



Australian Energy Market Commission

DRAFT RULE DETERMINATION

National Electricity Amendment (Compensation arrangements following application of an administered price cap and administered floor price) Rule 2015

Rule Proponent(s)
COAG Energy Council

13 August 2015

**RULE
CHANGE**

Inquiries

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

E: aemc@aemc.gov.au

T: (02) 8296 7800

F: (02) 8296 7899

Reference: ERC0176

Citation

AEMC 2015, Compensation arrangements following application of an administered price cap and administered floor price, Rule Determination, 13 August 2015, Sydney

About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

This work is copyright. The Copyright Act 1968 permits fair dealing for study, research, news reporting, criticism and review. Selected passages, tables or diagrams may be reproduced for such purposes provided acknowledgement of the source is included.

Executive Summary

The Australian Energy Market Commission (Commission or AEMC) has made a draft Rule that relates to the compensation arrangements following the application of an administered price cap or administered floor price. The draft Rule improves the way eligibility for compensation is determined and the overall compensation assessment process.

This is in response to a rule change request from the COAG Energy Council which proposes a number of ways in which these compensation arrangements, including the process followed by the AEMC in assessing and awarding compensation, could be improved.

Background

Wholesale spot prices in the National Electricity Market (NEM) are able to vary within a range of -\$1,000 to \$13,800 per MWh. This allows market participants the potential to earn a return on assets, and provides a framework within which investment signals can be provided. Persistent high or low prices can create risk for participants which could impact the stability of the market. To limit this variation, at times of extreme prices an administered price cap and or administered price floor can be applied.

The potential for market participants such as generators – particularly those with high costs – to incur a loss during these administered price periods may create a disincentive for them to supply energy. This could in turn have a negative impact on system reliability. To minimise these disincentives, the National Electricity Rules (NER) allow participants to claim compensation where they incur a loss during administered price periods. The AEMC manages this compensation process.

Administered price periods occur rarely. In the history of the NEM, there have only been five such periods, the most recent being in 2009. There has only been one claim for compensation arising from such a period.

The National Electricity Rules (NER) provide for matters such as the purpose of compensation; what types of participants may claim compensation; when compensation is payable, what process the AEMC must use to determine the amount of compensation; and how the compensation paid is recovered from consumers. The COAG Energy Council has proposed changes in each of these areas.

More preferable draft Rule

The AEMC has made a draft Rule in response to the rule change request. The draft Rule is a more preferable Rule because some of the changes are different from the rule change request.

The key features of the draft rule are set out below.

Eligibility criteria

Under the current arrangements, eligibility to claim compensation is assessed on a trading interval basis. This can encourage generators to cycle their units on and off if they become ineligible for compensation in a trading interval, reducing the efficiency of operation. Under the draft Rule, compensation is assessed over the entire period from when the administered price cap first sets the spot price to the end of the trading day, and is based on the difference between total costs and total spot market revenues. This should reduce the incentive for generators to cycle units on and off in a specific trading interval and enhance reliability.

Purpose of compensation

The NER currently provide that the objective of compensation is to maintain incentives for participants to both supply energy during an administered price period and to invest in plant that provides services during peak periods. Under the draft Rule the only objective for compensation would relate to supplying energy and consuming load. This change would improve clarity and certainty. The compensation arrangements do not provide for recovery of capital costs and as such will not contribute to investment incentives. Investment incentives are provided by other mechanisms in the NER, including the level of the market price cap and cumulative price threshold.

Assessment process

The current arrangements set out the process by which the AEMC is to assess any compensation claim. The draft Rule would improve the flexibility, efficiency and transparency of the assessment process, including by removing the requirement on the AEMC to appoint an expert panel to advise on claims for compensation. Instead, the AEMC would be provided with flexibility as to when it uses expert assistance. This specific change is additional to what the rule change request proposes.

Other elements

Other elements include amending the process by which costs are recovered from consumers to improve certainty, and extending eligibility for compensation to non-scheduled generators.

National Electricity Objective

The draft Rule would contribute to the National Electricity Objective. Where it differs from the rule change request it would better contribute to the National Electricity Objective than the rule change request. The changes would achieve this through:

- enhancing the reliability of electricity supply;
- increasing the transparency and reducing the administration costs of the assessment process; and
- contributing to efficient recovery of compensation costs from consumers.

Invitation for submissions

Stakeholders are invited to make written submissions in response to this draft determination by 24 September 2015. Any person or body may request that the Commission hold a hearing in relation to the draft determination.

Contents

1	COAG Energy Council's Rule change request	1
1.1	The Rule change request	1
1.2	Background information.....	1
1.3	Current arrangements	4
1.4	Proposed arrangements in Rule change request	7
1.5	Consultation Paper - additional changes.....	10
1.6	The rule making process to date	12
1.7	Consultation on draft Rule determination	12
2	Draft Rule determination	13
2.1	Rule making test.....	13
2.2	Assessment framework	14
2.3	Summary of reasons	14
3	Clarifying the purpose of compensation	17
3.1	Context and stakeholder views.....	17
3.2	Assessment.....	17
3.3	Conclusion	18
4	Clarifying eligibility criteria and removal of references to market suspension	20
4.1	New criteria based on the eligibility period	20
4.2	Extending eligibility to non-scheduled generators	22
4.3	Removal of eligibility for ancillary services providers	23
4.4	Amend eligibility criteria in an export price capped region	24
4.5	Amend eligibility criteria for scheduled network service providers	25
4.6	Removal of references to market suspension.....	26
4.7	Conclusion	26
5	AEMC processes for assessing compensation claims	28
5.1	Context and stakeholders	28
5.2	Assessment.....	29

5.3	Conclusion	32
6	Recovery of compensation costs.....	33
6.1	Context and stakeholder's views	33
6.2	Assessment.....	33
6.3	Conclusion	34
7	Transitional arrangements	35
	Abbreviations.....	36
A	Summary of issues raised in submissions	37
B	Legal requirements under the NEL	40
B.1	Draft Rule determination	40
B.2	Power to make the Rule	40
B.3	Commission's considerations	40
B.4	Civil penalties and conduct provisions.....	41

1 COAG Energy Council's Rule change request

This chapter provides an overview of the rule change request, background information, the current arrangements for compensation during an administered price period, the proposed arrangements in the rule change request, the proposed arrangements in the Consultation Paper, the rule making process to date and process for consultation on this draft determination.

1.1 The Rule change request

On 17 October 2013, the Council of Australian Governments' Energy Council (COAG Energy Council) (Rule Proponent) made a request to the Australian Energy Market Commission (Commission) to amend provisions in the National Electricity Rules (NER) in relation to compensation arrangements following the application of an administered price cap or an administered floor price (Rule Change Request).

The amendments in the rule change request originate from AEMC recommendations made to the COAG Energy Council in the AEMC's 2013 Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Price Floor (the review).¹

The rule change request proposes a number of amendments to address issues with the current compensation arrangements during an administered price period. It proposes to amend the purpose of compensation, introduce a new process for determining which parties are eligible to claim compensation, change the way in which the AEMC assesses compensation claims and change the way in which AEMO recovers the cost of compensation from market customers.

The rule change is expected to improve reliability for consumers during administered price periods, improve the efficiency and transparency of the compensation assessment process, while minimising regulatory complexity associated with the recovery of compensation costs.

1.2 Background information

This section provides background information on the current arrangements for compensation during an administered price period, the Synergen compensation claim and the AEMC review.

1.2.1 The compensation mechanism during an administered price period

The compensation provisions in clause 3.14.6 of the NER are a component of the broader framework involving the market price cap, market floor price, cumulative

¹ Final Report available on the AEMC's website:
<http://www.aemc.gov.au/Markets-Reviews-Advice/Review-of-Arrangements-for-Compensation-following>

price threshold, administered price cap and administered floor price. This framework is designed to protect customers from extended periods of high prices.

The National Energy Market (NEM) is a gross, energy-only market. The potential for volatility of spot prices for both energy and ancillary services is an important aspect of market design and operation. The ability of prices to move from $-\$1,000/\text{MWh}$ up to $\$13,800/\text{MWh}^2$ is designed to allow generators and other market participants to earn a reasonable return on assets and recover fixed costs, providing a signal for investment.

However, this volatility also creates risk for parties who participate in the wholesale market. A persistently high spot price can lead to participant financial distress and, in extreme cases, may impact the stability of the wider market.

While the management of risk by individual market participants is an essential and unavoidable aspect of participating in the NEM, the NER contain a number of mechanisms designed to help manage risks to individual market participants and systemic market wide risks.

