting material.

The NRF will, of course, give consideration to further comment as part of any subsequent consultation process.

2.0 GENERAL COMMENT

As a general statement, the NRF supports the development of transitional markets for frequency control ancillary services ('FCAS'). We also agree that the principle of "causer pays" should be applied in the development of proposed market based arrangements for the provision of ancillary services ('AS').

In progressing the goal of market development however, it must be ensured that the pricing signals arising from the compensation payments applied to AS arrangements encourage responses from Market Participants that are consistent with a competitive trading environment. Where this cannot be achieved, a form of price regulation should be maintained. For this reason, the NRF supports an ongoing contract market for network control ancillary services ('NCAS') and system restart ancillary services ('SRAS') as mechanisms appropriate to the current trading environment.

The NRF is however concerned that the contracting regime undertaken by NEMMCO as monopsony purchaser of these services on behalf of the market is not undertaken at least cost. We encourage the ACCC to require NEMMCO to prove to it that the contract prices are least cost.

Despite the NRF's broad agreement with the market development principles embodied in the Code Changes, there are a number of areas where amendment is required to ensure maximum benefit to the market is achieved. In particular, the NRF has concerns with the following areas:

- Implementation – the imposition of truncated periods for consultation and system builds to address the expiration of Schedule 9G.
- Transition Strategy – an inadequate "glide-path" from inception of the new AS market arrangements to the proposed "light on the hill".
- Framework – a failure to consider issues such as market failure and suspension.
- Technical – amendments required to ensure that the proposed AS market arrangements are workable in practice.

Each of these areas is discussed in detail below.

While these issues remain unresolved, the NRF is unable to support the proposed Code Changes as representative of market arrangements capable of implementation for 01/01/01 or as providing the market with an adequate level of certainty and confidence as to their impact. We do however believe that the Code Changes present a sound basis for developing market based arrangements for AS and we would encourage further consultation to ensure that the current proposals can be modified and implemented within a more realistic and achievable timeframe.

Further to this, it is the NRF's submission that the derogations contained in Schedule 9G of the Code should be extended until 31 August 2001 at the earliest to enable formulation of an implementation plan that provides Market Participants with a reasonable level of certainty as to AS costs and fosters general confidence within the market as to the development proposals.

3.0 TIMEFRAME FOR IMPLEMENTATION

It is clear that the primary driver for approval and implementation of the Code Changes for 01/01/01 is the expiration of the Schedule 9G Code derogations "*Ancillary Service Provisions*" on 31/12/00 and the perceived cost associated with NEMMCO negotiating another "round" of ancillary service contracts.

While the importance of ensuring the availability of AS cannot be denied, the benefits to be obtained from the revised arrangements will not be realised in isolation from a robust implementation plan and the confidence in the proposals that Market Participants would derive as a direct result.

Implementation

The NRF has previously expressed its concerns that NEMMCO should not attempt to implement too much too quickly and in doing so, escalate both costs and Market Participant uncertainty and risk.

Assessment of the proposed commencement date of 01/01/01 for the new AS arrangements against the activities that could naturally be expected to occur in the process of development and implementation shows that implementation of the new arrangements by this date is simply unachievable (irrespective of cost considerations):

ACTIVITY	DATE FOR COMPLETION
Commencement of Transitional Arrangements	01/01/01
30 Day Trial P2	01/12/00
30 Day Trial P1	01/11/00
Participant and NEMMCO Systems Finalised	01/11/00
Participant System Testing (14 Days)	15/10/00
Participant System Builds (60 Days)	15/08/00

Even on these conservative timeframes, NEMMCO would have needed to release the final version of the system functional specifications no later than 15/08/00 to enable Market Participants to commence necessary system builds. This timeframe sets aside issues such as market rules and policy which remain unresolved, and with no known process for resolution.

Should it be argued that the above estimates of time for system builds and testing are exaggerated and that implementation in a truncated period is achievable, the ability for NEMMCO and the market to meet the deadline of 01/01/01 is further called into question by the following:

- The level of resource depletion currently being experienced by Market Participants, NEMMCO, and Regulators as a result of major market projects such as full retail contestability ('FRC'). Detailing the requirements for introducing FRC has focused all available industry resources within Retailers on resolution of this issue. The system builds required by NEMMCO and industry to accommodate FRC would leave little scope for consideration of revised AS arrangements until well into 2001.
- Introduction of new AS market arrangements coinciding with the introduction of FRC will only exacerbate existing market uncertainty and risk. This is further compounded by the shifting or unresolved dates for the introduction of FRC in each jurisdiction and the impact of FRC on current market arrangements.
- Until such time as Retailers have a reasonable level of certainty regarding the FRC arrangements under which they will operate, it is impossible for them to assess their ability to pass on any additional costs (and price signals) that may be incurred as a result of the revised AS arrangements. This is particularly so in circumstances where, even under FRC, there is no guarantee that some form of price regulation will not continue to apply.

