
Australian Energy Market Commission

CONSULTATION PAPER

REVIEW INTO ELECTRICITY COMPENSATION FRAMEWORKS

2 NOVEMBER 2023

REVIEW

INQUIRIES

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ABOUT THE AEMC

The AEMC reports to the energy ministers. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the energy ministers.

ACKNOWLEDGEMENT OF COUNTRY

The AEMC acknowledges and shows respect for the traditional custodians of the many different lands across Australia on which we all live and work. We pay respect to all Elders past and present and the continuing connection of Aboriginal and Torres Strait Islander peoples to Country. The AEMC office is located on the land traditionally owned by the Gadigal people of the Eora nation.

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SUMMARY

- 1 The Australian Energy Market Commission (AEMC or Commission) has self-initiated a review into the compensation frameworks in the NER (the Review). The Review seeks to identify changes that would provide confidence to market participants and support better outcomes for consumers.
- 2 The Commission considers that better outcomes for consumers include improved reliability, security and cost outcomes. These can be achieved by setting appropriate incentives to encourage participation in the market rather than relying on interventions, such as directions, to manage dispatch during periods of market stress.
- 3 The Review will focus on the objectives and methodologies of the compensation schemes, their governance and administrative changes that could make the compensation frameworks more efficient and effective.
- 4 As part of considering the objectives and methodologies of the compensation frameworks, the Review will consider the effectiveness of the schemes in encouraging participants to provide services during periods of market stress. In this context, the Review will consider other reform options, such as the new participant obligations identified by the Australian Energy Regulator (AER) in its report on the June 2022 market events.¹
- 5 An assessment of objectives and methodologies also includes:
 - considering if there are opportunities to better align the schemes
 - the proposed reforms to directions compensation that were first identified in the *Improving security frameworks for the energy transition* rule change²
 - if further clarity is required about how specific types of claims apply to different technologies, including batteries
- 6 The Review's focus on governance seeks feedback on the roles and responsibilities of the market bodies when it comes to receiving and assessing compensation claims.
- 7 Administrative changes include issues relating to eligibility periods, overlapping compensation claims, cost recovery provisions and the option to introduce time limits for applying for compensation.

This review stems from the events of June 2022

- 8 The Review has arisen following the disruptive market events of June 2022 and the application of different compensation frameworks. These are the:
 - directions compensation framework
 - administered pricing compensation framework, and

1 AER, *June 2022 market events report*, 2022. See <https://www.aer.gov.au/wholesale-markets/compliance-reporting/june-2022-market-events-report>.

2 AEMC, *Improving security frameworks for the energy transition*. See <https://www.aemc.gov.au/rule-changes/improving-security-frameworks-energy-transition>. The final determination is expected to be published in December 2023.

- market suspension compensation framework.

Each compensation framework has a specific objective. These are as follows:

- **Directions compensation framework:** for participants to recover the costs associated with complying with a direction.³⁴
- **Administered pricing compensation framework:** to maintain the incentive, during price limit events (i.e administered price caps or administered price floors), for relevant participants to supply (or consume) energy or relevant services in the market.⁵
- **Market suspension compensation framework:** to maintain the incentive, during market suspension periods, for relevant participants to supply energy or relevant services in the market.⁶

In June 2022, a combination of factors led to significant operational challenges in the NEM.

Sustained high prices led to Queensland exceeding the cumulative price threshold (CPT) on 12 June 2022. This led to the application of the administered price cap (APC) of \$300/MWh being applied in Queensland.⁷ This was then followed by the CPT being exceeded in New South Wales, Victoria and South Australia on 13 June 2022 and the APC being applied in these regions. Due to ongoing operational challenges in the power system, AEMO suspended the market on 15 June 2022.

Significant amounts of the three different types of compensation payments were made to participants following the June events. As at 6 June 2023, the total compensation paid was approximately \$131 million, which is approximately 0.5% of annual market revenue.⁸ During the June events and the following compensation assessment processes, a number of issues were identified with the various compensation frameworks, including how they worked together.

Proposed areas for consideration

The Commission has published the Terms of Reference (TOR) for the Review alongside this consultation paper. The TOR sets out the three main areas of investigation identified by the Commission:

3 The Commission has previously noted that the NER does not explicitly state an objective for the directions compensation framework.

4 EMC, *Investigation into intervention mechanisms in the NEM*, Final report, 2019. See <https://www.aemc.gov.au/sites/default/files/2019-08/Investigation%20into%20intervention%20mechanisms%20in%20the%20NEM%20-%20Final%20report%20-%20published%20version.PDF>.

5 The objective of the administered pricing compensation framework is set out under clause 3.14.6 of the NER.

6 The objective of the market suspension compensation framework is set out in clause 3.14.5A of the NER. It is noted that this is a similar to the objective of the administered pricing compensation framework.

7 As a result of the making of the National Electricity Amendment (Amending the administered price cap) Rule 2022, the APC was changed from \$300/MWh to \$600/MWh from 1 December 2022 and will remain in place until 30 June 2025. See NER clause 11.155.2. The Amendment of the Market Price Cap, Cumulative Price Threshold and Administered Price Cap rule change project is currently considering the longer term setting of the APC to apply from 1 July 2025 to 30 June 2028. See <https://www.aemc.gov.au/rule-changes/amendment-market-price-cap-cumulative-price-threshold-and-administered-price-cap>.

8 This figure includes directions compensation, administered pricing compensation and market suspension compensation. It is noted that the amount of directions compensation, which is awarded more regularly than administered pricing and market suspension compensation, compared with similar time periods was relatively large due to the events of June 2022.

- 14 Objectives and methodology:** Are there changes or improvements to the way the compensation frameworks are designed that would lead to improved market outcomes that would better support the long-term interests of consumers? Issues that may be considered in this area include:
- whether the current objectives of the compensation frameworks are appropriate
 - whether changes to the methodologies (I.e. how the frameworks are designed to meet the objectives) of the various frameworks could improve the way they meet the objectives
 - whether other approaches are needed to encourage participants to provide services during periods of market stress, such as:
 - strengthening the incentives provided by the compensation schemes
 - introducing new participant obligations to provide services
- 15 Governance:** Are the current roles and responsibilities for the compensation frameworks appropriate? Issues that may be considered in this area include:
- Which market body should be responsible for receiving compensation claims?
 - Which market body is best placed to assess any direct or opportunity cost claims?
- 16 Administrative:** What administrative improvements and other implementation changes are required to help ensure the frameworks achieve their objectives? Issues that may be considered in this area include:
- Providing clarity on the process, eligibility and timelines for overlapping compensation claims. Following the events of June 2022, the AEMC became aware of issues regarding claims for administered pricing compensation that had overlap with directions and market suspension compensation claims.
 - Adding clear timeframes for all compensation frameworks, particularly the administered pricing compensation framework.
 - Issues related to cost recovery of compensation claims. Some of these issues include:
 - clarifications of cost recovery provisions for administered pricing compensation when there is more than one “home region” in an eligibility period
 - whether there should be changes made to the cost allocation mechanisms for the compensation frameworks
- 17** In considering the objectives and methodologies of the schemes, this review will assess if they provide adequate incentives for participants to provide services. This will include assessing whether other reform options are needed to achieve participation in the market during periods of market stress, such as new participant obligations. These are primarily those options identified by the AER in its report on the June 2022 market events.⁹ They include:

⁹ AER, *June 2022 market events report, 2022*, <https://www.aer.gov.au/wholesale-markets/compliance-reporting/june-2022-market-events-report>.

- removing commercial considerations from the list of reasonable causes for causing a direction in clause 4.8.9(c2)
- introducing a positive obligation on generators to continue to offer capacity into the market during actual Lack of Reserve (LOR) 2 or LOR3 conditions during an administered price period (APP), and
- introducing an obligation for generators to use the available price bands during APPs.

18 Given that this review stems from the events of June 2022, a number of the issues raised in this consultation paper are related to these events. The Commission is also seeking stakeholder feedback on other areas where improvements can be made to the frameworks.

19 This includes issues relating to directions compensation that are relevant not only during disruptive market events such as those that occurred in June 2022 but also during more normal operations.

20 Therefore, the assessment of the objectives and methodologies of the schemes also includes some of the issues relating to directions compensation that were identified by the *Improving security frameworks for the energy transition* rule change.¹⁰ In the recent directions paper for that rule change project, the Commission set out a proposal to change the way directions compensation payments are calculated. The current approach bases them on the 90th percentile price for energy or frequency control ancillary services (FCAS) over the preceding 12 months from when the direction was issued. The Commission identified that this approach led to generators being over or under-compensated. To remedy this issue, the Commission proposed a benchmark-based compensation framework, similar to that used during market suspension periods. Under this framework, directed participants would be entitled to compensation based on predetermined values of the short-run marginal cost (SRMC) for the relevant technology type, as determined through ISP data inputs. This would be combined with a 15% premium to account for variability of heat rates and other divergences between the estimated and actual costs on the day.

21 In response, stakeholders raised concerns about the proposed reforms and strongly advocated that any changes to the directions compensation framework be considered as part of a larger review. Consequently, the issue of directions compensation will no longer be considered in the *Improving security frameworks for the energy transition* rule change, but instead, will be considered through this review.

We consider that there are three assessment criteria that are most relevant to this review

22 Considering the NEO¹¹ and the scope of the Review, the Commission proposes to assess the Review's recommendations against 3 assessment criteria.

23 Please provide feedback on our proposal to assess the Review's recommendations against:

¹⁰ AEMC, *Improving security frameworks for the energy transition*. See <https://www.aemc.gov.au/rule-changes/improving-security-frameworks-energy-transition>. The final determination is expected to be published in December 2023.

¹¹ Section 7 of the NEL.

- **Principles of market efficiency:** The Commission considers that this assessment criterion is central to the aim of the compensation frameworks. That is to provide appropriate incentives to maintain productive and allocation efficiency during periods of market stress. In doing so, the frameworks are likely to promote the long-term interests of consumers in terms of reliability, system security and cost.
- **Implementation considerations:** The Commission will consider whether any proposed changes to the compensation frameworks will appropriately balance the cost and complexity of implementation and ongoing regulatory and administrative costs. The Commission notes that the current complexity of the frameworks may be a contributing factor to the frameworks not achieving their objectives.
- **Principles of good regulatory practice:** The Commission will consider whether any proposed changes to the compensation frameworks will lead to arrangements that are predictable and durable, while being as simple and transparent as possible.

Submissions are due by 1 February with other engagement opportunities to follow

- 24 The Commission considers there is value in completing a broad review of the electricity compensation frameworks. At this stage, we are aware of a set of possible issues related to the relevant compensation frameworks but note that stakeholders may be aware of other issues. Therefore, the scope of the Review will be finalised following this first consultation process.
- 25 Confirming the scope of the Review following consultation will also assist in managing any overlaps with other ongoing work, particularly the *Improving security frameworks for the energy transition* rule change and the changes the Commission is currently considering for gas compensation and dispute resolution, in the *Compensation and dispute resolution frameworks* rule change.¹² While this review will seek to achieve consistency across compensation frameworks, such as between gas and electricity, in order to minimise complexity, it is noted that there may be practical reasons for maintaining bespoke approaches.
- 26 Written submissions responding to this consultation paper must be lodged with Commission by **1 February 2024** via the Commission's website, www.aemc.gov.au.
- 27 There are other opportunities for you to engage with us, such as one-on-one discussions or industry briefing sessions. See the section of this paper about "How to engage with us" for further instructions and contact details for the project leader.

Full list of consultation questions

¹² AEMC, *Improving security frameworks for the energy transition*. See <https://www.aemc.gov.au/rule-changes/improving-security-frameworks-energy-transition>. The final determination is expected to be published in December 2023; AEMC, *Compensation and dispute resolution frameworks rule change*. See <https://www.aemc.gov.au/rule-changes/compensation-and-dispute-resolution-frameworks>.

QUESTION 1: ASSESSMENT FRAMEWORK

Are there any other relevant considerations or principles that should be included in the assessment framework?

QUESTION 2: OBJECTIVES

1. Do stakeholders have any proposed changes to the objectives of the various compensation frameworks?
2. Is the reasoning behind each objective still appropriate and relevant?
3. Regarding the directions compensation framework, how do we best balance the need to avoid creating a perverse incentive to be directed with the objective of compensating directed participants fairly? How well is this achieved under the current framework?

QUESTION 3: ACHIEVING THE OBJECTIVES

1. Do stakeholders agree with the observation that the administered pricing and market suspension compensation objectives may not have been achieved in the June 2022 events?
2. If directions compensation was preferred to the other frameworks, were there any specific reasons why this was the case?

QUESTION 4: METHODOLOGY

1. Do stakeholders have any suggestions related to the directions compensation framework that could enable it to more effectively meet its objective to fairly compensate directed participants without creating a perverse incentive to be directed?
2. Do stakeholders consider there is value in having different approaches to the various compensation frameworks? Would better outcomes be more likely if the frameworks were consistent where possible?
3. Should opportunity costs be considered in the compensation frameworks? If so, which ones and why?
4. Do stakeholders agree with providing more codification and guidance about how opportunity cost compensation is likely to be assessed?

