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P O W E R

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Dr John Tamblyn
Chairman
Australian Energy Market Commission
Level 16
1 Margaret Street
Sydney NSW 2000

Email: submissions@aemc.gov.au

Dear ~~Dr Tamblyn~~ John.

Rule Change Proposal – Cost Recovery of Localised Regulation FCAS

Flinders Power offers the following comments on the above Rule change proposal.

While the concept of regional cost recovery for localised FCAS regulation services appears fairly straightforward, we have some concerns over the additional complexities this could bring to current FCAS arrangements.

Firstly, it needs to be recognised that the current regulation FCAS cost apportionment arrangements do not actually reflect a true causer pays approach. Causer pays factors are calculated from the observed output pattern of relevant participants over a four week reference period, and then applied to determine regulation FCAS costs during a forward four week period, with a lag time in between of 3 weeks. The historic causer pays factors are therefore up to 7 weeks out of date by the time costs are actually apportioned.

Consequently, low output factor plant can inefficiently escape their portion of costs purely through the variability of their output patterns. A peaking generator for example, may not generate during the reference period, and yet contribute substantially to FCAS requirements during a time of extreme demand for these services. The converse also applies.

Ideally it would be preferable to move closer to a real time cost recovery arrangement for regulation FCAS before rolling out regional cost recovery arrangements across the NEM, and extending the distortions of the current regime further.

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Secondly, the disconnect between the recovery of costs for contingency FCAS (which is based on a real time assessment) and regulation FCAS (which is based on historic factors, as above) would be exacerbated.

This inconsistency can create contradictory drivers for participants. For example, a participant with a positive regulation FCAS causer pays requirement would be driven to commit plant to earn revenue to manage this exposure, but in so doing could attract a significant contingency FCAS liability, which provides the opposite signal.

These impacts are exacerbated in smaller regions, and pose a serious threat to efficiency and market management, particularly during 'stress' events such as actual or impending islanding, in which spot prices and ancillary service prices can reach extreme levels. The impact of this design issue is currently blunted by the global cost recovery regime for regulation FCAS. Again, it would be preferable for the drivers for the two services to align before introducing regionalised cost recovery.

It is also noted that a broad review of the operation of the FCAS markets in the NEM is currently under way, being undertaken by NEMMCO. This review might potentially result in a number of changes to current FCAS arrangements, including service requirements, market operation, and cost recovery arrangements. It is expected that any Rule change proposals which emerge from this review would be presented to the AEMC by the end of September 2007.

Whilst the current Rule change proposal is not without merit, Flinders Power believes in view of the current distortions, it would be preferable not to proceed with this change at this time, and to await the outcomes of the FCAS review before implementing changes to the current cost recovery arrangements.

Flinders Power appreciates the opportunity to comment on this proposal. Should you require any further information, please feel free to contact Ashley Nicholls on (08) 8372 8653.

Yours sincerely

Reza Evans
Manager
Energy Policy & Regulation