In light of these issues, the NRF believes that the proposed 01/01/01 implementation date for the transitional AS arrangements is incapable of being achieved.

We suggest that a practical solution would be to allow a reasonable period for bedding down FRC market and system changes prior to the introduction of the AS market proposals, by extending the Schedule 9G derogations for a period of 12 months. This would enable formulation of an implementation plan that provides Market Participants with a degree of certainty as to their costs and risks under the revised arrangements.

Interim Authorisation

Although not extensively explored in the Report, there is a general acceptance by NECA that implementation of the Code Changes will proceed via an interim authorisation from the ACCC pending final authorisation after commencement of the AS markets.

As understood from those involved in formulation of the Code Changes and as expressed at industry forums, the reasoning for this process appears to rest primarily

on a presumption of its expediency in an effort to meet the deadline posed by the expiration of the Schedule 9G derogations.

The NRF's concern is the danger of viewing interim authorisation as an easy or "fast-track" means of obtaining final authorisation. It is also dangerous to assume that interim authorisation will be granted merely on the basis that the ACCC has granted interim authorisations previously on Code changes reflecting National Electricity Market ("NEM") issues.

Authorisation (including interim authorisation) is intended to be granted by the ACCC only when identifiable benefits to the public result. Further to this, we note that the ACCC's *"Guide to Authorisations and Notifications"* states that an interim authorisation is unlikely to be granted where the effect of allowing the proposed conduct to occur would prevent the market being able to return to its pre-interim authorisation state if the ACCC was subsequently to deny full authorisation.

In the NRF's submission, the fundamental changes to the operation of the market evidenced by the proposed Code Changes, including the re-allocation of rights, obligations and risks as well as the expense associated with system builds, means that a restoration of the market to a pre-interim authorisation state would not be possible.

In light of the inability for the market to return to a pre-interim authorisation state, should full authorisation be denied, interim authorisation of the Code Changes should not be granted.

4.0 TRANSITION STRATEGY

The Code Changes contemplate a number of transitional arrangements in an effort to ensure a smooth development for the FCAS markets.

Leaving aside the issue of the appropriateness of the arrangements as proposed, the NRF is of the view that there has been a failure to provide a methodology for transition that will facilitate development of the market arrangements as envisaged. The following has essentially been proposed as the timetable for transition to full FCAS arrangements:

ACTIVITY	DATE FOR COMPLETION
Commencement of Transitional Arrangements	01/01/01
Successful Operation (3 months)	01/04/01
30 Day Notice of Full Arrangements	31/05/01
Full FCAS Commencement	01/06/01

In relation to this, the NRF comments as follows:

- The CCP in its Report recommends that the transitional arrangements *"should be introduced as soon as practicable, and no later than 1 January 2001, and should operate for a minimum of three months. **In the meantime**, NEMMCO should use the Code consultation procedures to develop a test programme and establish criteria for determining the **successful** operation of those final arrangements in shadow form, NEMMCO should report to the market and give thirty days' notice of full FCAS market commencement [emphasis added]."* Further to this, we comment that:

- The recommendation refers to the development of a test programme for final arrangements through the Code consultation process. While it is acknowledged that the recommendation is for transitional arrangements to last for a minimum of 3 months, it is highly unlikely that adequate/full consultation, development and successful testing for a period of 60 days will occur within this 3 month period.

A transitional timeframe that more realistically reflects the work required would assist in providing some certainty for Market Participants as to the minimum period for which they are required to assume the level of risk reflected by the arrangements proposed. We suggest that a formal system for defining "successful testing" is required where the parties determining whether testing is successful are not those who advocate the market (ie NECA or NEMMCO). In this regard a process similar to the MAP which was instigated prior to the commencement of NEM in November 1998 serves as a useful model. This Trial Assessment Group should contain representatives of both Retailers and Generators.