5. Do stakeholders consider that changes to the compensation frameworks may be necessary due to the advent of battery energy storage systems? If so, are there any specific changes that should be considered?
6. Do stakeholders consider that administered pricing compensation provides a sufficient incentive for participation in the market during an APP? If not, please explain why and include any measures that could be considered as part of this review.
7. Do stakeholders agree with the suggestions made by the AER regarding removing economic considerations for causing a direction given the availability of compensation?
8. Do stakeholders have a preference for a benchmark approach to compensation such as the market suspension compensation framework, or a more open framework such as the administered pricing compensation framework?

QUESTION 5: GOVERNANCE

1. Do stakeholders think it is appropriate to have a single point of receipt for all compensation claims to reduce confusion?
2. Who should be responsible for the various compensation frameworks?
3. Are there any other governance issues that should be considered?

QUESTION 6: OVERLAPPING COMPENSATION CLAIMS

1. Do stakeholders agree with the issues identified regarding overlapping compensation claims?
2. Do stakeholders agree with the potential solutions identified to address issues arising from overlapping compensation claims? Do stakeholders prefer a particular option or propose other options for consideration?

QUESTION 7: TIMEFRAMES FOR SUPPORTING INFORMATION

1. Is it appropriate to include timeframes for administered pricing compensation claims?
2. Should additional time be provided for opportunity cost claims, and if so, how much?

QUESTION 8: HARMONISING DEFINITIONS

1. Do stakeholders agree that there would be benefits in aligning definitions of cost categories across the various compensation frameworks?

QUESTION 9: COST RECOVERY

1. Do stakeholders consider that cost recovery provisions for administered pricing could be clarified with respect to situations where there are multiple “home regions”?
2. Do stakeholders have any thoughts on the existing cost allocation mechanisms for the compensation frameworks?

QUESTION 10: INFORMATION TO SUPPORT A CLAIM

1. Do stakeholders have suggestions for NER requirements and/or guidelines changes that could provide greater clarity for administered pricing compensation claimants?
2. Do stakeholders have views on the level of evidence that is required to substantiate claims under the current compensation frameworks?

How to make a submission

We encourage you to make a submission

Stakeholders can help shape the recommendations by participating in the review process. Engaging with stakeholders helps us understand the potential impacts of our recommendations and, in so doing, contributes to well-informed, high quality review recommendations.

We have included questions in each chapter to guide feedback, and the full list of questions is above. However, you are welcome to provide feedback on any additional matters that may assist the Commission in making its decision.

How to make a written submission

Due date: Written submissions responding to this consultation paper must be lodged with Commission by **1 February 2024**.

How to make a submission: Go to the Commission’s website, www.aemc.gov.au, find the “lodge a submission” function under the “Contact Us” tab, and select the project reference code EPR0095.¹³

¹³ If you are not able to lodge a submission online, please contact us and we will provide instructions for alternative methods to lodge the submission.

You may, but are not required to, use the stakeholder submission form published with this consultation paper.

Tips for making submissions are available on our website.¹⁴

Publication: The Commission publishes submissions on its website. However, we will not publish parts of a submission that we agree are confidential, or that we consider inappropriate (for example offensive or defamatory content, or content that is likely to infringe intellectual property rights).¹⁵

For more information, you can contact us

28

Please contact the project leader with questions or feedback at any stage.

| | |
|-----------------|------------------------|
| Project leader: | Tom Meares |
| Email: | tom.meares@aemc.gov.au |
| Telephone: | (02) 8296 7800 |

¹⁴ See: <https://www.aemc.gov.au/our-work/changing-energy-rules-unique-process/making-rule-change-request/our-work-3>

¹⁵ Further information is available here: <https://www.aemc.gov.au/contact-us/lodge-submission>.

CONTENTS

| | | |
|----------|--|-----------|
| 1 | Introduction | 1 |
| 1.1 | The context for the Review | 1 |
| 1.2 | Purpose of the Review | 4 |
| 1.3 | Approach to the Review | 5 |
| 2 | Overview of existing arrangements | 6 |
| 3 | Making our recommendations | 8 |
| 3.1 | The Commission must act in the long-term interests of consumers | 8 |
| 3.2 | We propose to assess this review using these three criteria | 8 |
| 4 | Objectives and methodology | 10 |
| 4.1 | Objectives and high level design of the compensation frameworks | 10 |
| 4.2 | The compensation frameworks may not have been effective during the June 2022 market events | 15 |
| 4.3 | We are seeking views on whether there is value in aligning the administered pricing and market suspension compensation frameworks | 17 |
| 4.4 | We are seeking stakeholder views on whether clarifications are required rather than fundamental methodological changes | 18 |
| 4.5 | We are seeking stakeholder views on whether more significant methodological changes are required | 23 |
| 4.6 | We are seeking stakeholder views on whether other options are needed to achieve participation during periods of market stress | 24 |
| 5 | Governance | 27 |
| 5.1 | The current governance arrangements | 27 |
| 5.2 | There are several potential options regarding governance | 28 |
| 6 | Administrative | 32 |
| 6.1 | Issues associated with overlapping compensation frameworks | 32 |
| 6.2 | Adding a time limit for supporting information | 39 |
| 6.3 | Harmonising definitions between frameworks | 40 |
| 6.4 | Issues related to cost recovery | 41 |
| 6.5 | There may be benefits associated with providing guidance on the standard of information that should be provided to support a claim | 43 |
| | Abbreviations | 50 |

APPENDICES

| | | |
|----------|---|-----------|
| A | Overview of compensation frameworks | 44 |
| A.1 | Directions compensation framework | 44 |
| A.2 | Administered pricing compensation framework | 46 |
| A.3 | Market suspension compensation framework | 47 |

TABLES

| | | |
|------------|--|----|
| Table 1.1: | Compensation arising from June 2022 NEM events | 3 |
| Table 2.1: | Overview of compensation frameworks in the NER | 6 |
| Table 5.1: | Assessment of governance options | 29 |

FIGURES

| | | |
|-------------|---|----|
| Figure 4.1: | Scheduled generator SRMCs and 90th percentile price by region | 12 |
| Figure 6.1: | Illustration of price scaling | 34 |
| Figure 6.2: | Overlap between the various compensation frameworks | 35 |
| Figure 6.3: | Illustration of price scaling | 37 |
| Figure 6.4: | No price scaling due to direction of power flow | 37 |
| Figure 6.5: | Administered price cap applies in both regions | 38 |

1 INTRODUCTION

1.1 The context for the Review

1.1.1 There are several compensation frameworks

There are several compensation frameworks set out in the National Electricity Rules (NER) which are used for:

1. directions compensation
2. market suspension compensation
3. administered pricing compensation
4. affected participant compensation
5. compensation for reductions
6. compensation for scheduling errors

Each of these compensation frameworks serves a different purpose. At a high level, they are designed to address imperfect market outcomes as a result of intervention. The result of these interventions is often that the market outcome is different to what it would have been without the intervention. This can lead to participants incurring certain losses leading to the need for compensation.

The Commission notes that AEMO did not receive any claims for affected participant compensation following the June 2022 market events.¹⁶ Further, the Commission is not aware of any issues associated with the compensation process for reductions and, therefore, this has not been considered in the scope of the Review.

The Commission notes that a rule change request has been submitted regarding the compensation framework for scheduling errors.¹⁷ The AEMC will consider this rule change on a standalone basis, and therefore, it will not be considered in this review.

A detailed comparison of the directions compensation, the market suspension and the administered pricing compensation frameworks is set out in table 2.1, as well as in Appendix A.

1.1.2 The events of June 2022 and subsequent compensation assessments

In June 2022, a combination of factors led to significant operational challenges in the NEM.¹⁸ These factors included:

- high commodity prices
- planned and unplanned outages of scheduled generating plant

16 AEMO, *June 2022 NEM events: Compensation update (15 August 2022)*. See <https://www.aemo.com.au/-/media/files/electricity/nem/data/mms/2022/compensation-update-15august22.pdf?la=en>

17 Tilt Renewables, *Rule Change Request – \$0 Floor Price to claims from the NEM participant compensation fund as a result of a Scheduling Error*, 23 February 2023. See <https://www.aemc.gov.au/rule-changes/zero-dollar-energy-floor-price-participant-compensation-fund-claims>

18 AEMO, *NEM market suspension and operational challenges in June 2022*, 2022, p. 4, https://www.aemo.com.au/-/media/files/electricity/nem/market_notices_and_events/market_event_reports/2022/nem-market-suspension-and-operational-challenges-in-june-2022.pdf

- low output from semi-scheduled generation, and
- high winter demand.

These factors led to a sustained period of high average prices across the NEM. Average prices between 1 June and 12 June ranged from \$283/MWh in Tasmania to \$549/MWh in Queensland.

The sustained high prices led to Queensland exceeding the cumulative price threshold (CPT) on 12 June 2022. This led to the application of the administered price cap (APC) of \$300/MWh in Queensland.¹⁹ This was then followed by the CPT being exceeded in New South Wales, Victoria and South Australia on 13 June 2022. Due to ongoing operational challenges in the power system, AEMO suspended the market on 15 June 2022.

During this event, the directions, administered pricing and market suspension compensation frameworks, as well as the gas compensation framework, were used in the following ways.

- The directions compensation framework, administered by AEMO, was used to compensate participants who were subject to directions from AEMO before the administered pricing period (APP), during the APP, and during the market suspension period.
- The market suspension compensation framework, administered by AEMO, was used to compensate participants during the market suspension period.
- The administered pricing compensation framework, administered by the AEMC, was used to compensate participants during price limit events in June 2022.
- The gas compensation framework for administered pricing compensation, administered by AEMO, was used for APPs in June and July.

Significant amounts of compensation payments were made to participants following the June events. AEMO's June 2022 NEM events compensation update on 6 June 2023 indicated that the total compensation paid to that point (excluding RERT payments) was approximately \$131 million.²⁰ This represents approximately 0.5% of annual market revenue. We note that there are still administered pricing compensation opportunity cost claims underway. At the time of writing the Commission:²¹

- has determined six claims
- is currently assessing another three
- has received supporting information for another two claims but has not yet commenced assessment
- is expecting the supporting information for a further claim to be submitted shortly.

¹⁹ As a result of the making of the National Electricity Amendment (Amending the administered price cap) Rule 2022, the APC was changed from \$300/MWh to \$600/MWh from 1 December 2022 and will remain in place until 30 June 2025. See NER clause 11.155.2. The Amendment of the Market Price Cap, Cumulative Price Threshold and Administered Price Cap rule change project is currently considering the long term setting of the APC to apply from 1 July 2025 to 30 June 2028. See <https://www.aemc.gov.au/rule-changes/amendment-market-price-cap-cumulative-price-threshold-and-administered-price-cap>

²⁰ AEMO, *June 2022 NEM Events: Compensation update (6 June 2023)*, 2023. See <https://aemo.com.au/-/media/files/electricity/nem/data/mms/2023/compensation-update-6-6-june-2023.pdf?la=en>.

²¹ AEMC, *Administered pricing compensation claims*, <https://www.aemc.gov.au/our-work/apc-claims>

Table 1.1: Compensation arising from June 2022 NEM events

| TYPE OF COMPENSATION | COST (\$ MILLION) |
|-----------------------------------|-------------------|
| Directions compensation | \$18.3 |
| Administered pricing compensation | \$18.1 |
| Market suspension compensation | \$94.9 |
| Total | \$131 |

Source: AEMO, *June 2022 NEM Events: Compensation update*, 6 June 2023). See <https://www.aemo.com.au/-/media/files/electricity/nem/data/mms/2023/compensation-update-6-6-june-2023.pdf?la=en>.

Note: In AEMO's report it included the \$82.3 million in RERT payments, increasing the total cost to approximately \$213.5 million. These costs have been removed from the table as RERT costs are not a form of compensation and as such are not being covered by this review.

During the June events and the following compensation assessment processes, several issues were identified with the directions, administered pricing and market suspension compensation frameworks including how they worked together. The Commission and the other market bodies agree that these issues should be investigated to improve outcomes in any future periods of market stress where these frameworks are used.

1.1.3

Other work related to this review

The Commission notes there are two other projects currently underway that are considering elements of the compensation frameworks. They are discussed below.

Improving security frameworks for the energy transition.

This rule change was proposed by Hydro Tasmania and Delta Electricity.²² It seeks to support the energy transition by ensuring security frameworks are fit for purpose. The rule change aims to reduce the regular and inefficient use of directions, ensuring it remains a mechanism of last resort. However, AEMO may still need to use directions from time to time. As such, the Commission has considered changes to the directions compensation arrangements in this rule change.

Currently, directions compensation is based on the 90th percentile price for energy or frequency control ancillary services (FCAS) over the preceding 12 months from when the direction was issued.²³ The Commission considered this may lead to over- or under-compensating participants. To remedy this issue, the Commission proposed in the second directions paper to this rule change to compensate directed participants based on predetermined values that reflect the SRMC for the relevant technology type, as determined through Integrated System Plan (ISP) data inputs.²⁴ The Commission considered this approach could reduce the risk of over- or under-compensation and better balance the needs of generators and consumers.

