

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

Amendments of the National Electricity Rules – Chapter 3

Rule change request and proposal

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1) Name and address of rule change request proponent

Standing Council on Energy and Resources
Senior Committee of Officials
c/o Standing Council on Energy and Resources Secretariat
GPO Box 1564
Canberra ACT 2601

2) The proposed rule

These proposed amendments relate to changes to the National Electricity Rules (the Rules) which define the process for compensation following the application of an administered price cap (APC) or administered floor price (AFP). These changes are based on the Australian Energy Market Commission's (AEMC) recommendations coming out of its *Review of Arrangements for Compensation following an Administered Price, Market Price Cap or Market Floor* (the review).

It is proposed that the Rules be amended to:

- introduce a new process for determining which parties are eligible to claim compensation following an APC or AFP;
- change the way in which the AEMC assesses compensation claims; and
- change the way in which the cost of compensation is recovered from market customers.

Background to the proposed rule

The proposed amendments to the Rules were initiated following the first claim for compensation in the National Electricity Market (NEM). This claim was from Synergen Power Pty Ltd (Synergen), for the operation of two South Australian generating units in early 2009.

While assessing this claim, the AEMC identified several problems with the existing compensation provisions in the Rules. 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.

At the conclusion of the assessment of the Synergen compensation claim, the AEMC identified that it would undertake a further, more detailed review of the compensation provisions to address these issues.

3) Key issues identified with the compensation arrangements and proposed rule changes:

3.1) Clarification of clauses defining the purpose of compensation

Clauses 3.14.6(c)(1)(i) and (ii) of the Rules define the purpose of compensation as maintaining the incentives for:

- i. scheduled generators, scheduled network service providers and other market participants to invest in plants that provide services during peak periods; and

- ii. market participants to supply energy and other services during an administered price period.

Issue with the Rules defining the purpose of compensation

The existing Rules state that the dual purpose of compensation is to maintain incentives for participants to supply energy during an administered price period and to invest in plants that provide during peak periods. While it is appropriate for compensation to maintain incentives for participants to supply energy during an administered price period, it is also important that the presence of administered price provisions in the Rules do not disincentivise investment in generation or other capacity. It is intended for such signals to be provided through the occurrence of high spot prices during the normal functioning of the market and not through the compensation mechanism.

The AEMC considers that this apparent contradiction between the purpose clause as defined in clause 3.14.6(c)(1), and the type of costs which can be claimed through compensation as defined in clause 3.14.6(2), may create confusion regarding the application of the compensation provisions to include capital costs.

Proposed rule change

It is proposed that this clause be amended to introduce a new description of the purpose of compensation:

- the purpose of compensation should be to maintain incentives for participants to supply energy and other services during an administered price period; and
- any reference in the purpose clause to the maintenance of incentives for participants to invest in plants that provides services during peak periods should be removed.

However, it is important to ensure that the presence of administered price provisions in the Rules does not disincentivise investment in generation or other capacity, and the compensation provisions may do this by ensuring participants are not forced to make a loss should an administered price period occur.

3.2) Eligibility to claim compensation and removal of reference to market suspension

Clauses 3.14.6(a), (a1), (a2) and (a3) currently set out the criteria which determine the eligibility of various parties to claim compensation, following the application of the APC, AFP, market price cap and market floor price. Clauses 3.14.6(a), (a1), (a2) and (a3) define the following parties which may claim compensation:

- scheduled generators in respect of generating units if the resultant spot price payable in respect of the dispatched generating units in any trading interval is less than the price specified in their dispatch offer for that trading interval;
- scheduled network service providers in respect of a scheduled network service if the resultant revenue receivable in respect of dispatched network services in any trading interval is less than the minimum requirement specified by its network dispatch offer for that trading interval;
- market participants which submitted a dispatch bid in respect of a scheduled load if, due to the application of an administered price floor, the resultant spot price in any trading interval is greater than the price specified in the dispatch bid for that trading interval; and
- ancillary service generating units or an ancillary service load if the resultant ancillary service price for that ancillary service generating unit or ancillary service

load in any dispatch interval is less than the price specified in the relevant market ancillary service offer.

3.2.1 Eligibility to claim compensation

Eligibility criteria describe the market conditions when compensation may be warranted. These criteria, in combination with the purpose clause described above, provide the market with guidance to inform participant operational decisions.

Issues with the eligibility criteria

In the assessment of the Synergen claim in 2010, the AEMC found the existing criteria defining eligibility to claim are generally ineffective. The criteria refer to the difference between the spot price and the price specified in a dispatch offer, but fail to recognise that capacity may be rebid between price bands in a dispatch offer. Furthermore, the term “price specified in a dispatch offer” is relatively ambiguous, as it is not clear whether this refers to one price band or all ten price bands in a dispatch offer. Lastly, 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. The existing Rules therefore provide no real guidance as to which parties are eligible to claim compensation and in what circumstances this would be appropriate.

