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Australian Energy Market Commission

## FINAL REPORT

# FINAL DECISION ON REVIEW OF COMPENSATION GUIDELINES TO INCORPORATE WHOLESALE DEMAND RESPONSE

21 OCTOBER 2021

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# REVIEW

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## ABOUT THE AEMC

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

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## SUMMARY

- 1 The Australian Energy Market Commission (AEMC or Commission) has made a final decision on amendments to the compensation guidelines that are developed by the AEMC in accordance with clause 3.14.6 of the National Electricity Rules (NER). The compensation guidelines support the operation of clause 3.14.6 of the NER which describes how compensation may be determined by the AEMC if a claim is made by an eligible party following the application of an administered price period.
- Amendments have been made to these compensation guidelines to reflect the final rule of the Wholesale demand response mechanism (WDRM)<sup>1</sup> and the final rule of the Fast frequency response market ancillary service.<sup>2</sup> In addition, other minor amendments have been made to the compensation guidelines.
- Purpose of the compensation guidelines**
- 2 The purpose of the compensation guidelines is to:
- set out how the AEMC may consider whether compensation should be paid and the amount of compensation payable under the NER; and
  - provide guidance for potential claimants and the Australian Energy Market Operator (AEMO) on the information required to be provided in support of a claim for compensation. Potential claimants include scheduled and non-scheduled generators, scheduled network service providers, scheduled loads, ancillary service providers and demand response service providers (DRSPs).
- 3 Under clause 3.14.6(n) of the NER, in making a final decision on a claim for compensation, the AEMC "must apply the compensation guidelines unless it is satisfied that there are compelling reasons not to do so". This means that, in most cases it is likely that the AEMC would apply the compensation guidelines in making a final decision on a claim for compensation. However, the AEMC is not bound to apply the compensation guidelines and there may be circumstances in which there are compelling reasons not to apply them in deciding on a claim for compensation.
- Final decision on amendments to the compensation guidelines.**
- 4 The following amendments have been made to the compensation guidelines:
- Added the DRSP as a new type of participant that is eligible to make a claim for compensation.
  - Clarified the types of direct and opportunity costs that can be claimed by a DRSP.
  - Provided guidance around the need for a DRSP to demonstrate how it has incurred direct or opportunity costs and the factors the AEMC may take into account in assessing a compensation claim from a DRSP.

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1 AEMC, *National Electricity Amendment (Wholesale demand response mechanism) Rule 2020*, 11 June 2020.

2 AEMC, *National Electricity Amendment (Fast frequency response ancillary service) Rule 2021*, 15 July 2021.

- Clarified that total opportunity costs cannot be larger than dispatch bids or dispatch offers, minus the administered price cap or administered floor price, as the case may be. This relates to trading intervals in which the participant was dispatched during an administered price period. This change was based generally on a suggestion from Shell Energy.
- Clarified that compensation may be payable relating to the provision of the two new types of Frequency Control Ancillary Services (FCAS) - the *very fast raise service* and the *very fast lower service* - when these new spot markets commence on 9 October 2023.

5 In amending the compensation guidelines, the AEMC has had regard to the national electricity objective (NEO). The changes to the compensation guidelines reflect new rules and provide additional clarity for eligible participants when submitting compensation claims and the AEMC when assessing compensation claims.

6 These amendments could impact the amount of compensation that would be able to be claimed by eligible participants under clause 3.14.6. Compensation is recovered from market customers in the region in which the administered pricing period was applied.

7 This final decision report summarises the final amendments to the compensation guidelines and explains where final amendments differ from the draft amendments. For additional detail on the amendments, please refer to the Explanatory statement that was published with the Draft amended compensation guidelines.<sup>3</sup>

8 Background information on the compensation mechanism following price limit events is provided in Appendix A of the final amended compensation guidelines.<sup>4</sup>

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3 AEMC, Review of compensation guidelines to include wholesale demand response, Explanatory statement, 26 August 2021.