²² AEMC, *Improving security frameworks for the energy transition*. See <https://www.aemc.gov.au/rule-changes/improving-security-frameworks-energy-transition>

²³ Clause 3.15.7(c)

²⁴ AEMC, *Improving security frameworks for the energy transition*, second directions paper, section 6.3, August 2023. See <https://www.aemc.gov.au/sites/default/files/2023-08/ERC0290%20%E2%80%933%20Improving%20security%20frameworks%20for%20the%20energy%20transition.pdf>

Following feedback from stakeholders, the Commission noted there was strong support for considering changes to the directions compensation framework as part of a larger review. Consequently, the issue of directions compensation will no longer be considered in the *Improving security frameworks for the energy transition* rule change, but instead, will be considered through this review.

Compensation and dispute resolution frameworks.

The Commission is currently considering changes to the framework for gas compensation and dispute resolution in the *Compensation and dispute resolution frameworks* rule change. This rule change was submitted by the Energy Ministers Sub-Group, and seeks to consider options to improve the compensation framework for AEMO directions in the east coast gas system (ECGS). More specifically, the Commission seeks to refine the compensation and dispute resolution frameworks to provide clear and consistent arrangements so that the gas sector operates efficiently and effectively in the long-term interest of consumers. The next step for this rule change is for the Commission to publish a draft rule determination.

This rule change has linkages to the Review in terms of developing a rationale for compensation frameworks. While the Commission notes a consistent rationale may be desirable, the Commission further notes that there may be a need for bespoke arrangements given the differences between the electricity and gas markets and frameworks.

The Commission will continue to consider the Review's interactions with these projects as work progresses.

1.2 Purpose of the Review

The purpose of this review is to determine how the current frameworks in the NER related to directions, administered pricing and market suspension compensation could be improved to achieve better market outcomes. The Review seeks to investigate the three categories of issues discussed below.

Objectives and methodology: Are there changes or improvements to the compensation frameworks' designs that could lead to improved market outcomes that are more in line with the long-term interests of consumers? Issues that may be considered in this area include:

- Whether the current objectives of the compensation frameworks are appropriate?
- Whether changes to the methodologies (I.e. how the frameworks are designed to meet the objectives) of the various frameworks could improve the way they meet the objectives?
- Whether other approaches are needed to encourage participants to provide services during periods of market stress, such as:
 - strengthening incentives provided by the compensation schemes or
 - introducing new participant obligations to provide services

Governance: Are the current roles and responsibilities for the compensation frameworks appropriate? Issues that may be considered in this area include:

- Which market body should be responsible for receiving compensation claims?

- Which market body is best placed to assess any direct or opportunity cost claims?

Administrative: What administrative improvements and other implementation changes are required to help ensure the frameworks achieve their objectives? Issues that may be considered in this area include:

- Providing clarity on the process, eligibility and timelines for overlapping compensation claims. Following the events of June 2022, the AEMC became aware of issues regarding claims for administered pricing compensation that had overlapped with directions and market suspension compensation claims.
- Adding clear timeframes for all compensation frameworks, particularly the administered pricing compensation framework.
- Issues related to cost recovery of compensation claims. Some of these issues include:
 - Clarifications of cost recovery provisions for administered pricing compensation when there is more than one “home region” in an eligibility period need to be clarified
 - Whether there should be changes to the cost allocation mechanisms for the compensation frameworks.

The origin of the Review stems from the events of June 2022. These events have exposed several issues, particularly associated with the administered pricing compensation framework. This consultation paper:

- sets out our thinking on these identified issues
- calls for stakeholders to identify any other issues related to the compensation frameworks that should be considered

1.3 Approach to the Review

The Commission has published the Terms of Reference (TOR) for this review alongside this consultation paper.²⁵ The TOR set out the purpose and objectives of the Review (discussed in section 1.2 above), as well as the approach the Commission will take to completing the Review.

As noted in section 1.2 above, the Commission considers there is value in completing a broad review of the compensation frameworks. At this stage, we are only aware of a set of issues with the relevant compensation frameworks but seek stakeholder views on other relevant issues for consideration. We also note the potential overlap of issues in this review and other ongoing work, particularly the *Improving security frameworks for the energy transition* and *Compensation and dispute resolution frameworks* rule changes.

Therefore, the scope of the Review will be finalised following this first consultation process.

Submissions to this consultation paper are due on **1 February 2024**. The draft report will be published in quarter two of 2024.

²⁵ See Review into Electricity Compensation Framework, Terms of Reference.

2

OVERVIEW OF EXISTING ARRANGEMENTS

Table 2.1 below provides a summary of existing arrangements for electricity. More details on the existing compensation frameworks in the NER can be found in appendix A.

Table 2.1: Overview of compensation frameworks in the NER

| | DIRECTIONS COM- PENSATION | ADMINISTERED PRICING COMPEN- SATION | MARKET SUSPEN- SION COMPENSA- TION |
|---|--|--|---|
| What is the purpose or objective of the framework? | For participants to recover the costs associated with complying with a direction. | To maintain the incentive to supply services during price limit events. | To maintain the incentive to supply during market suspension periods. |
| Where is the process set out in the Rules? | Clauses 3.15.7, 3.15.7A and 3.15.7B of the NER. | Clause 3.14.6 of the NER. | Clauses 3.14.5A and 3.14.5B of the NER. |
| Who is responsible for administering the framework? | AEMO | AEMC | AEMO |
| Who can be compensated and for what? | Participants who are directed to provide specific services, or additional compensable services. | Participants who provide services during price limit events. | Participants who provide services during a market suspension period. |
| What is the mechanism for calculation and payment? | Initially, participants receive the 90 th percentile spot price for energy or FCAS over the preceding 12 months. Participants can lodge claims for additional compensation for direct costs and loss of revenue. | Participants can be compensated for direct and opportunity costs. | Initially, participants receive a payment determined by a formula that estimates direct costs. Participants can lodge claims for additional compensation for direct costs. |
| What is the cost recovery mechanism? | Costs are recovered from market customers proportional to | Costs are recovered from market customers. Recovery is based on the region | Costs are recovered from market customers proportional to |

| | DIRECTIONS COM- PENSATION | ADMINISTERED PRICING COMPEN- SATION | MARKET SUSPEN- SION COMPENSA- TION |
|--|------------------------------|--|--|
| | consumption. ^ | where the APC was in place and is based on proportional consumption.* | consumption. .^^ |

Note: ^ Clause 3.15.8
Note: * Clause 3.15.10
Note: ^^ Clause 3.15.8A

3 MAKING OUR RECOMMENDATIONS

When considering the issues within this review, the Commission considers a range of factors.

This chapter outlines:

- issues the Commission must take into account
- the proposed assessment framework

We would like your feedback on the proposed assessment framework.

3.1 The Commission must act in the long-term interests of consumers

In conducting reviews, the Commission must have regard to the relevant energy objectives.²⁶ For this review, the relevant energy objective is the NEO.

The NEO is:²⁷

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; and
- (c) the achievement of targets set by a participating jurisdiction—
 - (i) for reducing Australia's greenhouse gas emissions; or
 - (ii) that are likely to contribute to reducing Australia's greenhouse gas emissions.

The targets statement, available on the AEMC website, lists the emissions reduction targets to be considered, as a minimum, in having regard to the NEO.²⁸

3.2 We propose to assess this review using these three criteria

3.2.1 Our regulatory impact analysis methodology

Considering the NEO and the issues we have identified, the Commission proposes to use the set of criteria outlined below to assess its recommendations. The assessment criteria reflects the key potential impacts – costs and benefits – of potential review recommendations. We consider these impacts within the framework of the NEO.

The Commission's regulatory impact analysis may use qualitative and/or quantitative methodologies. The depth of analysis will be commensurate with the potential impacts of any recommendations. We may refine the regulatory impact analysis methodology as this review progresses, including in response to stakeholder submissions.

²⁶ Section 32 of the NEL.

²⁷ Section 7 of the NEL.

²⁸ Section 32A(5) of the NEL.

Consistent with good regulatory practice, we will assess all viable policy options — using the same set of assessment criteria and impact analysis methodology where feasible.

3.2.2

Assessment criteria and rationale

The proposed assessment criteria and rationale for each is as follows:

- **Principles of market efficiency** — The Commission considers that this assessment criterion, and the two key sub-criteria, are central to the aim of the compensation frameworks. That is to provide appropriate incentives to maintain productive and allocation efficiency during periods of market stress. In doing so, the frameworks are likely to promote the long-term interests of consumers in terms of reliability, system security, and cost outcomes. This is explored in more detail below.
 - Incentives - The Commission will consider whether any proposed changes to the compensation frameworks will provide the appropriate incentives to participate in the market to avoid reliance on directions and obligations other than when necessary. The Commission considers that providing appropriate incentives will maximise market participation during periods of market stress. In turn, the market functioning normally will promote the reliable, secure and safe provision of energy at an efficient cost to consumers over the long term.
 - Concepts of efficiency - The Commission will consider whether any proposed changes to the compensation frameworks will deliver productive and allocation efficiency, particularly over the commitment and dispatch timeframes. The Commission considers that encouraging ongoing participation in the market during periods of stress is likely to lead to more efficient outcomes relative to a situation dependent on AEMO intervention.
- **Implementation considerations** - The Commission will consider whether any proposed changes to the compensation frameworks will appropriately balance the cost and complexity of implementation and ongoing regulatory and administrative costs. The Commission notes that the current complexity of the frameworks may be a contributing factor to the frameworks not achieving their objectives.
- **Principles of good regulatory practice** - The Commission will consider whether any proposed changes to the compensation frameworks will lead to an end result that is predictable and durable, while being as simple and transparent as possible.

QUESTION 1: ASSESSMENT FRAMEWORK

Are there any other relevant considerations or principles that should be included in the assessment framework?

4 OBJECTIVES AND METHODOLOGY

This section of the Review will consider changes to the way the compensation frameworks are designed, in order to improve outcomes for consumers. The specific issues considered are set out below.

As noted in Chapter 1, the review stems from the events of June 2022 and the subsequent assessment of compensation claims. This chapter, therefore, includes a discussion on how well the compensation scheme's objectives were achieved during the events of June 2022. The chapter seeks stakeholder feedback on what these events revealed about the appropriateness of the compensation methodologies and how well they operate together.

This chapter also seeks feedback on ways the administered pricing and market suspension schemes could better incentivise participants to provide services during future administered price periods (APPs) or market suspension periods. This includes consideration of whether:

- The frameworks could better accommodate batteries given the increasing importance of storage as progress is made towards lowering emissions.
- Risks for participants in recovering costs could impact the effectiveness of the incentives provided by the compensation schemes.
- There is a need for additional measures to achieve participation of participants during periods of market stress, such as reform options identified by the AER in its report on the June 2022 market events.

As this review includes directions compensation, this chapter will also discuss the recent proposals for changing the methodology for directions compensation that were first canvassed in the *Improving security frameworks for the energy transition* rule change. This includes summarising the stakeholder feedback.²⁹ Stakeholders are welcome to provide views on any changes they consider should be made to the methodology of the directions compensation framework.

4.1 Objectives and high level design of the compensation frameworks

Each of the compensation frameworks in the NER has a different objective. While this is the case, the objectives of the administered pricing compensation framework and the market suspension compensation frameworks are very similar, differing mainly in the situations in which they are applied. The various objectives are set out below.

The Commission considers that at a high level, these frameworks are currently designed to keep directions as a last-resort mechanism. This is because the frameworks for administered pricing compensation and market suspension pricing compensation generally offer more favourable compensation or have objectives that aim to be more favourable than the framework for directions compensation.

²⁹ See <https://www.aemc.gov.au/rule-changes/improving-security-frameworks-energy-transition>.

4.1.1

Objective and design of directions compensation

The NER does not explicitly state the objective of the directions compensation framework. The Commission has previously stated that the purpose is for participants to recover the costs associated with complying with a direction.³⁰

Rationale for design of the directions compensation framework

The entitlement of directed participants to receive compensation was included in the NER following a review of directions by the National Energy Market Management Company (NEMMCO) and the National Electricity Code Administrator (NECA) in 2000.³¹ That review concluded that directed participants should receive a “fair payment” that would cover the cost incurred by the participant complying with the direction while minimising inequitable impacts on other market participants.