However, compensation should only be payable where the application of the APC (or AFP) results in a participant incurring a net loss due to operating and providing energy services during an administered price period. These participants include scheduled generators, scheduled network service providers, scheduled load and non-scheduled market generators.

There are risks for each of those participants:

- Scheduled generators are at clear risk of incurring a loss due to the application of the APC if they are dispatched during this period but incur direct and opportunity costs in excess of the total spot price revenue they received during the eligibility period.
- A scheduled network service provider earns revenue through "buying" electricity in a lower priced region and "selling" this power in a higher priced region and could incur a loss if it is dispatched by the Australian Energy Market Operator (AEMO), through the central dispatch process, to 'sell' electricity in the region subject to an APC.
- A scheduled load earns revenue through offering to curtail its demand in response to market prices; where an administered price floor is applied and the load is “dispatched” the participant should be compensated if it incurs a net loss due to providing energy services during such a period.
- There is a potential risk of some non-scheduled market generators incurring direct or opportunity costs due to the application of the APC, if they chose to operate and export power during an administered price period.

Semi-scheduled generators and ancillary service providers are unlikely to incur costs in an administered price period and, therefore, should not be eligible for compensation, because:

- Typically, semi-scheduled generator types would not readily incur opportunity costs, given that they generally possess fuel resources which cannot be stored or used more profitably at a later point in time. These generators are also unlikely to have direct costs in excess of \$300/MWh.

- The application of the APC in ancillary services markets will not result in ancillary service providers incurring a loss and facing a disincentive to supply these services as any losses caused by being asked to provide energy would entitle the service provider to compensation as a scheduled generator (or potentially as a scheduled load), therefore, it is not necessary to identify an ancillary service provider as being eligible.

Proposed rule changes to the eligibility criteria

It is proposed that the Rules be amended to address these issues by introducing eligibility criteria based on market conditions. The new arrangements define a time period during which specific parties can claim compensation, emphasising that only net direct and opportunity costs can be claimed.

It is also proposed that the existing mechanisms for determining eligibility, which are based on differences between dispatch offer and spot price, are removed. In place of this mechanism, it is proposed that the following criteria are introduced that establish when each of the following market participant types should be eligible to claim compensation:

- Market generators
 - Market generators located in a region where the APC has actively capped prices become eligible to claim compensation from the beginning of the first trading interval during which the APC actively capped the spot price in a dispatch interval.
 - Market generators located in regions where the spot price has been capped through the application of rule clause 3.14.2(e)(2) become eligible to claim compensation at the beginning of the first trading interval during which the application of clause 3.14.2(e)(2) actively capped the spot price in a dispatch interval.
 - In both cases, eligibility for market generators to claim continues until the end of that trading day, concluding at the end of the final dispatch interval of the final trading interval of the trading day.
 - In both cases, market generators are eligible to claim compensation only where their total costs incurred during their respective eligibility period exceed the total revenue they received from the spot market during the eligibility period. These costs are limited to direct and opportunity costs, as defined in the AEMC's compensation guidelines.
- Scheduled network service providers
 - Scheduled network service providers become eligible to claim compensation from the beginning of the first trading interval during which the APC actively capped the spot price in a region into which the scheduled network service provider is importing power.
 - Eligibility for scheduled network service providers to claim continues until the end of that trading day, concluding at the end of the final dispatch interval of the final trading interval of the trading day.
 - Scheduled network service providers are eligible to claim compensation only where their total costs incurred during the eligibility period exceed the total revenue they received from the spot market during the eligibility period.
 - Scheduled network service providers are only eligible to claim for direct and opportunity costs incurred due to transporting power towards the APC capped region. Any costs incurred or revenues earned due to transporting power away

from the APC capped region are not to be considered in determining the total compensable amount for a scheduled network service provider.

- Scheduled load
 - Scheduled loads located in a region where the AFP has actively limited the spot price become eligible to claim compensation from the beginning of the first trading interval where they are dispatched during which the AFP actively limits the spot price in a dispatch interval.
 - Scheduled loads located in regions where the spot price has been limited through the application of clause 3.14.2(e)(4) become eligible to claim compensation at the beginning of the first trading interval during which the application of clause 3.14.2(e)(4) actively limits the spot price in a dispatch interval.
 - In both cases, eligibility for scheduled loads to claim continues until the end of that trading day, concluding at the end of the final dispatch interval of the final trading interval of the trading day.
 - In both cases, scheduled loads are eligible to claim compensation only where their total costs incurred during the eligibility period exceed the total revenue they received from the spot market during the eligibility period. These costs are limited to direct and opportunity costs, as defined in the AEMC's compensation guidelines.
- Ancillary service providers
 - It is proposed that the existing provisions allowing ancillary service providers to claim compensation should be removed.

