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Wednesday, 3 October 2018

Mr John Pierce
Chairman
Australian Energy Markets Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Pierce

RE: ERC0225 Draft Determination – Participant Compensation Following Market Suspension

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Commission's (the Commission) Draft Determination to the Australian Energy Market Operator's (AEMO's) rule change request – Participant Compensation Following Market Suspension.

About ERM Power

ERM Power is an Australian energy company operating electricity sales, generation and energy solutions businesses. The Company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load¹, with operations in every state and the Australian Capital Territory. A growing range of energy solutions products and services are being delivered, including lighting and energy efficiency software and data analytics, to the Company's existing and new customer base. ERM Power also sells electricity in several markets in the United States. The Company operates 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland. www.ermpower.com.au

General comments

ERM Power supports the Commission's Draft Determination which proposes that compensation be payable to participants who are determined by AEMO to be an *Eligible Claimant* to cover costs incurred complying with a dispatch instruction issued by AEMO during a period of market suspension where the Market Suspension Pricing Schedule (MSPS) is invoked and prices in the MSPS are below the costs incurred complying with the dispatch instruction. We support the Commission's view that the provision of an adequate compensation regime during periods of market suspension will incentivise participants to maintain bid availability and respond to AEMO's dispatch instructions on the understanding that costs incurred will be recovered without the need to bid unavailable and await issue of a National Electricity Rules (the Rules) clause 4.8.9 Direction by AEMO which would then allow compensation for recovery of costs.

We believe market intervention by AEMO in the form of the issuing of a clause 4.8.9 Direction should only be used as a last resort and the Rules should assist this where possible by facilitating alternative mechanisms such as this proposed compensation regime to remove the need for market intervention by AEMO.

We also support the proposed change to the calculation of compensation payable to a *Directed Participant* where a clause 4.8.9 Direction is issued by AEMO to a participant(s) during a period of market suspension to align with the proposed market suspension compensation methodology.

¹ Based on ERM Power analysis of latest published financial information.



ERM Power supports the aim of the Draft Determination to automate the compensation process as much as possible to reduce additional administrative costs to participants, the Market Operator and the market as a whole compared to the alternative where the assessment of compensation payable during a period of market suspension would occur on a bespoke basis. However, we are concerned that based on the draft rule changes, the proposed compensation regime falls short of that which would be needed to provide adequate compensation via an automated process. This is particularly likely for flexible plant such as open cycle gas turbines (OCGT), which can be expected to bear much of the initial restoration burden during a power system restoration event. These shortfalls in the proposed automated compensation process will result in the participant and AEMO incurring additional costs to lodge and process a claim for additional compensation with AEMO and the Independent Expert.

In considering the automated compensation framework it also needs to be noted that due to the impact of the price scaling provisions of rule 3.14.5(f), participants in regions not subject to market suspension may also be dispatched by AEMO at regional reference prices (RRPs) below actual costs. During the 2016 South Australian market suspension event, settlement prices in the remaining four National Electricity Market (NEM) regions were all adjusted to lower values for a number of *trading intervals* due to the impact of this Rules provision. As such, the proposed compensation framework has the potential to impact participant bid availability decisions in regions outside the region in which market suspension has been invoked resulting in potential power system security and supply reliability issues in regions not directly subject to market suspension at that time. In considering the proposed compensation framework, we believe the potential for this outcome also needs to be carefully considered by the Commission.

We offer a number of suggested changes to the draft rule changes with regards to these shortfalls for consideration by the Commission.

Changes proposed to improve the automated compensation methodology

Proposed use of National Transmission Network Development Plan (NTNDP) or Integrated System Plan (ISP) input assumptions for 'benchmark values'

The rule change as proposed requires AEMO to calculate 'benchmark values' on an annual basis to be used as inputs to the compensation process. In general we support the proposed development of 'benchmark values' to be used in the compensation calculation methodology.

The Commission proposes that input assumptions contained in the NTNDP/ISP adjusted by a multiplication factor of 1.1 would be used as the basis for these 'benchmark values'. In assessing this we believe the Commission needs to consider that the heat rate in the NTNDP/ISP assumes an output factor of 100% at winter loadings in calculating fuel and other operational costs for OCGTs. During a market suspension event, generating units could be required to operate anywhere between minimum stable loading and maximum capability. Actual unit heat rates could vary by 30% based on time of year and actual generator loading compared to the values contained in the NTNDP/ISP.

Given the extent of this expected variation in generator operating requirements and the impact this would have on heat rates and other operating costs during a period of market suspension we believe a multiplication factor to deal with this uncertainty of 1.25 would more accurately reflect the level of costs expected to be incurred during a period of abnormal market operation.