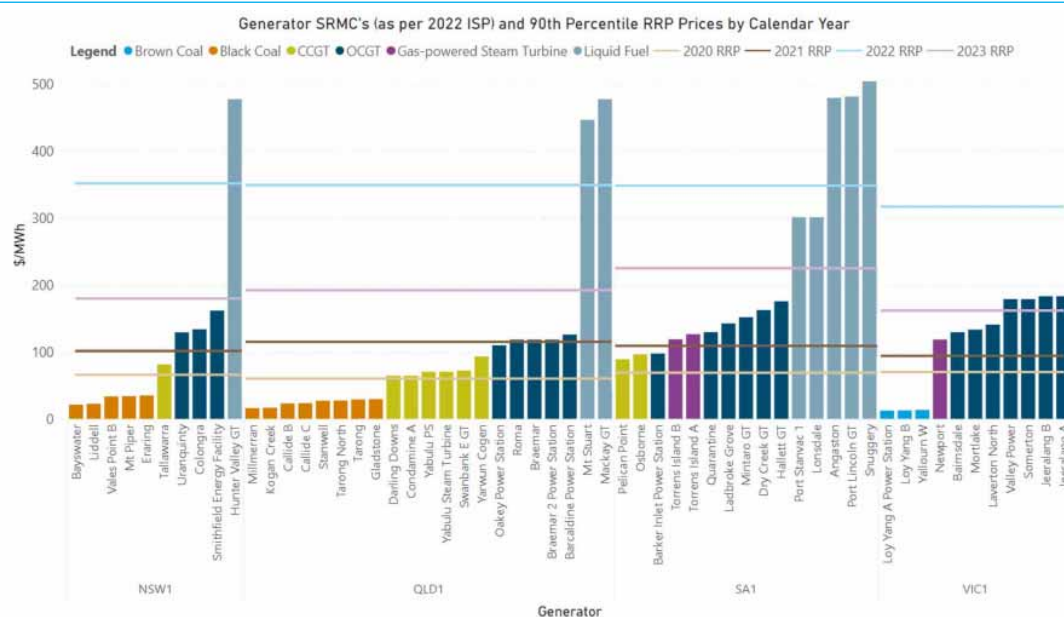
In other documents, the AEMC has noted the existence of the incentive to withdraw capacity and seek directions. The final determination of the *Compensation following directions for services other than energy and ancillary services* rule change concluded that the quantum of compensation paid to directed participants should not be set so high as to incentivise generators to withdraw capacity in order to be directed.³²

More recently, the Commission has raised issues regarding the directions compensation framework in the *Improving security frameworks for the energy transition* Rule change directions paper.³³ In that directions paper, the Commission noted that directions should be viewed as a ‘last-resort’ mechanism. This is because reliance on directions increases security risks to the power system due to inadequate transparency, increased administrative burden, not providing certainty to participants, and not supporting trials of new technologies to support power system security.³⁴

The Commission questioned whether it is appropriate to maintain the approach of compensating directed participants based on 90th percentile price for energy or FCAS over the preceding 12 months from when the direction was issued. This is because the Commission considers this method has a high risk of under or over-compensating participants relative to the SRMCs of generators.

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- 30 AEMC, *Investigation into intervention mechanisms in the NEM*, final report, 2019. See <https://www.aemc.gov.au/sites/default/files/2019-08/Investigation%20into%20intervention%20mechanisms%20in%20the%20NEM%20-%20Final%20report%20-%20published%20version.PDF>.
- 31 NEMMCO and NECA, *Final report – Power system directions in the National Electricity Market*, 2000.
- 32 AEMC, *Compensation following directions for services other than energy and market ancillary services*, Final determination, p. 45. See <https://www.aemc.gov.au/rule-changes/compensation-following-directions-services-other-energy-and-market-ancillary-services>.
- 33 AEMC, *Improving security frameworks for the energy transition*, Directions paper, 2023. See <https://www.aemc.gov.au/sites/default/files/2023-08/ERC0290%20%E2%80%93%20Improving%20security%20frameworks%20for%20the%20energy%20transition.pdf>.
- 34 AEMC, *Improving security frameworks for the energy transition*, Directions paper, 2023, p 5. See <https://www.aemc.gov.au/sites/default/files/2023-08/ERC0290%20%E2%80%93%20Improving%20security%20frameworks%20for%20the%20energy%20transition.pdf>.

Figure 4.1: Scheduled generator SRMCs and 90th percentile price by region



Source: AEMC analysis

Note: SRMC data is sourced from the 2022 ISP data inputs for 2023-24. The dates from the 2022 market suspension have been removed from the calculation of the 2022 90th percentile price.

Instances of over or under-compensation also risk increased costs for consumers. For instance, if a directed participant considers that they have been under-compensated, they may lodge a claim for additional compensation to recover a shortfall in their direct costs under NER clause 3.15.7B. However, consumers do not have any mechanism to claim back costs in the event of over-compensation to directed participants. This inherent asymmetry between market participants and consumers means that the risk of over-compensating directed participants is not identical to the risk of under-compensating them.

To remedy this issue, the Commission proposed a benchmark based compensation framework in the *Improving security frameworks for the energy transition* rule change, similar to that used during market suspension periods. Under this framework, directed participants would be entitled to compensation based on predetermined values of short-run marginal costs (SRMCs) for the relevant technology type, as determined through ISP data inputs. This would be combined with a 15% premium to account for the variability of heat rates and other divergences between the estimated and actual costs on the day.

The Commission further suggested in that paper that opportunity costs should part of compensation for directions, either automatically or via additional compensation claims. The rationale here is to remove any incentive for generators to await a direction rather than participate voluntarily, thereby supporting the intent that directions be a mechanism of last resort.

In response, stakeholders provided the following feedback:

- Calculating compensation based on SRMCs (with a 15% premium) was considered inequitable and not reflective of true costs. This is because compensation based on SRMCs does not account for scarcity, the increased costs of bringing forward plant maintenance and is often erroneously determined.
- Benchmarking these values on ISP data inputs was near-unanimously not supported, as it is considered a flawed method given the values are not updated with sufficient frequency.
- Almost all stakeholders called for the inclusion of opportunity costs, as well as consideration of fuel scarcity, wear and tear, and BESS/storage. For instance, the CEC submitted it is perverse to be considering moving to a compensation framework that deliberately disregards opportunity costs, and therefore purposefully penalises storage assets.
- Snowy Hydro, along with other stakeholders, suggested the risk with pursuing the proposed approach involves more frequent applications for additional compensation, imposing a greater burden on AEMO and the resources of generators.

Another key piece of stakeholder feedback was strong support for considering changes to the directions compensation framework as part of a larger review. Consequently, the issue of directions compensation will no longer be considered in the *Improving security frameworks for the energy transition* rule change, but instead, will be considered through this review.

4.1.2

Objective and design of administered pricing compensation

The objective of the administered pricing compensation framework under clause 3.14.6 of the NER is to maintain the incentive for participants to provide services during price limit events. This is either administered price caps introduced after a period of very high prices or administered price floor events introduced after a period of very low prices. Administered pricing compensation is available to provide the incentive for:

- scheduled generators, non-scheduled generators and scheduled network service providers to supply energy
- ancillary service providers to supply ancillary services
- market participants with scheduled load to consume energy
- demand response service providers to supply wholesale demand response

The framework is designed so that a participant is indifferent about participating in the market during an APP. The participant is indifferent at the point where their revenue from providing a service or services is equal to their costs of providing the service, including their opportunity costs.

Rationale for the design of the administered pricing compensation framework

The *Compensation arrangements under administered pricing* rule change in 2010 introduced compensation based on direct and opportunity costs.³⁵

The Commission's reasoning in the final determination sets out that:

³⁵ AEMC, *Compensation arrangements under administered pricing*, 2010. See <https://www.aemc.gov.au/rule-changes/compensation-arrangements-under-administered-pricing>.

“Whilst compensation based on short-run marginal costs (SRMC) (including opportunity costs) is not the simplest approach or necessarily the least cost approach, it appears to be the most likely option to provide the best balance between:

- maintaining the incentive to supply during an APP, and
- minimising the financial risks [to retailers and consumers] from a compensation payment following an APP.”

In this rule change, the Commission also considered:

- direct cost compensation
- compensation based on participant bids and offers

4.1.3

Objective and design of market suspension compensation

The objective of the market suspension compensation framework is similar to the administered pricing compensation framework. Its objective, which is also set out in the NER, is to maintain the incentive, during market suspension periods, for:³⁶

- scheduled generators to supply energy
- ancillary service providers to supply market ancillary services, and
- demand response service providers to supply wholesale demand response.

Rationale for the design of the market suspension compensation framework

The market suspension compensation framework was introduced in the *Participant compensation following market suspension* rule change in 2018.³⁷ The Commission made a more preferable rule to develop a compensation framework that differed from AEMO’s rule change proposal to introduce a compensation framework for market suspension that aligned with the administered pricing compensation framework. Rather than using the bespoke approach of administered pricing compensation, which the Commission noted was costly to administer, the final rule created a framework that more closely reflects the approach for directions. This is where compensation is, in the first instance, automatically calculated, and allows for claims for additional costs to be made where necessary.

The final determination of the *Participant compensation following market suspension* rule change, introduced important differences between the directions compensation and market suspension framework, particularly with respect to the amount of automatically calculated compensation. This reflects that market suspension compensation applies to all eligible claimants during a market suspension, whereas the directions compensation framework applies ‘ex post’ and only to those select participants who have been directed by AEMO to provide services.

While some stakeholders suggested to the Commission that market suspension compensation should be based on the 90th percentile price (consistent with the directions compensation framework), the Commission did not adopt that approach. Instead, the final rule created a

³⁶ NER clause 3.14.5A.

³⁷ AEMC, *Participant compensation following market suspension*, 2018. See <https://www.aemc.gov.au/rule-changes/participant-compensation-following-market-suspensi>.

framework that compensates generators by reference to the short run costs they are deemed to have incurred. These are calculated using the input assumption values to the ISP.

The Commission noted a range of concerns from stakeholders around the accuracy of these input values in the final determination, including concerns about assumptions regarding heat rates, fuel costs, and the approach to hydro-powered generation and battery storage SRMC estimation. The Commission noted there was difficulty in developing estimations for the SRMC of hydro and batteries and suggested that these be based on values used for gas plants in the same region. The Commission also noted that further details regarding the benchmark values for hydro and batteries could be addressed in the course of AEMO developing the Market Suspension Compensation Methodology.³⁸

It is also noted that market suspension differs from directions and administered pricing compensation in relation to the eligibility of scheduled loads. The final determination on market suspension compensation considered the question of eligibility. The Commission opted not to include ancillary service loads as it was not clear what direct costs would be incurred by ancillary service loads during a market suspension. For the same reason, the final rule did not confer eligibility for compensation on market customers with scheduled loads.

QUESTION 2: OBJECTIVES

1. Do stakeholders have any proposed changes to the objectives of the various compensation frameworks?
2. Is the reasoning behind each objective still appropriate and relevant?
3. Regarding the directions compensation framework, how do we best balance the need to avoid creating a perverse incentive to be directed with the objective of compensating directed participants fairly? How well is this achieved under the current framework?

4.2

The compensation frameworks may not have been effective during the June 2022 market events

During the events of June 2022, the directions, administered pricing and market suspension compensation frameworks were used to varying extents.

- AEMO issued directions between 10 June 2022 until 22 June 2022,³⁹ with additional compensation being paid for some of these directions.⁴⁰

38 AEMO, *Market suspension compensation methodology*, 2022. See https://aemo.com.au/-/media/files/stakeholder_consultation/consultations/nem-consultations/2020/wholesale-demand-response/final-stage/market-suspension-compensation-methodology.pdf?la=en&hash=4D9C7546C80F984B0808862E48871CD0.

39 AEMO, *NEM market suspension and operational challenges in June 2022*, 2022. See https://www.aemo.com.au/-/media/files/electricity/nem/market_notices_and_events/market_event_reports/2022/nem-market-suspension-and-operational-challenges-in-june-2022.pdf.

40 AEMO, *Additional compensation to generators during billing weeks 25 to 26 2022*. See <https://aemo.com.au/en/energy-systems/electricity/national-electricity-market-nem/nem-events-and-reports/market-event-reports/additional-compensation-to-generators-during-billing-weeks-25-to-26-2022>.

- Several participants made claims for additional compensation during the market suspension pricing period.⁴¹
- Participants also made claims for administered pricing compensation to the Commission.⁴²

4.2.1

Administered pricing compensation during June 2022

The events of June 2022 seem to indicate that the administered pricing compensation framework did not achieve its objective of maintaining the incentive for participants to provide services.

While some market participants continued to provide services, a significant number of participants, particularly generators with high SRMCs, withdrew capacity and were instead directed by AEMO.⁴³ This was a significant contributing factor to AEMO suspending the market on 15 June 2022.⁴⁴

In theory, market participants should have been indifferent between participating in the spot market or not during the APP. This is because the framework is designed to compensate participants' direct and opportunity costs. Participants should have preferred to receive administered pricing compensation over directions compensation, given that participants can be expected to be compensated at least equally and potentially more under the administered pricing compensation framework. Some reasons why this may not have been the case include that:

- Participants may be more familiar with the directions compensation framework compared to the other compensation frameworks due to it being used more frequently, or
- There may have been uncertainty around how the administered pricing compensation framework would be implemented.

4.2.2

Market suspension compensation during June 2022

It would also appear that the market suspension compensation framework did not meet its objectives during the June 2022 events. AEMO's NEM market suspension report indicates that a large number of directions were made during the market suspension period.⁴⁵ This indicates that there was some unwillingness for participants to continue to provide services during the market suspension period.

41 AEMO, *Additional compensation to generators during billing weeks 25 to 26 2022*. See <https://aemo.com.au/energy-systems/electricity/national-electricity-market-nem/nem-events-and-reports/market-event-reports/additional-compensation-to-generators-during-billing-weeks-25-to-26-2022>.

