



**Revocation of the Declaration of Raise Contingency  
Frequency Control Ancillary Services as a Declared  
Electrical Service**

**Decision and Statement of Reasons**

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## GLOSSARY OF TERMS

Term	Meaning
AEMO	Australian Energy Market Operator
Delayed raise contingency FCAS	five minute raise contingency FCAS
Fast raise contingency FCAS	six second raise contingency FCAS
FCAS	frequency control ancillary services
Hydro Tasmania	The trading name of the Hydro-Electric Corporation
Market generator	Generator registered as such under the NER
MEU	Major Energy Users Inc
NEM	National Electricity Market
Price Control Regulations	<i>Electricity Supply Industry (Price Control) Regulations 2003</i>
Pricing and Related Matters Regulations	<i>Electricity Supply Industry (Pricing and Related Matters) Regulations 2013</i>
Regulator	Tasmanian Economic Regulator who is the regulator for the purposes of the ESI Act
Slow raise contingency FCAS	sixty second raise contingency FCAS



# 1 DECISION

The Regulator decides to revoke the existing declaration, of the following services supplied by Hydro Tasmania:

- fast raise contingency frequency control ancillary service;
- slow raise contingency frequency control ancillary service; and
- delayed raise contingency frequency control ancillary service,  
as declared electrical services.

In accordance with Section 40AD(4) of the *Electricity Supply Act 1995*, the Regulator hereby revokes the declaration. The revocation takes effect on 1 February 2016.

This Statement of Reasons provides the reasons for the revocation.





## 2 BACKGROUND

The Australian Energy Market Operator (AEMO) is responsible for controlling the frequency of the Tasmanian power system within the Tasmanian frequency operating standards. To do this, it purchases FCAS from National Electricity Market (NEM) participants in eight distinct spot markets for FCAS, which include three raise contingency FCAS spot markets. Participants must register with AEMO for each of the eight FCAS markets in which they wish to provide their services.

Raise contingency FCAS are supplied in the Tasmanian region of the NEM by registered service providers which comprise Hydro Tasmania (the only registered provider of raise contingency FCAS in Tasmania) and mainland suppliers through the frequency control facility provided by Basslink. In certain circumstances, transmission of the required raise contingency FCAS over Basslink is not possible. It must, therefore, be sourced from within the Tasmanian region, ie from Hydro Tasmania.

The costs of raise contingency FCAS in the NEM are met nationally by market generators in proportion to the energy they generate during the relevant five minute dispatch interval of the market. However, where local regional requirements determine the cost of the local services, all generators in the Tasmanian region bear the costs in proportion to their output during the relevant period. Hydro Tasmania, as the sole registered provider of these services in the Tasmanian region, receives these payments.

In 2009 the Regulator noted that through high pricing of blocks of its energy, Hydro Tasmania could ensure that Basslink imported cheaper electricity from Victoria to Tasmania. When Basslink was importing at or close to its limit, Hydro Tasmania, as the only source of raise contingency FCAS in the Tasmanian region, could (and had) bid its FCAS at such high levels that competing Tasmanian generators could be liable for FCAS costs that exceed the revenue they receive from generating electricity. These generators were therefore compelled in the short-term to curtail their generation; shut down; hedge their exposure with the sole provider and price setter, Hydro Tasmania, or seek higher prices for their energy, which would inevitably translate into higher prices paid by Tasmanian customers. The Regulator also noted that Hydro Tasmania's ability to set raise contingency FCAS prices in the Tasmanian region at any level it chooses and exercise control through its energy and FCAS bidding behaviour, could therefore deter new generators from entering the Tasmanian energy market.

In April 2009, the Australian Energy Regulator reported significantly high prices in all three raise contingency FCAS markets in Tasmania for the first three weeks of April 2009.<sup>1</sup> The high pricing of these services also generated complaints from other

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<sup>1</sup> Weekly market analysis reports of April 2009, published by the Australian Energy Regulator.

Tasmanian generators with claims that Hydro Tasmania's substantial market power in the supply of these services was negatively impacting on competition in the Tasmanian electricity generation market.

On 4 January 2010, the Regulator announced its decision to declare, as "declared electrical services", the following services supplied by Hydro Tasmania to meet local Tasmanian requirements:

- fast raise contingency frequency control ancillary service;
- slow raise contingency frequency control ancillary service; and
- delayed raise contingency frequency control ancillary service.

The existing declaration of raise contingency FCAS as a declared electrical service was made under Regulation 19 of the *Electricity Supply Industry (Price Control) Regulations 2003* (the 2003 Price Control Regulations). Under this Regulation, the Regulator had the power to declare a good or service provided by an electricity entity to be a declared electrical service if the Regulator was of the opinion that –

- (a) the electricity entity has substantial market power in respect of that good or service; and
- (b) the promotion of competition, efficiency or the public interest requires the making of that declaration.