In addition, the value in \$/MWh contained in the NTNDP/ISP is based on a static assumption, which could be eighteen months historically distant, regarding fuel input costs, given the fluctuations in fuel prices which have been historically observed, we believe that in the interests of both consumers and participants, the actual fuel input costs should be based on the real time costs of fuel as set by verifiable transparent benchmarks such as the Gas Short Term Trading Markets. We propose that the applicable transparent benchmarks for fuel costs would be consulted on by AEMO during the proposed Market Suspension Compensation Methodology consultation.



We also submit that in assessing the structure of generator categories as proposed by the Commission, these categories must allow for OCGTs that are dual-fuelled – capable of operating on gas or diesel – as we believe that during a system restoration event, the liquid fuel capability of OCGTs, when this is available, may be relied on heavily by AEMO if gas infrastructure has been impacted by any power system event. ERM Power considers that separate categories for Gas Fuelled OCGTs and Liquid Fuelled OCGTs as opposed to a single OCGT category and compensation payable to dual-fuelled generators based on actual fuel used as verified by independent gas meter readings should form part of the Market Suspension Compensation Methodology.

Recovery of unit start costs

Unit start costs are a significant cost incurred by OCGTs and potentially other thermal generators. In assessing the structure of bids to be submitted in the NEM, generators allow for recovery of these start costs as part of their bid submission and unit commitment and de-commitment process. During a period of market suspension, generators with flexible operating characteristics may be required to start and stop on a frequent basis by AEMO to assist the restoration of large generating units and demand blocks, incurring significant additional costs in complying with AEMO's dispatch instructions. Where the MSPS prices are below a participant's bid prices, the currently proposed automatic compensation provision does not allow for the recovery of these start costs.

In assessing this request that unit start costs are included within the automated compensation framework we believe the Commission should also consider the Draft Report and Determination for AEMO's current consultation on the methodology used for the calculation of the MSPS. The Draft Determination recommends that the maximum pricing to apply to all *dispatch intervals* in any individual *trading interval* (or 30 minute period) be capped at the Administered Price Cap² (currently \$300). This increases the probability that unit start costs for OCGTs will not be recovered during *trading intervals* when the MSPS is invoked. As set out above, this has implications for not only the region subject to market suspension but also all regions where the RRP is impacted by price scaling.

We submit that the automatic compensation calculation as set out in draft rule 3.14.5A (d) should be amended to allow for the reasonable recovery of unit start costs where AEMO issues a *dispatch instruction* to commit a generating unit into service and that generating unit has a bid price for dispatch higher than the price in the MSPS. Where the bid price offered by the generating unit is lower than the price in the MSPS, no compensation for unit start costs would be payable. This amended provision will have the added benefit to the power system of ensuring that units are committed into service or de-committed out of service as determined by AEMO to facilitate secure operation of the power system and reliable supply to consumers during a period of market suspension where operation of the power system may be under considerable stress. This suggested change would have even greater benefit during an extended period of market suspension where the number of unit starts as instructed by AEMO could be high which absent this amendment would encourage participants to reconsider a unit(s) bid availability.

We propose that Unit Start Costs (USC) would be included as a separate 'benchmark value' which would be consulted on by AEMO during the Market Suspension Compensation Methodology consultation.

We offer the following suggested amendment to draft rule 3.14.5A (d) for the Commission's consideration.

$$CO = (SOG \times BVG) + (MWE \times BVAS) + (USC \times NAIUS)$$

where:

SOG = the sum of the Eligible Claimant's sent out generation (in MWh) during the market suspension pricing schedule period.

BVG = the amount (in \$/MWh) calculated in accordance with paragraph (e) below.

² AEMO Market Suspension Pricing Schedule Draft Report and Determination - Section 4.1.3 Page 6 Published September 2018



MWE = the sum of the relevant market ancillary services (in MW) which the Eligible Claimant's ancillary service generating unit has been enabled to provide during the market suspension pricing schedule period.

BVAS = the amount (in \$/MWh) calculated in accordance with paragraph (f) below.

USC = the assessed costs of starting a unit in accordance with an AEMO issued *dispatch instruction* on a per unit start basis during a market suspension period.

NAIUS = Number of AEMO instructed unit starts

As the value for CO is calculated across the entire period where the MSPS is invoked, as opposed to an individual trading interval based calculation, the *Eligible Claimant* would only receive compensation for an AEMO instructed unit start(s) where either the number of dispatch intervals were insufficient or the MSPS prices were less than the calculated benchmark values where AEMO instructed the generating unit to start and generate to allow recovery of the cost of the unit start.

