

17 December 2018

Mr John Pierce
Chair
Australian Energy Market Commission

10 Eagle Street
Brisbane QLD 4122
T 07 3347 3100

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

THRESHOLD FOR PARTICIPANT COMPENSATION
FOLLOWING MARKET INTERVENTION

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) that set a minimum threshold for participant compensation following intervention by AEMO.

The frequency of interventions has increased in the last two years, with directions lasting on average 3 days and up to 22 consecutive days for one direction in April 2018. 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 is one of a number of requests (being submitted together) relating to intervention pricing and compensation for intervention events that AEMO has developed in consultation with stakeholders.

The NER currently sets a threshold of \$5,000 per trading interval for Affected Participant or relevant Market Customer¹ compensation adjustments and claims, and additional claims by Directed Participants. Where an AEMO intervention event extends for a long duration, the calculated participant compensation amount could far exceed \$5,000 over the entire event without breaching the \$5,000 threshold in an individual trading interval. This could result in participants not being adequately compensated in respect of the intervention event.

To address this issue, this rule change request proposes that the minimum threshold for participant compensation should apply to the AEMO intervention event rather than an individual trading interval. AEMO considers this would provide efficient incentives for market participants to support the reliability and security of the power system, striking a fair balance between the interests of market participants and consumers.

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 Reliability and Emergency Reserve Trader (RERT).

The Final Report of the Reliability Frameworks Review described two objectives of the intervention compensation framework: ensuring that participants are not out of pocket as a result of an intervention and minimising market distortions.²

Where an AEMO intervention event occurs:

- AEMO must 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 intervention not occurred;³
- A Directed Participant, or a Market Customer in respect of scheduled load, is entitled to formula-based compensation,⁴ and a Directed Participant may claim additional compensation if that amount was insufficient to cover its direct net costs and lost revenue;⁵ and

¹ In respect of scheduled loads only.

² See page 104 of the Final Report, available at <https://www.aemc.gov.au/markets-reviews-advice/reliability-frameworks-review>.

³ Clause 3.9.3(b) of the NER.

⁴ Clauses 3.15.7 and 3.15.7A of the NER.

⁵ Clause 3.15.7B of the NER.



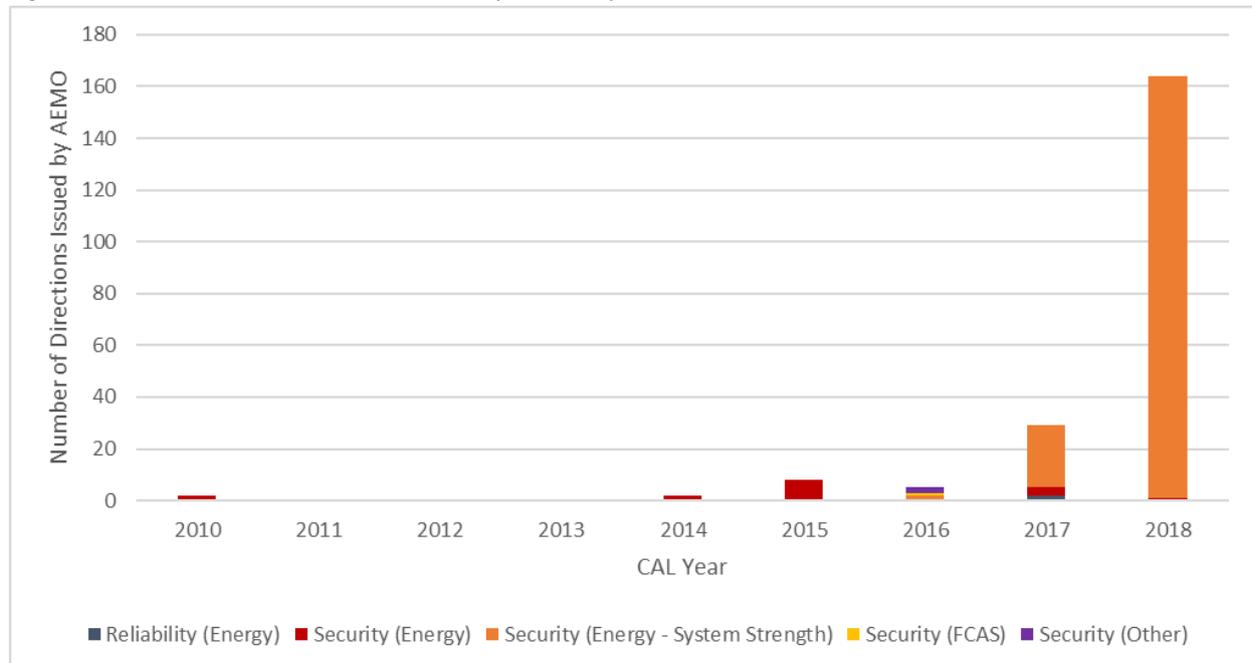
- An Affected Participant is entitled to receive from, or required to pay to, AEMO an amount that puts it in the position that it would have been in had the intervention not occurred, and may submit a claim for additional compensation if it considers that its entitlement or liability should be redetermined.⁶