The design of this area of the NEM has undergone several changes since its creation in 1996. Currently, the NER contain several mechanisms that together make up an overall package for managing the risks posed by periods of sustained high prices:

- a spot market price cap (MPC) and a market floor price (MFP) which apply during the normal functioning of the market;
- a rolling cumulative price threshold (CPT) that applies over a seven day period. The cumulative price threshold is currently set at $\$207,000$ and is calculated by the cumulative sum of spot prices in a region across a rolling seven day period.³ If the total exceeds the cumulative price threshold, an administered price period commences in which the spot price is collared in the region between the administered floor price of $-\$300$ per MWh and the administered price cap of $\$300$ per MWh, and cannot exceed these limits for the entirety of the administered price period;⁴ and
- a compensation mechanism for eligible parties who have incurred losses due to the application of an administered price period.

The application of the administered price cap may cause some participants to incur a loss, where the participant's direct or opportunity costs are in excess of $\$300$ per MWh. While we understand there are not many participants with costs in excess of $\$300$ per MWh, the potential for them to incur a loss may create a disincentive to supply energy during an administered price period. Accordingly, the NER allows these participants

² Current Market Price Cap, see Schedule of Reliability Settings, 12 February 2015, www.aemc.gov.au.

³ Ibid.

⁴ The administered price period continues until the rolling seven day cumulative price threshold drops back below the level of the cumulative price threshold. The administered price period ceases at the end of the trading day in which the price drops below the cumulative price threshold.

² Compensation arrangements following application of an administered price cap and administered floor price

to claim compensation for direct and opportunity costs incurred during an administered price period. The current process is shown in Figure 1.1 below.

Figure 1.1 Current compensation mechanism during an administered price period



The AEMC is responsible for assessing claims for compensation following application of an administered price cap and administered floor price.

1.2.2 AEMC's assessment of Synergen's compensation claim

Administered pricing events have occurred rarely in the NEM. To date, an administered pricing period has only been declared five times in the history of the NEM. Claims for compensation are even less common.

The only claim for compensation following an administered price cap or administered floor price event under the NER was lodged by Synergen Power Pty Ltd (Synergen) in relation to the operation of its Snuggery and Port Lincoln generation units, during an administered price cap event in 2009.⁵

While assessing this claim, the AEMC identified a number of issues with the existing compensation provisions during an administered price period in the NER.⁶ These issues related to which parties should be eligible to claim compensation and in what circumstances this was appropriate. The AEMC also identified issues relating to the processes for assessing compensation claims.

Following its final decision on the Synergen claim published in September 2010, the AEMC decided to initiate a review of the arrangements for determining compensation under clause 3.14.6 and 3.15.10 of the NER. A summary of the AEMC's review is outlined below in section 1.2.3.

⁵ AEMC, Final Decision, Compensation claims from Synergen Power Pty Ltd, 8 September 2010

⁶ Ibid.

1.2.3 AEMC review of compensation arrangements following an administered price, market price cap or market floor price

The AEMC reviewed the arrangements for compensation set out in clauses 3.14.6 and 3.15.10 of the NER and published its final report in 2013. The final report noted that, while compensation claims are rare, it is important that the NER are clear regarding how these claims are assessed. This will help deliver fair compensation to claimants who continue to supply energy to consumers during an administered price period and help restrict the payment of compensation to those situations where it is likely to deliver beneficial reliability outcomes for consumers.⁷

The recommendations from this review were designed to improve the function of the compensation frameworks, in order to promote more efficient market outcomes. The key recommendations were:

- **Purpose of compensation:** Amend the purpose clause such that the sole purpose is to maintain incentives for participants to supply energy during an administered price period;
- **Eligibility to claim compensation - who should be eligible:** Maintain eligibility for market generators, scheduled load and scheduled network service providers and remove eligibility for ancillary service providers;
- **Eligibility to claim compensation - eligibility criteria and market suspension:** Introduce new eligibility criteria based on net losses over the eligibility criteria and remove references to market suspension;
- **The AEMC's assessment process:** Include a requirement to publish notices to inform the market about a claim; only require public consultation for claims involving opportunity costs; and provide the AEMC with discretion to appoint a varying sized expert panel, depending on the complexity of a claim; and
- **Recovery of compensation costs:** Amend the process such that compensation costs are recovered from market customers in proportion to their total energy consumption during the compensation eligibility period.

The COAG Energy Council rule change request is based on these recommendations.

1.3 Current arrangements

This section summarises the current arrangements for compensation due to the application of an administered price cap or administered floor price.

⁷ AEMC, Final Report, Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor price, 16 May 2013, p.i.

⁴ Compensation arrangements following application of an administered price cap and administered floor price

1.3.1 Purpose of compensation

The NER currently define the purpose of paying compensation as maintaining the incentives for market participants to invest in plant that provides service during peak periods and to supply energy and other services during an administered price period.

1.3.2 Eligibility criteria

The NER specify the types of market participants that are currently eligible to apply for compensation as a result of an administered price period and the circumstances in which this can occur. Currently scheduled generators, scheduled network service providers, scheduled loads and ancillary services providers are eligible to claim for compensation. They are eligible for compensation if there is a difference between the price specified in their dispatch offer and the spot market price, calculated for each trading interval when the administered price cap or floor applies. Table 1.1 below summarises the specific circumstances in which each of these participant types are eligible to claim compensation.

Table 1.1 Current criteria for eligible participants

Participant type	NER clause	Eligibility criteria
Scheduled generator (market)	3.14.6(a)	If, due to the application of an administered price cap during either an administered price cap or market suspension, the spot price payable in any trading interval is less than the price specified in their dispatch offer.
Scheduled network service provider	3.14.6(a1)	If, due to application of an administered price cap, the market price, the market floor price or an administered floor price, the revenue receivable in any trading interval is less than the minimum requirements specified by its dispatch offer.
Market participant (in respect of a scheduled load)	3.14.6(a2)	If, due to the application of an administered floor price during either an administered price period or market suspension, the spot price in any trading interval is greater than the price specified in the dispatch bid.
Market participant (in respect of an ancillary service generating unit or load)	3.14.6(a3)	If, due to the application of an administered price cap, the ancillary service price in any dispatch interval is less than the price specified in the relevant market ancillary service offer.

1.3.3 AEMC processes for assessing compensation claims

The AEMC is the body which manages the compensation claim process and determines the compensation payable. It is assisted by a panel of experts who are appointed by the dispute resolution adviser (the adviser) provided for in the NER and

guided by a set of compensation guidelines made by the AEMC which set out the methodology that will be used to calculate compensation.

The NER currently describe the processes and timing to be followed by the AEMC when assessing compensation claims. This includes the roles and responsibilities of the adviser and the panel. The NER involve the following steps in assessing claims for compensation following the application of an administered price period:

- the claimant submits a claim for compensation to the AEMC;
- the adviser establishes a three member panel to review all types of claims (direct and opportunity costs);
- the panel reviews the claim and provides a draft report to the AEMC;
- the AEMC reviews the panel's draft report and publishes it and its own draft report;
- public consultation occurs on the draft reports for all types of claims (direct and opportunity costs);
- the panel provides a final report to the AEMC; and
- the AEMC reviews the panel's final report and publishes it and its own final report.

The current Rules do not require the AEMC to publish any notices to inform the market as to the initiation or progress of a compensation claim.

The adviser is also required to establish a three member panel to assist the AEMC in developing the compensation guidelines.

The current role of the panel is to make recommendations to the AEMC as to whether compensation should be payable by AEMO in relation to all claims and if so, the amount of the claim. The panel must publish draft and final recommendations.

The current role of the AEMC is to review the participant's compensation claim and the panel's recommendations in relation to the claim. It must determine where compensation should be paid and the amount of compensation payable. The AEMC must also develop and publish the compensation guidelines.

More information on the current compensation assessment process is included in chapter 5 of this draft determination.

1.3.4 Recovery of compensation costs

Any compensation determined to be payable to a claimant under the compensation assessment process in clause 3.14.6 is recovered from market customers. The NER currently requires AEMO to recover the cost of compensation from market customers

who purchased electricity in a region where the spot price was affected by administered pricing.⁸ AEMO determines the amounts payable by market customers according to their individual share of total energy consumption, on a trading interval basis.

1.4 Proposed arrangements in Rule change request

In the rule change request, the COAG Energy Council considered that there is a need to improve the compensation arrangements. The proposed solution seeks to resolve issues relating to the purpose of compensation, eligibility criteria, the compensation assessment process and the cost recovery process, as outlined below.

1.4.1 Amending clauses defining the purpose of compensation

The rule change request proposes that clause 3.14.6 be amended such that the sole purpose of compensation is to maintain incentives for participants to supply energy during an administered price period. The rule change request notes that incentives to invest in plant that provide services during peak periods are intended to be provided through the occurrence of high wholesale spot prices during the normal functioning of the market, and not through the compensation mechanism. The rule change request therefore proposes to remove from the purpose of compensation the incentive to invest in plant that provides services during peak periods.

