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Submitted online: https://www.aemc.gov.au/contact-us/lodge-submission

Submission to EPR0095 – Review into electricity compensation frameworks

Dear Tom Meares

Delta Electricity (Delta) welcomes the opportunity to respond to the AEMC's consultation paper on its review into electricity compensation frameworks. Delta notes that it currently has an APC compensation claim before the Commission and is expecting a final decision later in 2024. As such, Delta has withheld providing some feedback on some questions as it feels it appropriate to consider some questions with the full knowledge of the Commission's final decision on its claim.

In reviewing the compensation frameworks, Delta strongly considers that the objectives should be always kept in mind and returned to when decisions are being made in amending the compensation frameworks. The primary objective is to maintain the incentive for participation in the market. This, along with instilling transparency and clearer guidance in how the compensation frameworks will be applied would be a good foundation with which to start the assessment.

Q1 – Assessment framework

Delta agrees with the assessment framework but highlights that with respect to 'principles of market efficiency' it needs to strongly leverage the objectives of the compensation frameworks, which is to maintain the incentive for participation in the market. In this sense, it is allocative efficiency that is key. That is, do the compensation frameworks ensure enough incentive for the most efficient generator to allocate themselves to the meet the market needs.

Q2 – Objectives

The objective of each framework should be to ensure that an affected participant that is required to take an action that it otherwise would not take, is reasonably compensated for this action. What 'reasonably compensated' means will vary depending on the circumstances under which the intervention has taken place.

Delta considers that directions compensation should therefore include an amount that covers forgone or missed opportunity that the participant incurs as a result of being directed, not just the direct costs associated with the direction.

Both the administered pricing cap (APC) compensation and market suspension compensation frameworks include ‘to maintain the incentive to supply’ which should mean both direct and opportunity costs are considered when determining compensation.
The consultation paper states (emphasis added)…

> “…The framework is designed so that a participant is **indifferent about participating** in the market during an APP. The participant is indifferent at the point where their revenue from providing a service or services is equal to their costs of providing the service, including their opportunity costs.”[1]

Delta’s direct experience is that the APC framework has not been implemented in a way where a participant is indifferent about participating in the market during an APP.

Q3 – Achieving the objectives

Delta considers the administered pricing and market suspension compensation objectives were not achieved in the June 2022 events.

Delta also notes that during the June 2022 event it did not withdraw capacity from the power system to the point that it was directed. Delta wanted to avoid being directed as this would have handed over control of its generation output to AEMO and potentially put its critically low coal stockpile at risk of being fully depleted.

Q4 – Methodology

Directions compensation should be based on the direct costs incurred by the directed generator as a result of the direction plus an additional opportunity cost component that covers the loss from not being able to use that directed resource in a more profitable way. There are a number of ways opportunity costs could be calculated, but it would be more practical to develop one that is simple and easy to implement. One approach, which removes the perverse incentive to be directed, could be where the opportunity cost component is determined by a post-hoc assessment based on a lost opportunity from using the directed resource to either provide a different service or a service at a later time. That is;

- at the time of the direction, the directed generator would need to nominate the conditions under which it would have used the resources had it not been directed;
- the nominated conditions need to be reasonable (parameters would be set beforehand within the guidelines); and
- If the nominated conditions do not occur, the directed generator does not receive any opportunity cost compensation as it did not incur, according to its own nominated conditions, a lost opportunity from being directed.

[1] Consultation paper, page 13

An example of this is where a generator has limited fuel and is directed on when it would prefer not to generate (or not generate as much). That generator has lost the opportunity to use that fuel when the spot price is higher at a later date. Most dispatchable generators would have a hedge position or customer load to supply. Being directed when fuel is scarce would reduce its ability to defend its contract/load position at a later date.

Delta considers compensation frameworks should be similar where possible, and that opportunity costs should apply to all of them. This is because at their core, each compensation framework should be trying to achieve the same objective of incentivising market participation when the market conditions themselves are not providing that incentive.

In theory, the APC compensation framework should provide sufficient incentive for generators to participate in the market during an APP however this depends on how the AEMC, or other determining body if the responsibility shifts, implements the compensation rules and guidelines. Delta advises the project team to engage directly with participants who have gone through the APC compensation process, once the AEMC concludes their assessments from the June 2022 event. It is Delta's preliminary thought that there is a disconnect between what the AEMC considers is sufficient incentive and what the market considers sufficient incentive to be.

Delta does not agree with the AER's suggestion to remove the economic considerations for causing a direction. If this were implemented, it would remove the ability for market participants to manage their own commercial risk and would distort the key drivers and incentives for investment and participation in the energy market. Instead of taking away decision making from market participants, the focus should be on ensuring the compensation frameworks are clear, effective, and sufficiently incentivise participation in the market.

Question 5 – Governance

Noting the pros and cons outlined in table 5.1 of the consultation paper, making AEMO responsible for all compensation frameworks in the NEM is the simplest approach. Of the three market bodies, AEMO's role and objectives are most closely aligned with the objective of the compensation frameworks; to provide incentive for participation in the market and maintain reliability and system security during times of stress. Whereas both the AEMC and the AER have primary focuses of efficient market design (rule making) and monitoring and compliance (rule following), respectively. Any deficiency in skills faced by AEMO could be addressed through creating working groups where key staff from the AEMC and AER can be seconded in, or through the use of consultants.

Question 6 – Overlapping compensation claims

Delta agrees that there were points of confusion during and after the June 2022 event in relation to the application of compensation frameworks. First and foremost, whatever option is eventually implemented, it must be made clear to the market and not allowed to be re-interpreted at a later date, such as what happened with eligibility for APC compensation that overlapped with the market suspension period.

Of the options presented in the consultation paper, Delta prefers option 1 as it provides better incentive for market participation, which is the objective of the compensation frameworks.

Question 7 – Timeframes for supporting information

Delta agree with including a timeframe for APC compensation claims on the provision that the amount of time allowed for opportunity cost claims is sufficient.

Delta strongly advises that the time for an opportunity cost claim to be submitted is no less than eight weeks, and preferably 10-12 weeks, after the notice of claim is submitted. This is based on Delta's direct experience after the June 2022 event. Delta did not make a direct cost claim in 2022 but estimates a four-week period would be sufficient.

Question 8 – Harmonising definitions

Delta agrees that there would be benefits in aligning definitions of cost categories across the various compensation frameworks.

Question 9 – Cost recovery

Delta agrees with; any further clarification where there is ambiguity on the cost recovery mechanism, and the current practise of cost recovery from the region under the APC with respect to when price scaling occurs.

Question 10 – Information to support a claim

Delta agrees that more guidance is needed on the information that is necessary to support a claim for administered pricing compensation. Delta has direct experience with the APC compensation claim process and strong views on the pros and cons of the framework. However, Delta's compensation claim from the June 2022 event is still being assessed by the Commission and considers it appropriate to wait for the conclusion of the that process before providing further input on this matter.

Delta thanks the AEMC for initiating the review and is hopeful of changes to the compensation frameworks that better encourage and incentivise market participants to continue to participate in the market during times of reliability and system security stress.

To discuss further please contact me at joel.aulbury@de.com.au.

Yours sincerely,

Joel Aulbury

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