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3 October, 2002

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FILE No:
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By email to [electricity.group@accc.gov.au](mailto:electricity.group@accc.gov.au)

Dear Michael,

### **Safety net provisions and reserve contracting derogation**

AGL considers that the decision by NECA to grant NEMMCO's request for a derogation to the Code should be rejected. This view is taken because:

- a derogation is an inappropriate way to expand or clarify the operation of the Code
- the changes put forward by NEMMCO have been misdescribed
- no provision is made in the derogation to prevent the negative consequences that have been identified.

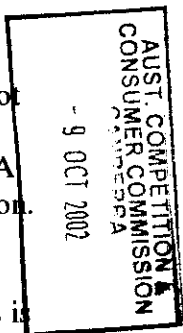
A derogation under the Code is to allow a participant or participants to gain relief from the operation of aspects of the Code "that would otherwise apply" (clause 8.4.1). This proposal is, to paraphrase the cover note, designed to create a concept, address inconsistencies and clarify the Code operation. These aspects require a Code change process not a derogation process. The ACCC should therefore refer the matter back to NECA as contemplated in clause 8.4.4 of the Code since it fails to comply with the meaning of a derogation under clause 8.4.1 of the Code.

The full impact of the derogation is not described in the text, notably:

- the reduction on the obligation of NEMMCO from "... must ensure that ..." to "... must use its reasonable endeavours to ensure that ..." in relation to dispatch under conditions of supply in clause 3.8.14 (derogation clause 2(b))
- the ability of NEMMCO to dispatch reserve plant before all other options are exhausted (derogation clause 2(f))

Changes of this nature need to be fully considered and examined for their broader impact not considered from a single perspective as they are in this derogation. NECA have therefore failed to correctly consult as contemplated by clause 8.4.2. It is also unclear whether NECA has fully complied with clauses 8.4.3 and 8.4.4 in determining and submitting this derogation. The ACCC should therefore refer it back to NECA as contemplated by clause 8.4.5(c)

The changes are intended to allow NEMMCO to contract a broader range of reserves. This is a laudable objective. In fact, it is probable that the current restrictions on the operation of the Reserve Trader require that non-scheduled options be



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considered since there is no ability of NEMMCO to encourage new investment. These changes are, however, not comprehensive enough to ensure this objective can be met without potentially damaging the market for demand side response.

The covering note to the proposed derogation identifies serious risks with the proposal and notes that NEMMCO must consider how to implement the changes without damaging the market. The changes do not, however, include provisions that would assure the market that those risks would be minimised. Serious risks are:

- that NEMMCO's use of the Reserve Trader to contract demand side would trample over the efforts of Retailers contracting demand side response, reducing the ability of the market to respond on its own
- the potential for NEMMCO to contract with demand side providers that would have responded to the high price signal without the contract, thus distorting the market
- overstatement of reserves expected by NEMMCO where a contract is placed with a demand side provider that has ceased drawing load when reserves are required for other reasons.

AGL and other retailers are actively seeking demand side capability in the market as a defence against high price events. In general, AGL contracts demand side as part of a sale contract and works with customers to develop demand side capability. This usually involves redesigning plant configuration and working with the customers to develop mechanisms to price and verify demand side activities.

Most demand side response is non-firm since it requires the demand to be in place before it can be curtailed and for customers to be able to reduce demand at the specific time curtailment is required. Retailers are able, by contracting with a range of customers, to develop a level of firmness for their demand side activities. This means, however, that customers are left with discretion on the demand side use.

NEMMCO's proposed approach has the potential to undermine these activities of retailers. Firstly, customers may contract with NEMMCO. Even if firm, the effect is to withdraw it from the pool available to the retailer reducing their capability to respond. If not firm, the curtailment may have already occurred (through operation of retailer contracts or simply in response to high prices) leaving NEMMCO short of its expected capability. In any case it is likely that NEMMCO will be purchasing capability nurtured by retailers at some cost and then requiring retailers to pay for the capability again through reliability safety net charges.

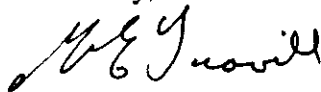
AGL considers, therefore, that the proposed changes will have the effect of reducing the effectiveness of and competition in the demand side market. The ACCC should not therefore authorise the derogation.

If, as is likely, NEMMCO required access to demand side response to meet its reserve requirements NEMMCO should be contracting with retailers in the first instance. Using the reliability safety net funding to firm up existing capability, enhancing its value to the market would be the most efficient approach. This approach would have the effect of increasing competition in the demand side market.

The requirement for NEMMCO to work with Market Customers in establishing any demand side components of this proposal should be included in any Code change or derogation. AGL would be pleased to discuss this with the ACCC and NEMMCO to determine how this could be achieved. Since an interim authorisation has been requested, AGL requests that a meeting between the ACCC, NEMMCO and interested parties be held before the ACCC makes that determination.

If you have any questions regarding the above matters, please contact Alex Cruickshank, Manager NEM Development on (03) 9201 7694 or e-mail [acruicks@agl.com.au](mailto:acruicks@agl.com.au).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Mark Travill', written in a cursive style.

Mark Travill  
Acting General Manager Wholesale Energy