42 AEMC, *Administered pricing compensation claims*. See <https://www.aemc.gov.au/our-work/apc-claims>.

43 AER, *June 2022 Market Events Report*, p.2. See <https://www.aer.gov.au/system/files/AER%20June%202022%20Market%20Events%20Report-%20FINAL%20VERSION%20-%2014%20December%202022.pdf>.

44 AEMO, *NEM market suspension and operational challenges in June 2022*, section 7.1, 2022 See https://aemo.com.au/-/media/files/electricity/nem/market_notices_and_events/market_event_reports/2022/nem-market-suspension-and-operational-challenges-in-june-2022.pdf?la=en.

45 AEMO, *NEM market suspension and operational challenges in June 2022*. See https://aemo.com.au/-/media/files/electricity/nem/market_notices_and_events/market_event_reports/2022/nem-market-suspension-and-operational-challenges-in-june-2022.pdf?la=en

Given the objective of market suspension compensation is to maintain the incentive to supply and avoid the use of directions, stakeholders may consider that this was not achieved during the June 2002 events.

AEMO has also noted some issues with the market suspension compensation framework in its submission to the *Improving security frameworks for the energy transition* second directions paper.⁴⁶

In that directions paper, the Commission suggested adopting the approach used in the market suspension compensation framework for directions compensation. This involved moving from the current approach (where directed participants were compensated based on the 90th percentile price from the preceding 12 months) and instead basing compensation on the SRMC for technology types benchmarked against values in the ISP. The key issue raised by AEMO is that relative to the amount claimed by participants in recent compensation claims, the benchmark values in the market suspension pricing framework are relatively low. This suggests that the formula for calculating the benchmark values set out in the rules and/or the Market Suspension Compensation Methodology may need to be updated to avoid under-compensation of participants, which may have reduced the incentive to provide services during the market suspension period.

QUESTION 3: ACHIEVING THE OBJECTIVES

1. Do stakeholders agree with the observation that the administered pricing and market suspension compensation objectives may not have been achieved in the June 2022 events?
2. If directions compensation was preferred to the other frameworks, were there any specific reasons why this was the case?

4.3

We are seeking views on whether there is value in aligning the administered pricing and market suspension compensation frameworks

A potential reason that the administered pricing and market suspension compensation schemes did not maintain the incentive to participate in all instances, could be due to a lack of familiarity with the schemes. This could be made worse by the complexity of each scheme having a different methodology.

There is a clear rationale for the directions compensation methodology to be different from the methodologies for administered pricing and market suspension compensation. Unlike administered pricing and market suspension compensation, directions compensation does not need to maintain the incentive to provide services. There may be an opportunity to reduce

⁴⁶ AEMO, *Submission to the Improving security frameworks for the energy transition: second directions paper*, September 2023. See <https://www.aemc.gov.au/sites/default/files/2023-10/12%2020230928%20Submission%20Improving%20security%20frameworks%20for%20the%20energy%20transition.pdf>

complexity by aligning methodologies of administered pricing compensation and the market suspension compensation given those schemes have similar objectives.

Despite having similar objectives, the methodologies of administered pricing compensation and market suspension compensation are quite different. The timeframes for the assessment of claims also differ between the two frameworks.⁴⁷

The administered pricing compensation process has the following high level steps:

1. Participants are settled at the spot price, which is capped at the APC or administered floor price (AFP).
2. Participants who have made a net loss in the relevant eligibility period can apply to the AEMC for compensation for both direct and opportunity costs.
3. The AEMC makes a determination about whether any compensation should be paid to the claimant.
4. Any compensation amount determined by the AEMC is recovered from consumers by AEMO following the approach set out in NER clause 3.15.10.

The market suspension compensation process takes a different approach:

1. AEMO notifies parties who have been deemed to have made a loss during a market suspension pricing schedule period that they are eligible for compensation.
 - a. This is determined based on a formula set out in clause 3.14.5A(d) of the NER.
2. Eligible parties receive an automatic compensation payment based on a benchmark approach using inputs from the ISP.
3. Claimants who have still made a loss following this automatic compensation payment are entitled to make a claim for additional compensation from AEMO.
4. Either AEMO or the independent expert makes a determination on whether any additional compensation should be paid to the claimant.
5. Any compensation amount determined by AEMO or the independent expert is recovered from consumers following the approach set out in NER clause 3.15.8A.

The Commission is seeking feedback from stakeholders as to whether there is value in maintaining these different approaches given the frameworks have similar objectives.

4.4 We are seeking stakeholder views on whether clarifications are required rather than fundamental methodological changes

There may be a case for not making fundamental methodological changes to the administered pricing compensation framework or the market suspension compensation and instead focusing on clarifications for participants.

⁴⁷ Clause 3.12.1 of the NER specifies that market suspension additional compensation claims should be reflected in the routine revised statement issued approximately 30 weeks after the relevant billing period when the claim was made. The timeframes for administered pricing compensation claims are specified in clause 3.14.6 of the NER. The timeframes are less certain due to the lack of a deadline for providing supporting information for claims.

Reflecting on the events of June 2022, stakeholders may consider that a key factor that led to reduced participation was a lack of clarity and familiarity with the compensation schemes which reduced the effectiveness of the incentive they provided to participants. In addition, stakeholders may consider the level of the APC was a key factor in the suspension of the market in June 2022. Further, stakeholders may consider that the higher administered price cap has minimised any economic issues that may have led to limited participation.

In June 2022 the APC was set at \$300/MWh in June 2022. In November 2022, the Commission made a final determination to increase the APC to \$600/MWh until 30 June 2025.⁴⁸ The Commission has also recently published a draft determination in the *Amendment to the market price cap, cumulative price threshold and administered price cap* rule change which proposes to set the APC at \$600/MWh for the period between 1 July 2025 and 30 June 2028.⁴⁹ It is noted that the Commission acknowledged in the final determination of the *Amending the administered price cap* rule change that the level of the APC was a key factor in the suspension of the market in June 2022. The Commission considers that a higher APC is also likely to increase the likelihood of participation in the market when the price is capped by the APC.

However, participants may still perceive there to be risks associated with participating because there is uncertainty about the information required to support a claim and potentially the way such claims are assessed. Additional clarity and guidance regarding the methodology for administered pricing compensation and market suspension compensation may mitigate the perceived risks without making major changes. These are:

- Changes to improve clarity for opportunity cost claims under administered pricing compensation.
- Changing the premium added to benchmark prices to accommodate fluctuations with fuel prices and heat rates.
- Improving the way that different technology types are valued in the ISP inputs, including storage and dual-fuel technologies.

Other chapters of this paper discuss governance and administrative changes which are areas we are also seeking feedback from stakeholders on, particularly regarding potential clarifications.

4.4.1

We are seeking feedback on whether changes should be confined to clarifying aspects of the administered pricing compensation methodology for opportunity cost claims

The administered pricing compensation framework is the only framework in the NER that considers opportunity costs.⁵⁰

48 AEMC, *Amending the administered price cap*, Final determination, 2022. See <https://www.aemc.gov.au/sites/default/files/2022-11/Amending%20the%20administered%20price%20cap%20-%20Final%20Determination.pdf>.

49 AEMC, *Amendment to the market price cap, cumulative price threshold and administered price cap*, Draft determination, 2023. See <https://www.aemc.gov.au/rule-changes/amendment-market-price-cap-cumulative-price-threshold-and-administered-price-cap>.

50 There are provisions in the directions compensation framework, specifically clauses 3.15.5A(g)(2) and 3.15.7B(a)(1) related to "loss of revenue". This is not a defined term in the NER, however previous independent expert determinations cover concepts of foregone forward-looking revenue.

Clause 3.14.6(e) of the NER requires the Commission to develop and publish the compensation guidelines that:

- define the types of opportunity costs that can be claimed, and
- outline the methodology to be used to calculate direct costs and opportunity costs.

The compensation guidelines define opportunity cost as:⁵¹

“The value of the best alternative opportunity for eligible participants during the application of a price limit event or at a later point in time. The opportunity cost is the foreclosure of this alternative opportunity to use scarce capacity or resources more profitably at the same point in time or at a later point in time.”

Opportunity cost claims were introduced in 2009

The concept of opportunity costs was introduced to the administered pricing compensation framework in the *Compensation arrangements under administered pricing* rule change, which commenced in January 2009.⁵²

In the final determination, the Commission noted that a direct cost only approach may be inappropriate for “fuel limited plants such as hydro power stations, where opportunity costs may comprise a significant share of total costs.”⁵³ The Commission went on to note that “basing compensation following administered pricing on direct costs may not be the most effective way to ensure that supply reliability and market stability are maintained during an APP.”⁵⁴

There may be a case for maintaining opportunity cost claims

The Commission notes that since this determination, hydro-powered generation and gas-powered generation have arguably increased in relevance in the market due to the retirement of other thermal generation capacity, particularly coal generation. In addition to these technologies, battery storage is expected to play a significant role in the NEM within a relatively short horizon.⁵⁵

The underlying logic of including opportunity costs for consideration as part of administered pricing compensation appears to have remained unchanged. Arguably, due to the advent of battery storage technologies and the growing importance of energy storage in the NEM more generally, the importance of considering opportunity costs has increased.

51 AEMC, *Compensation guidelines*, 2022. See <https://www.aemc.gov.au/sites/default/files/2022-11/Final%20compensation%20guidelines%20Dec%202022.pdf>.

52 AEMC, *Compensation arrangements under administered pricing*, 2008. See <https://www.aemc.gov.au/rule-changes/compensation-arrangements-under-administered-pricing>

53 Ibid, p. 34.

54 Ibid, p. 34.

55 AEMO, *2022 Integrated System Plan*, p. 10, <https://aemo.com.au/-/media/files/major-publications/isp/2022/2022-documents/2022-integrated-system-plan-isp.pdf?la=en>.

BOX 1: AEMC ASSESSMENT OF OPPORTUNITY COST CLAIMS

The AEMC is currently assessing four claims for opportunity cost compensation arising from the June 2022 market events. These claims are from:

- Delta Electricity/Sunset Power International Pty Ltd related to its Vales Point Power Station.
- EnergyAustralia Pty Ltd related to its Mt Piper Power Station.
- Origin Energy Electricity Limited related to its Uranquinty, Quarantine and Mortlake Power Stations.
- Snowy Hydro Limited related to its Tumut Three, Upper Tumut and Murray Power Stations.

The AEMC has published a draft opportunity cost methodologies paper for the Delta Electricity and Snowy Hydro claims.*

Note: * - AEMC, *Draft Opportunity Cost Methodologies*. See <https://www.aemc.gov.au/sites/default/files/2023-09/AEMC%20APC%20Draft%20opportunity%20cost%20methodologies%2020230914-wcover%20%282%29.pdf>.

Can the opportunity costs framework be improved?

In the final determination for the *Compensation arrangements under administered pricing* rule change, the Commission noted that:

“Compensation which takes into account the opportunity costs of claimants can create significant uncertainty for Participants.”

There was significant uncertainty regarding opportunity costs during the events of June 2022. This uncertainty may have been caused by:

- a lack of familiarity with the framework, given this is the first time that it has been used
- limited guidance in the NER or compensation guidelines as to what could be considered an opportunity cost claim.

There are multiple potential ways to improve the effectiveness of the opportunity costs framework. These include:

- enhancing the codification of the opportunity cost framework
- providing more certainty about how opportunity cost claims would be treated, including how they could be applied to the full range of technologies, including battery storage

These matters are discussed below.

Enhancing the codification of the opportunity cost framework

The Commission notes that until the events of June 2022, opportunity cost compensation as part of the administered pricing compensation framework had not been considered in the NEM.⁵⁶ The lack of certainty regarding processing opportunity costs claims may have provided a disincentive for participants to submit a claim. One way to improve certainty regarding opportunity cost compensation would be to provide additional codification of the opportunity cost compensation process.

Some potential approaches may be:

- Setting out some standardised methodologies for participants to follow when contemplating an opportunity cost claim
- Providing additional details regarding the evidence that may be needed to support a claim, and
- Setting out more clearly what is considered an opportunity cost and what is not.

Clarifying how opportunity cost claims apply to different technologies including batteries

The Commission notes that in recent years, battery storage has become an increasingly important part of the NEM's generation mix. This trend is closely related to the changes occurring in the market as progress is made towards reducing emissions. AEMO's ISP suggests that this trend is expected to continue.⁵⁷

The Commission has noted in numerous documents that opportunity costs are an important part of the short-run marginal cost of energy limited plant.⁵⁸ Historically, thinking about opportunity costs has been done with other energy limited plant, such as hydro generators, in mind.

To the extent that opportunity cost compensation remains appropriate, the Commission may consider whether any changes to the opportunity cost framework would be necessary to ensure that battery storage technologies are appropriately covered.

The Commission notes that it may be appropriate to consider this issue more broadly. The Commission is aware that the treatment of battery compensation is an issue that applies to all compensation frameworks, and not just the administered pricing compensation framework.

The issue of battery compensation is currently being considered in the *Improving security frameworks for the energy transition* rule change.⁵⁹ Given the overlap between the

56 The Commission notes that a compensation claim was made for "loss of revenue" under the directions compensation framework in 2016. https://aemo.com.au/-/media/files/electricity/nem/market_notices_and_events/market_event_reports/2017/final-determination_additional-comp-claims_01-dec-2016-direction.pdf?la=en&hash=58665C008C64F19F047C408A2268F0C7.

