Your ref: EPR0095

26 September 2024

Mr Tom Meares
Project Leader, AEMC
Submitted online at: www.aemc.gov.au

Dear Mr Meares

Submission: Review into electricity compensation frameworks

CS Energy welcomes the opportunity to provide a submission to the Australian Energy Market Commission's (**AEMC's**) *Draft report – Review into electricity compensation frameworks* (**Draft Report**).

About CS Energy

CS Energy is a proudly Queensland-owned and based energy company that provides power to some of our state's biggest industries and employers. We employ almost 600 people who live and work in the Queensland communities where we operate. CS Energy owns and operates the Kogan Creek and Callide B coal-fired power stations and has a 50% share in the Callide C station (which it also operates). CS Energy sells electricity into the National Electricity Market (**NEM**) from these power stations, as well as electricity generated by Gladstone Power Station for which CS Energy holds the trading rights.

CS Energy also provides retail electricity services to large commercial and industrial customers throughout Queensland and has a retail joint venture with Alinta Energy to support household and small business customers in South-East Queensland.

CS Energy is creating a more diverse portfolio of energy sources as we transition to a new energy future and is committed to supporting regional Queensland through the development of clean energy hubs at our existing power system sites as part of the Queensland Energy and Jobs Plan (**QEJP**).

Overall views

The AEMC's review into electricity compensation frameworks is timely as the energy crisis in June 2022 highlighted the uncertainty and lack of confidence in the existing regime. Further, as the NEM transitions to a power system with more variable renewable energy (**VRE**), this is likely to exacerbate issues present in the current regime. Against this

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landscape, CS Energy supports the need to reform the electricity compensation frameworks to ensure that they are fit-for-purpose.

The AEMC made 14 draft recommendations to improve the directions, administered pricing and market suspension compensation frameworks. Key recommendations include:

- Adopting a consistent methodological approach for lost value (revenue) by allowing participants to be compensated for such costs across all frameworks.

- Aligning the upfront compensation methodology across the directions and market suspension frameworks:

    - For the directions framework, upfront payment is proposed to be based on the volume-weighted average price (**VWAP**) received by assets of the same technology type in the same region over the previous 12 months, capped at the administered price cap (**APC**);

    - For the market suspension framework, upfront payment is proposed to be the greater of:
        - The prices under the market suspension pricing schedule (**MSPS**); and
        - The VWAP identified above.

- Streamlining and aligning the governance structure, administrative and assessment processes across all compensation frameworks by:

    - Establishing the Australian Energy Market Operator (**AEMO**) as a single point of lodgement for all claims;

    - Using AEMO's independent expert function to assign experts to assess claims for lost value and direct costs across all frameworks;

    - Retaining the AEMC's responsibility to develop guidelines for assessing lost value claims that will apply across all frameworks;

    - Imposing timeframes for claims under the administered pricing framework by using AEMO's intervention settlement timetable (**IST**) (that is currently applicable to the directions and market suspension frameworks);

    - Standardising the types of direct costs that apply to all frameworks and identify them in a single list;

    - Applying the same standards of supporting evidence required for claims across all frameworks.

- Retaining clause 3.9.7(b) of the National Electricity Rules (**NER**) that precludes constrained-on[1] generators from receiving compensation when the spot price is less than their dispatch offer price.

[1] In this context, to avoid exceeding a power system limit, a binding constraint in the NEM dispatch engine would increase the output of a generator above the volume limit specified by its dispatch offer bids.

CS Energy supports the following draft recommendations:

- Allowing participants to be compensated for lost value across all frameworks – such an approach more accurately reflects the costs that participants incur to provide energy and system security services, especially costs associated with fuel scarcity, maintenance and lost revenue when energy-constrained plants are directed to bring forward their generation. Compensation frameworks that adequately reflect the true costs of participants would avoid market distortions and maintain the incentive to supply during system stress, which lowers costs for all consumers in the long run.

- The above identified initiatives that streamline and align the rules, eligibility and processes across all three compensation frameworks. These measures should improve the clarity, timeliness and predictability of the compensation frameworks as participants will be compensated for costs based on processes, timeframes, parameters and level of required evidence that are more standardised across all frameworks. More consistency across frameworks means that participants are likely to be less concerned under which framework they will be compensated, therefore incentivising the voluntary provision of services.

  While CS Energy supports imposing timeframes to facilitate the timely assessment of claims for the administered pricing framework, the proposed time limit (under the IST) of 15 business days for participants to submit additional claims is likely too short. Administered pricing periods are typically disruptive events that can stretch a participant's organisational resources, which makes it more challenging for participants to gather the required information and assess the impacts in a short timeframe. A timeframe of 30 business days may be more appropriate considering the disruptive nature of administered pricing events.

<u>VWAP approach</u>

CS Energy considers that the VWAP approach to determining upfront compensation for the directions framework is an improvement to the short-run marginal cost (**SRMC**) benchmarking methodology that was initially proposed.

However, while CS Energy agrees in-principle that the VWAP approach is more technology specific and reflects some of the lost value when being directed, it is unclear whether this approach would sufficiently reflect the costs incurred by peaking plants that are fewer in number and dispatched infrequently (such as pumped hydro and open-cycle gas turbine).

This is likely to be an increasingly relevant consideration as the NEM transitions to a power system with a high level of VRE where peaking plants may only be dispatched infrequently (directed or voluntarily) during periods of tight demand-supply and system stress. Under the VWAP approach, the calculation of upfront compensation will exclude periods where generators have been directed. This may further reduce the already limited data points available to calculate the upfront payment and potentially make the VWAP approach more susceptible to manipulation.