1.4.2 Amending eligibility criteria and removal of references to market suspension

The rule change request proposes a number of changes to the eligibility criteria and the removal of references to market suspension. The rationale for each of these changes is outlined below.

New criteria based on the eligibility period

The rule change request notes the following issues with the current eligibility criteria:

- Compensation is based on the difference between the spot price and the price specified in a dispatch offer. The reference to “dispatch offer” is ambiguous, as it is not clear whether this refers to one price band or all ten price bands in a dispatch offer. It also does not recognise that capacity may be rebid between the ten price bands in a dispatch offer;
- It is unclear whether any energy capacity must actually be associated with a price specified in a dispatch offer in order for the participant to be eligible; and
- Generators are only eligible when their dispatch offer is greater than the administered price cap and the spot price is at the level of the administered price cap, during an administered price period.

⁸ Market customers are defined under clause 2.3.4 of the NER.

To address these issues, the rule change request proposes to introduce new criteria which allow market participants to claim compensation when their total costs exceed their total revenue from the spot market over an entire "eligibility period". This starts from the first trading interval when the spot price is set by the administered price cap or administered floor price, until the last trading interval of that day. This is intended to recognise the operational characteristics of generators, which are at a clear risk of incurring a loss if they are dispatched during an administered price period and have high direct or opportunity costs.⁹

The new criteria based on net losses over the eligibility period would also avoid ambiguities that result from references to dispatch offers.

The new criteria would apply to all participants that are eligible in the draft Rule, that is scheduled and non-scheduled generators, market participants (scheduled load) and scheduled network service providers.

Include eligibility for non-scheduled market generators

The rule change request notes the potential for non-scheduled market generators to incur direct or opportunity costs due to the application of an administered price cap, if they choose to operate and export power during an administered price period. This may create disincentives for these participants to supply energy. It therefore proposes to extend eligibility for compensation to non-scheduled market generators.

Remove eligibility for ancillary service providers

The rule change request considers that ancillary services providers are unlikely to incur costs in an administered price period, and therefore, should not be eligible for compensation under clause 3.14.6. Ancillary service providers have not faced a disincentive to supply ancillary services as any losses caused by being asked to provide energy would entitle the service provider to compensation as a scheduled generator or scheduled load.

Amend eligibility criteria in an export price capped region

Administered price caps in one region can have a flow on effect to spot prices in other regions, which are limited where power is flowing from the second region into the first. The rule change request considers that market generators and scheduled loads, located in 'export' regions where the spot price has also been limited, should be eligible to claim compensation if they incur a net loss over the eligibility period. The rule change request therefore proposes to amend the existing eligibility criteria regarding compensation in export price capped regions, such that eligibility is based on the eligibility period and not individual trading intervals.

⁹ The opportunity cost of a particular choice refers to the value of the best alternative. This is defined as the foreclosure of opportunities to use scarce resources more profitably at another point in time.

⁸ Compensation arrangements following application of an administered price cap and administered floor price

Amend eligibility criteria for scheduled network service providers

The rule change request proposes to amend the eligibility criteria for scheduled network service providers, which are currently eligible to claim compensation due to the application of an administered price cap, market price cap, market floor price or an administered floor price. It proposes to remove eligibility due to the application of a market price cap, market floor price and administered floor price, such that these participants are only eligible to claim compensation as a result of an administered price cap.

Removal of references to market suspension

The rule change request notes that market suspension does not result in the application of an administered pricing under the NER. There is already a process for participants to claim compensation under market suspension in clause 3.15.7. Therefore references to compensation as a result of market suspension in clause 3.14.6 should be clarified to only apply to any loss of revenue from spot market that is not captured in clause 3.15.7.

1.4.3 Amending AEMC processes for assessing compensation claims

The rule change request notes that the current compensation assessment process lacks flexibility and transparency and may result in an inefficient assessment process. The following changes are proposed to address these issues:

- require the AEMC to publish notices on its website advising of receipt of a compensation claim and formal commencement of assessment of the claim;
- allow the AEMC to appoint a varying sized panel of between one and three experts, depending on the complexity of the claim;
- specify a different timeframe for assessment depending on whether it is a direct or opportunity cost claim, as well as allowing the AEMC to extend the timeframe for assessment, under certain predefined conditions;
- a public consultation process would only be required for claims involving opportunity costs and not for direct cost only claims;
- remove the requirement to publish a draft report for direct cost only claims; and
- include greater obligations on the AEMC to publish its methodology for determining opportunity costs.

The AEMC's Consultation Paper proposed a specific change to the compensation assessment process that was additional to the change in the rule change request (i.e. a more preferable rule). The nature of the more preferable rule is detailed in section 1.5 and chapter 5 of this draft determination.

AEMC, Compensation Guidelines under Clause 3.14.6 of the National Electricity Rules, Amended Guidelines, 17 February 2015, p15.

1.4.4 Amending the process to recover compensation costs

The rule change request notes that the current rules are unclear as to the appropriate process to be followed by the AEMC and AEMO in recovering the costs of compensation from market customers. It is not clear if compensation should be recovered based on energy consumption in a trading interval basis or another approach, and whether compensation costs should be shared by customers in multiple regions.

To clarify the rules, the rule change request proposes that compensation costs be recovered based on a customer's energy consumption over the eligibility period in the region in which the spot prices was set by the administered price cap or administered floor price.

1.5 Consultation Paper - additional changes

The AEMC's Consultation Paper sought stakeholder feedback on a potential additional change to the compensation assessment process under clause 3.14.6 in addition to the changes described in the rule change request.

In the Consultation Paper, the AEMC sought feedback on whether the compensation assessment process could be further streamlined, by removing the roles of the adviser and panel. The AEMC asked stakeholders to consider whether removing the requirement to use an expert could increase the flexibility and efficiency of the process by providing the AEMC with discretion to draw on external expertise as required, as it does in general for rule changes and reviews, rather than requiring it to use an expert panel in every case.¹⁰

The AEMC suggested removal of the dispute resolution adviser as, in the circumstances of a compensation assessment process following an administered price period, it was not clear if the additional time required in the process through involvement of the adviser was justified by any benefits this offers.¹¹

Table 1.2 below compares the compensation assessment process between the existing rules, the rule change request and the suggested process in the consultation paper.¹²

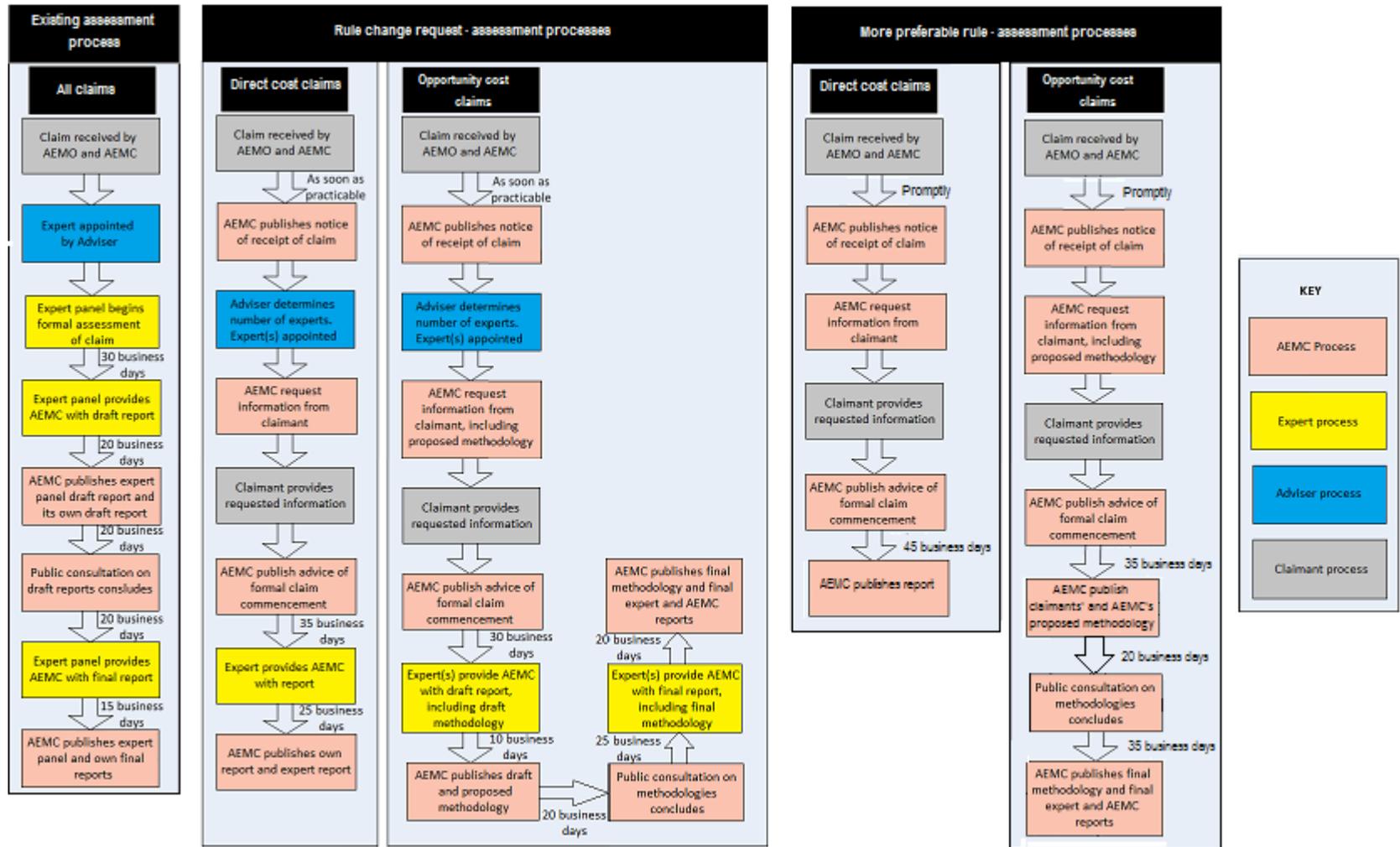
¹⁰ AEMC, Consultation Paper - Compensation Arrangements following application of an Administered Price Cap and Administered Floor Price, 7 May 2015, p13