Where an entity has substantial market power in the relevant market, it has the ability to charge higher prices, and/or provide a lower level of quality for the good or service than would be provided by a competitive market. Without the discipline of competition or regulation, a misallocation of resources may result since prices no longer reflect the underlying economic efficient costs. In these circumstances, economic regulation may be applied to promote efficiency, to protect the public interest and promote competition in upstream and downstream markets.

Under Regulation 19 of the 2003 Price Control Regulations, the possession of substantial market power of itself was insufficient to justify the declaration of a service ie the Regulator also had to be satisfied the declaration was required to promote competition, efficiency or the public interest.

The Regulator decided that Hydro Tasmania had substantial market power in the supply of raise contingency FCAS in the Tasmanian region and that the promotion of competition, efficiency and the public interest required these services to be declared by the Regulator as declared electrical services.

The declaration took effect on 3 February 2010. Further information on the existing declaration can be found on the Regulator's website: [www.economicregulator.tas.gov.au](http://www.economicregulator.tas.gov.au) (Electricity>Wholesale Pricing>Frequency Control Ancillary Services (FCAS)>2010 Frequency Control Ancillary Services (FCAS) Investigation).

Following the declaration of the services, the Regulator gave notice on 4 March 2010 of the commencement of the investigation into Hydro Tasmania's pricing policies in respect of the declared electrical services and consulted on terms of reference for the investigation.

Following the investigation, the Regulator made a determination (the 2011 FCAS Price Determination) which was effective from 1 February 2011. This determination will expire on 31 January 2016.

In accordance with Regulation 35 of the *Electricity Supply Industry (Pricing and Related Matters) Regulations 2013* the Regulator is required, to invite submissions on whether the declaration of FCAS as a declared electrical service should be retained or revoked.

On 27 April 2015, the Regulator published its *Retention or revocation of the declaration of raise contingency Frequency Control Ancillary Services (FCAS) as a declared electrical service – Consultation Paper* (Consultation Paper) which outlined the circumstances that, in the Regulator's view, warranted the revocation of the declaration. The Regulator invited submissions on the proposal.

Submissions on the Consultation Paper closed on 15 May 2015. The Regulator received two submissions, one from Hydro Tasmania and one from Major Energy Users Inc (MEU), which it has considered in drafting this statement of reasons.



### 3 PUBLIC SUBMISSIONS: ISSUES AND RESPONSES

Regulation 35 of the *Electricity Supply Industry (Pricing and Related Matters Regulations 2013)* (the 2013 Pricing and Related Matters Regulations)<sup>2</sup> requires the Regulator to review an existing electrical services declaration and invite submissions at least six months before the expiry date of a declared electrical service price determination ie in the case of the 2011 FCAS Determination, on or before 31 July 2015.

The Regulator has reviewed the retention or revocation of the existing declaration in terms of the tests applied in deciding whether to declare the services in the first place (Hydro Tasmania also based its preliminary submission on those tests).

The following sections set out the Regulator's deliberations on whether to retain or revoke the existing declaration together with details of the submissions received in response to the Consultation Paper and the Regulator's responses and conclusions.

The Regulator received two submissions in response to the Consultation Paper, one from Hydro Tasmania and the other from MEU. Hydro Tasmania's submission stated that it was supportive of the Regulator's proposal to revoke the existing declaration as described in the Consultation Paper. MEU's submission supported the retention of the declaration and concluded that the long term interests of consumers would be better served by a continuation of the stable and reliable energy prices that regulated FCAS provides.

#### 3.1 Substantial market power

Hydro Tasmania's preliminary submission argued that raise contingency FCAS could be made available via eligible market bids from a variety of sources including registered generators, registered customer loads and other standalone technologies registered to provide equivalent mitigation (such as flywheels).

In this regard Hydro Tasmania noted that in Tasmania there are several large loads that could be registered to provide raise FCAS for generator contingencies and that other providers had the option of participating in the FCAS market. Hydro Tasmania believes that the lack of participation from other providers is due to a lack of value in the market ie the prices ordinarily paid for FCAS provide little incentive to do so and this has therefore not happened to date.

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<sup>2</sup> The 2013 Pricing and Related Matters Regulations replaced the 2012 Pricing and Related Matters Regulations on 1 June 2013 with the *Electricity Supply Industry (Pricing and Related Matters Regulations 2012)* having previously replaced the 2003 Price Control Regulations.

MEU noted in its submission that the number of loads able to be registered is very small, especially for fast raise FCAS products. Further, MEU considers that the costs to a consuming customer of providing any raise service is likely to be high as it results in a loss of production and that these businesses might not want to enter the FCAS market as their core business is not to provide electricity services.

The Regulator considered Hydro Tasmania's and MEU's submissions and notes that Hydro Tasmania is the sole registered provider of raise contingency FCAS in the Tasmanian region. When Basslink is not importing at or close to its limits or within its "no-go" zone, Hydro Tasmania is competing globally with other generators on the mainland for the provision of FCAS.