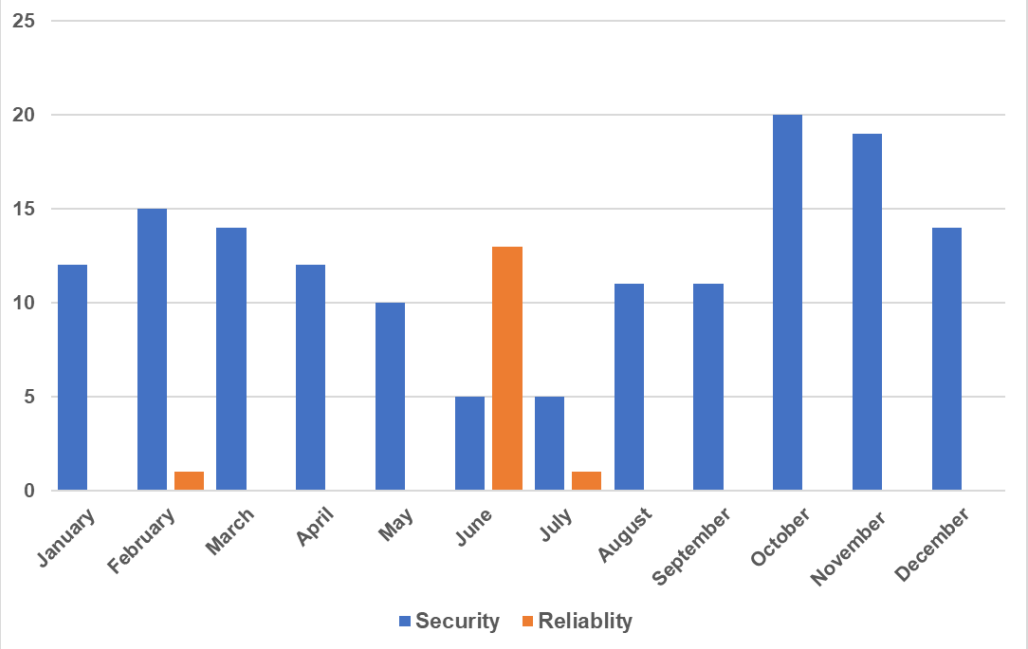
It is also unclear whether negative spot prices will be included under the VWAP approach. This is particularly relevant for less flexible directed plants (such as coal-fired generators) that get dispatched more frequently during negative price periods due to a required level of minimum generation. If negative prices are included under the VWAP approach, this means that less flexible directed plants would receive a lower upfront compensation that may not adequately cover their costs, which could lead to inefficiencies associated with higher volume of subsequent compensation claims.

If the VWAP approach leads to significant under-/over-compensation for peaking or inflexible plants, it would create market distortions and inefficiencies, which would likely increase costs for all consumers. CS Energy considers that more work is necessary to evaluate the materiality of the issues raised.

Further, the VWAP approach seems to be designed primarily for compensation relating to directions issued for energy services to maintain reliability (during Lack of Reserve conditions). However, directions issued to maintain system security are substantially more frequent than those for energy services (**Figure 1**).

While CS Energy agrees that the *Improving Security Frameworks* (**ISF**) rule change aims to reduce the reliance of directions for the management of system security, it is likely that AEMO would still use directions to complement the ISF mechanisms, especially in the short-term. On this basis, CS Energy considers more work is necessary to assess whether the VWAP approach is appropriate for determining upfront compensation for system security related directions.

Figure 1 Number of AEMO directions across the NEM by type – 2022



Source: CS Energy's analysis of AEMO data.

Compensation for constrained generators

Consistent with our previous submission, CS Energy considers that clause 3.9.7(b) of the NER can serve as a disincentive for generators to make capacity available as they may incur a loss that is not compensable when constrained-on, especially during times of system stress. Such a disincentive may prompt constrained-on generators to withdraw capacity and await direction from AEMO rather than providing services voluntarily to ensure that they are compensated adequately.

Further, there are suggestions that AEMO may be opting to use constraints to manage system security as an initial step rather than procuring services using the mechanisms

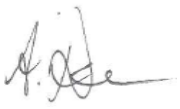
established under the ISF rule change. For example, during AEMO's consultation on the Minimum System Load (**MSL**) procedure, it was proposed that scheduled/semi-scheduled units would be constrained-off[2] as a first step to manage MSL condition, where losses incurred by units are not compensable.

CS Energy considers such an approach if adopted by AEMO raises several issues including whether losses incurred by generators when constrained-on/-off should be compensable. Given that these losses are not compensable, it would serve as a disincentive for generators to provide services voluntarily during system stress, leading to market distortions and inefficiencies which would increase costs for all consumers in the long run.

To mitigate the disincentive of providing services voluntarily, generators should be allowed to receive compensation for losses incurred when constrained-on/-off.

If you would like to discuss this submission, please contact Wei Fang Lim, Market Regulatory Manager, at wlim@csenergy.com.au or on 0455 363 114.

Yours sincerely



Dr Alison Demaria
Head of Policy and Regulation

[2] In this context, to avoid exceeding a power system limit, a binding constraint in the NEM dispatch engine would reduce the output of a generator above the volume limit specified by its dispatch offer bids.