- The transition timetable envisages that full FCAS arrangements can be implemented by 01/06/01. The NRF does not however believe that this date can be achieved when consideration is given to the implications for Market Participants of the system builds required.

On information received from NRF members it can generally be said that Retailers would require between 5-6 months once a finalised functional specification is received. As NEMMCO would not be in a position to provide a finalised functional specification until after successful operation of the shadow arrangements, Retailer system builds would not be completed until late 2001 (even if it is assumed that development, testing and operation of the shadow

arrangements occurs within 3 months). The NRF is of the view that an extension to Schedule 9G until 31 August 2001 as a minimum is required. Further, NEMMCO must be compelled to immediately commence negotiations for the extension of existing ancillary service contracts for this period. Should extension not be formalised prior to 1 January 2001 then NEMMCO's power of direction provides a ready remedy and incentive upon generators to extend existing contracts.

- The recommendations leave unaddressed the process that will be adopted should the arrangements fail to successfully operate in final shadow form. Under the current proposal, the transitional arrangements could continue indefinitely.

While the NRF agrees that transitional arrangements are an important part of ensuring that market systems are proven and to allow Market Participants a better understanding of risk and operation, the transitional proposals are not an acceptable means of market development in themselves. From this perspective we disagree with the CCP that the transitional arrangements are adequate to *"shield the market from the risk of excessive volatility"*. An unending continuation of the transitional arrangements could compound the artificial nature of price signals and stifle alternative means of developing successful market arrangements.

The NRF therefore suggests that the Code Changes should be amended to incorporate a process for addressing a failure of the shadow arrangements and to include a mechanism for backing out of the transitional arrangements in such circumstances.

- Without a robust transition plan that allows each stage to be fully implemented and its effectiveness reviewed, it will be impossible for the market to accurately gauge the benefits derived from the AS market arrangements.

The NRF believes that further analysis is required of the incremental benefits represented by the move from current arrangements to transitional/ light on the hill arrangements. The absence of demonstrable net benefits will result in a failure of industry to embrace the revised AS arrangements and the system changes required for implementation. If net benefits are not proven, the bias should be in favour of no change due to the costs and the increase in risks which can be severe although difficult to quantify.

- The consultation process adopted and the material provided in support of the AS market regime does little to address the system build and associated costs of moving to an AS market. On information received from NRF members, although it is estimated that interim arrangements could be implemented from an IT perspective within approximately 3 weeks (once a detailed functional specification is received), full arrangements are significantly more detailed and costly.

It is estimated that the costs associated with system builds and implementation of full arrangements would be in the order of between \$600,000 and \$675,000 per Retailer, with approximately 14 major Retailers operating in the national market.

Although in themselves these costs are considerable, a complete assessment of costs should not only involve weighing the benefits of moving to the new system against the cost of implementation but also a comparison of the costs of, and benefits over, maintaining the current arrangements under Schedule 9G. An analysis on this basis would be in-line with NEMMCO's Objectives under clause 1.6.2 of the Code to promote improved market efficiencies while incurring costs on an efficient basis.

It is suggested that the lack of certainty as to the timeframe and glide path within which the transitional/final arrangements will apply make it extremely difficult for Market Participants to assess the risk management tools that will need to be employed. We suggest that:

- A full Cost Benefit Analysis that takes into consideration both benefits and whole of industry costs, is required as a matter of urgency.
- A longer period for development and implementation of all steps towards the "light on the hill" is required to ensure that each stage is fully delivered and that the anticipated market efficiencies do exist.

5.0 FRAMEWORK

A review of the proposed Code Changes reveals a number of issues fundamental to the framework of the FCAS market arrangements that require further discussion and resolution prior to AS market start:

- We note that it is intended for the FCAS markets to be settled on a 5 minute basis rather than the 30 minute basis for settlement that currently exists for the energy market (eg as evidenced by clauses 3.2.2 and 3.4.1 of the Code Changes and the definition of "*ancillary service price*").

Without justification as to its perceived benefits, a 5 minute basis for settlement would create a more complex settlement and reconciliation regime than may be required, effectively doubling the cost of system reconciliation and rebuilds for no justifiable benefit.

We would suggest that, for market and participant system simplicity and cost effectiveness, both bidding and dispatch should be on 5 minute intervals and settlement on 30 minute intervals to replicate the existing energy market settlement arrangements.

