

17 September 2019

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

Rule change request – No Affected Participant compensation without intervention pricing

AEMO submits the attached request for the AEMC to make a Rule change under section 91 of the National Electricity Law.

The attached Rule change request proposes that:

- there should be no Affected Participant compensation without intervention pricing; and
- this Rule change should be implemented no later than the draft RRN Rule that removes intervention pricing when AEMO intervenes for non-market services.

This Rule change request was recommended in the AEMC's Final Report on Intervention mechanisms in the NEM.

Any questions on this Rule change request should be directed to Kevin Ly, Group Manager - Regulation on kevin.ly@aemo.com.au.

Yours sincerely



Peter Geers
Chief Strategy and Markets Officer

Attachments:

1. No Affected Participant compensation without intervention pricing

ELECTRICITY RULE CHANGE PROPOSAL

NO AFFECTED PARTICIPANT COMPENSATION WITHOUT
INTERVENTION PRICING

September 2019





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1. SUMMARY

AEMO is requesting a rule to ensure that Affected Participants and Market Customers are eligible for compensation only when intervention pricing is used during an AEMO intervention event.

The AEMC has made a draft more preferable rule on the application of the regional reference node (RRN) test (draft RRN rule).¹ The draft RRN rule also precludes the use of intervention pricing when AEMO intervenes to correct a shortfall of a service that is not traded in the NEM. However, the current NER require AEMO to calculate compensation for Affected Participants and relevant Market Customers whenever AEMO intervenes in the NEM, regardless of the reason for the intervention.

If the draft RRN rule is made and the current rules on Affected Participant and Market Participant compensation remain unchanged, this creates an economic conflict and a practical problem:

- If there is no economic justification for setting intervention prices when AEMO intervenes to secure a non-market service, such as system strength, then there is also no justification for compensating Affected Participants and Market Customers during that intervention.
- Practically, AEMO would need to establish costly new systems for calculating Affected Participant and Market Participant compensation during system strength directions. These systems would not be required if the economic conflict is resolved.

The AEMC recognised the economic conflict in its investigation into intervention mechanisms in the NEM. In its final investigation report (AEMC investigation report)² the AEMC recommended that AEMO submit a rule change request to limit Affected Participant compensation to times when intervention pricing is used.³ This rule change proposal answers that request.

The practical problem requires that, if the AEMC's draft RRN rule is finalised in its current form, it should not be implemented unless this proposed rule change proposal is implemented at the same time.

AEMO asks that the AEMC's consideration of this proposal is fast-tracked, so that the proposed rule is made with an effective date that aligns with the commencement of the final RRN rule, and with minimal delay to that rule.

2. RELEVANT BACKGROUND

2.1 Current framework

An 'AEMO intervention event' may be a direction to scheduled plant, or the dispatch or activation of contracts under the reliability & emergency reserve trader (RERT) mechanism. The intervention framework in clause 3.9.3 of the NER requires AEMO to declare intervention price dispatch intervals prices when AEMO intervenes in the NEM. Intervention prices are currently applied in those intervals (with a short time allowance for the adjustment to occur), unless the RRN test is not met. Intervention prices represent the prices AEMO considers would have applied had AEMO not intervened.

The intervention framework in the NER also requires AEMO calculate compensation for Affected Participants, and for Market Customers in relation to scheduled load only, for losses or costs in respect of every intervention price trading interval. This means a potential compensation entitlement applies

¹ AEMC, Application of the regional reference node test to the reliability and emergency reserve trader, Draft rule determination, 15 August 2019

² AEMC, Investigation into intervention mechanisms in the NEM, Final report, 15 August 2019

³ *ibid.*, p. 78 (recommendation 3).



whenever an AEMO intervention event is occurring in the NEM, irrespective of whether AEMO has set intervention prices for that interval.