57 AEMO, *2022 Integrated System Plan (ISP)*, 2022. See <https://aemo.com.au/en/energy-systems/major-publications/integrated-system-plan-isp/2022-integrated-system-plan-isp>.

58 AEMC, *Compensation arrangements under administered pricing*, Final determination, p. 33. See <https://www.aemc.gov.au/rule-changes/compensation-arrangements-under-administered-pricing>, AEMC, *Improving security frameworks for the energy transition*, Second directions paper, p. 101. See <https://www.aemc.gov.au/sites/default/files/2023-08/ERC0290%20%E2%80%93Improving%20security%20frameworks%20for%20the%20energy%20transition.pdf>.

59 AEMC, *Improving security frameworks for the energy transition*, Second directions paper, section 6.3.2. See <https://www.aemc.gov.au/sites/default/files/2023-08/ERC0290%20%E2%80%93Improving%20security%20frameworks%20for%20the%20energy%20transition.pdf>.

consideration of battery compensation in this rule change, the Commission is seeking stakeholder feedback on the approach to compensation for batteries more broadly in this review.

The Commission emphasises the potential inconsistency with including opportunity costs in the directions compensation framework given that at a high level, directions are supposed to be viewed as a last resort. The Commission is interested in stakeholder views on this issue.

4.4.2 We are seeking feedback about whether there should be changes to the premium added to benchmark prices in the market suspension compensation framework

As set out in section 4.1.1, the market suspension compensation framework is based on a formulaic assessment of short-run marginal costs. The Commission noted at the time of the decision that this approach was not designed to be precisely reflective of actual costs.⁶⁰ In order to accommodate differences between estimated and actual costs facing a given generator at a given time, the Commission determined that a 15% premium should be applied to automatic market suspension compensation payments.

To the extent that this premium does not appropriately accommodate this variability, an option may be to increase the premium to further incentivise participation during an administered price period.

4.4.3 We are seeking feedback about improving the way that different technology types are valued in the market suspension compensation framework

The Commission is aware that there are issues associated with the current values in the ISP inputs. As set out in the *Improving security frameworks for the energy transition* rule change, benchmark values for energy storage systems would be close to zero, given that the fuel costs for these systems are very low. This may not be reflective of the actual costs incurred by these technologies, and therefore may not provide the appropriate incentive to participate in the market during a market suspension.

AEMO has also noted issues around the benchmark compensation values for variable renewable energy plant and dual-fuel units.⁶¹

4.5 We are seeking stakeholder views on whether more significant methodological changes are required

There may be a case for more significant methodological changes to the compensation schemes if you consider that the incentives provided by administrative pricing and market suspension compensation need to be stronger to encourage participants to provide services during an APP or market suspension. In particular, you may consider that the incentives cannot be made effective through methodological clarifications discussed above, or the governance changes addressed in chapter 5 or administrative changes (such as changing the

⁶⁰ AEMC, *Participant compensation following market suspension*, Final determination, p. 28, https://www.aemc.gov.au/sites/default/files/2018-11/Final%20determination_0.pdf.

⁶¹ AEMO, Submission to the Improving security frameworks for the energy transition: second directions paper, September 2023. See <https://www.aemc.gov.au/sites/default/files/2023-10/12%2020230928%20Submission%20Improving%20security%20frameworks%20for%20the%20energy%20transition.pdf>.

eligibility period for administered pricing compensation) that are covered in chapter 6. Participants may perceive that more significant changes are needed to address the uncertainty and risks to participants in recovering costs during APPs.

In relation to strengthening the incentive provided by market suspension compensation, one of the changes that we could consider is allowing for opportunity costs in the market suspension framework.

The market suspension compensation framework is currently based on the concept of “short-run marginal costs”, which is referred to in the *Participant compensation following market suspension* final determination as “estimated costs”.⁶²

Generally, the concept of short-run marginal cost includes consideration of opportunity costs.⁶³ In the final determination for the *Participant compensation following market suspension* rule change however, the Commission did not include opportunity costs as “compensable costs”. This decision was made on the basis that opportunity costs do not form part of the directions compensation framework, which was a key reference point to the rule.⁶⁴ As stated in section 4.1.1, the Commission recognised in the determination that this approach may have issues for storage plant, particularly hydro and batteries.

The Commission is interested in stakeholder views on whether including opportunity costs in the market suspension compensation framework would improve the incentive to participate during market suspension periods.

In relation to strengthening the incentive provided by administered pricing and/or market suspension compensation, stakeholder views are welcome on whether the framework that compensates participants for direct and opportunity costs is sufficient for incentivising participation. If not, we are interested to understand why, including any measures that could be considered as part of this review. It is noted that any considerations of sending a stronger incentive would need to be considered in the context of the NEO, which requires us to consider what would be in the long term interests of consumers, including cost impacts to consumers.

4.6

We are seeking stakeholder views on whether other options are needed to achieve participation during periods of market stress

The Commission is interested in stakeholder views about whether other changes are required to achieve participation during APP and market suspension periods.

62 AEMC, *Participant compensation following market suspension: Final determination*, November 2018. See <https://aemc.gov.au/rule-changes/participant-compensation-following-market-suspensi#:~:text=Final%20determination&text=The%20compensation%20framework%20will%20apply,central%20dispatch%20and%20pricing%20process>.

63 ERA, *Short run marginal cost – simplified paper*, 2009. See <https://www.era.gov.au/cproot/8210/2/20091223%20Short%20Run%20Marginal%20Cost%20-%20Simplified%20Paper.pdf>.

64 AEMC, *Participant compensation following market suspension*, Final determination, p. 47. See https://www.aemc.gov.au/sites/default/files/2018-11/Final%20determination_0.pdf

Potential changes that could be considered in this option are those suggested by the AER in the June 2022 market events report.⁶⁵ This report analysed the events that led to the market suspension and sets out some possible reform options for consideration.

These reform options arose from the AER's investigation which involved it gathering evidence of behaviour that it stated resulted in poor market outcomes. According to the AER a number of generators engaged in conduct that significantly contributed to the circumstances causing AEMO to issue directions - particularly in the context of withdrawing capacity when a forecast or actual LOR 2 notice or a forecast LOR 3 notice had been issued. The evidence obtained by the AER appeared to indicate that several generators had little or no regard about the effect of their actions on the broader system.

However, the AER stated that, under the current Rules framework these generators are likely to be found to have had reasonable cause to withdraw capacity, given the circumstances. The AER considered this is most likely where these causes included limited fuel availability and the NEM Dispatch Engine not being able to dispatch effectively due to withdrawn capacity.

The AER's report also explains that another cause cited by generators was that they would have had to supply electricity at a loss. The AER stated that while compensation was available, which was intended to incentivise generators to supply energy during the APP, the generators instead chose to rebid to withdraw capacity from the market. The AER consider that there were a number of relevant factors:

- the low awareness and understanding of compensation schemes
- an APC of \$300/MWh which was insufficient to cover the short-run marginal costs of most conventional gas or coal generation in these particular circumstances
- an underpinning principle of the Rules that generators have maximum commercial freedom to operate
- no positive obligation to supply in response to a LOR notice.

The AER considered that the key issue that flows from this conclusion is that while the Rules currently appear to allow for market participants to have maximum commercial freedom to decide how they will operate in the market, this can be detrimental to power system security, particularly under times of system stress.

The AER noted that the compensation scheme designed to incentivise generators to supply did not effectively avoid the challenges. AER also noted that due to the availability of compensation through the NER, there is not a strong rationale for market participants to fear making a loss. It is on this basis that the AER identified the following reform options:

- removing commercial considerations from the list of reasonable causes for causing a direction in clause 4.8.9(c2), due to the existence of the compensation frameworks
- introducing a positive obligation on generators to continue to offer capacity into the market during actual LOR2 or LOR3 conditions during an administered price period, and

⁶⁵ AER, *June 2022 market events report*, 2022. See <https://www.aer.gov.au/wholesale-markets/compliance-reporting/june-2022-market-events-report>.

- introducing an obligation for generators to use available price bands during APPs.

Stakeholders are welcome to provide views on whether these reform options are needed to supplement the incentives provided by the compensation schemes.

QUESTION 4: METHODOLOGY

1. Do stakeholders have any suggestions related to the directions compensation framework that could enable it to more effectively meet its objective to fairly compensate directed participants without creating a perverse incentive to be directed?
2. Do stakeholders consider there is value in having different approaches to the various compensation frameworks? Would better outcomes be more likely if the frameworks were consistent where possible?
3. Should opportunity costs be considered in the compensation frameworks? If so, which ones and why?
4. Do stakeholders agree with providing more codification and guidance about how opportunity cost compensation is likely to be assessed?
5. Do stakeholders consider that changes to the compensation frameworks may be necessary due to the advent of battery energy storage systems? If so, are there any specific changes that should be considered?
6. Do stakeholders consider that administered pricing compensation provides a sufficient incentive for participation in the market during an APP? If not, please explain why and include any measures that could be considered as part of this review.
7. Do stakeholders agree with the suggestions made by the AER regarding removing economic considerations for causing a direction given the availability of compensation?
8. Do stakeholders have a preference for a benchmark approach to compensation such as the market suspension compensation framework, or a more open framework such as the administered pricing compensation framework?

5 GOVERNANCE

This section of the Review seeks stakeholder feedback on which market body should be responsible for administering the elements of the compensation framework.

5.1 The current governance arrangements

As set out in chapter 2, different market bodies are currently responsible for different elements of the compensation framework. AEMO is responsible for compensation for directions and market suspension, and the Commission is responsible for administered pricing compensation.

AEMO also administers compensation claims for gas under the NGR.⁶⁶

In considering the issues with the current governance arrangements it is important to reflect on the organisational challenges associated with maintaining a standing capability for events that are infrequent and difficult to predict. This unpredictability refers not only to the timing of administered pricing and market suspension events but also to their characteristics. Each event has the potential to be quite different when it comes to the volumes of claims and the level of complexity. For example, the AEMC was required to re-allocate and hire resources, set up processes and provide advice to the industry in relation to multiple claims for administered pricing compensation following the events in June 2022. In comparison, the Commission's previous experience of administered pricing compensation dated back to 2010, where the AEMC was required to assess a single claim.⁶⁷ Not only did the June 2022 event result in multiple claims, it also gave rise to additional layers of complexity in terms of coordinating the assessment of administered pricing compensation claims with market suspension compensation claims and directions compensation.

5.1.1 There may be some issues with this approach to governance

During the events of June 2022 and the following compensation assessment process, a number of issues arose likely due, in part, to the governance arrangements for this framework. These issues are set out below.

The governance arrangements may have contributed to confusion about how to apply for compensation

The first issue was confusion about how to apply for compensation given the various overlapping compensation frameworks, particularly the administered pricing compensation framework and the market suspension compensation framework.

Clause 3.14.6(h) and (i) set out that an eligible participant may make a claim for administered pricing compensation by providing the Commission and AEMO with written

⁶⁶ Section 237 of the NGR. We note that claimants submit claims to AEMO and the claim is then assessed by the Wholesale Energy Market Dispute Resolution Adviser.

⁶⁷ AEMC, *Administered pricing compensation claims*. See <https://www.aemc.gov.au/markets-reviews-advice/compensation-claim-from-synergen-power>.

notice of its claim within five business days of notification by AEMO that the administered price period has ended.

Clause 3.14.5B of the NER sets out that participants may make a claim for additional market suspension compensation by making a written submission to AEMO within 15 business days of being notified by AEMO that they are eligible for compensation.

Participants noted that having to submit claims to different organisations led to confusion and uncertainty about cost recovery. If the current governance arrangements are maintained, this could have an impact on the effectiveness of the administered pricing compensation process to maintain the incentive for participants to provide services in a future event and result in an increased risk of poor reliability outcomes.

Difficulty maintaining capacity and capability to respond to claims in a timely manner due to infrequent use of the schemes

Prior to the events of June 2022, the administered pricing compensation framework had only been used once, with a decision made by the Commission in 2010 following an administered price period in South Australia between January and February 2009. This was for a direct cost claim only.⁶⁸ Given the infrequency of the claims, the AEMC and AEMO needed to act quickly to establish appropriately resourced teams to deal with the number of claims that we received. While the AEMC has made substantial progress in assessing claims, there are some practical issues that have arisen from the claims that have been assessed thus far. These include:

- The Commission is reliant on information and confirmation from AEMO in order to complete compensation claims, which can lead to more time being required to assess a claim, and
- Given the infrequency of these events, the Commission had to establish new processes, in collaboration with AEMO, to deal with the claims that we received.

5.2 There are several potential options regarding governance

The Commission considers there are a range of possible options for setting out the governance of the compensation framework. There are two key questions to consider regarding the governance arrangements for compensation claims:

1. Who is responsible for receiving claims?
2. Who is responsible for assessing claims?

The Commission considers that it may be appropriate to have a single body responsible for receiving all claims for compensation to minimise the possibility of confusion and improve coordination and information flows. This would address concerns regarding confusion about who to submit various claims to.

