



12 February 2024

Anna Collyer
Chair
Australian Energy Market Commission
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Sydney South NSW 1235

Submitted online at: www.aemc.gov.au

Dear Ms Collyer

Review into Electricity Compensation Frameworks – Consultation Paper

Origin Energy Limited (Origin) welcomes the opportunity to provide comment on the Australian Energy Market Commission's (AEMC) *Review into Electricity Compensation Frameworks – Consultation Paper* (the Consultation Paper).

In the context of other on-going reforms in the National Electricity Market (the NEM) and the market transition currently underway, this review is timely. It provides an opportunity to assess the compensation regime on a holistic basis, having regard to recent experience and how it could potentially be improved going forward.

In general, we consider there are several key changes that should be adopted to improve the efficiency of the regime, as noted below:

- The scope of claimable costs should include opportunity costs across all frameworks, including directions. The AEMC has noted the directions compensation framework should ensure participants are not 'out-of-pocket', and effectively returned to the position they would have been in had the intervention not occurred.¹ The current framework does not adequately satisfy this objective, noting generator directions can for example, result in consumption of gas that had been allocated to manage a different exposure (e.g. to supply forecast retail gas load or fuel for gas-powered generation (GPG) in a future period), giving rise to additional costs that are not currently recoverable. The exclusion of opportunity costs under directions is also problematic for storage assets due to the strategic nature in which they are deployed and the relatively small direct costs they incur. While it is important to ensure the underlying cause of directions is addressed, it is equally crucial market participants are appropriately compensated where directions are required.
- A simplified process should be adopted to streamline the three frameworks currently in place. The rationale for having three separate frameworks with varying objectives is unclear. Establishing a single overarching objective and associated regime would reduce complexity and likely support more timely outcomes. A two-stage process whereby claimants are initially compensated for directions costs and required to apply for any additional compensation (e.g. opportunity costs), would be a reasonable approach.
- The Compensation Guidelines should be strengthened to provide greater codification and clarity around how claims will be assessed. This could include the standardisation of direct cost

¹ AEMC (2019), [Investigation into intervention mechanisms in the NEM](#), Final Report, p. iv.

categorisations and definitions, the establishment of methodologies for claimants to follow, and the provision of examples as to what constitutes an opportunity cost. Greater certainty and transparency will likely reduce the time taken to prepare a claim and hasten the review process.

The Consultation Paper is also seeking feedback on whether additional reforms proposed by the Australian Energy Regulator (AER) following the events of winter 2022 may be necessary, including removing commercial considerations as a reasonable cause in the event generator rebidding contributes to AEMO directions, and imposing mandatory supply obligations on market participants during defined periods. In Origin's view, these changes are not necessary / justified.

The focus of any reforms should be on the implementation of more efficient market-based solutions, preserving commercial decision-making to the greatest extent possible. The events of June 2022 demonstrated the prevailing administered price (APC) was not set at a level that adequately balanced the need to minimise financial stress in the market while also incentivising the provision of sufficient supply during administered pricing periods (APPs). This issue has been addressed, with the AEMC raising the APC to \$600/MWh to account for higher fuel costs as part of a temporary rule change and subsequently determining to retain the APC at that level at least over the period to mid-2028.²

If you wish to discuss any aspect of this submission further, please contact Steve Williams at steve.williams@originenergy.com.au or on 0409870998.

Yours Sincerely,



Shaun Cole
Group Manager, Regulatory Policy

² AEMC 2023, [Amendment of the market price cap, cumulative price threshold and administered price cap](#), Final Rule Determination, December.

1. Scope of claimable costs should include opportunity costs and apply to all regimes

The current Rules allow opportunity costs to be claimed under the administered pricing framework, but not where participants operate under directions or during market suspension. The exclusion of opportunity costs from the direction's framework was predicated on the AEMC's view that its purpose is to allow for recovery of the costs associated with complying with a direction,³ and consistent with that, '*... participants should not view directions as a means to earn profitable revenue*'.⁴ This position was seemingly a decisive factor in the AEMC excluding opportunity costs from the market suspension compensation framework.⁵ More recently, the AEMC has also stated that opportunity costs should not be part of compensation for directions as the inclusion of those costs could create an incentive for generators to await a direction rather than participate voluntarily.⁶

Origin does not agree with this underlying rationale and considers opportunity costs should be claimable under all frameworks.