2.2 Narrative of issue and proposed changes

Over the past two years AEMO has increasingly intervened in the NEM to maintain power system security. This prompted AEMO to convene the Intervention Pricing Working Group to review the framework for intervention pricing. Amongst other things, the IPWG recommended that the RRN test should be expanded to include RERT. Accordingly, AEMO submitted a rule change request to include RERT in the RRN test.⁴

The AEMC's draft RRN rule extends the RRN test to include RERT but, as a more preferable rule, also narrows the scope of interventions for which AEMO sets intervention prices. Essentially, the draft RRN rule precludes the application of intervention prices when AEMO intervenes to correct a shortfall of a service that is not traded in the NEM, such as system strength. However, the policy and economic impact of this change will be defeated if AEMO is still required to compensate Affected Participants and relevant Market Customers for periods when intervention prices have not applied.

This aspect of the draft RRN rule can only be implemented if:

- the NER requirement to calculate Affected Participant and Market Customer compensation for every intervention price trading interval is replaced by a requirement to calculate Affected Participant and Market Customer compensation only when AEMO sets intervention prices; and
- the compensation requirement is amended at the same time as the RRN rule.

3. STATEMENT OF ISSUE

3.1 Current Rules

3.1.1 Definition of AEMO intervention event

The current NER define an AEMO intervention event as:

An event where AEMO intervenes in the market under the Rules by:

(a) issuing a direction in accordance with clause 4.8.9; or

(b) exercising the reliability and emergency reserve trader in accordance with rule 3.20

In other words, an AEMO intervention event occurs whenever AEMO intervenes in the NEM, regardless of the reason for that intervention.

3.1.2 Definition of intervention price trading interval

NER 3.9.3(a) states that:

In respect of a dispatch interval where a[n] AEMO intervention event occurs AEMO must declare that dispatch interval to be an intervention price dispatch interval.

and the NER define an intervention price trading interval as:

⁴ https://www.aemc.gov.au/sites/default/files/2018-12/Rule%20change%20request_0.pdf.



A trading interval in which AEMO has declared an intervention price dispatch interval in accordance with clause 3.9.3.

In other words, an intervention pricing trading interval is any trading interval during which AEMO intervenes in the NEM, regardless of the reason for that intervention or whether intervention prices apply.

3.1.3 Compensation for Affected Participants and Market Customers

NER 3.12.2(a)(1) states that:

In respect of each intervention price trading interval:

an Affected Participant is entitled to receive from AEMO, or must pay to AEMO, an amount as determined in accordance with this clause 3.12.2 that will put the Affected Participant in the position that the Affected Participant would have been in regarding the scheduled generating unit or scheduled network service, as the case may be, had the AEMO intervention event not occurred...

NER 3.12.2(a)(2) extends the principle to Market Customers, although they can only receive compensation in respect of scheduled loads.

In other words, the current NER state that Affected Participants and relevant Market Customers may be entitled to receive, or be required to pay, compensation when there is an AEMO intervention event, regardless of the reason for the intervention. Compensation is triggered by the presence of an intervention, and not on the presence of intervention pricing.

3.2 Draft RRN rule

The AEMC's Draft National Electricity Amendment (Application of the regional reference node test to the Reliability and Emergency Reserve Trader) Rule 2019 proposes a new NER 3.9.3(b)(3), which says:

AEMO must continue to set dispatch prices pursuant to clause 3.9.2 and ancillary service prices pursuant to clause 3.9.2A if:

...

- (ii) *the reason for the AEMO intervention event is to obtain a service for which a dispatch price or ancillary service price is not determined by the dispatch algorithm. Without limitation examples of the services referred to in this subparagraph (ii) include the provision of:*
 - (A) *inertia;*
 - (B) *voltage control;*
 - (C) *system strength;*
 - (D) *non-market ancillary services.*

regardless of whether energy or market ancillary services are also provided as a by-product of the provision of the services listed in sub paragraphs (A) to (D).

In other words, AEMO must not use intervention pricing when it intervenes to correct a shortfall of a non-market service. In particular, AEMO must not set intervention prices when it directs for system strength.

3.3 Issues with the current and draft Rules

The draft RRN rule precludes the use of intervention pricing when AEMO intervenes to correct a shortfall of a non-market service. However, the current NER state that Affected Participants and Market Customers may be entitled to receive, or be required to pay, compensation whenever AEMO intervenes in the NEM, regardless of the reason for the intervention. This creates economic policy and practical problems.