⁶⁸ AEMC, *Compensation claim from Synergen Power*, <https://www.aemc.gov.au/markets-reviews-advice/compensation-claim-from-synergen-power>.

There are a range of possible options regarding who is responsible for the assessment of the claims.⁶⁹ These are set out below, and assessed in table 5.1:

- Option 1: AEMO is responsible for all compensation frameworks in the NEM. This option would leave AEMO responsible for its current sections of the compensation framework, and also make it responsible for administered pricing compensation. To the extent that opportunity costs are included in compensation frameworks in future, AEMO would also be responsible for these. If AEMO were to become responsible for further areas of the compensation framework, it is likely that the existing role of the independent expert would need to be considered.
- Option 2: The Commission retains responsibility for opportunity cost claims only. This option would make AEMO responsible for the direct cost component of the administered pricing compensation framework, and leave the determination of opportunity costs as the Commission's responsibility.
- Option 3: The AER takes responsibility for opportunity cost claims. This option would make AEMO responsible for the direct cost component of the administered pricing compensation framework, and make the AER responsible for assessing opportunity cost claims.
- Option 4: No change to the current governance arrangements. There would be no change to the governance structure of the compensation frameworks. The Commission notes AEMO's current responsibilities for determining compensation claims may be referred to an independent expert in some cases.⁷⁰ If AEMO were to become responsible for further areas of the compensation framework, it is likely that the role of the independent expert will need to be considered.

Table 5.1: Assessment of governance options

| OPTION | PROS | CONS |
|---|---|---|
| AEMO is responsible for all compensation frameworks in the NEM. | <p>Lower administrative burden for completing claims given:</p> <ul style="list-style-type: none"> • AEMO experience in administering direct cost claims. • AEMO access to relevant data to determine direct cost claims. <p>Reduced uncertainty for market participants that all compensation claims are</p> | AEMO is not an economic regulator and it's functions to date have not included determining opportunity costs. |

⁶⁹ These options are based on the current design of the various compensation frameworks. To the extent that stakeholders have suggestions on the design of the frameworks in chapter 4, these may impact the governance arrangements of the frameworks. If such changes are made, the governance can be reconsidered.

⁷⁰ NER clause 3.15.7A(h) sets out the arrangements for directions compensation. NER clause 3.14.5B(f) sets out the arrangements for market suspension compensation.

| OPTION | PROS | CONS |
|---|--|---|
| | received by AEMO. | |
| The AEMC retains responsibility for opportunity cost claims only, with AEMO administering direct cost claims. | <p>Lower administrative burden for completing claims given:</p> <ul style="list-style-type: none"> AEMO experience in administering direct cost claims. AEMO access to relevant data to determine direct cost claims. <p>The AEMC considers economic efficiency in all market designs, so is reasonably placed to consider opportunity costs.</p> | <p>Different market bodies would assess the opportunity and direct cost components of participant claims.</p> <p>The AEMC does not have a dedicated resource to process assessment claims.</p> <p>The AEMC does not have ownership of the data required to process these claims, leading to a reliance on AEMO to process claims.</p> |
| The AER takes responsibility for opportunity cost claims only, with AEMO administering direct cost claims. | <p>Lower administrative burden for completing claims given:</p> <ul style="list-style-type: none"> AEMO experience in administering direct cost claims. AEMO access to relevant data to determine direct cost claims. <p>The AER is the economic regulator in other areas, and is therefore reasonably placed to consider opportunity cost claims.</p> | <p>Different market bodies would assess the opportunity and direct cost components of participant claims</p> <p>The AER does not have a dedicated resource to process assessment claims.</p> <p>The AER does not have ownership of the data required to process these claims, which means it would have to rely on AEMO to process claims</p> |
| No change to the current arrangements. | Stability for market participants given the framework was used for the June 2022 events. | <p>The AEMC would continue to face the challenge of building the appropriate capability and capacity to assess infrequently occurring compensation claims.</p> <p>AEMC does not have ownership of the data required to process these claims, leading to reliance on AEMO to process claims, particularly direct cost claims.</p> |

QUESTION 5: GOVERNANCE

1. Do stakeholders think it is appropriate to have a single point of receipt for all compensation claims to reduce confusion?
2. Who should be responsible for the various compensation frameworks?
3. Are there any other governance issues that should be considered?

6 ADMINISTRATIVE

This section will consider administrative changes to the compensation frameworks.

As noted in Chapter 1, the origins of this review were the events of June 2022 and the subsequent assessment of compensation claims. As such, there are several known issues that can be discussed in more detail. This does not preclude other relevant issues about the administration and implementation of the compensation frameworks being raised in submissions to this paper.

6.1 Issues associated with overlapping compensation frameworks

During the assessment of compensation claims related to the June 2022 events, issues arose regarding the application of overlapping compensation frameworks. Specifically, the events revealed that there is potentially a lack of clarity about the interaction between administered pricing compensation and the directions and market suspension frameworks.

While the NER sets out the interaction between market suspension compensation and directions compensation, it does not clearly set out interactions between the administered pricing compensation framework and the other compensation frameworks.

The NER states that when a directed participant is also a market suspension compensation claimant in any trading interval during a market suspension pricing schedule period, then that participant:

- Is entitled to automatic market suspension compensation⁷¹ but not automatic directions compensation^{72,73}
- May recover additional directions compensation⁷⁴, but may not claim additional market suspension compensation.^{75,76}

The Commission is interested in stakeholder views about whether a similarly clear hierarchy or process for dealing with overlapping administered pricing compensation claims in the NER would be beneficial. In particular, the Commission is seeking feedback on the following issues created by the framework's eligibility period. These are:

- eligibility periods that create overlaps between claims, whereby compensation claims are to be assessed twice, leading to:
 - higher administrative costs
 - uncertainty for claimants that may give rise to financial issues for them.
- eligibility periods that create a perverse incentive for generators to withdraw services during an APP and await a direction.

71 Under clause 3.14.5A(d) of the NER.

72 Under clause 3.15.7 of the NER

73 Clause 3.15.7(d1) of the NER.

74 Under clause 3.15.7B of the NER.

75 Under clause 3.14.5B of the NER

76 Clause 3.14.5B(b) of the NER.

The Commission also seeks feedback on two options for addressing these issues and the pros and cons of the different approaches.

Before describing these issues and solutions, it is important to understand the administered pricing compensation framework's eligibility period. Therefore, this section commences with an overview.

6.1.1

Overview of the eligibility period for administered pricing compensation

The eligibility period is a critical part of the administered pricing compensation framework. A participant is eligible for administered pricing compensation if total costs over an entire eligibility period exceed the total revenue received from the spot market (i.e. incur a net loss). The eligibility period starts from the first trading interval when the spot price is set by the APC or administered floor price (AFP), until the last trading interval of that day.

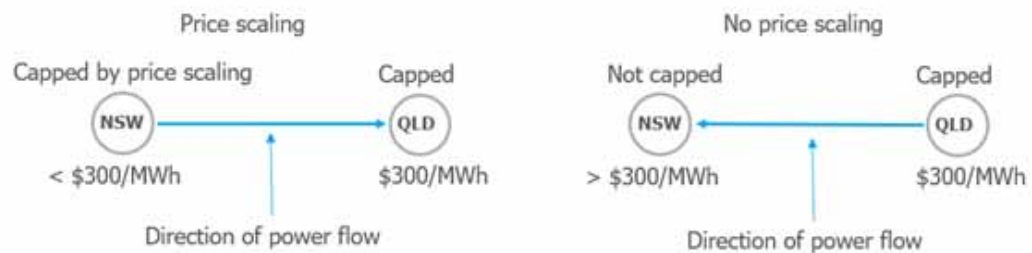
The definition of an eligibility period for administered pricing compensation is dependent on a "price limit event." A price limit event is defined in clause 3.14.6(a)(1) to (4) of the NER, and generally means that either:

- The spot price for a trading interval is set by the APC or AFP during an administered price period.
- The spot price for a trading interval is set as a result of "price scaling."

Price scaling is set out in clause 3.14.2(e)(2) of the NER. This clause states that if any regional reference node (RRN) is set by the APC, then spot prices at all other RRNs connected by a regulated interconnector that have energy flows towards the capped RRN must not exceed the APC divided by the average loss factor that applies in the direction of energy flow.

Therefore, an eligibility period can occur in a region before the APC is applied to that region. The illustration below shows an example where the Queensland region, that is capped by the APC, causes power flows towards Queensland from the uncapped New South Wales region to be capped by price scaling. In this example, the eligibility period applies not only to generators providing services in the capped region (Qld) but also to those generators in New South Wales that are providing power when the energy flows across the interconnector towards the capped region (Qld).

Figure 6.1: Illustration of price scaling



Source: AEMC

Note: This illustration is using the previous APC of \$300/MWh. As a result of the making of the National Electricity Amendment (Amending the administered price cap) Rule 2022, the APC was changed from \$300/MWh to \$600/MWh from 1 December 2022 and will remain in place until 30 June 2025. The Amendment of the Market Price Cap, Cumulative Price Threshold and Administered Price Cap rule change project is currently considering the longer term setting of the APC to apply from 1 July 2025 to 30 June 2028. See <https://www.aemc.gov.au/rule-changes/amendment-market-price-cap-cumulative-price-threshold-and-administered-price-cap>

6.1.2

The administered pricing compensation framework's eligibility period creates the potential for overlapping compensation claims

The need to consider all costs and revenues across each eligibility period is unique to the administered pricing compensation framework, both in terms of determining eligibility for compensation and calculating the amount of compensation to be paid. This is different to:

- directions compensation: where a directed participant will receive directions compensation for energy or other services it supplies during an intervention trading interval, which is a trading interval declared by AEMO where one or more AEMO intervention event(s) is in effect.⁷⁷
- market suspension compensation: where eligible participants may receive market suspension pricing compensation during market suspension pricing schedule periods. These are the periods during which spot prices are set by AEMO in accordance with the market suspension pricing schedule.⁷⁸

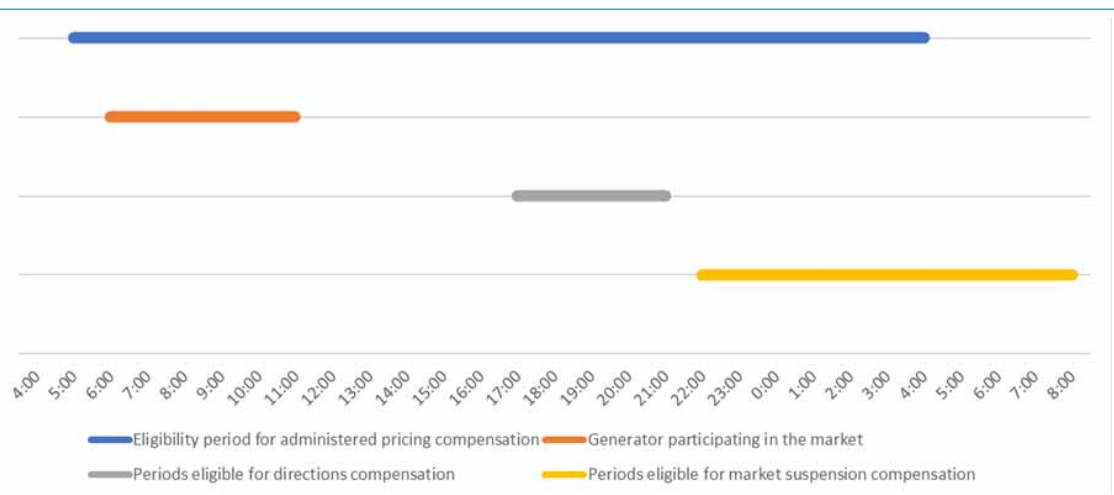
Unlike the eligibility period in the administered pricing compensation framework, that can be up to a full trading day, both the directions and market suspension frameworks only compensate participants during the trading intervals where the claimant was affected by the intervention.

Figure 6.2 below provides an illustration of the potential for overlap between administered pricing compensation and other compensation frameworks.

⁷⁷ Chapter 10, definition of "intervention trading interval" and clause 3.9.3(a) of the NER.

⁷⁸ Chapter 10, definition of "market suspension pricing schedule period".

Figure 6.2: Overlap between the various compensation frameworks



Source: AEMC

In this example, the eligibility period begins at 5:00am. The generator in question participates in the market between 6:00am and 11:00am. It is then directed between 5:00pm and 9:00pm, and the market is suspended from 10:00pm onwards. The relevant eligibility period ends at 4:00am the following day. Although any compensation for the direction or market suspension would only consider the relevant trading intervals in which the generator was directed or the market was suspended, administered pricing compensation must consider the entire eligibility period, necessitating the inclusion of directions and market suspension compensation. This raises a number of issues which are discussed below.

6.1.3

The concept of eligibility periods leads to issues with administered pricing compensation

Eligibility periods create areas of overlap between claims

During the June 2022 events, there were multiple times when a generator applied for administered pricing compensation as well as making claims for additional directions compensation. This is because generators may have bid into the market at some points throughout the event, and received directions from AEMO at other points.

