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Australian Energy Market Commission

By online submission

Compensation and dispute resolution frameworks (gas) – Draft Rule Determination

Alinta Energy welcomes the opportunity to provide a submission on the draft determination. We support the alignment of governance for compensation frameworks across the east coast and the improvements to the cost recovery methodology but consider that the model for directions' compensation in the National Electricity Rules (NER) strikes a better balance between incentivising behaviour that supports system reliability and supply adequacy and avoiding perverse outcomes associated with either over or under-compensation.

We make the following specific comments in respect of this draft:

New compensation framework and alignment across the gas markets

Alinta Energy supports the proposed framework and agrees both that separation from the existing Part 15C dispute resolution process and alignment across the east coast gas system (including for the DWGM and STTMs) is sensible.

Minimum threshold of \$50,000 and no option for fast-tracked process

The imposition of a minimum threshold for matters which require expert determination is also sensible, and the proposed threshold appears to be set at an appropriate level. However, as suggested in our submission to the consultation paper, a default payment for gas provided under direction based on a benchmark price calculated by either AEMO or the AER, with a fallback provision enabling more complete compensation where the circumstances require it would be consistent with the national gas objective in that:

1. It would provide an alternative path for participants to recover costs that does not involve burdening the market with the costs associated with expert determination.
2. It would provide a faster resolution of such matters allowing retailers to then provide certainty to their customers about the likely magnitude and timing of impact on their bills. One of the key problems Alinta Energy has experienced under compensation frameworks for the energy markets is timeliness. When the impact of a direction cannot be determined for up to a year after an event, it is difficult for customers to manage the consequences from a cashflow and risk perspective.
3. It would allow for efficient compensation processes below the proposed financial threshold that applies to matters subject to expert determination.

Only direct costs compensated

Alinta Energy welcomes the clarity provided in the draft determination around categorization of different cost types and urges the Commission to reconsider its position that only direct costs be covered for the following reasons:

1. During an emergency it is critical that participants can communicate openly with the market operator about their capabilities without fear of financial punishment via inadequate compensation (that only covers direct costs). The proposal in the draft determination risks creating an adversarial environment between the market operator and participants during emergencies.
2. Inadequate compensation creates perverse incentives by essentially punishing participants who have taken responsible physical positions (for example holding gas in storage) that can assist the gas system in times of stress rather than punishing participants who have failed to obtain adequate redundant gas supplies to meet their demand in all circumstances.

An example of market design that failed on this point can be found in the recent need for AEMO to reinstate its LNG reserve at the Dandenong LNG facility. In the period leading to the reinstatement of the LNG reserve, market participants decreased storage levels at Dandenong as the costs of storage exceeded the perceived benefit. This perception arose because:

- gas storage at Dandenong LNG is critical for system security and AEMO could not allow gas storage levels to fall below certain thresholds, meaning that should participants have wished to use their gas stored at Dandenong for their own purposes, AEMO would have needed to direct the facility operator not to inject the gas;
- market parameters did not allow for sufficient price signaling; and
- the DWGM does not provide for consequential costs associated with directions.

The above factors taken together meant that the benefit of LNG in storage at Dandenong as a physical hedge was considerably diminished and highlights the real risk that if policy makers do not provide for adequate compensation pursuant to directions, that participants will avoid taking positions that can assist with market emergencies (for example filling gas storage facilities or limiting physical interconnection between their own gas facilities and relevant parts of the east coast gas system). A further consequence of this is that AEMO will increasingly need to intervene in the market leading to inefficiencies and increased costs to customers in the long run as well as increased risks to system security in the short to medium term.

3. The risk of a direction that does not compensate a participant adequately as in the example of a gas-fired generator selling caps at \$300/MWh (see table 3.2 in the draft determination) does not need to exist and is likely to impose higher total costs on consumers than the costs associated with providing for complete compensation. With more complete compensation (see for example the provisions around electricity directions under NER 3.15.7B) the market benefits from a built-in insurance policy. The inevitable outcome of placing such a risk on each participant individually is that prices of caps increase across the board as each participant factors in a risk premium to compensate. This ongoing cost may far exceed the marginal cost associated with occasionally more complex expert determinations and there would be similar inefficiencies across the east coast gas market.
4. The ignorance of any of the non-direct costs incurred by a direction means likely inefficiencies and a lack of transparency in the directions process, as there is no price signal or evaluation (even in the report after an event) of the true cost associated with a direction.
5. We note the Commission's comments that extending the cost categories beyond direct costs could lead to participants preferring a directed state. We disagree with this. Only a fixed or benchmark compensation that ignores actual losses incurred (whether consequential, direct or opportunity) can potentially over-compensate a participant. Even the most 'generous' compensation provisions across AEMO's markets that include opportunity costs only seek to compensate and cannot lead to a windfall gain such that a participant would seek it out in preference to a market-based outcome (assuming the market is free to solve). The appropriate solution to market failure, rather than seeking

to force existing participants to provide a service below cost (which will have negative impacts on the market both short and long term as discussed above), is to address the source of market failure itself, or accept that it can occur and that it is appropriate for the market operator to rely on interventions which include directing and compensating participants who cannot otherwise provide a service without incurring a substantial loss.