3.3.1 Economic problem with the current and draft Rules

If there is no justification for setting intervention prices when AEMO intervenes to secure a non-market service, then there is also no justification for compensating Affected Participants and relevant Market Customers during that intervention. The reasons for this conclusion were canvassed in Section 4.3 of the AEMC investigation report, and summarised as follows:

Given that affected participant compensation is not payable where constraints are used, and that dispatch targets in intervention pricing runs are both infeasible (for system security directions) and open to participant influence, the Commission considers that affected participant compensation is not warranted in connection with system security interventions and nor is it in the interests of consumers. Accordingly, the Commission recommends that eligibility for affected participant compensation be narrowed to those instances where intervention pricing is triggered in accordance with the revised regional reference node test, and should not be payable when interventions occur in response to system security issues. (p.76)

Accordingly, the AEMC recommended that AEMO submit this rule change proposal to limit relevant compensation to times when intervention pricing is used.

3.3.2 Practical problems with the current and draft Rules

The current NER require AEMO to calculate potential compensation for Affected Participants and Market Customers when AEMO intervenes in the NEM. The base compensation amount is calculated by reference to the dispatch outcomes that would have occurred had it not been for the AEMO intervention event. AEMO draws these inputs from the different dispatch targets in the Outturn and What-If NEMDE⁵ runs described in AEMO's Intervention Pricing Methodology.⁶

As the draft rule would remove intervention pricing when AEMO intervenes for a non-market service, there will be a large number of directions for which intervention prices will not be set. AEMO would then need a new source of What-If dispatch targets to calculate Affected Participant and Market Customer compensation.

What-If dispatch targets

The vast majority of AEMO's recent interventions have been to maintain system strength. When AEMO intervenes to maintain system strength it triggers intervention pricing under the current rules. Intervention pricing automatically produces two NEMDE runs in each intervention pricing dispatch interval:

- an Outturn run, which reflects physical reality and is used to set dispatch targets; and
- a What-If run, which attempts to simulate what would have happened without intervention and is used to set prices.

Both runs produce prices and dispatch targets. The prices from the Outturn run are not used, except in studies. The dispatch targets from the What-If run are compared to the dispatch targets from the Outturn run to calculate Affected Participant and Market Customer compensation.

Under the draft Rule, system strength directions would no longer trigger intervention pricing. Without intervention pricing, there would be no What-If run to provide What-If dispatch targets. AEMO would then need an alternative source of What-If dispatch targets for calculating Affected Participant and Market Customer compensation.

⁵ National Electricity Market Dispatch Engine

⁶ https://www.aemo.com.au/-/media/Files/Electricity/NEM/Security_and_Reliability/Dispatch/Policy_and_Process/2019/Intervention-Pricing-Methodology.pdf



3.3.3 Why solving the practical issues is not a realistic option

AEMO has considered potential solutions to the practical problem described in section 3.3.2 at a high level, which might involve:

- A production change that would trigger a third type of NEMDE run during interventions without intervention pricing. This run would attempt to simulate what would have happened without intervention.
- A real-time parallel process that would detect interventions without intervention pricing and automatically rerun the affected dispatch intervals. The reruns would attempt to simulate what would have happened without intervention. The results of this process would be used only in calculating Affected Participant and Market Customer compensation.
- A resource-intensive manual process that would rerun dispatch intervals containing intervention without intervention pricing. The reruns would attempt to simulate what would have happened without intervention.

In each case, this would be a bespoke process that would only be used for a single purpose. As identified in the AEMC investigation report, that purpose is not economically justified. Even if a solution to the lack of What-If dispatch targets were only required temporarily until the economic conflict is resolved in the rules, given the current volume of directions impacted any solution is still likely to be complicated, costly, and time-consuming to design and implement. It could take months simply to design and test any solution, necessitating a delay in the commencement of the RRN rule in any event.

Accordingly AEMO considers it is necessary to resolve the underlying economic conflict, and to do so at the same time as the changes contemplated in the draft RRN rule come into effect.

3.3.4 Timing

This rule change proposal should be considered in parallel with the AEMC's draft RRN rule, so that an appropriate rule can be made with the same effective date.

