

14 August 2009

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

Dear Mr Appleyard

Notice of intention to declare the supply of raise contingency frequency control ancillary services (FCAS) by Hydro Tasmania as a declared electrical service – Issues Paper.

Thank you for the invitation to make a submission in response to the above paper.

Summary

Infratil Energy Australia (IEA) strongly supports the regulator's intention to declare FCAS as a declared electrical service. The paper sets out well the case for Hydro Tasmania having substantial market power in the provision of FCAS.

IEA, as a potential competitor, has been severely harmed by Hydro Tasmania's actions in pricing FCAS substantially above its economic cost. Further, as is described below, it would not be rational for IEA to continue to participate or expand in any sector of the Tasmanian energy market while such market power exists.

IEA does however disagree with the regulator's proposal that the period of declaration be just three years. Power generation plants are long term investments - without long term certainty it is unlikely that any of the substantial investment will be forthcoming. IEA recommends instead that a review be conducted after three years to determine whether Hydro Tasmania's market power still exists. Only when it has been demonstrated that such market power no longer exists should the declaration be terminated.

IEA would also note that, in the absence of competition (or threat thereof), should FCAS not be a declared service the additional costs of supplying and managing the NEM will ultimately fall on consumers.

Background to IEA

IEA provides energy procurement and risk management services to its related retail businesses. These retail businesses have around 400,000 customers, mainly in Victoria but also in the other mainland states.

IEA owns and operates around 100MW of peaking generation plant in SA & NSW and is developing similar, larger scale gas and liquid fuelled generation plant in Victoria and SA. It also has a major shareholding in Perth Energy, a small retailing business in WA which has recently commenced construction of a 120MW dual-fuel generation plant.

To complement its portfolio of financial hedge contracts and peaking generation, IEA also enters into power purchase agreements (PPAs) with third party owners of power plants.

IEA is party to such a PPA from a small landfill gas fuelled power plant, near Launceston, owned and operated by LMS Generation. The plant gathers methane¹ produced from landfill operations which it burns to produce power delivered to the National Electricity Market (NEM). IEA is the party registered in the NEM with respect to this plant so receives all the revenue related to the plant and takes responsibility for all the NEM related costs (which include FCAS).

¹ Methane is a particularly harmful greenhouse gas with a CO₂ equivalent of 21 (i.e. 21 times worse than CO₂).

Harm to IEA's Operation

As identified in the Issues Paper, the registered generator is allocated FCAS costs in proportion to its generation output during each dispatch interval. Throughout April, with Hydro Tasmania regularly pricing FCAS at up to \$5,000 / MWh, IEA's allocated costs were greater than the revenue earned from selling power to the NEM.

Clearly IEA cannot continue to operate in a market which presents such risk, especially where it cannot be managed - other than through buying protection from the monopoly provider which is causing the risk. Forcing the closure of the landfill gas operation would result in a substantial loss to IEA over the 10 year term of its contract with LMS.

(Outside of the commercial issues, this would have a material greenhouse impact through the closure of a renewable generating facility and the release, or flaring, of methane from the landfill.)

Substantial Market Power

Prices for FCAS have typically been around \$5 / MWh since Tasmania joined the NEM (with occasional high prices when the system is genuinely under stress). That Hydro Tasmania has been able to cause prices to clear at levels up to \$5,000 / MWh is a clear demonstration of its substantial market power.

This was further demonstrated by its change in bidding strategy once it has executed a hedge agreement with AETC Power.

Investment and Competition Implications

While Hydro Tasmania can cause substantial costs to fall on any new generation plant, it is inconceivable that such plant will be forthcoming – leaving the Tasmania government responsible for all new generation investment and Hydro Tasmania the only feasible off-taker for new capacity.

IEA understands that LMS was planning to expand the Launceston plant, to capture more methane, later this year but will not be able to do so if it cannot secure a commercial off-take agreement.

Given a power plant is a 20 year (plus) investment, a period of declaration of just three years is unlikely to provide sufficient confidence to commit such large amounts of capital. Without longer term certainty, it is unlikely that further generation plant will be forthcoming. IEA therefore recommends that a review be conducted after three years to determine whether Hydro Tasmania's market power still exists. Only when it has been demonstrated that such market power no longer exists should the declaration be terminated.

I trust this will assist in supporting your intention to declare FCAS a declared electrical service. Should you wish to discuss any matter further please call me on 03 8680 6402 or email darryl.flukes@infratilenergy.com.au.

Yours sincerely

Darryl S Flukes
Chief Executive