A minimum threshold of \$5,000 per trading interval applies to claims for additional compensation for Directed Participants, or for Affected Participant compensation payments.⁷ The principle behind the threshold was explained by SW Advisory and Endgame Economics: “The rationale for the threshold is that, if the amount is less than \$5,000, this amount is immaterial and does not justify the costs of determining a compensation payment.”⁸ This rationale was reiterated in the Final Report of the Reliability Frameworks Review.⁹

2.1.2 Changing nature of interventions

In the last two years, the number of directions has increased from less than ten in 2016, to 29 in 2017 and nearly 163 so far in 2018 (as at 7 December). Figures 1 and 2 below show the growth in the number and duration of interventions.

Figure 1: Number of interventions and causes by calendar year



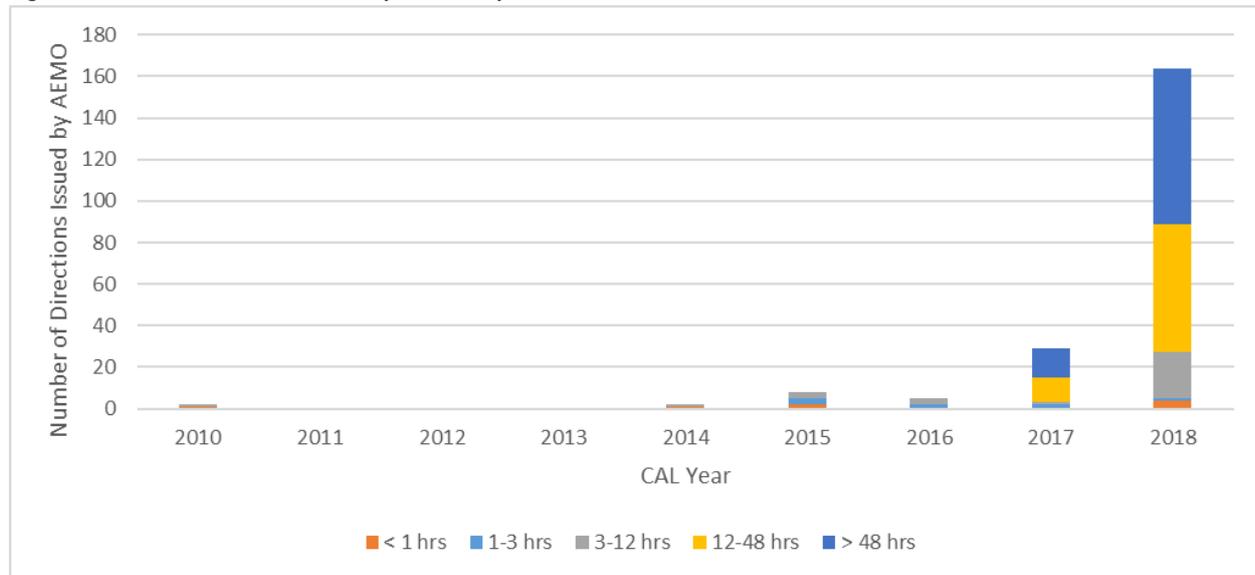
⁶ Clause 3.12.2 of the NER.

⁷ Clauses 3.12.2(b), 3.12.2(i) and 3.15.7B(a4) of the NER.

