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9 January 2024

Ms Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
SYDNEY, NSW, 2001

Dear Ms Collyer

Re: Review into electricity compensation frameworks – consultation paper

The Australian Energy Regulator (AER) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) consultation paper for the Review into electricity compensation frameworks.

Risk of change to objectives and methodology

In general, the AER supports reviewing the objectives and methodologies for the different compensation frameworks to ensure they complement each other and can operate holistically. If these frameworks are designed or implemented without regard to each other, there is a risk of creating new or exacerbating existing incentives for market participants to game the system and/or exert market power. For example, the level of compensation available compared to the potential revenue from the market could inadvertently incentivise participants to deliberately stop participating in markets and wait to be directed if they consider this would be more favourable. The AER considers this to be an important consideration in reviewing the appropriateness of the current frameworks as well as contemplating any changes.

Relatedly, the AER also considers that it is important to establish the policy objectives underlying each compensation mechanism, and then to consider whether the present arrangements meet these arrangements or whether changes are required.

Responsibility for compensation claims

The AER notes the different options put forward regarding the responsibility of assessing compensation claims for administered pricing periods. We specifically comment on option 3

whereby the AER would take on responsibility for opportunity cost claims only while AEMO would administer the direct cost claims.

The AER agrees with the pros and cons that the AEMC have identified in its comparison of options. As the AEMC has noted a benefit of this option is that, as the economic regulator in other areas, the AER could be reasonably placed to take on this role. The AER also concurs with the cons that the AEMC have also identified, namely that:

- different market bodies would assess the opportunity and direct cost components of participant claims,
- the AER does not have a dedicated resource to process assessment claims, and
- the AER does not have ownership of the data required to process these claims, which means it would have to rely on AEMO to process claims.

The AER considers that the lack of established AER resources to carry out this function may be a significant consideration for comparing options. Administered pricing periods and assessing opportunity costs for compensation payments are not common occurrences. Without a firm idea of the frequency with which this function will need to be carried out, it may be challenging (but not impossible) to establish and maintain the necessary capacity and capabilities. We suggest that the AEMC consider whether this is a greater or lesser challenge for other market bodies. In addition, we recommend the AEMC consider whether continuity in arrangements provides benefits in terms of market participants' willingness to participate in the market during administered pricing events.

Premium added to benchmark prices in the directions framework

The AER reiterates the concerns voiced in our submission¹ to the AEMC's second directions paper on the "Improving security frameworks for the energy transition" rule change process. In this submission, the AER noted that a premium added a benchmark price for directions compensations could create incentives for generators to deliberately withhold supply to force being directed by AEMO. The submission contains further information on this risk and also notes that a benchmark approach without a premium does not risk under-compensating generators. This is because if the benchmark is lower than their operating costs, generators would be able to claim for additional cost recovery under existing frameworks by lodging a claim for additional compensation in addition to the automatic payment. The AER considers adopting benchmark prices without a premium may warrant further consideration as a suitable alternative for pricing.

Clarifying the timeframe for determining compensation payments

The timeframes for determining compensation payments impact the AER's ability to set the Default Market Offer (DMO) as such payments are a relevant input cost for retailers and need to be reflected in the DMO.

Clarifying the timeframe for determining compensation payments may help provide greater certainty in setting DMOs. As a general rule, the AER considers that determinations on compensation costs and the timing of payments should be made as close as possible to the market event that caused it whilst still allowing time for proper assessment processes to be undertaken. In addition, the AER considers that if a retailer faces compensation costs in a certain DMO period they should be able to recover those costs (through the relevant DMO)

¹ Australian Energy Regulator, [AER submission: Improving security frameworks for the energy transition – Second Directions Paper](#), 28 September 2023

in the same year. This would help ensure fairness to market participants and energy users. The AER considers that the timeframes for lodging and assessing compensation claims must be practical and workable in the real-world meaning some degree of discretion and flexibility may be necessary. A cut-off of 12 months following the event could be a realistic timeframe, and the AER will then endeavour to reflect the compensation into the DMO as soon as practicable.

We look forward to engaging further on this matter and any suggested timeframes.

Continued engagement

The AER appreciates the opportunity to provide feedback on the draft determination and we look forward to continued engagement as the AEMC progresses this review.

Yours sincerely

A handwritten signature in black ink, appearing to read 'S. Jolly', enclosed in a thin black rectangular border.

Stephanie Jolly
Executive General Manager
Consumers, Policy and Markets

Sent by email on: 02.02.2024