Firstly, it is unlikely the inclusion of opportunity costs would incentivise participants to rely on directions being issued. Generator directions can result in gas that has been allocated to manage a specific exposure (e.g. to supply forecast retail gas load or fuel for gas-powered generation (GPG) in a future period) being diverted for a different use. It can also impact a range of other areas such as resource allocation or generator maintenance requirements (e.g. a GPG may have a limited number of starts to utilise prior to major maintenance being required). This is a disruptive and undesirable outcome that can potentially undermine the ability of an impacted participant to efficiently manage its risk across both gas and electricity markets.⁷

Moreover, participants seeking to claim opportunity costs would face uncertainty around the quantum of potential compensation and the administrative burden of submitting and (appropriately) justifying claims. This would likely further reduce any inherent reliance on the directions framework by participants in the course of normal operations.

As noted above, the current framework appears to be inconsistent with the AEMC's contention that the directions compensation framework should '*... ensure that participants who have been directed by AEMO to provide services are not out-of-pocket ... [and]... put them in the position that they would have been in had the intervention not occurred*'.⁸ Opportunity cost is also widely accepted as an element of SRMC.⁹

The exclusion of opportunity costs is particularly problematic for storage assets such as batteries and pumped hydro due to the strategic nature in which they are deployed and the relatively small direct costs they incur. The collective extent of this shortcoming will grow over time as storage technology becomes more prevalent. The AEMC acknowledges that the treatment of battery compensation in this context is a broad issue that applies to all compensation frameworks. Nonetheless, it is important that any solution should not discriminate in favour of one technology, for example by allowing storage assets to recover opportunity costs across other frameworks without extending that right to other generator-types.

The impact of these factors will be exacerbated where heavy reliance is placed upon directions. At the commencement of the NEM, the issuing of directions was seen to be an exceptional event. However,

³ AEMC (2019), [Investigation into intervention mechanisms in the NEM](#), Final Report, p.40.

⁴ AEMC (2023), [Improving security frameworks for the energy transition](#), Directions Paper, p. 101.

⁵ AEMC (2018), [Participant compensation following market suspension](#), Final Determination, pp. 47.

⁶ AEMC (2023), [Review into electricity compensation frameworks](#), Consultation Paper, p. 12.

⁷ This is further complicated by the fact the movement of gas is not instantaneous and it takes time to transport gas to where it is needed in the system.

⁸ AEMC (2019), [Investigation into intervention mechanisms in the NEM](#), Final Report, p.iv.

⁹ See, for example [King \(2004\)](#), [Concept Economics \(2008\)](#), [Economic Regulation Authority \(2009\)](#) and [The Brattle Group \(2020\)](#).

despite still being considered a last resort measure, it is clear AEMO is relying on directions far more than initially envisaged. For example, during Q4 2023, directions were in place in South Australia for 65 per cent of all dispatch intervals.¹⁰

While it is important to ensure that the underlying cause of directions is addressed to enable the energy transition to proceed smoothly, it is equally important that market participants are appropriately compensated where directions are required. Accordingly, directions compensation should fully reflect all costs associated with compliance – including opportunity cost. In addition, given there is no clear distinction between operating under market suspension and administered pricing, eligibility for opportunity cost compensation should also be extended to the former.

2. A simplified process should be adopted to streamline the three frameworks currently in place

There is a strong case for aligning the three compensation frameworks. This would remove any concerns the AER has raised around the potential impact of having varying frameworks in place on generator incentives. More importantly, it would provide procedural advantages in terms of enhanced simplicity and timeliness.

Under this uniform framework, claims for compensation could be assessed in two stages.

Stage One - deterministic

The initial stage could seek to promptly reimburse claimants for direct costs incurred in excess of any revenue earned on supply in relevant trading intervals. For simplicity, this could involve:

- harmonising the definition of direct costs across all frameworks;
- specifying cost-reflective benchmarks;
- determining revenue earned based on the APC or other relevant prices in the market suspension pricing framework; and
- establishing a deterministic mechanism to automatically reimburse claimants.

Origin acknowledges there are challenges in identifying appropriate cost benchmarks. To be as granular and cost-reflective as possible, it is important that these benchmarks:

- capture all relevant cost components, including start-up costs and consequent wear and tear, and allow for the bring-forward of maintenance expenditure when directed;
- are localised to the greatest extent possible. For example, fuel for gas generation could be derived from the spot price in the relevant facilitated market; and
- are updated with sufficient frequency (at least monthly) to maintain relevance.

