

17 December 2018

Mr John Pierce
Chair
Australian Energy Market Commission

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Brisbane QLD 4122
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By electronic submission

Dear Mr Pierce

Requests for Rules – Market Intervention Pricing and Compensation

AEMO submits the four attached proposals requesting the AEMC to make Rules under section 91 of the National Electricity Rules, relating to market intervention pricing and compensation. The rules relate to:

- Threshold for participant compensation following market intervention
- Alignment of intervention compensation and settlements timetables
- Regional reference node test following activation of the reliability and emergency reserve trader
- Deadline for additional compensation claims following market intervention

AEMO requests the AEMC consider making these Rules as proposed.

Any queries concerning these changes should be direction to Brian Nelson on 02 9239 9132 or brian.nelson@aemo.com.au.

Yours sincerely



Peter Geers
Executive Group Manager Markets

Attachments:

1. Amended intervention compensation threshold
2. Alignment of compensation and settlement timetables
3. RRN test for RERT
4. Deadlines for compensation claims

ELECTRICITY RULE CHANGE PROPOSAL

REGIONAL REFERENCE NODE TEST FOLLOWING
ACTIVATION OF THE RELIABILITY AND EMERGENCY
RESERVE TRADER

November 2018





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1. SUMMARY

AEMO requests the AEMC to consider a proposal to amend provisions of the National Electricity Rules (NER) to require AEMO to apply a 'regional reference node (RRN) test' before using intervention pricing following the exercise of the Reliability and Emergency Reserve Trader (RERT).

The frequency of interventions has increased in the last two years, including the scheduling of reserves under the RERT mechanism. This has led to the identification of several anomalies and inefficiencies in the compensation process that AEMO considers should be addressed. This rule change request relates to intervention pricing and compensation for intervention events that AEMO has developed in consultation with stakeholders.

Intervention pricing is applied under the NER to preserve price signals, including of supply scarcity if appropriate, and the associated incentives for market participants to respond. However, the NER recognise there is little rationale for this price signal following a direction to a participant if AEMO considers that a similar direction to another facility located at the regional reference node (RRN) would not have avoided the need for the direction that was issued. This is referred to as the 'RRN test'. Intervention pricing does not apply if a direction does not meet the RRN test.

AEMO proposes that the same principles should apply for all AEMO intervention events, including following the exercise of the RERT. AEMO considers that applying the same RRN test following the exercise of the RERT would remove the scarcity price signal where it is not appropriate, with the potential to reduce the costs of intervention for consumers.

As the drafting of the RRN test itself is not be as clear as it could be, AEMO is also proposing amendments intended to better express the intent of the test.

AEMO notes the issue highlighted in its recent review of intervention pricing, that the application of the RRN test may not always result in optimal price signal outcomes when interventions are required for system security reasons (unrelated to supply shortfalls). Based on stakeholder feedback, AEMO considers this issue does not have a straightforward solution and is unlikely to meet the requirements for a non-controversial rule. It is therefore not addressed by this rule change request.

2. STATEMENT OF ISSUE

2.1 Background

2.1.1 Current framework

AEMO intervention events occur when AEMO issues a direction (in respect of scheduled plant or a market generating unit) or exercises the RERT.

The Final Report of the Reliability Frameworks Review described two objectives of the intervention pricing and compensation framework: ensuring that participants are not out of pocket as a result of an intervention and minimising market distortions.¹

The application of intervention pricing – or 'what-if' pricing - aims to preserve market price signals by requiring AEMO to set the dispatch price and ancillary service prices for an intervention price dispatch interval at the value which AEMO, in its reasonable opinion, considers would have applied had the

¹ See page 104 of the Final Report, available at <https://www.aemc.gov.au/markets-reviews-advice/reliability-frameworks-review>.



intervention not occurred.² This mechanism preserves the scarcity price signal to increase supply to, or reduce demand from, the RRN. That is, intervention prices are expected to be higher than the initial dispatch prices that may be depressed as a result of the intervention.

The rationale for intervention pricing was described in a report prepared for AEMO by SW Advisory and Endgame Economics:³

In economic terms, a direction by the market operator is a last resort action – a decision to override the function of the market which has failed to deliver a secure and reliable power system. In the absence of the intervention the market outcomes might have been load-shedding, or an insecure system that is at risk of load-shedding.

These outcomes would be expected to be associated with high prices ... However, the intervention of the market operator means these outcomes never eventuate – the market never reaches the insecure, unreliable state, and so prices may not signal the scarcity of supply.