- A number of clauses have been amended to either remove all reference to "*ancillary services fund*" (eg clause 1.11) or to narrow the application of the Code to "*market ancillary services*" only. We are concerned that in doing this, the Code Changes are unnecessarily restricting the application of Chapter 3 with respect to "*non-market ancillary services*" (ie NCAS and SRAS).

We suggest that a review of the Code Changes in the context of "*non-market ancillary services*" is required to ensure that these triggers and processes for these services continue to operate effectively.

- Clauses such as 2.2.6(f) and 2.3.5(f) provide NEMMCO with broad powers to impose terms and conditions on Market Generators. Given that Market Generators are Code Participants and are required by the terms of clause 2.8.1(a1) to comply with the provisions of the Code, we question the necessity for clauses 2.2.6(g)(1) and 2.3.5(g)(1), which effectively duplicate this obligation.

We would suggest that for the sake of avoiding ambiguity as to the interaction of these clauses with clause 2.8.1(a1), clauses 2.2.6(g)(1) and 2.3.5(g)(1) should be removed.

- Clause 2.3.5(h) appears to tie the AS to a particular "*ancillary services load*" (ie at one connection point). We believe that this provision should be modified to allow a Market Customer to trade a portfolio load.
- Clause 2.11.1(c)(2) provides for the procurement of non-market AS to be "passed-through" by NEMMCO's in its recovery of budgeted requirements. The NRF believes that further discussion on this issue is required to ensure that the pass-through methodology proposed does not unduly disadvantage NEMMCO or Market Participants in the event of a Dispute regarding the amount of payment for the non-market AS provided. In addition, incentive should be placed upon NEMMCO to ensure that these costs are minimised.
- The report and analysis built into the terms of clause 3.1.4(a1) and (2) should not have their scope tied to the NEMMCO report of 15 October 1999 as appears implied from their terms. The scope of the review and report should be sufficiently broad to enable consideration of relevant issues raised past this date and to account for changes in technology and market experience.

The NRF recommends that these clauses be amended to allow the inclusion of these additional issues for consideration and that the cost benefit analysis should follow the criteria set by the National Competition Council for Public Benefit Tests.

- Clause 3.5.1 should be amended to explicitly acknowledge the AS market and its costs in the context of a determination/definition under clause 3.5.1 of regional boundaries.
- The amendment in relation to central dispatch requirements under clause 3.8.1(b)(4) should be removed from this round of Code Changes as it is clearly outside of the scope of amendments consequent upon the introduction of market AS arrangements.
- The NRF has a number of concerns in relation to the amendments to clauses 3.8.7A and 3.8.7B to account for market and interim market AS offers. In particular:
 - Clause 3.8.7A(b) implies that an bid must be made in terms of the whole trading day rather than allowing the flexibility to bid for only a portion of the trading day as should be permitted. Similarly, clause 3.8.7B(b) appears to impose a mandatory 7 day bid market for the interim market period.

- Sub-paragraphs (d) – (h) inclusive of clause 3.8.7A refer to the *"enabling price"* when we would suggest that use of the *"dispatch price"* would be more appropriate. The drafting of the Code changes do not appear to reflect the Report explaining the proposed changes.
- We are concerned that clause 3.8.7B(a) fails to provide any detail on the manner in which *"satisfactory operation and testing of the systems"* will be determined and by whom. We suggest that this should be determined by the Trial Committee of Market Participants established (as discussed earlier).
- NECA's explanatory notes to the Code Changes do not explain the reasoning behind the removal of clauses 3.8.15 or 3.15.7. This information would be useful to provide comfort to Market Participants that they will not be adversely impacted by the amendments proposed.
- The NRF is concerned that clauses 3.8.20(k) and 3.8.21(m) may have an anti-competitive impact by encouraging Market Participants to rebid. Further investigation of the basis upon which this may occur is required together with the information protocols and requirements necessary when rebidding.
- We query the reasoning behind the removal of clause 3.8.23(3)? The provisions of clauses 3.8.23(f) and (g) address compliance in the context of AS however we suggest that clause 3.8.23(3) is still required in relation to energy.
- Clause 3.9.2A(b) should be clarified to account for the use of actual bids as the pricing mechanism applying to the interim AS arrangements, rather than the marginal bid. There appears to be a disconnect between the Report explaining the Code changes proposed. The former implies that the interim AS market will be settled on an actual bid basis whereas the Code change proposed appears to settle on marginal bid via the cross reference back to clause 3.8.1(b).
- We believe that further discussion is required as to whether NEMMCO's decisions under clauses 3.11.2(c) and (d); 3.11.3(c) and (d); 3.11.4(d) and (e); 3.11.6(c) and (d); and 3.15.6A(l) and (m), should be reviewable decisions.
- Clause 4.9.9B by its terms appears to inherently assume that an AS load comprises "plant" rather than an available "service". We believe that the heading to this clause should be amended to remove the word "plant" and that a general sanity check of the Code Changes should occur to ensure that the reference to "plant" is not used in the same context elsewhere.
- We are concerned that neither the Report nor the Code Changes embodying the AS proposals, address the possibility of AS market suspension or failure. In particular the following needs to be considered:
 - Who will be the provider of last resort in the event of the FCAS market collapsing?
 - Can the markets for AS be suspended and if so, under what circumstances?
 - If there is a market suspension, what will be the impact on dispatch schedules and prices?