- Implementing the AEMC's draft rule on the RRN test without implementing this proposal would fail to address the underlying conflict identified in the AEMC investigation report.
- Implementing the AEMC's draft rule on the RRN test before implementing this proposal would require AEMO to waste resources developing a new source of What-If dispatch targets to calculate Affected Participant and Market Customer compensation.
- Implementing the AEMC's draft rule on the RRN test at the same time as implementing this proposal would avoid inefficient outcomes and ineffective administration by:
 - resolving the underlying economic conflict identified in the AEMC investigation report; and
 - avoiding AEMO wasting resources in developing a new source of What-If dispatch targets to calculate Affected Participant and Market Customer compensation, which would also delay implementation of the changes to the application of intervention pricing proposed in the draft RRN rule.

AEMO also asks the AEMC to consider this proposal under the 'fast-track' process (section 96A of the National Electricity Law), as it is submitted on the basis of a recommendation in the AEMC investigation report. Fast-tracking would minimise the delay in implementation of the changes proposed in the draft RRN rule.



4. PROPOSED RULE

4.1 Description of proposed rule

AEMO proposes that Affected Participants and relevant Market Customers should be eligible for, or required to pay, compensation under clause 3.12.2 only when intervention pricing is used during an AEMO intervention event.

Noting that the AEMC has already considered the need for this change, AEMO has not proposed detailed drafting for the proposed rule. AEMO considers that a relatively simple implementation option would be to modify the definition of an intervention price trading interval⁷ for the purposes of clause 3.12.2 and 3.12.3 only. For those purposes, a *relevant* intervention price trading interval will be one in which AEMO has set dispatch prices and ancillary service prices in accordance with clause 3.9.3(b). There should be no need for further modifications in the settlement rules for recovery of compensation amounts, since they will only apply where those amounts have actually been determined under rule 3.12.

4.2 How the proposal will address the issues

If this proposed rule is made, it will resolve the economic conflict identified in the AEMC investigation report, by ensuring that Affected Participants and relevant Market Customers only receive (or pay) compensation in respect of intervention events when intervention pricing has been applied.

If this proposal is implemented at the same time as the AEMC's draft RRN rule, it would avoid the need for AEMO to establish a new system for calculating What-If dispatch targets during interventions without intervention pricing. This will avoid both wasted resources and a delay in realising the benefits of the changes to the application of intervention pricing contemplated in the draft RRN rule.

5. HOW THE PROPOSED RULE CONTRIBUTES TO THE NATIONAL ELECTRICITY OBJECTIVE (NEO)

The proposed rule would contribute to the NEO by reducing costs to consumers.

When AEMO intervenes in the NEM it must calculate Affected Participant and relevant Market Customer compensation. The AEMC's draft rule on the RRN test does not modify this obligation. The compensation costs are then recovered from (or paid to) Market Customers in the region(s) that benefit from the intervention.

The combination of this proposal and the AEMC's draft RRN rule would greatly reduce the compensation costs to be recovered from consumers. The vast majority of AEMO's recent interventions have been for non-market services (primarily system strength). The draft RRN rule on the RRN test precludes intervention pricing when AEMO intervenes for a non-market service. This proposal precludes compensation for Affected Participants and Market Customers if there is no intervention pricing. To the extent that the current number and nature of AEMO intervention events continues, in future there would be very few instances requiring recovery of Affected Participant and Market Customer compensation from consumers.

The combination of this proposal and the AEMC's draft RRN rule would also reduce AEMO's administrative costs of calculating compensation. AEMO's costs are recovered through market fees, which are ultimately paid by consumers.

⁷ Noting that, from 1 July 2021, this term will change to 'intervention pricing interval' under the five minute settlement rule changes.



Without this proposal, any benefits to consumers from the AEMC's draft rule on the RRN test would be reduced because AEMO would still need to determine compensation for Affected Participants and relevant Market Customers, and build a new source of What-If dispatch targets for to do so.

6. EXPECTED BENEFITS AND COSTS OF THE PROPOSED RULE

The expected benefits of the proposed rule are:

- improved consistency between the treatment of intervention pricing and Affected Participant and Market Customer compensation during interventions for non-market services;
- the avoided costs of building a new source of What-If dispatch targets for calculating Affected Participant and Market Customer compensation;
- reduced costs to consumers from calculating and recovering Affected Participant and Market Customer compensation; and
- an earlier start date for the AEMC's draft rule on the RRN test.