3.2.2) Removal of references to market suspension

Clauses 3.14.6 (a) and (a2) refer to market suspension in reference to the payment of compensation.

Issue with reference to market suspension

The AEMC does not consider that market suspension should act as a trigger for eligibility to claim compensation under clause 3.14.6. Market suspension does not result in the application of the APC and the processes for price determination under market suspension are defined in clause 3.14.5, hence it is not necessary for this reference to be included in clause 3.14.6. The AEMC therefore considers that clause 3.14.6 is not the appropriate mechanism to address issues related to possible pricing outcomes under conditions of market suspension.

There is already a process for participants to claim compensation under market suspension. Specifically, clause 3.14.4(e)(1) refers to AEMO being able to issue clause 4.8.9 directions to participants during a market suspension. It follows that a participant so directed by AEMO would be eligible to claim compensation under the directions provisions set out in clause 3.15.7 of the Rules.

Proposed rule change by removal of reference to market suspension

Given the potential for compensation to be awarded under clause 3.15.7 of the Rules, it is proposed 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 that is not captured under clause 3.15.7.

3.3) AEMC's processes for assessing compensation claims

Clauses 3.14.6(d) to (p) currently describe the processes and timing to be followed by the AEMC when assessing compensation claims. In general terms, clauses 3.14.6 (d) to (p) describe:

- the requirement for the AEMC to establish a three member panel when a compensation claim is made;
- the requirement for the AEMC to publish and update or amend the compensation guidelines when appropriate;
- the timeframes and process under which the panel must develop, consult and produce its report; and
- the process and timeframes under which the AEMC must make a final decision on a claim for compensation.

Issues with inflexible compensation claims process

As identified during the Synergen compensation claim in 2010, the existing Rules which set out the AEMC's compensation claim assessment framework are relatively inflexible. The AEMC observed the following issues:

- strict timeframes defined in the existing Rules may result in inefficient assessment processes and may also reduce the ability of the AEMC to minimise the costs of assessment for smaller or less contentious compensation claims;
- public consultation requirements in this framework do not recognise the varying usefulness of consultation on different kinds of compensation claims. This may necessitate extended public consultation processes which do not add material value to the AEMC's assessment of a claim; and
- existing Rules do not provide sufficient guidance as to how and when the AEMC should notify the public that a claim has been received and when formal assessment of that claim has commenced. This may result in a lack of transparency to market participants as to the progression of assessment of a claim.

Proposed changes to compensation claims assessment processes in the Rules

To address these issues, it is proposed the AEMC be provided with increased flexibility in its claim assessment processes by requiring the AEMC to publish notices of the receipt and formal commencement of claims and only requiring the AEMC to undertake public consultation for claims which involve opportunity costs.

More specifically, it is proposed that the Rules be amended to require the following:

- Upon receipt of a compensation claim, the AEMC must publish a notice on its website advising of receipt of the claim and providing relevant information as to the nature of the claim.
- When the AEMC is satisfied that it has received adequate information to commence formal assessment of the compensation claim, it must publish a notice on its website advising of the formal commencement of assessment of the compensation claim.
- In assessing a compensation claim, the AEMC should have discretion to appoint a varying sized expert panel, depending upon the complexity of the claim.
- During the assessment of a compensation claim, the AEMC should have discretion to extend the timeframe for assessment, under certain predefined conditions.

- For compensation claims which include only direct costs, the AEMC should not engage in a public consultation process but will proceed directly to publication of the expert panel's report and the AEMC's report.
- For compensation claims which include opportunity costs, the AEMC should publish a copy of the claimant's proposed methodology for assessing opportunity costs, its own proposed methodology, a draft report from the expert panel and its own draft report. Stakeholders will be invited to provide comment on these documents. The AEMC will publish a final report and a final report from the expert panel.

3.4) Recovery of compensation costs

Clause 3.15.10 currently sets out the processes for the recovery of the cost of compensation from market customers when the AEMC awards compensation. Specifically, clause 3.15.10 details how AEMO must determine the amount payable by market participants and the formula to be used in determining the amount.

Issues with process for recovery of compensation costs in the Rules

The existing Rules are relatively unclear as to the appropriate process to be followed by the AEMC and AEMO in recovering the cost of compensation from market customers. For example, it is unclear as to whether these costs should be recovered against consumption by market customers in only those trading interval where the APC actively capped prices, or across all trading intervals in an administered price period. It is also unclear as to whether compensation costs should be shared by customers in multiple regions.

Proposed rule changes to better specify the recovery of compensation

To address these issues it is proposed several amendments are made that are designed to simplify the cost recovery process. These include clarifying which market customers should bear the cost of compensation and defining when this compensation can be claimed from market customers.