- How is a suspension lifted?
- Does NEMMCO's power of AS direction remain as a "fall-back" under the revised market arrangements and what is the compensation and cost allocation methodology to be followed?
- If the power of direction does remain, how will it be applied?

The absence of this information significantly increases the level of Market Participant uncertainty and the risk of the market collapsing. Further, it reveals the technical implementation focus/priority which this issue has received relative to the absence of policy and market development thought.

- Neither the Market Rules contained in the Code Changes nor the Report address the circumstance where there is a failure in the co-functioning of the AS and energy markets. For example, where one market is suspended and the other is not (such as where an FCAS deviation is caused by rapid load shedding).

The NRF is of the view that the only means of effectively mitigating adverse market impacts in these circumstances is for both sets of market rules to be examined jointly in an effort to identify and address potential areas of risk. This is yet to be done.

- We are of the view that the requirement for Network Service Providers to advise NEMMCO of any services "*similar*" to ancillary services is unreasonably broad and should be removed.
- It is unclear whether a prudential regime will exist for Generators who owe money to NEMMCO for AS payable. It is the NRF's view that the imposition of appropriate prudential requirements on Generators is only equitable in circumstances where Retailers are required to provide unconditional payment undertakings to NEMMCO to secure electricity trading and AS related market exposure and to insulate the market against potential financial distress via the prudential requirements. For example, the existing prudential requirements account for energy prices, volumes and volatility only. With the introduction of ancillary serviced markets generators may accrue liability in areas that are unrelated to energy trading (ie ancillary services) and thus the issue of set-off and the appropriate prudential formula to apply to ancillary service trading results. This is not addressed in the proposals at all.

Rather than engage in detailed discussion of this issue we suggest that a review is required of Chapter 3 of the Code to ensure that its terms are sufficiently broad to capture Generators for the purposes of meeting the Code's prudential requirements, and an examination of how these prudential requirements should be amended to ensure the market remains a blind to credit risk from all parties with liabilities. Public consultation on this issue is the best method of ensuring that all prudential risks are adequately examined.

- The trading, price and volatility assumptions upon which a Market Participant's prudential requirements are based relate to average energy spot prices and trading amounts. Analysis is required of both the impact of the AS market

arrangements on prudential requirements and of the extent to which the Chapter 3 prudential methodologies accommodate the volatility introduced by an AS market.

The NRF proposes the inclusion of a Code requirement for NEMMCO to provide regular and detailed information to the market regarding actual expenditure, and allocation of, AS under the proposed arrangements. As stated in our submission to NECA of 3 March 2000:

"This would provide sound information upon which to review the operation of the new arrangements and the achievement, or otherwise, of the established objectives as well as building market confidence in the new arrangements. The market needs to know the extent of 'causers' paying, which causers are objecting, proposed reallocation of payments and similar issues to ensure that the necessary confidence can be established.

As stated above, further examination of the revised AS arrangements in the context of its effect on the market as a whole is required prior to implementation of any FCAS market, whether on a transitional or a fully developed basis.

6.0 RISK MANAGEMENT AND MARKET LIQUIDITY

The FCAS arrangements are based on the premise that there will be a natural development in hedging activity upon market establishment. The NRF submits however that:

- Market indications are that the hedges offered by Generators may be limited. In circumstances where hedges are offered, they are likely be via an energy hedge only with the result that only coincident instances of large deviation FCAS and increases in regional reference prices will be covered. This means that non-coincident AS will be unhedgeable.
- As raised in earlier submissions, the NRF is concerned that the absence of analysis regarding the anticipated level of prices at each stage of the implementation process and the uncertainty this creates, is likely to impact upon participation thereby effecting consequent market liquidity.