⁸ SW Advisory and Endgame Economics, *Review of Intervention Pricing – Final Report prepared for AEMO*, 4 October 2017, p51. This report is in the meeting pack for Meeting 1 of the IPWG, which is available at <https://www.aemo.com.au/Stakeholder-Consultation/Industry-forums-and-working-groups/Other-meetings/Intervention-Pricing-Working-Group>.

⁹ See page 106 of the Final Report, available at <https://www.aemc.gov.au/markets-reviews-advice/reliability-frameworks-review>.

Figure 2: Duration of interventions by calendar year



2.1.3 Intervention Pricing Working Group

As was explained in the Final Report of the AEMC’s Reliability Frameworks Review,¹⁰ 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 report¹¹ (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 Methodology¹², AEMO established the Intervention Pricing Working Group (IPWG).¹³ The IPWG was open to all interested parties in the energy industry and consisted of representatives from 14 organisations, 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,¹⁴ 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.

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

Clauses 3.12.2(b), 3.12.2(i) and 3.15.7B(a4) of the NER set a minimum threshold of \$5,000 per intervention price trading interval for initial adjustments and additional claims for Affected Participant or Market

¹⁰ See section 6.10 of the Final Report, available at <https://www.aemc.gov.au/markets-reviews-advice/reliability-frameworks-review>.

¹¹ The consultant report (‘Intervention Pricing Final Report’) 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>.

¹² The Intervention Pricing Methodology is developed in accordance with clause 3.9.3(e) of the NER and the Rules consultation procedure.

¹³ 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>.

¹⁴ 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>.



Customer compensation, and for additional compensation claims by Directed Participants. By contrast, clause 3.12.2(d) provides that the initial compensation in a trading interval determined for an Affected Participant or Market Customer can only be included in a final statement if it exceeds \$5,000.

The application of the threshold to each trading interval could result in participants not being adequately compensated in respect of the intervention event. For example, if the assessed compensation is \$4,000 per trading interval over 12 hours, the cost accumulated would be nearly \$100,000 but the compensation payable would be zero. This is contrary to the objective that participants are not unreasonably out of pocket as a result of the intervention.

AEMO presented analysis to the IPWG in May 2018 from two intervention events in early 2018, replicated in Table 1 below, that estimated the extent of under-compensation that can occur under the current Rules. Both interventions involved directions to participants to manage system strength. Market prices were at extreme levels during the first event and were at normal levels during the second event.

Table 1: Estimated under-compensation of Affected Participants¹⁵

Event dates	Estimated compensation, \$5,000 threshold per trading interval	Estimated compensation, \$5,000 threshold per event	Difference
12-15 January 2018	\$400,000	\$822,000	\$422,000
23-26 February 2018	Nil	\$114,000	\$114,000

AEMO adopted a new practice of basing compensation on assessed short run marginal cost from 1 July 2018. In the first 3 months of 2017/18 financial year, the estimated amount of additional compensation would have been around \$1.4 million.

AEMO considers that the potential for material under-compensation creates operational and financial risks for participants. There is also an incentive to allocate costs and losses to a single trading interval in compensation claims, to circumvent an artificial threshold, creating the potential for unnecessary dispatch and inconsistency between outcomes.

3. PROPOSED RULE

3.1 Description of the proposed Rule

AEMO proposes that clauses 3.12.2(b), 3.12.2(i) and 3.15.7B(a4) of the NER be amended by replacing each instance of "*intervention price trading interval*" with "*AEMO intervention event*", deleting clause 3.12.2(d) to remove inconsistency, and making a consequential amendment to clause 3.12.2(e). AEMO considers that clause 3.12.2(d) will be redundant because the \$5,000 limit will be adequately covered in paragraph (b), and clause 3.15.10C addresses the inclusion of compensation amounts in settlement statements.¹⁶

¹⁵ Data replicated from slide 6 of IPWG Meeting 5 – Slide presentation, available at <https://www.aemo.com.au/Stakeholder-Consultation/Industry-forums-and-working-groups/Other-meetings/Intervention-Pricing-Working-Group>. The data in Table 1 has been estimated after deducting avoided net direct costs, consistent with AEMO's current method for determining compensation payments.

¹⁶ AEMO is submitting a separate rule change request to address inconsistencies in clause 3.15.10C



3.2 How the proposal will address the issues

The potential to under-compensate a participant following an intervention will be largely eliminated by applying the \$5,000 threshold for intervention compensation to the entire AEMO intervention event, rather than individual trading intervals.