4 AEMC, Compensation guidelines, 21 October 2021

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# 1 FINAL AMENDMENTS TO THE COMPENSATION GUIDELINES TO INCORPORATE WHOLESALE DEMAND RESPONSE

This section covers final amendments made to the compensation guidelines to incorporate wholesale demand response. This includes amendments related to:

- the new type of participant that is eligible to make a claim for compensation;
- direct costs; and
- opportunity costs.

## 1.1 New type of eligible participant

The draft amended compensation guidelines included a new participant category, the DRSP, and recognised that DRSPs are eligible to make a claim for compensation under clause 3.14.6 of the NER.<sup>5</sup>

No stakeholders commented on this draft amendment in submissions. The final amendments to the compensation guidelines reflect these draft amendments.

## 1.2 Direct costs

The draft amendments to the compensation guidelines:<sup>6</sup>

- clarified that a DRSP can make a claim for compensation for direct costs relating to the provision of either wholesale demand response or FCAS; and
- included information and guidance for DRSPs on the types of direct costs that may be claimed by a DRSP.

No stakeholders commented on these draft amendments in submissions. The final amendments to the compensation guidelines reflect these draft amendments.

## 1.3 Opportunity costs

### 1.3.1 Draft amendments

The draft amendments to the compensation guidelines clarified that a DRSP can make an opportunity cost claim relating to the provision of wholesale demand response or FCAS and provided additional guidance for DRSPs relating to opportunity cost claims. In summary, this guidance:<sup>7</sup>

- set out the additional factors that the AEMC may consider in assessing opportunity cost claims; and

<sup>5</sup> New clause 11.125.6(d) of the NER, AEMC, *Wholesale demand response mechanism*, Rule Determination, 11 June 2020.

<sup>6</sup> For more detail on the draft amendments, please refer to: AEMC, *Review of compensation guidelines to incorporate wholesale demand response*, Explanatory statement, 26 August 2021, pp.3-4.

<sup>7</sup> For more information refer to AEMC, *Draft amended compensation guidelines*, 26 August 2021, pp. 13-14

- clarified that commercial losses resulting from lower production of products other than wholesale demand response and market ancillary services can be claimed by a DRSP under certain circumstances.

### 1.3.2 Stakeholder submission

Shell Energy considered that the draft guidance for DRSPs on making a compensation claim for opportunity costs was unnecessarily complex. Shell considered that claimants may incur inefficiently high costs in substantiating a claim and it may be challenging for the AEMC to assess the extent to which claimants have been impacted or whether claimants are gaming the compensation framework.<sup>8</sup>

Shell suggested replacing the draft guidance for DRSPs relating to opportunity cost claims with the following provision for all participants:

“The dispatch bids provided by the participant will be taken to reflect the total opportunity costs for the participant during those trading intervals for which a claim for additional compensation has been lodged. All claims for additional compensation will be assessed and capped based on a participant’s dispatch bids.”<sup>9</sup>

### 1.3.3 Commission's analysis and final amendments

The Commission has retained the specific draft guidance for DRSPs, and provided additional clarity for all participants relating to opportunity costs claims.

The specific guidance provides clarity for DRSPs around the additional factors that the AEMC may take into account in assessing opportunity cost claims from DRSPs. It clarifies that a DRSP has the ability to choose its method of valuing opportunity costs, which could be based on dispatch bids or commercial losses resulting from lower production of products other than wholesale demand response or market ancillary services.

The Commission provided additional clarity for all participants, based generally on the suggestion from Shell Energy. The Commission clarified that total opportunity costs cannot be larger than dispatch bids or dispatch offers, minus the administered price cap or administered floor price, as the case may be. This relates to trading intervals in which the participant is dispatched during an administered price period. A bid is expected to reflect the participants' short run marginal costs or the maximum opportunity costs for the participant in providing the relevant service.