But the very need for the market operator to intervene proves that that there is indeed a scarcity of supply. The economically drastic action of intervention has only occurred because there was insufficient supply provided by the market. It follows that prices should signal this scarcity of supply, so as to provide an incentive for generators and loads to respond.

Clause 3.9.3(d) of the NER provides that intervention pricing does not apply where, in AEMO's reasonable opinion, the need for a direction issued in respect of particular plant could not have been avoided by issuing a direction to (hypothetical or real) plant at the RRN.

This exclusion, the RRN test, recognises that the scarcity price signal at the RRN serves no purpose where action at the RRN could not have prevented the direction. Put another way, scarcity price signals are not appropriate where a direction is issued for plant at a specific location on the network to resolve a localised condition.

The RRN test currently only applies to directions, not to all AEMO intervention events. If AEMO activates a reserve contract under its RERT function, intervention pricing will be applied even if the RRN test would not have been met for a direction with the same impact on dispatch.

2.1.2 Intervention Pricing Working Group

As was explained in the Final Report of the AEMC's Reliability Frameworks Review,⁴ the increased frequency and duration of interventions have led to the identification of several anomalies and inefficiencies in the intervention pricing and compensation processes that AEMO considers should be addressed. In June 2017, AEMO engaged consultants (SW Advisory and Endgame Economics) to undertake a comprehensive review of the intervention pricing and compensation process. The consultants' final report⁵ (produced in October 2017) outlined recommendations for improvements to the compensation process as well as alternative methodologies for intervention pricing.

To seek industry feedback on the recommended alternative approaches for the Intervention Pricing Methodology⁶, AEMO established the Intervention Pricing Working Group (IPWG).⁷ The IPWG was open to all interested parties in the energy industry and consisted of representatives from 14 organisations,

² Clause 3.9.3(b) of the NER.

³ See pages 6-7 of the consultant report ('Intervention Pricing Final Report'), which is included in the IPWG Meeting 1 – Meeting Pack, available at <https://www.aemo.com.au/Stakeholder-Consultation/Industry-forums-and-working-groups/Other-meetings/Intervention-Pricing-Working-Group>.

⁴ See section 6.10 of the Final Report, available at <https://www.aemc.gov.au/markets-reviews-advice/reliability-frameworks-review>.

⁵ Op cit.

⁶ The Intervention Pricing Methodology is developed in accordance with clause 3.9.3(e) of the NER and the Rules consultation procedure.

⁷ IPWG meeting papers and minutes are available at <https://www.aemo.com.au/Stakeholder-Consultation/Industry-forums-and-working-groups/Other-meetings/Intervention-Pricing-Working-Group>.



including thermal and renewable generators, settlement residue unit holders and the AEMC. It met on five occasions between November 2017 and May 2018.

In addition to agreeing on changes to the Intervention Pricing Methodology,⁸ the IPWG also agreed that various rule changes should be proposed to amend elements of the intervention pricing and compensation mechanisms. This rule change request is one of a number of requests (being submitted together) relating to intervention pricing and compensation that AEMO has developed in consultation with stakeholders.

2.1.3 Application of the regional reference node test

AEMO's practice is to apply the RRN test considering the following practical considerations:

- There is no distinction in the test between 'reliability' or 'security' directions.
- The RRN test does not require the existence of a real physical unit to be directed and that the test can be applied to a notional unit at the regional reference node.
- Generally, directions to resolve 'local' issues do not require use of intervention pricing. However, where a local issue coincides with the regional reference node, intervention pricing is applied.
- System strength directions in South Australia require one of a number of combinations of units to be directed. One of these combinations involved only units at Torrens Island Power Station, which is located at the regional reference node. Thus the test is passed for all combinations and intervention pricing is required.
- Recent directions in Victoria to address voltage control and reactive power reserves have been given to address a specific local issue at Keilor 500kV Terminal Station. AEMO did not initially apply intervention pricing to these directions, but has subsequently done so on the basis that the provision of reactive power from a unit at the RRN would have resolved the issue. AEMO is currently developing a position paper for broader discussion with the market.
- The RRN test is only met if all directions that relate to an AEMO intervention event could have been substituted by a direction at the regional reference node.

2.2 Nature and scope of issue(s) to be addressed

2.2.1 Abiguity of the RRN test

The current drafting of the RRN test has proved difficult for AEMO to interpret. AEMO proposes to improve the drafting of the test by removing double negatives and redundant cross references. These changes are not intended to alter the meaning or application of the test.