Claim for additional costs requiring review by the Independent Expert

The draft rule proposes that claims for additional costs be referred to an independent expert where they exceed a \$50,000 threshold. This threshold level could be adequate where the period of market suspension is of limited duration, however, as observed during the 2016 South Australian market suspension, the duration of a market suspension event where the MSPS is invoked may be lengthy; in that case the \$50,000 threshold would be inadequate and result in increased administrative costs in processing claims for additional costs. We propose a change to draft rule 3.14.5B (f) as set out below to stipulate the threshold where claims for additional costs are referred to the independent expert is \$50,000 per *trading day*. Alternatively, the Commission could consider a revised threshold of \$200,000 per *billing period* with a secondary threshold of \$50,000 in any *trading day*. Our proposed amendment to draft rule 3.14.5B (f) is:

(f) AEMO must, in accordance with the *intervention settlement timetable*, refer a claim by an *Eligible Claimant* under paragraph (a) to an independent expert to determine such claim in accordance with clause 3.12.3 where:

(1) the claim is equal to or greater than \$50,000 *per trading day*; or

(2) with respect to a claim less than \$50,000 *per trading day*, AEMO considers such claim to be unreasonable.

Whilst draft rule 3.14.5B(g) requires AEMO to advise the *Eligible Claimant* that it has referred the claim for additional costs to the independent expert and AEMO's reasons for doing so, we are concerned that this could be used as a means to discourage claims or encourage justifiable claims to be lowered due to the higher administrative costs to the *Eligible Claimant* associated with processing of the claim. We propose that when AEMO refers a claim for less than the threshold to the independent expert and the independent expert subsequently agrees that the claim for additional costs is reasonable that the full costs of the independent expert is payable by AEMO.

We therefore submit for the Commission's consideration, our proposed draft rule 3.14.5B (h):

(h) Where AEMO considers a claim to be unreasonable under subparagraph (f)(2), and refers the claim to the independent expert and the independent expert determines that the claim is reasonably based, AEMO shall pay all costs associated with the independent expert's determination.



In addition, whilst draft rule 3.14.3 (d) requires that AEMO report on the amount of compensation payable to all *Eligible Claimants*, the administrative costs of claims for additional costs payable to the independent expert is not reported. We believe that in the interests of market transparency that AEMO should report on costs associated with the independent expert's determination and the amounts paid by AEMO and the *Eligible Claimant*. This may assist participants in the assessment and lodgement of future claims for additional costs.

We submit for the Commission's consideration draft rule 3.14.5B (i):

- (i) Where AEMO refers a claim for additional costs to the independent expert, AEMO shall report on all costs associated with the independent expert's determination including the amounts paid by AEMO and amounts paid by the *Eligible Claimant*.

Consideration of additional change to draft rule 3.14.5 (e) (3)

Draft rule 3.14.5 (e) (3) requires that AEMO publish the *market suspension pricing schedule* at least 14 days prior to the first day to which the schedule relates.

As part of the current AEMO consultation on the calculation methodology for the market suspension pricing schedule AEMO conducted a workshop on 22 August 2018 where participants strongly recommended that the 14 day timeframe be reduced.³ Participants' reasoning for this reduction to the 14 day timeframe included:

- Ensuring the current market suspension pricing schedule was as close to real-time market outcomes as reasonably possible.
- The current 14 day timeframe reflected the capability of IT systems available at the time of Market commencement. With improvements in market systems this extended timeframe is no longer required.
- The need to manually implement the market suspension pricing schedules when invoked into participants' market system has been superseded by AEMO's automated process to implement the market suspension pricing schedules when invoked into real-time dispatch outcomes combined with automated links to the current market suspension pricing schedules on AEMO's website.

Whilst a separate rule change could be raised to reduce this timeframe, this would come at an additional administrative cost to participants and the Commission. As the Commission is currently amending this rule, and AEMO's Draft Report and Determination indicates strong support amongst participants for such a change, we ask that the Commission give consideration to reducing this timeframe to one day if sufficient support for the change is provided in submissions to the Draft Determination. This will remove the need for an additional minor rule change to be lodged, reducing costs to the Market as a whole.

Conclusion

In general, ERM Power supports the Commission's Draft Determination. In our submission we have set out two improvements to the automated compensation methodology which we believe will reduce administration costs to participants and AEMO and create improved incentives for participants to maintain bid availability in all regions. This will improve AEMO's ability to maintain secure operation of the power system and reliable supply to consumers at a time of abnormal market operation where the power system may be operating under stress conditions.

We have also suggested improvements to the process where AEMO refers claims for additional costs to an independent expert which recognises that periods of market suspension may not be limited to only a short duration and that significant administrative costs by a participant(s) and AEMO may be incurred when a claim is referred to an independent expert.

³ AEMO Market Suspension Pricing Schedule Draft Report and Determination - Section 4.5.1 Page 12 Published September 2018



We believe the draft rule changes including our own suggested amendments will better align the incentives for participants to maintain bid availability during a period of market suspension and remove the need for market intervention by AEMO in the form of the issue of clause 4.8.9 Directions.

Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

Ben Ernst

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