¹¹ Ibid.

¹² The suggested process in the consultation paper is the compensation assessment process as reflected in the Commission's draft Rule

¹⁰ Compensation arrangements following application of an administered price cap and administered floor price

Figure 1.2 Compensation assessment processes - existing, rule change request and more preferable draft Rule



1.6 The rule making process to date

On 7 May 2015, the Commission published a notice advising of its commencement of the rule making process and the first round of consultation in respect of the rule change request. A consultation paper prepared by AEMC staff identifying specific issues and questions for consultation was also published with the notice. Submissions closed on 4 July 2015.

The Commission received three submissions on the rule change request as part of the first round of consultation. They are available on the AEMC website. A summary of issues raised in submissions and the Commission's response to each issue is contained in Appendix A.

1.7 Consultation on draft Rule determination

The Commission invites submissions on this draft Rule determination, including the more preferable draft Rule, by 24 September 2015.

Any person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than 20 August 2015.

Submissions and requests for a hearing should quote project number "ERC0176" and may be lodged online at www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

2 Draft Rule determination

In this chapter the Commission considers the rule making test and assessment framework used for this rule change request. It also outlines the summary of reasons for the draft determination.

The Commission's draft Rule determination is to make a more preferable draft Rule (draft Rule). The draft Rule specifies the purpose of compensation, introduces new eligibility criteria, removes references to market suspension and amends the compensation assessment process and the process to recover compensation costs.

This Chapter outlines:

- the Commission's rule making test for changes to the NER;
- the Commission's assessment framework for considering the rule change request; and
- the Commission's reasons for making the draft Rule. Further information on the legal requirements for making this draft Rule determination are set out in Appendix B.

2.1 Rule making test

Under the NEL the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the National Electricity Objective (NEO). It may only make a more preferable rule where this will, or is likely to, better contribute to the achievement of the NEO than the rule change request.¹³ This is the decision making framework that the Commission must apply.

The NEO is:

“to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.”

For this rule change request, the Commission considers that the relevant aspects of the NEO are efficient operation and use of electricity services for the long-term interests of consumers, with respect to the price of electricity and the reliability of the national electricity system.

¹³ National Electricity (South Australia) Act 1996, Section 91A.

2.2 Assessment framework

To determine whether the draft Rule is likely to contribute to the achievement of the NEO, the Commission has considered the following matters.

2.2.1 The reliability of the electricity system

Reliability of electricity supply underpins national economic activity and investment decisions. The contribution of the rule change request to maintaining reliability of supply of electricity and the reliability of the national electricity system is to be tested. The rule change request relates in part to the application of eligibility criteria which recognise the operational characteristics of those market participants which are most likely to be affected by an administered price cap or administered floor price and its impact on productive efficiency (i.e. producing electricity at least cost). In addition, a key benefit of paying compensation following an administered price cap or administered floor price event is the reliability benefit to relevant customers, because participants will have an improved incentive to supply energy and consume load across an administered price period.

2.2.2 Transparency and administration costs

The rule change may increase transparency and lower administration costs through the proposal to improve the efficiency of the compensation claim assessment process.

Reducing administration costs as part of the assessment process should contribute to the NEO through a reduction in costs flowing through to stakeholders. Greater transparency should mean more active stakeholder involvement and regulatory decisions which better take into account stakeholder concerns.

2.2.3 Efficient recovery of compensation claim costs

Where generators receive compensation for operating during an administered price period, the costs involved must be allocated to and recovered from customers. The most efficient way these costs can be recovered is by allocating them to customers in proportion to the benefit the customers receive from generators continuing to supply energy during an administered price period. This outcome is consistent with allocative efficiency. In addition, when assessing the cost recovery mechanism the level of granularity should also be considered. This should provide an appropriate balance between efficient allocation and a reasonably simple and transparent approach.

2.3 Summary of reasons

Having regard to the issues raised in the rule change request, the Commission is satisfied that the draft Rule will, or is likely to, contribute to the achievement of the NEO for the following reasons:

- the new description of the purpose of compensation will make it clear that the objective of paying compensation is to maintain the incentive for market generators and scheduled network service providers to supply energy during an administered price period. This will promote the long term interests of consumers with respect to the reliability of the national electricity system;
- the new eligibility criteria based on net losses over an entire eligibility period, rather than specific trading intervals, will promote the reliability of the national electricity system because generators should have a reduced incentive to cycle their units on and off in a specific trading interval;
- the inclusion of eligibility for non-scheduled market generators will reduce the disincentive they face to supply energy during an administered price period and promote the reliability of the national electricity system;
- the removal of eligibility for ancillary service providers will improve compensation arrangements as these participants are unlikely to incur a compensable loss due to the application of an administered price period;
- it will clarify how compensation costs are calculated and allocated to market customers, while minimising the regulatory and administrative burden on AEMO; and
- the draft Rule clarifies that the compensation guidelines may define the types of opportunity costs in relation to which a person may make a claim for compensation. This should improve the transparency of decision-making in the compensation assessment process.

In addition, the Commission is satisfied that the draft Rule will better meet the NEO than the rule change proposal, for the following reasons:

- the draft Rule will remove the roles of the expert and adviser from the compensation assessment process which is likely to result in a more timely and efficient process;
- the draft Rule makes further amendments to the purpose of compensation which better reflect the amended eligibility criteria (i.e. removal of eligibility for ancillary services providers) and make clear the incentive that should be provided for to scheduled loads to consume energy, and are likely to enhance reliability for the national electricity system;
- the draft Rule extends the definition of price limit events for scheduled loads and scheduled network service providers;
- the draft Rule removes references to market suspension from the relevant provisions; and

- the draft Rule clarifies that compensation costs are to be recovered from customers in the cost recovery region, which is the home region in which the wholesale spot price is set by administered pricing.

In addition, it is noted that the draft Rule contains some drafting matters that are different from the proposed rule published with the Consultation Paper.

The draft Rule made by the Commission is published with this draft Rule determination.

Further detail on the draft Rule can be found in sections 3 to 6 below.

3 Clarifying the purpose of compensation

This chapter considers the rule change request to amend the purpose of compensation.

3.1 Context and stakeholder views

The COAG Energy Council's rule change request proposes that the NER be amended to introduce a new description of the purpose of compensation. This would clarify that the sole purpose is to maintain incentives for participants to supply energy during an administered price period.

Stakeholder views differ on whether the purpose of compensation should also be to maintain an incentive to invest in plant that provides services during peak periods. EnergyAustralia supports the draft Rule to remove this from the purpose clause on the basis that the cumulative price threshold sets the balance between investment incentives and risk and provides sufficient opportunity to recoup long-term costs outside administered prices.¹⁴ GDFSAE does not support the draft Rule to remove the investment signal and states that generators will not be incentivised to invest in plant simply by being assured they will not suffer a loss.¹⁵

In respect of maintaining in the purpose clause the existing incentive to supply energy during an administered price period, GDF Suez Australian Energy (GDFSAE), EnergyAustralia¹⁶ and Origin¹⁷ all support retaining this.

