



Hydro Tasmania
the renewable energy business

10 June 2010

Mr Glenn Appleyard
Regulator
Office of the Tasmanian Economic Regulator
GPO Box 770
Hobart TAS 7001

Dear Mr Appleyard

2010 FCAS INVESTIGATION – RESPONSE TO AETV POWER AND AURORA SUBMISSIONS

Hydro Tasmania wishes to respond to AETV Power and Aurora's submissions to the 2010 FCAS Investigation. This is a complex area and it is important for the Regulator, if he is to make a sound decision, to have any factual errors corrected.

In general, AETV Power and Aurora's submissions and their scrutiny of Hydro Tasmania's submission, contribute comprehensively to your process. However, there are certain issues raised by them on which Hydro Tasmania feels obliged to comment.

Points of agreement

Hydro Tasmania agrees with AETV Power's statement on page 10 of its submission that "the Regulator might consider the 'efficient' costs of supply to be the actual costs of supply, together with a reasonable return". It is not clear how AETV Power defines actual costs (particularly in light of its discussion of efficient cost elsewhere in its submission), so Hydro Tasmania would like to emphasize that these costs should include economic costs, as AETV Power appears to confirm in the third paragraph on page 10.

Further input

On page 16 of its submission, AETV Power expresses its interest in hearing the views of the AEMC and AER in relation to the impact of a price control mechanism for spot FCAS offers on energy price outcomes. Hydro Tasmania suggests that the market operator, AEMO, should also be consulted on this matter as it is well placed to comment on the potential impacts.

In its submission, Aurora state that "there may be more effective alternatives to those presented in Hydro Tasmania's response". Hydro Tasmania notes that under the rules of natural justice, it must be provided with an opportunity to comment on any alternatives that

Aurora wishes to propose and consequently we request that these proposals should be brought forward for assessment.

Scope of relevant considerations

AETV Power suggests (on page 12) that the Regulator's findings as to market power should take priority over those matters identified by Hydro Tasmania as key considerations for the investigation. This suggestion is not consistent with either the objectives and principles identified by the Regulator in the Investigation's Terms of Reference or the *Electricity Supply Industry (Price Control) Regulations*.

The market power matters referred to by AETV relate to the threshold question of whether the Regulator should declare an electrical service. This threshold issue was addressed in the Regulator's declaration of 4 January 2010. The Regulator's current inquiries need to address the efficient provision of the services and other matters set out in the Regulations (particularly regulation 33(2)), which do not include the removal of any market power the Regulator has concluded may exist. This is entirely appropriate as the Regulator's process (and the setting of costs at efficient levels) will protect generators' interests in this regard.

Full scope of inefficiency

AETV Power states on page 20 that "fixing the hedge price with reference to the cost to a new entrant means that Hydro Tasmania will recover significantly more than its efficient cost of supply". This statement assumes that Hydro Tasmania's cost for providing this service is less than new entrant, which has not been established and which, given respective inefficiency factors of 1.5:1 for combined cycle gas fired generation and 4:1 for hydro, Hydro Tasmania doubts. In addition, our understanding of the process is that OTTER will attempt to set the price for Hydro Tasmania at the level of Hydro Tasmania's efficient costs without reference to new entrant costs.

On page 20, AETV Power states that:

Hydro Tasmania has suggested that the opportunity cost of the energy which is effectively lost when water is reserved for contingency FCAS, is the cost that is associated with potential for future spill of water over the dams because Hydro Tasmania could not use that water when it wanted to (i.e. Hydro Tasmania was forced to reduce its output so as to supply fast raise FCAS).

This statement is incorrect. As stated in our April 2010 submission to this investigation, there are a number of short run cost elements in providing FCAS. One of these elements is the cost of inefficient operation, which is a calculation of the opportunity cost of lost energy. This energy is lost through the operation of power stations below their minimum efficient level (with a resultant loss in energy output per cumec of water) in order to provide FCAS. There is no material loss of water attributed to spill.

Factual Errors

Finally, Hydro Tasmania wishes to correct three factual errors contained in AETV Power's submission.

Firstly, AETV Power states on page 8 that, "At times (for example, when Basslink is on import), the whole of the raise contingency FCAS required for the Tasmanian local region must be obtained 'on island'". This is technically incorrect since the requirement for the

maximum generator (MG) event is co-optimised. The raise contingency required for the Basslink contingency must be obtained on-island.

Secondly, AETV Power states on page 17 that, “Whether some control might be imposed in respect of 70 MW of fast raise contingency FCAS (which will always be required to be sourced on island, to cover the contingency of a Basslink outage) and some different form of control might be imposed in respect of other bands of FCAS”. This is incorrect since the 70MW requirement quoted is not a static value. The actual requirement changes depending on the direction of Basslink flow (import, export or no-go zone) and is also very sensitive to system inertia.

Thirdly, AETV Power states on page 15 that, “registration as a non market participant is only available to generators with a very low (less than 5 MW) name plate rating”. This statement is incorrect since a generator of any size may register as non-market under the rules. For example, the Smithfield Energy Facility is classified as non-market, yet has a registered capacity of 160MW. As a non-market generator it will not be liable for any market ancillary services costs.

If you have any queries, please contact the undersigned on 6230 5775 or via email at david.bowker@hydro.com.au

Yours sincerely

A handwritten signature in black ink that reads "D. Bowker." with a horizontal line underneath the name.

David Bowker
Manager Market Regulation