However, when Basslink is importing at its limits, switching between import and export, or has tripped, all raise contingency FCAS are provided by Hydro Tasmania. Moreover when Basslink is importing, the local raise contingency FCAS requirements to cater for a Basslink trip must be provided locally by Hydro Tasmania. MEU highlights this limitation in its submission, stating that there are many periods of time where Basslink is not able to provide all forms of FCAS needed and during these periods Hydro Tasmania has a monopoly on the supply of FCAS in the region. MEU also notes that "...Hydro Tasmania can, through its own actions, initiate the circumstances which constrain Basslink's ability to transfer FCAS from the mainland". In the absence of competitive forces, MEU therefore considers that Hydro Tasmania can, price its services in Tasmania as it sees fit.

### **Regulator's Response**

The Regulator notes MEU's concerns about the limitations of Basslink and the ability of customer loads to provide FCAS services. Taking into account these factors, the Regulator agrees with MEU that Hydro Tasmania has significant market power in providing raise contingency FCAS in Tasmania.

## **3.2 Promotion of competition**

Neither submission received directly addressed the issue of the promotion of competition in relation to the existing FCAS declaration.

As argued in its Consultation Paper, the Regulator considers that the existing FCAS declaration has not promoted competition in the energy market in any meaningful way and that there is no reason to believe that retaining the declaration into the future will change this outcome.

## **3.3 Promotion of efficiency**

In Hydro Tasmania's preliminary submission, it contended that the lack of purchases of FCAS hedges is evidence of the inefficiency caused by the current regulation of raise FCAS. Hydro Tasmania also argued that it would be expensive to review the methodology of the FCAS pricing mechanism, if the need ever arose. Hydro Tasmania stated that the threat of declaration alone would be an effective deterrent against excessive future prices. Hydro Tasmania also claimed that the fact that

average FCAS spot prices over the regulated period had been lower than the regulated price was evidence that an efficient market outcome can be achieved without regulation.

On the other hand, MEU stated that the cost on Hydro Tasmania for providing the regulated service is likely to be 'very modest', given that Hydro Tasmania is continually providing FCAS pricing to the market operator. MEU also noted that despite the lack of interest in the regulated service for FCAS, its existence effectively provides a cap to the cost that Hydro Tasmania can impose on the market for the supply of FCAS.

### **Regulator's Response**

The Regulator accepts that there are costs associated with any form of active regulation and considers that the threat of declaration may be an effective deterrent to any excessive prices in the future ie if the Regulator decides not to retain the declaration, it will continue to monitor the FCAS market and could re-instate the same regulatory arrangements if it saw inappropriate pricing behaviour by Hydro Tasmania in the future. Monitoring the FCAS market for excessive price rises, with a view to re-instating the current regulatory arrangements if such inappropriate pricing behaviour is detected, is therefore considered to be a more efficient arrangement than active regulation.

## **3.4 Promotion of the public interest**

In its preliminary submission, Hydro Tasmania contended that the development of competition and lack of efficiency gains in FCAS regulation is evidence that retaining the declaration is not in the public interest.

MEU considered that the revocation of a regulated service requires a public interest test and that it is not convinced that the long term interests of consumers are served by the revocation of the declaration. MEU in fact considers that there is an argument for seeking to expand the regulation of all Hydro Tasmania pricing for FCAS services.

### **Regulator's Response**

The Regulator has considered FCAS prices since the declaration was made and notes that prices have remained low. Whilst the Regulator acknowledges that a return to the FCAS pricing behaviours which Hydro Tasmania displayed in 2009 would not be in the public interest, the Regulator considers it unlikely that this type of pricing would return, especially considering if it did occur the Regulator could make a new declaration at any time and recommence the regulation of FCAS pricing.

### **3.5 Summary**

The Regulator is of the opinion that whilst Hydro Tasmania has substantial market power in providing raise contingency FCAS there is insufficient evidence to support the continued active regulation of these services in terms of promoting competition, efficiency or public interest.

The Regulator also notes:

- the lack of interest from market participants in purchasing the regulated FCAS products;
- the recent history of raise FCAS pricing; and
- the Regulator's ability to declare FCAS as a declared electrical service should its ongoing monitoring activities identify FCAS pricing anomalies in the future.

For these reasons, the Regulator has decided to revoke the existing FCAS declaration.

The Regulator will, however, continue to monitor FCAS pricing to ensure that regulatory action can be taken if evidence is found of inappropriate pricing behaviour.



## APPENDIX A – SUBMISSIONS

The following bodies made submissions to the Regulator's *Retention or revocation of the declaration of raise contingency Frequency Control Ancillary Services (FCAS) as a declared electrical service – Consultation Paper*, April 2015:

- Major Energy Users Inc.
- Hydro Tasmania

Both submissions have been published on the Regulator's website: [www.economicregulator.tas.gov.au](http://www.economicregulator.tas.gov.au).