The proposed Rule would efficiently incentivise participants to work collaboratively with AEMO without having to weigh this against the risk of financial losses from an intervention event.

AEMO acknowledges that the proposed changes may increase the quantity of compensation payable by market customers and ultimately by consumers. However, AEMO considers that efficient incentives for market participants to support the reliability and security of the power system are in the long term interests of consumers. Further, AEMO considers that the proposed changes strike a fair balance between the interests of market participants and consumers. If this is a concern, then the appropriate level of compensation at the 90th percentile should be considered for situations where directions are common place.

This proposed Rule will not increase AEMO's administrative costs. The work involved in calculating compensation is independent of both the threshold and the period to which the threshold applies.

3.3 Stakeholder engagement

This proposed change to the intervention compensation threshold was recommended by SW Advisory and Endgame Economics in their report to AEMO.¹⁷ AEMO then raised this matter for discussion with the IPWG at Meeting 3 (held on 15 February 2018) at which members agreed that the threshold should be applied to each AEMO intervention event.¹⁸

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.¹⁹

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 efficiently incentivise participants to work collaboratively with AEMO, supporting the reliability and security of the power system, without having to weigh this against the risk of financial losses from an intervention event.

¹⁷ SW Advisory and Endgame Economics, op cit, p51.

¹⁸ See page 3 of the minutes from Meeting 3 of the IPWG. These are in the meeting pack for Meeting 4 of the IPWG, which is available at <https://www.aemo.com.au/Stakeholder-Consultation/Industry-forums-and-working-groups/Other-meetings/Intervention-Pricing-Working-Group>.

¹⁹ 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>.



AEMO considers that the proposed changes strike a fair balance between the interests of market participants and consumers in respect of the cost of electricity.

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 deliver the following benefits:

- increased certainty for participants that they will be fairly compensated for actions that support the reliability and security of the power system; and
- removal of any incentive for participants to avoid or minimise financial losses that may accrue due to interventions, potentially in ways that compromise AEMO's ability to manage the power system.

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

The expected impact on compensation payments from the proposed rule is dependent on the extend, timing and complexity of the direction. It is thus difficult to predict the impact of the rule, although the total additional compensation that would be payable under the proposed rule would have been approximately \$1.4 million for the third quarter of 2018.

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*.

3.12.2 Affected Participants and Market Customers entitlements to compensation in relation to AEMO intervention

...

- (b) In respect of a single ~~intervention price trading interval~~ ***AEMO intervention event***, an *Affected Participant* or *Market Customer* is not entitled to receive from, or obliged to pay to, *AEMO* an amount pursuant to this clause 3.12.2 if such an amount is less than \$5,000.

...

- (d) **[Deleted]** ~~*AEMO* must include in an *Affected Participant's* or *Market Customer's* final statement provided pursuant to clause 3.15.15 for a billing period in which one or more intervention price trading intervals occurred:~~

- ~~(1) the amount notified by *AEMO* pursuant to paragraph (c) if the absolute value of such amount is greater than \$5,000; and~~
- ~~(2) in all other cases no amount in relation to compensation pursuant to this clause 3.12.2.~~

- (e) **Subject to paragraph (b), if** ~~If~~ the figure calculated in accordance with paragraph (c) is:



- (1) negative, the absolute value of that amount is the amount payable to AEMO by the relevant person; and
- (2) positive, the absolute value of that amount is the amount receivable from AEMO by the relevant person.

...

- (i) In respect of a single ~~intervention price trading interval~~ AEMO intervention event, an *Affected Participant* or *Market Customer* may only make a claim pursuant to paragraph (f) in respect of that ~~intervention price trading interval~~ AEMO intervention event, if it claims that its entitlement or liability pursuant to this clause 3.12.2 is greater than \$5,000.

...

3.15.7B Claim for additional compensation by Directed Participants

...

- (a4) In respect of a single ~~intervention price trading interval~~ AEMO intervention event, a *Directed Participant* may only make a claim pursuant to clauses 3.15.7B(a), 3.15.7B(a1) or 3.15.7B(a2) if the amount of the claim ~~in respect of that intervention price trading interval~~ is greater than \$5,000.

...

3.15.10C Intervention Settlements

...