3.2 Assessment

3.2.1 Maintaining a supply incentive in the purpose clause

Maintaining an incentive to supply energy during an administered price period is central to the purpose of compensation. An administered price period generally occurs following periods where the supply / demand balance may be tight. It is therefore important to encourage generators to continue to supply in such market circumstances in order to promote the reliable supply of electricity to customers. This element of the purpose of compensation should be retained.

3.2.2 Removing investment incentive in purpose clause

The signal to invest in generation plant is provided through the prices the market delivers under the normal functioning of the market. These include the market price cap, market price floor and cumulative price threshold. For example, when the supply

¹⁴ EnergyAustralia submission, 5 June 2015, p1.

¹⁵ GDFSAE submission, 4 June 2015, p2.

¹⁶ EnergyAustralia submission, 5 June 2015, p1.

¹⁷ Origin Energy submission, 4 June 2015, p1.

and demand balance is tight generators have the opportunity to receive high spot prices up to the market price cap.

These mechanisms are regularly reviewed by the Reliability Panel in accordance with clause 3.9.3A of the Rules. The Reliability Panel most recently assessed these settings in its review of reliability settings and standards that was released on 16 July 2014.¹⁸

Including the investment signal in the purpose clause could imply that capital costs could also be recovered through the compensation mechanism. If capital costs were included in the existing rules or draft Rule, this would reallocate part of the risk associated with the decision to invest in plant from generators to market customers. This risk is more appropriately borne by generators who are better placed to manage it through natural profit and risk incentives.

In addition, it is noted that the type of costs (i.e. direct and opportunity costs) which can be claimed through compensation as defined in clause 3.14.6(d) do not include capital costs under the current arrangements. Removing the incentive to invest in plant from the purpose of compensation will address this potential contradiction.

3.2.3 Consequential changes

The draft Rule includes two additional changes to the NER relating to the purpose of compensation.

The eligibility for ancillary service providers to claim compensation has been removed, as discussed below in chapter 4. Therefore, there is no need to maintain an incentive for "other services" to be supplied during an administered price period in the purpose of compensation. These words have been removed.

In addition, to reflect the objective of encouraging scheduled load to continue to consume during administered price periods, the draft Rule amend the purpose clause to provide specifically for scheduled load.

3.3 Conclusion

The Commission considers that the draft Rule will contribute to the NEO by promoting the reliability of the national electricity system.

The maintenance of an incentive to supply energy during an administered price period is central to the purpose of compensation and improving reliability outcomes during an administered price period.

The compensation arrangements do not provide for recovery of capital costs and as such will not contribute to investment incentives. They therefore do not provide an investment incentive, and it would not be appropriate for them to do so because

¹⁸ Reliability Panel AEMC, Final Report - Reliability Standard and Reliability Settings Review 2014, 16 July 2014.

¹⁸ Compensation arrangements following application of an administered price cap and administered floor price

generators are better able to manage investment risk than customers. Investment incentives are provided by other mechanisms in the NER, including the level of the market price cap and cumulative price threshold.

4 Clarifying eligibility criteria and removal of references to market suspension

This chapter considers the rule change request to clarify the criteria for eligibility to claim compensation.

4.1 New criteria based on the eligibility period

4.1.1 Context and stakeholder views

The rule change request proposes to replace the existing criteria in the NER with new criteria based on compensation for market participants over the eligibility period. This would have the effect of reducing the disincentive to supply or consume energy during the administered price period.

EnergyAustralia agreed that the new criteria are likely to be effective in incentivising operational decisions to supply energy across an administered price event. While this could produce some inefficiencies through the dispatch of high cost plant, the reliability benefits are likely to offset any short term productive inefficiencies.¹⁹

4.1.2 Assessment

Problem with existing criteria

There are two broad problems with the existing eligibility criteria.

Firstly, there is some ambiguity in the criteria, in particular regarding the term “dispatch offer”. The existing criteria refer to the difference between the price specified in dispatch offers and the spot price, however as there are ten prices included in any dispatch offer, the term “price specified in the dispatch offer” could be interpreted to refer to any of these ten prices. Therefore, the current eligibility criteria could mean that any participant who includes a price in its dispatch offer, which is higher than the spot price, could be eligible to claim compensation.

It is unclear whether any energy capacity must actually be associated with a price specified in a dispatch offer in order for a participant to be eligible for compensation.

It is also unclear whether the reference to “dispatch offer” includes rebids.

Secondly, the existing criteria focus on trading intervals. Eligibility for generators during an administered price period is limited to those trading intervals when their dispatch offer is greater than the administered price cap and the spot price is at the level of the administered price cap.

¹⁹ EnergyAustralia submission, 4 June 2015, p1.

²⁰ Compensation arrangements following application of an administered price cap and administered floor price

The problem with this is that as the spot price moves up and down during an administered price period, a generator may move from being eligible in one trading interval to ineligible in the next trading interval.

For example, if the spot price dips below \$300 then the administered price cap cannot apply and a generator would not be eligible for compensation. Alternatively, even if the administered price cap applies, if the generator's dispatch offer is less than the price cap, it would not be eligible for compensation.

This can be a problem because it can result in "unit cycling". Generators generally avoid turning their plant on and off (i.e. unit cycling) due to plant and cost implications of this behaviour.²⁰ Unit cycling can also create reliability risks for the market as a whole by increasing the wear and tear on plants and the risk of plant failure.²¹ Such plant failure could have a material impact on supply reliability for customers, particularly during a period of high demand.

If the market dispatch curve falls below a generator's offer, it may no longer be in merit and be ordered to switch off by the NEM dispatch engine. If the generator considers that the dispatch curve would rise again, it may prefer to continue operating at a minimum level to avoid unit cycling. It would achieve this by rebidding its minimum capacity into lower price bands. However, if compensation were not available in a trading interval in the event it rebid capacity in this way, there may be an incentive for the generator just to switch off and then switch on again, causing inefficient unit cycling.

Solution

The eligibility criteria in the draft Rule are based on the new concept of an eligibility period, which could comprise multiple trading intervals. This eligibility period starts from the first trading interval when the spot price is set by the administered price cap or administered floor price, and continues until the last trading interval of that day. The new approach would allow market participants to claim compensation when their total costs exceed their total spot market revenue over the eligibility period.²² This would have two positive effects.

First, it would avoid the focus on the difference between dispatch offers and spot prices which creates confusion in the current arrangements.

Second, it would allow market participants to rebid capacity from higher into lower price bands and claim compensation if they incur a net loss over the eligibility period, rather than in respect of particular trading intervals. This reduces the disincentive for a generator to cycle off its plant in a trading interval during an administered price period

²⁰ AEMC, Final Report - Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price, p29.

²¹ AEMC, Final Report - Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price, p30.

²² Any revenue or costs incurred by a generator in periods prior to the commencement of an eligibility period would be excluded from the calculation of the generator's compensable costs.

when the spot price is lower than its costs. Instead it would be eligible for compensation based on the difference between its total costs and total revenues over the entire eligibility period. The new criteria therefore recognise the operational characteristics of generators and will help promote beneficial reliability outcomes for customers.

There could be some disadvantages of the new approach. Allowing generators to rebid capacity to lower price bands and remain eligible for compensation through the eligibility period may result in productive inefficiencies. These may include:

- Bidding in this manner may not be efficient, in that peaking units may displace other lower cost generators in the merit order;²³ and
- Allowing a rebid generator to remain eligible may also reduce the incentives on all generators to adopt a load-following operational pattern, which is undesirable as generators should operate their units in a flexible manner in order to follow variations in load.

However, the reliability benefits of allowing generators to rebid capacity and remain eligible for compensation are likely to outweigh these inefficiencies. This reflects the fact that cycling of units can have negative consequences for individual generators and can create supply reliability risks for the market as a whole.

4.2 Extending eligibility to non-scheduled generators

4.2.1 Context and stakeholder views

The rule change request considers that the eligibility criteria in clause 3.14.6 of the NER should be extended to include eligibility for non-scheduled generators. There is a possibility that some non-scheduled market generators could incur direct or opportunity costs due to the application of an administered price cap, and therefore should be eligible for compensation. There were no stakeholder submissions in relation to extending eligibility for non-scheduled market generators.

4.2.2 Assessment

The eligibility criteria should be extended to include non-scheduled market generators as this will reduce the disincentive they face to supply energy during an administered price period and potentially improve reliability outcomes. Non-scheduled generators do not participate in central dispatch and do not submit a dispatch offer²⁴, but are potentially subject to direction by AEMO under clause 4.8.9. While they can be

²³ This assumes that a "cost reflective" bid includes only short run variable and operating costs and does not factor in the opportunity costs of unit cycling.