Alinta Energy notes, and shares, the general concern around complexity and timing of compensation pursuant to complex compensation determinations that consider more than just direct costs, particularly given the impact to both directed participants and customers of significant delays to the eventual allocation of the costs of a direction. However, we consider that there are more appropriate solutions to this than simply not paying for any costs that fall outside the 'direct cost' category such the staged approach to compensation for directions set out in NER 3.15.7 and 3.15.7B.

Proposed new civil penalty provision – rule 706

Alinta Energy does not object to the general principle of the proposed civil penalty, however the draft rule is not clear on exactly what sort of behaviour would be targeted under the provision. In particular, the phrase 'without reasonable cause' should be considered further. Given the complex interactions between east-coast gas markets and misaligned market prices caps there are a number of real-world scenarios in which participants may rationally seek to minimize injections into one market in favour of another. Would a decision by a participant that is profitable and otherwise consistent with the rules and law be automatically deemed 'reasonable' for this purpose? Is the participant required to consider only its own interests or does the participant need to consider the impact on third parties? If so, what is the extent of the participant's duty of care?

Clarity on cost recovery methodology

Alinta Energy supports the clarifications made to the cost recovery methodology and in particular the rectification of an existing defect under AEMO's cost allocation methodology that excused relevant entities that have made a claim from contributing towards the cost of funding the compensation. We suggest that the drafting of rule 707(8) be strengthened further:

"AEMO ~~must~~ may set off against amounts payable to a claimant any amount the claimant is required to pay AEMO pursuant to subrule (7) or rule 135JJ(4)"

Further clarity needed on the meaning of 'direct cost' and application of compensation

The draft determination provides some helpful clarity on the meaning of direct cost. However, some further examples could be helpful to understand how this might apply in specific situations:

1. Is the direct cost of gas in storage the cost of gas as originally supplied including all transportation and storage costs to date with a risk premium included? Is it the replacement cost of gas on the next gas day? Participants traditionally use shallow storage to hedge for peak day requirements in winter in the DWGM, for example using EGP storage to hedge several days of peak demands. If the participant in this scenario was directed to inject some of this stored volume on a day it is then exposed to the market on the following day(s); how would the compensation regime treat this?
2. Is the cost of gas from a production facility the cost of production? Or is it the market price/LNG netback that is relevant (this could be considered their cost of replacement)? If the cost of gas from a production facility is based on direct costs of production rather than the market price of the gas does that mean that the cost of directing a production facility operator to inject is different from the cost of directing a customer of the production facility to nominate and inject that same gas? If yes, is it an intended outcome of this compensation regime that the market operator target facility operators (production, pipelines etc), rather than participants, to minimise the cost of the direction?
3. If a participant acquires or replaces gas at a price that is not reflective of market conditions, how would this impact an assessment of direct costs associated with a direction in relation to that gas?

Minor drafting suggestions

Rule 704 covers the entitlement to receive compensation under part 27 and rule 705 outlines the notification process. However, as drafted the rules assume a part 27 compensation claim is notified under rule 704(1). Given this, Alinta Energy suggests that:

1. The definition of compensation claim be amended as follows:

compensation claim means any of the following:

- a) a claim for compensation under rule 344 or 350 of Part 19, notified to AEMO under rule 237(1);
- b) a claim for compensation under rule 433 of Part 20, notified to AEMO under rule 465(1);
- c) a claim for compensation under Division 6 of Part 27, notified to AEMO under rule ~~704(1)~~ 705(2).

2. Rule 704(1) be amended with one of the following options:

(1) A relevant entity may, ~~by written notice to AEMO in accordance with [rule 705(2)/the Procedures]~~, make a claim for compensation under this rule for the following ~~financial detriment~~ direct costs exceeding \$5,000 suffered by the relevant entity as a direct result of AEMO issuing an east coast gas system direction, if the amount of the claim exceeds the applicable claims threshold:

3. Rule 705 be amended as follows:

705 Notice of claim ~~Application of Part 15C~~

(1) As soon as practicable after the completion (as determined by AEMO, acting reasonably) of actions required to be taken as a direct result of an east coast gas system direction, AEMO must publish a notice requesting relevant entities that wish to claim compensation under this Division in respect of that east coast gas system direction to submit a notice of claim ~~under rule 704(1)~~.

(2) A notice of a claim ~~under rule 704(1)~~ must:

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Thank you for your consideration of Alinta Energy's submission. If you would like to discuss this further, please contact me at hugh.ridgway@alintaenergy.com.au.

Yours sincerely,

Hugh Ridgway

Wholesale Regulation Manager