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<sup>8</sup> Shell Energy, submission to Draft amended compensation guidelines, 7 October 2021, pp. 1-2.

<sup>9</sup> Ibid, p. 2.

## 2 OTHER AMENDMENTS TO THE COMPENSATION GUIDELINES

This section sets out other amendments made to the Compensation guidelines.

### 2.1 Clarified that compensation applies to new types of FCAS

The draft amendments to the compensation guidelines clarified that compensation may be payable relating to the provision of the two new types of Frequency Control Ancillary Services (FCAS) - the *very fast raise service* and the *very fast lower service* - when these new spot markets commence on 9 October 2023.

No stakeholders commented on these draft amendments in submissions. The final amended compensation guidelines reflect these draft amendments.

### 2.2 Other minor amendments

Other draft minor amendments to the compensation guidelines included:

- merging sections on the historical record of amendments to the compensation guidelines into a new version control table in section 1.3; and
- moving the section on background information from Chapter 1 to Appendix A.

No stakeholders commented on these draft amendments in submissions.

In the final compensation guidelines, the Commission made additional minor amendments to provide clearer and simpler guidelines. The Commission:

- merged the three chapters on 'Methodology to calculate compensation' (Chapter 5), 'Direct costs' (previously Chapter 6) and 'Opportunity costs' (previously Chapter 7) into a new combined chapter 5 that covers the methodology and approach for calculating compensation;
- moved the section on confidentiality (Appendix A.5 of the Draft amended compensation guidelines) to section 4.3;
- deleted the section on the purpose of the compensation guidelines (Appendix B.2 of the Draft amended compensation guidelines) as similar content is in Chapter 1; and
- deleted the section on the objectives of paying compensation (Appendix B.4 of the Draft amended compensation guidelines) as the objective is summarised in Appendix B.1 and set out in NER clause 3.14.6.

## 3 ASSESSMENT FRAMEWORK

The assessment framework the AEMC must follow for changes to guidelines is different to that for the assessment of changes to the NER. For changes to the NER, the AEMC must assess whether a proposed rule, will, or is likely to, contribute to the achievement of the National Electricity Objective (NEO), as set out in Section 7 of the National Electricity Law (NEL).<sup>10</sup>

This is distinct from the assessment of proposed changes to the compensation guidelines. Section 32 of the NEL provides that “in performing or exercising any function under this Law, the Regulations or the Rules, the AEMC must have regard to the national electricity objective”. Therefore, in amending the compensation guidelines, the AEMC must have regard to the NEO. In order to have regard to the NEO the AEMC considered the following matters in assessing changes to the compensation guidelines:

- the reliability and security of the electricity system;
- the price of electricity supply (including the price of wholesale demand response); and
- regulatory certainty and clarity.

The amendments to the compensation guidelines have regard to the NEO as follows:

- Providing regulatory certainty by incorporating DRSP eligibility into the Compensation Guidelines.
- Clarifying that compensation may be payable relating to the provision of the two new types of FCAS - the *very fast raise service* and the *very fast lower service*.
- Clarifying that a DRSP is eligible to make a claim for compensation for direct or opportunity costs and the types of direct or opportunity cost that may be claimed. This relates to the reliability and security of the electricity system and the price of electricity supply.
- Providing additional guidance for all participants in relation to opportunity cost claims. This relates to the reliability and security of the electricity system and the price of electricity supply.

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<sup>10</sup> 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.”

## ABBREVIATIONS

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AFP	Administered floor price
APC	Administered price cap
Commission	See AEMC
CPT	Cumulative price threshold
DRSP	Demand response service provider
MFP	Market floor price
MPC	Market price cap
NEL	National Electricity Law
NEO	National electricity objective
NER	National Electricity Rules
WDRM	Wholesale demand response mechanism
WDRM rule	National Electricity Amendment (Wholesale demand response mechanism) Rule 2020 No. 9