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AEMC
Level 15, 60 Castlereagh Street
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Submitted online at: www.aemc.gov.au

Re Contingency Frequency Control Ancillary Services rule changes

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the AEMC on the proposed rule change - Contingency Frequency Control Ancillary Services.

The AEC is the peak industry body for retailers and generators operating in energy markets. Our members generate and sell energy to over 10 million homes and businesses. We seek to deliver a market that allows consumers to benefit from the transition to a reliable, affordable and decarbonised energy system.

The AEC supports the transition to net zero emissions by 2050, and the role of the electricity sector in unlocking opportunities for reductions in other sectors. AEC members are major investors in the renewable energy, firming and energy security services needed to deliver an effective transition.

Overall Views

As the National Electricity Market (NEM) transitions toward a system dominated by variable renewable energy, ensuring the effective and efficient management of grid security and reliability is crucial. Reforms are necessary to guarantee that essential system services (ESS) continue to be supplied adequately and at the least cost, particularly as thermal synchronous plants exit the NEM.

Whilst the AEC supports some of the principles underpinning the rule change proposal, such as cost-reflectivity and prudent system management, the AEC does not support the specific proposed contingency FCAS rule changes. We suggest these proposals could lead to detrimental effects on long-run investment efficiency and derivative contract market liquidity. Further, potential benefits stemming from the rule proposals could be outweighed by erosion of efficiency in the spot and contract markets, given the substantially smaller FCAS market relative to the previously mentioned markets. We suggest that a rigorous cost benefit analysis be undertaken by the AEMC.

Detailed Comments

The proponent of the rule changes submitted that an obligation should be placed on AEMO to optimise the size of contingencies by constraining generation or load of the largest scheduled or semi-scheduled units when it reduces the volume required for contingency FCAS and leading to lower overall costs.

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It also proposed recovering contingency FCAS costs using a 'runway' cost allocation methodology based on dispatched unit size instead of the current approach of allocating costs in proportion to energy generated or consumed. The key implication of the 'runway' methodology is the allocation of a greater share of costs to the larger units.

The AEC does not support the proposed rule change. The proposals could have negative impacts on:

- ***Long-run investment efficiency*** - by undermining the commercial viability of larger plants due to higher allocation of FCAS costs and forgone revenues from the spot and derivative markets (owing to actual or potential curtailment). Larger units (both VRE and synchronous plants) provide broader efficiency benefits through economies of scale and higher fuel/thermal efficiency. Larger synchronous units also supply a higher level of system strength and inertia due to their heavier mass. Unwarranted reduction in the commercial viability of larger plants would result in less investment in such units, which could lead to material efficiency losses that would also increase the costs for consumers in the long run.

- ***Derivative contract market liquidity*** - by decreasing the willingness of larger generators to offer swaps, caps and options due to the risks of curtailment undermining the ability of these plants to defend their contractual positions. Larger scheduled plants are the predominant source of electricity derivatives because of their controllability, which allows them to better manage price volatility within the NEM. Reduced contract liquidity will have detrimental effects not only on price discovery but also the ability of retailers to hedge price/volume volatility, ultimately increasing costs for consumers.

The efficiency losses in the spot market and reduction in contract liquidity could significantly outweigh potential benefits stemming from the rule proposals, given the substantially smaller FCAS market relative to both spot and derivative markets. Further, the costs of contingency FCAS are expected to decline further due to the influx of battery energy storage systems increasing the supply of FCAS, therefore reducing the benefits of the proposed changes.

Other key points:

- ***Modelling of cost and benefits*** – the AEC strongly suggests that the AEMC undertakes detailed modelling of the costs and benefits of the rule change proposal. The rule change proposes significant changes to dispatch, adding a level of complexity not yet present in the market and these changes should not be considered to be trivial. We understand that similar proposals have been made before and that cost-benefit analysis for such proposals has not been favorable.

- ***Implementation*** - the AEC suggests that such the implementation of this proposal by AEMO is likely to be complex and costly due to the need for individual FCAS constraint equations to be written for each large unit within the NEM Dispatch Engine. We would suggest that AEMO provide a cost estimation of the implementation as part of the consultation process.

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