2.2.2 Application of RRN test to RERT

As explained in section 2.1, the RRN test is currently applied to all interventions involving AEMO's exercise of the RERT. This can lead to different price outcomes when AEMO issues a direction or exercises RERT, even when it has the same physical impact on the power system. This is also inconsistent with the RERT principle in 3.20.2(b) that in exercising the RERT, actions taken should be those which have the least distortionary effect on the operation of the market.

To resolve this issue, AEMO considers that the RRN test should be extended to the exercise of RERT. All AEMO intervention events have the potential to distort market outcomes, and intervention pricing is the

⁸ Consultation on the agreed changes to the Intervention Pricing Methodology was recently completed. Details of this consultation process are available at <http://aemo.com.au/Stakeholder-Consultation/Consultations/Intervention-Pricing-Methodology-Consultation?Convenor=AEMO%20NEM>.



mechanism for mitigating that distortion. Limiting the application of the mitigation to directions only is inconsistent and risks sending confused signals to the market.

AEMO activated reserve contracts in summer 2017-18 and expects that in 2018-19 and beyond there will be a higher likelihood of the RERT being exercised than in previous years.

3. PROPOSED RULE

3.1 Description of the proposed Rule

AEMO proposes that clause 3.9.3(d) be amended to broaden the application of the RRN test for intervention pricing to include the exercise of the RERT as well as directions.

AEMO's proposed drafting changes are also intended to enhance the clarity of the RRN test and reduce ambiguity, but without altering the current meaning of clause 3.9.3(d).

3.2 How the proposal will address the issues

The proposed Rule would prevent the application of higher intervention prices for all intervention events where there is no value in a scarcity price signal at the RRN. This has the potential to reduce costs for consumers.

3.3 Stakeholder engagement

This proposed extension of the RRN test to the exercise of the RERT was agreed with the IPWG at Meetings 3 and 4 (held on 15 February 2018 and 22 March 2018 respectively).⁹

The final recommendations of the IPWG, including the recommendation to submit this rule change request, were also presented to Meeting 32 of AEMO's National Electricity Market Wholesale Consultative Forum.¹⁰

3.4 AEMO Procedure changes

This proposed change to the intervention compensation threshold would not require any changes to AEMO's procedures and guidelines that are established and maintained under the NER.

3.5 Transitional matters

AEMO could apply this proposed Rule immediately following approval, so does not consider any transitional provisions are required.

4. HOW THE PROPOSED RULE CONTRIBUTES TO THE NATIONAL ELECTRICITY OBJECTIVE

As explained in earlier sections, the proposed Rule would mitigate additional market costs that would arise from exercising the RERT under conditions that do not satisfy the RRN test. It would also remove potential

⁹ See page 5 of the minutes from Meeting 3 of the IPWG (in the meeting pack for Meeting 4) and pages 10-11 of the minutes from Meeting 4 of the IPWG (in the meeting pack for Meeting 5). The respective meeting packs are available at <https://www.aemo.com.au/Stakeholder-Consultation/Industry-forums-and-working-groups/Other-meetings/Intervention-Pricing-Working-Group>.

¹⁰ The meeting pack and draft minutes for Meeting 32 are available at <https://www.aemo.com.au/Stakeholder-Consultation/Industry-forums-and-working-groups/Wholesale-meetings/NEM-Wholesale-Consultative-Forum>.



uncertainty over the appropriate AEMO approach where different options (direct or exercise RERT) have different market price outcomes.

These outcomes directly promote the National Electricity Objective by maintaining the efficient operation of electricity services for the long term interests of consumers with respect to price and security of supply.

5. EXPECTED BENEFITS AND COSTS OF THE PROPOSED RULE

The proposed Rule would remove distortions to the market from exercising the RERT that do not pass the RRN test.

There are no costs to AEMO or market participants to implement the proposed Rule if it is adopted.

6. DRAFT RULE

This draft is based on version 113 of the National Electricity Rules, therefore does not incorporate the *National Electricity Amendment (Participant compensation following market suspension) Rule 2018*.

3.9.3 Pricing in the event of intervention by AEMO

[This version includes suggested drafting improvements]

- (d) *AEMO* must continue to set *dispatch prices* pursuant to clause 3.9.2 and *ancillary service prices* pursuant to clause 3.9.2A if *AEMO* is satisfied that the need for the *AEMO intervention event* could not have been met by a direction to provide energy or market ancillary services given to a Registered Participant in respect of plant at the regional reference node would not in *AEMO's* reasonable opinion have avoided the need for any direction which constitutes the *AEMO intervention event* to be issued.

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