Stage Two

At this second stage, market participants could seek reimbursement for:

- direct costs in excess of these compensated for in stage one; and

¹⁰ AEMO 2023, [Quarterly Dynamics Q4 2023](#), p.49.

- opportunity costs incurred.

Origin notes that lodging claims for compensation through a second-stage process could impose an additional administrative burden. However, this burden is alleviated to some extent by the benefit of establishing a relatively simple and swift automatic direct cost recovery in the first instance. Moreover, the effort in preparing any second stage claim could be minimised by clarifying obligations and expectations, as discussed further below.

3. Greater codification and clarity around how claims will be assessed is required

There is merit for all parties in ensuring the process for preparing and reviewing claims for compensation is as efficient and transparent as possible. Comprehensive guidelines would facilitate this.

For *direct costs*, the current Compensation Guidelines (the Guidelines) identify categories of costs that are eligible to be claimed. While these should be standardised across the individual frameworks, the Guidelines should also specify the standard of information required for each of those categories in the event where an additional claim for direct costs is made.

For *opportunity costs*, the existing Guidelines provide limited clarity around the information requirement of claimants. In addition, they afford the AEMC a high level of discretion in relation to its assessment, indicating that '*... the AEMC is not bound to follow [them], and there may be circumstances in which there are compelling reasons not to do so.*'¹¹

Origin considers that the Guidelines could be improved by:

- providing examples of what constitutes an opportunity cost, including for market participants with an integrated energy portfolio;
- establishing standardised methodologies for market participants to follow when making a claim; and
- highlighting what supporting evidence is required.

Clarifying the information required of market participants could be expected to reduce the time taken to prepare a claim and facilitate a more efficient review process, lessening the need for follow up questions and the submission of further data.

Under the current Guidelines, the total opportunity cost that can be claimed by any participant cannot be larger than its dispatch bids or dispatch offers minus the administered cap (in the case of dispatch bids) or administered price floor (in the case of dispatch offers).¹² Origin recognises the intent of this requirement is to avoid a claimant receiving compensation that exceeds their reasonable net costs. However, we do not consider it practical to strictly apply this requirement given there is a range of factors that can impact the level of a dispatch bid (or offer), including technical, safety, legal or other operating requirements, or to manage constraints. The compensation assessment process also already provides sufficient scope to test the reasonableness of a claim given it provides for publication and consultation on the claimants' methodology, and engagement of experts to assist with claim review.

¹¹ AEMC 2021, [Compensation guidelines](#), p. 12.

¹² *ibid.*, p.13.

Similarly, defined timeframes for information submission should not be unnecessarily short, recognising generators' competing operational obligations, particularly immediately following a period of market stress.

Where an independent expert is retained to assess any elements of the compensation claims, they should be provided with sufficient guidance to ensure consistency of decision-making over time – particularly where different experts are appointed. This guidance should be publicly available in the interests of transparency.

4. Additional obligations on participants during periods of market stress are not necessary

Since its inception, the NEM has operated on the basis of commercial principles that have enabled market participants to recover costs incurred through financing, building and operating their generation assets. In this context, the Rules generally afford generators strong incentives to continue to supply the market. To the extent that supply availability reduces during times of market volatility, the preservation and promotion of those incentives should be the focus of regulatory policy.

The events of June 2022 demonstrated the prevailing APC was not set at a level that adequately balanced the need to minimise financial stress in the market while also incentivising the provision of sufficient supply during APPs. This issue has been addressed, with the AEMC raising the APC to \$600/MWh to account for higher fuel costs as part of a temporary rule change and subsequently determining to retain the APC at that level at least over the period to mid-2028.¹³

In making the Determination, the AEMC observed the increase would '*... promote better market participation during an APP, reducing the need for AEMO intervention.*'¹⁴ The AEMC also foreshadowed its preference for promoting commercial incentives over the imposition of availability obligations, noting that the higher APC would '*... better promote efficient outcomes through competition by providing incentives rather than directions or obligations.*'¹⁵

Given this, the AER's proposals to remove commercial considerations as a reasonable cause in the event generator rebidding contributes to AEMO directions, and impose mandatory supply obligations on market participants during defined periods, do not seem necessary. The latter proposal could also create significant risk for market participants, given there is a range of factors that can impact the ability to dispatch plant at a given point in time, including operating restrictions, fuel availability and maintenance requirements.

¹³ AEMC 2023, [Amendment of the market price cap, cumulative price threshold and administered price cap](#), Final Rule Determination, December.

¹⁴ *ibid.*, p.33.

¹⁵ *Ibid.*