²⁴ The fact that non-scheduled generators do not make a dispatch offer would effectively prevent them from being eligible to claim under the existing criteria, which are based on the difference between dispatch offer price and the spot price. However, no such barrier exists under the recommended eligibility criteria, given that it contains no reference to dispatch offers.

²² Compensation arrangements following application of an administered price cap and administered floor price

compensated for being directed under clause 3.15.7, the amount of compensation potentially awarded is less certain. For this reason there is merit in providing for them to be able to access compensation through clause 3.14.6 and this is reflected in the draft Rule which includes non-scheduled generators as registered participants that are eligible to claim compensation.

4.3 Removal of eligibility for ancillary services providers

4.3.1 Context and stakeholder views

The rule change request considers that ancillary services providers are unlikely to incur costs in an administered price period, and therefore should not be eligible for compensation. There were no stakeholder submissions in relation to the removal of eligibility for ancillary services providers.

4.3.2 Assessment

Eligibility for ancillary services providers should be removed. There is no clear risk that ancillary services providers can incur a loss when an administered pricing event applies in both the energy and ancillary services markets. Compensation should also not apply due to the price differential between the energy and ancillary services markets when an administered pricing only applies in the ancillary services market.

Administered pricing event in energy and ancillary services markets

The most likely type of administered pricing event is when the administered price period applies in both the energy and ancillary service markets. All administered price period events in the NEM to date have been triggered by a breach of the cumulative price threshold in the energy market, which results in the application of the administered price cap in both the energy and ancillary services markets.²⁵

The current eligibility for ancillary services generating units and loads should not apply in this event, as ancillary services providers will not face a disincentive to supply these services. For a generator that provides an ancillary service, it would receive a payment through the ancillary services market for keeping capacity in reserve, and would not incur any costs, as it is not actually generating electricity with this capacity. To the extent it did generate energy it would be entitled to compensation as a scheduled generator (and similarly for scheduled loads).²⁶ Therefore, there is no clear risk that the generator (or scheduled loads) would incur a loss.

²⁵ AEMC, Final Report - Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price, 16 May 2015, p44.

²⁶ COAG Energy Council, Compensation arrangements following application of an administered price cap and administered floor price, rule change request and proposal, 16 October 2013, p4.

Administered pricing event in ancillary services market only

A less likely event occurs when the administered price cap applies only in the ancillary services market. This situation has not occurred in the NEM to date. In this event, a generator could potentially face a reduction in revenue available from relatively high spot prices in the energy market, as its output in the energy market is reduced to provide reserve capacity in the ancillary services market.

Compensation would be calculated based on the difference between the capped price in the ancillary services market and the uncapped price in the energy services market, which could be high. Allowing compensation in these circumstances could weaken the protections provided by the administered price cap in ancillary services markets by allowing access to the energy market price. For this reason, and given this is an event that occurs rarely, eligibility for ancillary services providers should not apply in this event.

4.4 Amend eligibility criteria in an export price capped region

4.4.1 Context and stakeholder views

The most likely situation in which a scheduled generator will incur a loss is where that generator is located in the same region in which the administered price period applies. In this case, the administered price cap is setting the spot market price in the "home region". However, generators located in a region where the administered price cap is not directly applied may also incur a loss, due to the effect of price scaling.

Price scaling is the process whereby the spot price in a region exporting power to the home region (the "exporting region") is capped at a level equal to the administered price cap, adjusted for losses. The price cap in the export region only applies where these two regions are linked by a regulated interconnector.

The rule change request considers that market generators (both scheduled and non-scheduled) and scheduled loads, located in 'export' regions where the spot price has been limited through the application of clause 3.14.2(e), should be eligible to claim compensation if they incur a net loss over the eligibility period. The rule change request therefore proposes to amend the existing criteria in clause 3.14.6 to provide for generators in export price capped regions to be eligible for compensation. There were no stakeholder submissions in relation to eligibility criteria in an export price capped region.

4.4.2 Assessment

The application of an administered price cap in an exporting region may result in market generators incurring a loss, due to the effect of price scaling. Market generators should therefore be eligible to claim compensation, given that the export of power from their region provides improved reliability for customers in the home region in which the spot price is capped by the administered price cap.

A similar (inverse) situation may apply for scheduled loads. The NER allows for the price in any region with a flow away from a region in which the spot price is capped by administered pricing to be equal or greater than the administered floor price. Therefore, scheduled loads in regions impacted in this way may incur net losses over the eligibility period. Scheduled loads should therefore be eligible to claim compensation, given that the import of power into their region provides improved reliability for customers in the home region in which the spot price is limited by the administered floor price.

4.5 Amend eligibility criteria for scheduled network service providers

4.5.1 Context and stakeholder views

A scheduled network service provider acts as a merchant carrier of electricity between regions. It submits a network dispatch offer, which defines the minimum price difference that must exist between the two regions before the scheduled network service provider will transport power from one region to another. It therefore earns revenue through "buying" electricity in a lower priced region and "selling" this power in a higher priced region.

Under the existing clause 3.14.6(a1), scheduled network service providers are eligible to claim compensation due to the application of an administered price cap, market price cap, market floor price or an administered floor price.

The rule change request proposes that scheduled network service providers should only be eligible to claim compensation due to the application of an administered price cap. There were no stakeholder submissions in relation to this rule change request.

4.5.2 Assessment

References to eligibility for scheduled network service providers to claim compensation following the application of a market price cap, market floor price and administered floor price, should be removed.

Scheduled network service providers should be eligible to claim compensation due to the application of an administered price cap in a region into which it is transporting power. If an administered price cap applies in the region to which the scheduled network service provider is transporting power, the price in the region from which the power is flowing will not be scaled or adjusted to the level of the administered price cap. This could result in the scheduled network service provider incurring a compensable loss, for example if it was transporting power from an uncapped region at \$600 per MWh toward an APC capped region at \$300 per MWh.

The purpose of compensation is to maintain incentives to supply energy during an administered price period, whereas the market price cap and market floor price occur during the normal function of the market. As these situations occur outside of the

constraints of the administered price period, they should be removed from the eligibility criteria.

The application of an administered floor price may affect scheduled network service provider revenue, in the situation where the scheduled network service provider is exporting power from a negatively priced region into another region. However, providing compensation in these circumstances is unlikely to improve reliability outcomes. Therefore, compensation is not warranted in these circumstances.

4.6 Removal of references to market suspension

4.6.1 Context and stakeholder views

The rule change request proposes to remove references to market suspension. It states that market suspension should not act as a trigger for eligibility to claim compensation under clause 3.14.6, as it does not result in the application of an administered price period. There were no stakeholder submissions in relation to the proposal to remove references of market suspension.

4.6.2 Assessment

References to market suspension should be removed from clause 3.14.6. At times of market suspension the NER already provide in clause 3.14.5 for a mechanism for prices to be set in a certain way. The administered price cap does not apply during periods of market suspension. On this basis, references to compensation as a result of the application of the administered price cap during a period of market suspension in clause 3.14.6 are redundant and should be removed.

The draft Rule is an improvement on the rule change request which proposes that references to compensation as a result of market suspension in clause 3.14.6 should be clarified to only apply to any loss of revenue from the spot market that is not captured under clause 3.15.7.²⁷ However, given that administered pricing does not apply during periods of market suspension the draft Rule omits references to market suspension entirely rather than carving out amounts recovered under clause 3.15.7 from compensation amounts as proposed in the rule change request.

4.7 Conclusion

The Commission considers that the draft Rule will contribute to the NEO by promoting the reliability of the national electricity system.

The new criteria based on the eligibility period will promote beneficial reliability outcomes as it better reflects the operational characteristics of generators than the current NER.

Extending eligibility to non-scheduled market generators will potentially reduce the disincentives they face to supply energy during an administered price period and enhance reliability. Eligibility for ancillary services providers should be removed as they are unable to incur costs as an ancillary services provider. Amendments to the eligibility criteria relating to price scaling in export price capped regions and scheduled network service providers are also warranted.

References to market suspension should be removed as an administered price cap would not apply at times of market suspension.

²⁷ COAG Energy Council, Compensation arrangements following application of an administered price cap and administered floor price, rule change request and proposal, 16 October 2013, p5.

5 AEMC processes for assessing compensation claims

This chapter considers the rule change request to amend the compensation assessment process. This involves amendments to timeframes and processes, requirements for public notices, draft reports and public consultation; and the removal of the adviser and expert from the assessment process.

5.1 Context and stakeholders

Described in this section are the current arrangements for the compensation assessment process, along with what the rule change request proposes and the more preferable rule described in the Consultation Paper.