Specifically, it is proposed that the Rules be amended to require the following:

- When assessing the amount of compensation to be awarded to a compensation claimant, the AEMC should determine a total compensable amount for each claimant, for each eligibility period. This amount should reflect the difference between the costs incurred and revenues earned by the claimant during the eligibility period.
- AEMO should recover the total compensable amount for each eligibility period from market customers in the region in which the APC actively capped the spot market price (or in the case of scheduled loads claiming compensation, in the region where the AFP actively limited the spot price).
- The total compensable amount should be recovered from market customers by reference to their total energy consumption during the eligibility period.

4) How the proposed rule will or is likely to contribute to the achievement of the National Electricity Objective

The National Electricity Objective (NEO) is set out in section 7 of the National Electricity Law. The NEO states:

"The objective of this Law 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."

The proposed changes to the Rules would contribute to the achievement of the NEO as they are likely to promote efficient use, operation of and investment in electricity services. Generally, the proposed changes to the Rules should help to improve the transparency of the operation of the compensation process, which should in turn allow participants to make more efficient decisions regarding the operation of their plant.

Improved clarity regarding the compensation processes should help provide suppliers of energy with certainty that they will not incur a loss due to continuing to supply energy during an administered price period. This should help ensure that these parties continue to supply energy and other services during an administered price period, resulting in improved reliability benefits for consumers.

The eligibility criteria included in the proposed changes to the Rules have been designed in a way that recognises the specific operational characteristics of those units which are most likely to be affected by the application of the APC. The eligibility criteria allow these units to be run continuously and smoothly during an administered price period, avoiding the problem of unit "cycling", where a unit is switched on and off repeatedly. These should help minimise the risk of premature shutdown, improving reliability outcomes for consumers. This smooth operation of plant should also help to reduce maintenance and fuel costs, resulting in improved operational efficiencies and lower overall costs.

The proposed changes to the Rules also include better processes to be followed by the AEMC when assessing compensation claims. Allowing the AEMC to engage a smaller panel and removing the need for public consultation on direct cost claims should help reduce administrative costs associated with claim assessment. It may also result in faster assessment of claims, reducing costs to claimants. Requiring the AEMC to publish multiple notices should also provide the market with improved information regarding the claim process.

Lastly, the proposed changes to the Rules should also provide improved clarity regarding the recovery of the costs of compensation from customers. The proposed changes should help allocate the cost of compensation to those parties who most benefit from its payment, while minimising regulatory complexity. This should help promote efficient use of energy services.

5) Australian Energy Market Operator's Declared Network functions

These proposed changes to the Rules will not affect AEMO's declared network functions.

6) Expected costs, benefits and impacts of the proposed rule

Implementation of the proposed changes to the Rules may result in some regulatory costs for AEMO in developing new procedures and making amendment to information technology infrastructure to allow for the new cost recovery processes.

As identified by the AEMC in the review, there is also some risk that the new eligibility processes may result in productive inefficiencies via dispatch of high cost units ahead of lower cost units, in some limited circumstances.

However, as identified above it is expected that the proposed changes to the Rules will result in a number of benefits including:

- improved transparency regarding eligibility to claim compensation should promote more efficient operational decisions by market participants. This should help promote positive reliability outcomes for consumers;
- a more flexible claim assessment process should help minimise regulatory costs, while facilitating effective public consultation where appropriate; and
- the new arrangements for cost recovery should help provide all participants with improved transparency as to how these costs are determined and allocated.

It is expected that these benefits will outweigh the expected costs of the new arrangements.

7) Background to the proposed rule

In May 2013 the AEMC published the final report for its Review of Arrangements for Compensation following an Administered Price, Market Price Cap or Market Floor Price (the review), which examined the processes for compensating market participants who have incurred a loss due to the impact of administered pricing.

The review was instigated following the AEMC's assessment of the first compensation claim under clause 3.14.6 of the Rules, which was received from Synergen. At the conclusion of that claim assessment in 2010, the AEMC identified a number of problems with the rule clauses governing the compensation provisions. These problems related to:

- which parties were eligible to claim compensation and in what circumstances;
- the appropriate roles of the AEMC and the three member expert panel;
- the AEMC's power to disclose information subject to a claim of confidentiality; and
- lack of flexibility in the timing for processing a compensation claim.

The review examined these issues and made a number of key recommendations including amendments to the Rules clauses defining the purpose of compensation, the AEMC's compensation claim assessment process, eligibility and cost recovery.

The AEMC recommended that changes to the Rules be made to implement these changes. The AEMC identified that these changes would be likely to improve transparency around the compensation processes. This was intended to facilitate efficient operational decisions by market participants.