Factors such as this and the non-firm nature of AS are likely to result in Retailers continuing to rely on hedging through energy contracts and as such, any hedge market that does emerge is unlikely to be the liquid two-way market envisaged in the Report. We do not believe that risk management tools will naturally develop in the manner suggested by the Report. We have failed to witness the development of adequate hedge cover in the primary market and therefore doubt predictions of over generation in a new subsidiary market.

- The Report by Randell Consulting appears to acknowledge that the operation of interconnectors could crowd out the provision of AS. The NRF is of the view that further investigation of the impact of interconnection on frequency standards is required. Our concerns are discussed in more detail under section 7.0 below.

Essentially, the NRF suggests that market and Market Participant uncertainty; price uncertainty under the new arrangements; the lack of competition in certain industry

sectors and the tight supply demand balance in certain NEM regions, are likely to contribute to reduced market liquidity and stifle the development of hedging activity.

To the extent that these issues remain unaddressed, the NRF disagrees with the findings of Randell Consulting that there is nothing in NEMMCO's proposals to prevent the development of a market to hedge AS. The real issue is not whether the proposal prevents the development of a hedge market but rather whether a hedge market is capable of development at all. This issue has not been addressed. Another issue requiring attention is the effect upon existing energy hedge arrangements of dissecting the market into energy and FCAS and the implication upon energy hedge availability and secondary liquidity. While development of a viable hedge market for AS, without diminishing energy market contract liquidity may be achievable in the long-term, , there is nothing in the current transitional arrangements (or long term proposals) that provide certainty to Retailers that they will be able to manage the risks created and thereby encourage participation.

7.0 COST ALLOCATION

The CCP in its Report recognised the distortions introduced as a result of averaging and imprecision in identifying the cause of frequency deviations, yet was satisfied that NEMMCO's proposals (with minor amendment) represent a "*reasonable and sensible way forward*". In relation to the CCP's proposals for cost allocation, the NRF comments as follows:

- A driver in determining an appropriate cost allocation should be to place higher costs upon those "causers" able to effect the outcome of the service provided. Further to this, the NRF supports the EUGA's recommended cost allocation as representing a more cost/causer reflective allocation of expenses for AS than that proposed by NEMMCO.
- While the NRF agrees generally with the cost allocation proposed by the EUGA, further consideration is required of those circumstances where the allocation does not capture the "causer" of the AS event for example, where there is a transmission network outage or the "tripping" of an interconnector. In these circumstances, the methodology for cost allocation does not penalise the causer of the event and distorts the price signals received. This issue is also linked to the current debate on the lack of firm access to transmission network assets.

As proposed under section 6.0 above, further investigation of the impact of such events on frequency standards is required prior to the commencement of the AS market.

- An appropriate level of Market Participant certainty is crucial to successful operation of the AS regime. The NRF agrees with the concerns expressed in earlier consultation that the use of SCADA data for calculating historical deviation factors requires reliance on an as yet unproven algorithm for frequent recalculation. We are however equally concerned that the CCP's recommendation to adopt the fallback option of historical calculation will reduce economic efficiency and significantly impair the ability of Market Participants to manage risk.

While we note that the CCP proposed this as an interim measure with review of the proposed cost allocation after 6 months, implementation of any allocation that admittedly distorts price signals is unsatisfactory, particularly in the initial stages of a market where regulatory and participant confidence in the new arrangements is crucial and where the market has not been provided with detail as to the level of the distortions anticipated.

The NRF is of the view that the AS markets should not be introduced in a vacuum of regulatory and participant certainty and further investigation of these issues should occur prior to implementation of the Code Changes.

8.0 REVIEW OF AS AREAS

As stated above, while the NRF supports the goal of market development, we are equally concerned to ensure that the pricing signals arising from the compensation payments applied encourage responses that are consistent with a competitive

trading environment. Where this cannot be achieved, a form of price regulation should be maintained. In relation to the specific areas of AS provision reviewed by NEMMCO for their scope for market development, we comment that:

FCAS

The NRF maintains its earlier expressed concerns that the frequency standards appear onerous and that a wider tolerance would provide significant cost savings as the requirement for FCAS would be lower. To further discussion and resolution on this issue, we would propose that an early review of standards be undertaken and the result utilised in the development of the FCAS market arrangements.