5.1.1 Current arrangements

The current arrangements for the assessment of compensation claims involve strict timeframes and include roles and responsibilities for the panel, adviser and the AEMC. The current arrangements are detailed above in section 1.3.3 and Figure 1.2.

5.1.2 Rule change request

The rule change request considered that the current compensation assessment process is relatively inflexible, lacks transparency and may result in an inefficient process. It proposes to require public notices for all claims; only require public consultation for claims involving opportunity costs; provide discretion to the AEMC to appoint a varying sized panel; and extend the timeframe for assessment, under certain conditions.

5.1.3 Consultation Paper

In the Consultation Paper, the Commission asked stakeholders to provide feedback on a proposal to further streamline the compensation assessment process, beyond what the rule change request proposes, by removing the roles of the adviser and expert panel.

5.1.4 Stakeholder submissions

Origin agrees with the rule change request that the assessment process should provide flexibility between an assessment of direct costs that are unlikely to be contentious, and opportunity costs that are inherently more complex.

Origin and EnergyAustralia each support aspects of the more preferable rule in the Consultation Paper. Origin²⁸ supports the removal of the role of the adviser from the

²⁸ Origin submission, 4 June 2015, p2.

²⁸ Compensation arrangements following application of an administered price cap and administered floor price

compensation process, as this would be consistent with AEMO's role in nominating an expert to determine compensation for directed participants.²⁹ EnergyAustralia supports the removal of the expert and for the AEMC to draw upon expert advice only when necessary.³⁰

5.2 Assessment

This section outlines the assessment of amendments to the compensation assessment process, involving the rule change request to publish notices relating to a claim, the need for public consultation, extensions of time and the more preferable rule to remove the role of expert and adviser. It also clarifies the obligations for the AEMC to consult with the claimant during the assessment process.

5.2.1 Requirement to publish notices

The current NER lack transparency regarding the progression of assessment of a claim. As some time is likely to be spent gathering all necessary information and assessing it, this could mean that the first information stakeholders receive regarding a compensation claim is when the AEMC publishes its draft report, which may be some time after the original claim was received.

Including a requirement to publish notices for the initial receipt of a claim and the commencement of formal assessment will improve the transparency of the process. For claims involving opportunity costs, this may increase stakeholder involvement in the public consultation process and therefore improve assessment decisions.

5.2.2 Public consultation

Direct cost only claims

The current requirement for public consultation for all types of compensation claims is inflexible and may lead to inefficient assessment processes. For direct cost only claims, this requirement is likely to add little value, as much of the information provided may be confidential and unable to be shared and assessed through public consultation.³¹

Third parties are also unlikely to be able to add real value in the assessment of direct costs. The most likely areas for direct costs are operational labour or fuel costs and the views of third parties may be subjective and based on incomplete information. They would add little material value to the process of verifying the total costs actually incurred by the claimant and the final compensation amount to be awarded.

²⁹ AEMO is responsible for determining compensation for directed participants under clause 3.15.7 of the NER.

³⁰ EnergyAustralia submission, 5 June 2015, p1.

³¹ AEMC, Final Report - Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price, 16 May 2013, p17.

The need for public consultation may increase the administrative costs of assessing less contentious direct cost claims. The removal of this requirement therefore promotes efficient outcomes by reducing the administrative burden on stakeholders.

Other than direct cost only claims

There is likely to be value associated with public consultation for claims involving opportunity costs. Such claims will involve the development of a methodology for calculating opportunity costs and consultation on that methodology will be valuable. Public consultation should allow for an enhanced examination of the costs and benefits associated with these types of compensation claims.

5.2.3 Extension of time

The current NER set out strict timeframes for the assessment of compensation claims. This may impede the AEMC's ability to undertake adequate assessment of compensation claims, where new or more complex issues may be identified during assessment of a compensation claim, or the AEMC faces a material change in circumstances.

Providing the AEMC with discretion to extend the timeframe for assessment, under predefined conditions, would therefore help to improve the compensation assessment process. The draft Rule defines the conditions when an extension of time can occur as when the AEMC considers it reasonably necessary to enable it to properly assess a claim due to the complexity or difficulty of assessing the claim or due to a material change in circumstances.

5.2.4 More preferable draft Rule to remove expert and adviser

Removal of requirement to use an expert

The requirement in the rule change request to appoint a varying sized expert panel provides greater flexibility than current NER which require the appointment of three experts. However, the requirement to still appoint at least one expert may result in an inefficient assessment process if the AEMC has sufficient internal capability to assess a claim.

The draft Rule, which provides the AEMC with discretion regarding the need to appoint any experts, increases the flexibility and efficiency of the process. The removal of the requirement on the AEMC to appoint an expert or expert panel for the purposes of assessing a compensation claim will not prevent the AEMC from engaging external experts when it considers this necessary or appropriate to supplement its internal expertise. This is consistent with the approach applied by the AEMC for rule changes and market reviews.

Eliminating the requirement to use an expert should improve the efficiency and timeliness of the assessment processes. There is currently duplication in the assessment process, as a number of prescribed functions around the role of the expert must also be

performed by the AEMC. For example, the expert and the AEMC are both required to form a view on the eligibility of a claimant to claim compensation and the amount of compensation that should be paid. Involving an expert therefore adds additional time to the process.

The removal of the role of the expert translates to a reduction in the total time required to complete the assessment process in the more preferable draft Rule. The draft Rule will reduce the time required to assess compensation claims by a minimum of 15 days, as explained below:

- for direct cost only claims, the time required from formal commencement of the claim until publication of the AEMC's final report is reduced from 60 days (proposed Rule in the Consultation Paper) to 45 days (more preferable draft Rule); and
- for other than direct cost only claims, the time required from the formal commencement of the claim until publication of the AEMC's final report and final methodology is reduced from 105 days (proposed Rule in the Consultation Paper) to 90 days (more preferable draft Rule).

Removal of adviser from compensation assessment process

In addition, the role of the adviser is redundant if the role of the expert is removed from the assessment process, as is the case in the draft Rule. The only function of the adviser in the current rules is to appoint the expert panel, a responsibility which is not required when the expert panel is no longer included in the assessment process.

5.2.5 Obligation to consult with the claimant

It is noted that the new compensation assessment process in the draft Rule requires the Commission to consult with the claimant on whether compensation should be provided in relation to the claim, and if so, the amount of this compensation. In the draft Rule, these obligations are contained in clause 3.14.6(k) for direct cost only claims and clause 3.14.6(p) for other than direct cost only claims.

5.2.6 Definition of opportunity costs in Compensation Guidelines

In addition, the new compensation assessment process in the draft Rule includes a provision that the compensation guidelines must define the types of opportunity costs which a person may make a claim for compensation. In the draft Rule, this is outlined in 3.14.6(e)(1). This will provide greater guidance on the opportunity costs that may be recovered to improve the clarity and transparency of the compensation assessment process.

5.3 Conclusion

The draft Rule will better contribute to the achievement of the NEO than the proposed rule in the Consultation Paper. It will improve the flexibility and transparency of the compensation assessment process. This will minimise administration costs.

Including a requirement to publish notices will improve the transparency of the assessment process. The removal of the requirement for public consultation for direct cost claims will minimise the administrative burden. The removal of the expert and adviser will also improve the timeliness of the assessment processes.

6 Recovery of compensation costs

In this chapter the Commission considers the rule change request to amend the process to recover compensation claim costs from customers. This involves changes to the time period and regions in which compensation costs are to be recovered from market customers by AEMO.

6.1 Context and stakeholder's views

6.1.1 Recovery of costs from eligibility period

The rule change request notes that the current rules are unclear as to whether compensation costs should be recovered based on consumption by market customers in those trading intervals where the spot price is set by the administered price cap or administered floor price, or across all trading intervals in an administered price period.

Origin and EnergyAustralia supported the rule change proposal to recover compensation costs based on the eligibility period as it aligned with the time period compensation is available to generators³², and provided transparency around when a participant would be eligible for compensation.³³

6.1.2 Recovery of costs from same region only

The rule change request also considered that the current rules are unclear as to whether compensation costs should be shared by customers in multiple regions.

Origin and EnergyAustralia supported the rule change request proposal to recover compensation costs from customers in the same region in which the wholesale spot price is capped or limited. It was considered that customers in the same region as the generator were generally the beneficiaries of improved reliability during an administered price period.³⁴

6.2 Assessment

6.2.1 Recovery of costs from eligibility period

The existing cost recovery processes may create complexities due to its highly granular approach. Under the current arrangements, AEMO is required to recover the amounts payable by market customers according to their individual share of total energy consumption, on a trading interval basis. This granular approach may improve the

³² EnergyAustralia submission, 5 June 2015, p1

³³ Origin submission, 4 June 2015, p2.

³⁴ EnergyAustralia submission, 5 June 2015, p1.

likelihood that the total compensable amount is allocated to those parties who received the greatest benefit, however it could be complex to administer.

The rule change request, which proposes that costs are recovered over the entire eligibility period, provides an appropriate balance between efficient allocation and a reasonably simple and transparent approach. It recognises that customers benefit from reliable supply throughout the entire eligibility period and not just in the trading intervals when the spot price is set by the administered price cap or administered floor price. It minimises complexity and is likely to reduce administration costs. It is also straightforward and transparent and may reduce the likelihood of disputes regarding cost allocation following a compensation claim.

The new cost recovery process also aligns with the time compensation is available to generators. That is, it aligns with the new eligibility criteria which allow market participants to claim compensation across the eligibility period.

6.2.2 Recovery of costs from same region only

The current criteria are unclear as to whether costs are to be recovered only from market customers in the region in which the spot price is capped or limited, or other regions affected by the administered pricing.

The draft Rule clarifies the rules by stating that compensation is all to be recovered from market customers in the same region in which the spot price is set by the administered price cap or administered floor price (the “home region” referred to in section 4.4.1 above). Recovering all costs in this manner is appropriate as the payment of compensation should be borne by customers in the home region, given that these customers are the primary recipients of the enhanced reliability associated with generators continuing to operate during an administered price period. This means that even though prices in other regions may be affected by administered pricing (the “export region” described in section 4.4.1 above), any compensation for generators in those regions would still be recovered from customers in the home region.

The same cost recovery arrangements would apply in the situation in which there were multiple claimants in the same region within one eligibility period. If this occurred, the sum of the compensation claim amounts would be recovered from market customers in that region.

It is also possible that an administered price period may apply in two regions simultaneously. In this case, the administered price cap may set the spot price in both regions, triggering separate eligibility periods in each region. If this occurred, market customers in the same region as the claimant would bear the compensation costs awarded to that participant.

6.3 Conclusion

The draft Rule clarifies and amends the process to recover compensation costs. It will contribute to the NEO with respect to the efficiency of the supply of electricity.

34 Compensation arrangements following application of an administered price cap and administered floor price

7 Transitional arrangements

If the draft Rule is made as proposed, certain aspects of the guidelines as currently drafted will no longer be appropriate and additional matters will need to be covered. For example, references to the adviser and panel will need to be removed.

In addition, changes would be made to the guidelines to:

- remove the requirement for the objective of the payment of compensation to be included in the guidelines; and
- set out the types of opportunity costs in relation to which a person can make a claim.

The guidelines will therefore need to be amended. In order to amend the guidelines the AEMC must follow the transmission consultation procedures. If the draft Rule is made as proposed, the new rules should not commence until the guidelines have been amended to reflect the draft Rule.

This means that there will need to be a period of time between when any rules are made and when they commence. To accommodate the transmission consultation procedures, and assuming consultation on the revised guidelines commences when the final rule is made, the transitional rules provide for a period of time for the compensation guidelines to be amended, and the final rule to commence at that point.

In addition to the changes to the guidelines, AEMO's cost recovery process will need to be amended if the draft Rule is made as a final Rule. These must occur before any new rules commence. The time period for this will need to be factored into the making of the final Rule.

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AFP	Administered Floor Price
APC	Administered Price Cap
COAG Energy Council	Council of Australian Government's Energy Council
Commission	See AEMC
CPT	Cumulative Price Threshold
MCE	Ministerial Council on Energy
MFP	Market Floor Price
MPC	Market Price Cap
NEL	National Electricity Law
NEO	National Electricity Objective

A Summary of issues raised in submissions

Stakeholder	Issue	AEMC Response
General		
EnergyAustralia	EnergyAustralia was not aware of any recent changes that may have impacted the rule change proposal.	Noted.
GDFSAE	GDFSAE suggest that the circular process of AEMC review, leading to a rule change request which is then assessed by the AEMC, gives a sense that there is little scope to influence the AEMC's thinking at this time.	The AEMC takes into account all submissions received during consultation on a rule change, including those that relate to a previous review on a related matter. As indicated in the Consultation Paper, in this consultation the AEMC has been particularly interested in submissions that raise matters based on changes in circumstances following the review.
Purpose of compensation		
EnergyAustralia Origin Energy	EnergyAustralia agreed that the purpose of compensation should be to incentivise generation in the short term. The CPT ensures sufficient opportunity to recoup long-term costs. Origin Energy acknowledged that the proposal could produce some inefficiencies through the dispatch of high cost plant but the reliability benefits are likely to offset these.	See section 3.2.
GDFSAE	GDFSAE suggest that the incentive to invest should remain in the purpose clause as avoiding a loss is not a sufficient incentive for peaking generator investment.	The incentive for peaking generator investment is provided through the normal function of the market and is not intended to be provided through the compensation mechanism. The normal function of the market provides the opportunity for peaking generators to achieve high spot market prices up to the market price cap of \$13,800 per MWh when the supply and demand balance is tight. Including the investment signal in the purpose clause and extending the types of costs that can be recovered to include a contribution to

Stakeholder	Issue	AEMC Response
		capital costs, would reallocate the part of the risk associated with the decision to invest in plant from generators to market customers. This risk is more appropriately borne by generators who are better placed to manage it through natural profit and risk incentives.
Eligibility criteria		
EnergyAustralia	EnergyAustralia agreed that the proposed new criteria based on the eligibility period is likely to be effective in incentivising operational decisions to supply energy through an administered price event.	See section 4.1.
AEMC processes for assessing compensation claims		
EnergyAustralia	EnergyAustralia were comfortable with the AEMC drawing on expert advice only when necessary.	See section 5.2.
Origin Energy	Origin agrees that the compensation process should provide flexibility between an assessment of direct costs and opportunity costs.	See section 5.2.
Origin Energy	Origin considers that the Commission is the correct body for appointing an expert to determine compensation claims, and not the dispute resolution advisor.	See section 5.2.
Recovery of compensation costs		
EnergyAustralia Origin Energy	EnergyAustralia and Origin supported cost recovery from the eligibility period as it is transparent and aligns with the time compensation is available to generators.	See section 6.2.
EnergyAustralia	EnergyAustralia and Origin supported the recovery of compensation costs from the same region in which the	See section 6.2.

Stakeholder	Issue	AEMC Response
Origin Energy	administered price period was applied.	
Indicative draft of proposed Rule		
EnergyAustralia	EnergyAustralia are not aware of any issues in the drafting of the Rule.	Noted.

B Legal requirements under the NEL

This appendix sets out the relevant legal requirements under the NEL for the AEMC to make this draft Rule determination.

B.1 Draft Rule determination

In accordance with section 99 of the NEL the Commission has made this draft Rule determination in relation to the rule the COAG Energy Council proposes.

The Commission's reasons for making this draft Rule determination are set out in this rule determination.

A copy of the draft Rule is attached to and published with this draft Rule determination.

B.2 Power to make the Rule

The Commission is satisfied that the draft Rule falls within the subject matter about which the Commission may make rules. The draft Rule falls within section 34 of the NEL as it relates to section 34(a)(ii) as it relates to the operation of the national electricity system for the purposes of the reliability of that system. Further, the draft Rule falls within the matters set out in schedule 1 to the NEL because it relates to the setting of prices for electricity and services purchased through the wholesale exchange operated and administered by AEMO, including maximum and minimum prices (clause 7); and the methodology and formulae to be applied in setting prices (clause 8).

B.3 Commission's considerations

In assessing the rule change request the Commission considered:

- the Commission's powers under the NEL to make the rule;
- the rule change request;
- the fact that there is no relevant Ministerial Council on Energy (MCE) Statement of Policy Principles;³⁵
- submissions received during first round consultation; and

³⁵ Under section 33 of the NEL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for Energy. On 1 July 2011 the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated Council is now called the COAG Energy Council.

⁴⁰ Compensation arrangements following application of an administered price cap and administered floor price

- the Commission’s analysis as to the ways in which the proposed rule will or is likely to, contribute to the NEO; and the ways in which the more preferable draft Rule will, or is likely to, better meet the NEO than the proposed rule.

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of Australian Energy Market Operator (AEMO)’s declared network functions.³⁶ The draft Rule is compatible with AEMO’s declared network functions because it is unrelated to, and does not affect the performance of, AEMO’s declared network functions.

B.4 Civil penalties and conduct provisions

The draft Rule does not amend any clauses that are currently classified as civil penalty or conduct provisions under the NEL or National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the COAG Energy Council that any of the proposed amendments made by the draft Rule be classified as civil penalty or conduct provisions.

³⁶ See section 91(8) of the NEL.