The NRF is also concerned with the rejection by the CCP and wavering support by NEMMCO for the application of a "price cap" for FCAS in the transition period.

We disagree with NEMMCO's revised view that price caps are *"unlikely to assist in mitigating risk and may even make the situation worse"*. NEMMCO in our view does not possess experience in trading operations or in the development of financial markets and consequently, is not in a position to comment upon such matters.

Market immaturity combined with the trials of introducing a new FCAS market simultaneously with other major market developments such as FRC, will only exacerbate participant uncertainty in the new arrangements. It is the NRF's view that the use of a price cap in the early stages of the market would assist in alleviating the pressure likely to be faced by Retailers from a lack of risk management tools in a developing market.

Further to this, the NRF repeats its earlier suggestion that a price cap of \$300 per unit apply to the 1st 2 years of the new arrangements. A review of the development of the hedging market should occur after the 1st 18 months with a view to reassessing the level of the cap at the end of the 2-year period. As stated above, the NRF does not believe that a hedging market will develop quickly and the financial impacts of this lack should be carefully managed until such time as there is clear evidence that a market has developed.

NCAS

The NRF agrees with NEMMCO's recommendation that the existing NCAS arrangements should remain in their current form pending further development at a more appropriate time. NEMMCO's report foreshadowed that this would be via a detailed review of generic constraints aimed at modelling the costs and benefits of utilising NCAS services. Given the number of major market developments that are currently occurring and the admitted complexities and administratively difficult nature of the potential NCAS market, the NRF would not support this review occurring until market developments such as FRC and FCAS have been fully implemented.

Further to this, the NRF does not support the joint review suggested by the CCP as appropriate for completion within 9 months (as proposed) of the current draft changes being incorporated into the Code.

From this perspective, we would propose that any NCAS review be deferred for a period of approximately 3 years until existing market developments are bedded down and the market has had the opportunity to mature.

SRAS

The NRF agrees with the CCP's recommendation to continue the contract-based approach to SRAS as proposed by NEMMCO. We firmly believe that the move to equal allocation of the costs of SRAS between Retailers and Generators is justified. Clearly generators require the system to be operational in order to produce revenue and are "beneficiaries" of SRAS. While we agree that NEMMCO should undertake to enter new agreements (3 – 5 years) as existing contracts expire and in doing so, establish what is effectively a portfolio approach to SRAS contracts, the primary motivator in negotiating the contracts should remain the minimisation of total cost to the market.

The NRF also supports the CCP's proposal to refine the NEMMCO review outcome by incorporating an arbitration process to determine contract conditions in recognition of the limited competition that exists within the SRAS market.

9.0 CONCLUSION

As stated above, the NRF supports an ongoing contract market for NCAS and SRAS as mechanisms appropriate to the current trading environment.

While in the majority of instances, Code Changes reflecting NEM issues can be adequately canvassed through the CCP and ACCC consultation processes, the current FCAS market proposals involve system builds, technical considerations and increased risks for consideration in a compressed timeframe and with limited supporting analysis. The following is therefore required prior to approval of the application for authorisation and the implementation of any FCAS market arrangements:

- A full Cost Benefit Analysis that takes into consideration both benefits and whole of industry costs.
- Subject to a full Cost Benefit Analysis, a revised and extended period for development and implementation of all steps towards the "light on the hill" to ensure that each stage is fully delivered and that the anticipated market efficiencies do exist.
- An analysis of those factors that are likely to contribute to reduced market liquidity and the development of risk management tools for Market Participants.

As stated above, the NRF is concerned that the date for expiration of Schedule 9G has become the primary driver for implementation of an AS market proposal that represents a significant departure from the current market environment. This has resulted in these issues progressing prematurely past the point where the consultation undertaken could be said to represent informed debate based on adequate analysis of market impacts and costs. We would encourage the ACCC to ensure that a level of analysis is undertaken prior to implementing any new AS market arrangements (transitional or light on the hill) that adequately addresses the concerns raised in this submission and in particular, the additional costs and

uncertainty the arrangements create for Market Participants. Until such time as this analysis has occurred, the derogations in Schedule 9G should be extended.

The NRF would welcome the opportunity to discuss these issues in greater detail and seeks the opportunity to be involved in any subsequent consultation process.