Further, due to the market being suspended at 14:05 on 15 June, there was overlap between administered pricing claims on 15 June and market suspension compensation claims.

Because of the requirement to consider all costs and revenues across an eligibility period, the Commission will take into account the value of any other sources of compensation paid to the claimant where the compensation arises out of the same events.⁷⁹

⁷⁹ AEMC, Compensation guidelines, 2022. See <https://www.aemc.gov.au/sites/default/files/2022-11/Final%20compensation%20guidelines%20Dec%202022.pdf>.

The Commission has set out the practical implications of these arrangements in various administered pricing compensation determinations.⁸⁰ The Commission noted that it is clear from the compensation guidelines, the AEMC's previous determinations and general principles that market participants should not be compensated twice for the same losses. The administered pricing compensation guidelines note that in determining the amount of administered pricing compensation payable, the Commission may take into account the value of any other sources of compensation paid, or to be paid, or under consideration to be paid to the claimant where that compensation arises out of the same events and covers the same costs that are the subject of this compensation claim.⁸¹

Applying the compensation guidelines in assessing overlapping claims (claims where a claimant has been awarded compensation by AEMO in the relevant eligibility period) requires the Commission to (in effect) re-make and potentially revise earlier compensation decisions determined by a separate market body. This is because:

- The method set out in the compensation guidelines requires the AEMC to make a determination in relation to all costs and revenues across each eligibility period.
- The formula provided in the guidelines for calculating administered pricing compensation contemplates an adjustment to be made for other compensation payable to avoid compensation being paid twice.
- Application of the formula requires the AEMC to assess costs for the entirety of the eligibility period(s), including sub-periods which are the subject of separate compensation claims that have already been determined and awarded by AEMO or its independent expert.

The Commission considers that this may not be a good approach because:

- It increases the administrative costs of determining compensation claims by assessing claims twice, and
- Having claims assessed twice creates uncertainty for participants that could give rise to financial issues for them

Eligibility periods may create perverse incentives for generators

During the events of June 2022, price scaling occurred over 12 and 13 June, as Queensland, New South Wales, South Australia and Victoria chronologically entered APPs.

This led to periods where, depending on power flows, prices fluctuated between very low or very high in regions that had not yet entered an APP.

For claimants, this meant that although they may not have been consistently affected by the APC on 12 and 13 June, their compensation claim must take into account the revenues and costs incurred in every trading interval in the eligibility period. This may have created perverse incentives for generators in deciding whether or not to provide services during an APP. This is explored using the example below.

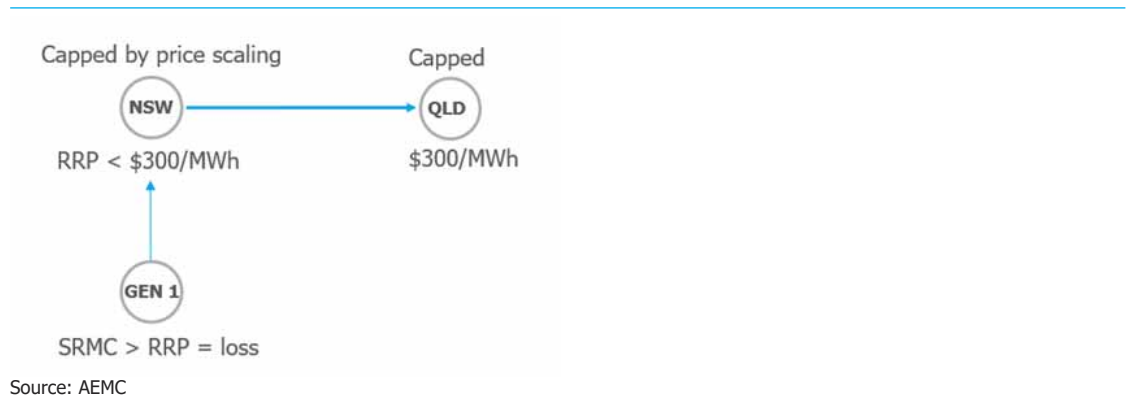
⁸⁰ AEMC, *Administered pricing compensation claims*, Braemar Power Project, pp. 6-8, Shell Energy, pp. 5-7.

⁸¹ AEMC, *Compensation guidelines*. See <https://www.aemc.gov.au/sites/default/files/2022-11/Final%20compensation%20guidelines%20Dec%202022.pdf>.

For this example, an APP is in place in Queensland and there is not an APP in place in New South Wales where the generator is located.⁸²

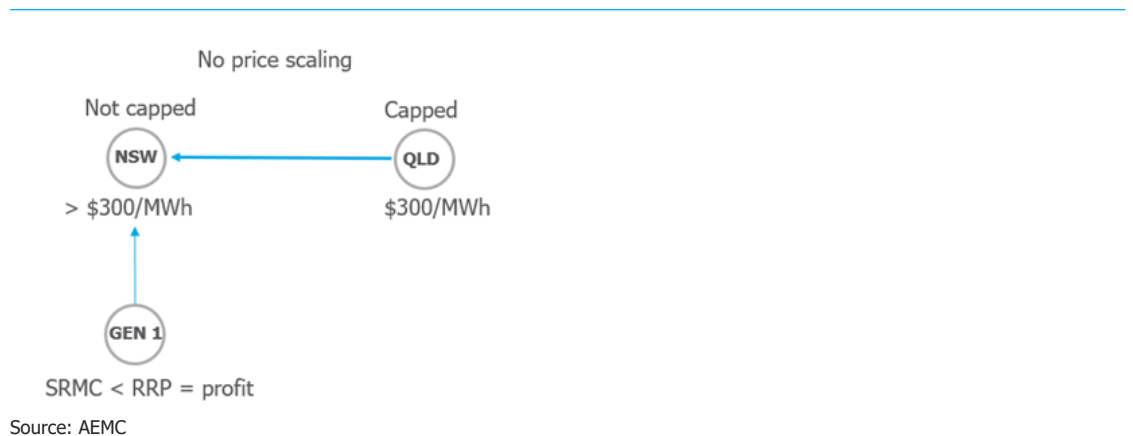
When power is flowing towards Queensland, the generator is affected by the APC and makes a loss during those intervals (because costs are higher than what they received from the capped spot price).

Figure 6.3: Illustration of price scaling



When the direction of power flows changes so that it is flowing into New South Wales from Queensland, the generator is no longer affected by the APC, and makes a profit, such that it is in a net profitable position.

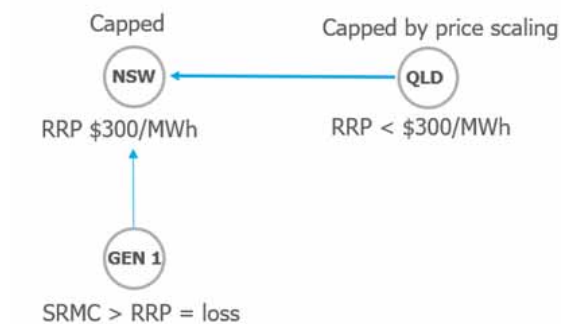
Figure 6.4: No price scaling due to direction of power flow



Then assume the APC comes into effect in New South Wales.

⁸² The illustrations below are using the previous APC of \$300/MWh. As a result of the making of the National Electricity Amendment (Amending the administered price cap) Rule 2022, the APC was changed from \$300/MWh to \$600/MWh from 1 December 2022 and will remain in place until 30 June 2025. The Amendment of the Market Price Cap, Cumulative Price Threshold and Administered Price Cap rule change project is currently considering the longer term setting of the APC to apply from 1 July 2025 to 30 June 2028. See <https://www.aemc.gov.au/rule-changes/amendment-market-price-cap-cumulative-price-threshold-and-administered-price-cap>.

Figure 6.5: Administered price cap applies in both regions



Source: AEMC

Because the generator made a net profit during the eligibility period, this must be taken into account in any claim for administered pricing compensation. Any future losses incurred by operating during the APP would reduce the net profit position of that generator. The profit maximising choice may be to simply not generate any further during the eligibility period, and instead wait to receive a direction, where previous revenues are not taken into account. This may not be an optimal outcome because generators may be incentivised in this scenario to prefer a direction rather than participate in the market.

6.1.4

Possible options to address these issues

There are a few possible solutions to deal with these issues:

Option 1: Align the periods of eligibility for administered pricing compensation with other frameworks and only consider compensation in trading intervals where the party is affected by the APC or price scaling.

The advantages of this option are that it:

- addresses both of the issues raised by:
 - Considering administered pricing on a trading interval basis, it would be possible to clearly delineate between the application of different frameworks.
 - Removing consideration of earlier profits it would remove the incentive for participants to seek a direction rather than participate in the administered pricing compensation framework if the participant was in a net profitable position.
- is straightforward to implement

The disadvantages of this option are that it may lead to increased compensation payments relative to the current arrangements. As the current framework takes into account all costs and revenues across an eligibility period, it also includes periods where the claimant may not have been subject to the APC, and may have made a profit. This has the effect of reducing the overall compensation payment in that eligibility period.

Option 2: Leave consideration of costs across an eligibility period, but exclude periods where the generator has applied for, or been paid other compensation.

The advantages of this option are that it:

- addresses the issue of overlapping compensation claims by providing clear delineation between the different compensation frameworks
- is straightforward to implement

The disadvantage of this option is that it does not solve the issue of perverse incentives for generators associated with considering compensation payments across an entire eligibility period.

QUESTION 6: OVERLAPPING COMPENSATION CLAIMS

1. Do stakeholders agree with the issues identified regarding overlapping compensation claims?
2. Do stakeholders agree with the potential solutions identified to address issues arising from overlapping compensation claims? Do stakeholders prefer a particular option or propose other options for consideration?

6.2

Adding a time limit for supporting information

The administered pricing compensation framework does not include a time limit for claimants to submit supporting information. This is different from the directions and market suspension frameworks in the NER.⁸³

The NER states that claimants must submit a written notice of its claim to the Commission and AEMO within five business days of the end of the APP as notified by AEMO.⁸⁴ Following this, however, there are no timeframes in which claimants must provide supporting information to demonstrate their claim.

This led to a number of issues during the assessment of the claims, including:

- uncertainty for the Commission about when the assessment of claims would begin, leading to resourcing uncertainty.
- consequences for cost recovery, including:
 - delayed pass-through to retailers
 - interference with the liquidation of failed retailers due to requirements to hold capital for future compensation cost recovery
 - implications for the Default Market Offer and Victorian Default Offer, in estimating the amount of compensation that will need to be recovered from customers
- uncertainty about the interaction of this with other compensation processes.

⁸³ The timeframes for claiming additional directions and market suspension compensation are set out in clauses 3.15.7B(a) and 3.14.5B(a) respectively, and the Intervention settlement timetable. Claimants have 15 business days from being notified by AEMO of the automatic compensation they are entitled to receive to make a submission to AEMO for additional compensation.

⁸⁴ Clause 3.14.6(h) and (i) of the NER.

The Commission considers that it may be appropriate to include timeframes for providing supporting information, similar to those that apply to the directions and market suspension additional compensation frameworks. Additionally, these timeframes would be binding such that claimants would not be eligible for compensation for any claims received outside of the specified timeframes.

The Commission recognises that further time may be required to develop a claim for opportunity costs compared to a claim for direct costs.

QUESTION 7: TIMEFRAMES FOR SUPPORTING INFORMATION

1. Is it appropriate to include timeframes for administered pricing compensation claims?
2. Should additional time be provided for opportunity cost claims, and if so, how much?

6.3

Harmonising definitions between frameworks

The Commission notes that there are differences between the types of costs included under the banner of direct costs across the three relevant frameworks.

The relevant components of direct costs for the directions and market suspension compensation frameworks are set out in the NER. The components of direct costs specified in the directions compensation framework include:

- fuel costs
- incremental maintenance costs
- incremental manning costs
- acceleration costs of maintenance work
- delay costs for maintenance work, and
- other costs incurred to comply with the direction.⁸⁵

The components of direct costs specified in the market suspension compensation framework are:

- fuel costs
- incremental maintenance costs
- incremental manning costs, and
- other direct costs reasonably incurred.⁸⁶

Conversely, the relevant components of direct costs for the administered pricing compensation framework are set out in the compensation guidelines.⁸⁷ The components of direct costs specified include:

⁸⁵ NER clause 3.15.7B(a3).

⁸⁶ NER clause 3.14.5B(d) and (d1).

⁸⁷ AEMC, *Compensation guidelines*, 2022, <https://www.aemc.gov.au/sites/default/files/2022-11/Final%20compensation%20guidelines%20Dec%202022.pdf>.

- fuel costs
- operation and maintenance costs, including:
 - consumables such as water and chemicals
 - advancement of future maintenance
 - staff and operating systems, and
- wear and tear costs.

The Commission considers there may be benefits associated with aligning the categories of costs available to be claimed under administered pricing with other compensation frameworks. The AEMC may address this by amending the guidelines, which would not require a rule change process.

QUESTION 8: HARMONISING DEFINITIONS

1. Do stakeholders agree that there would be benefits in aligning definitions of cost categories across the various compensation frameworks?

6.4

6.4.1

Issues related to cost recovery

Cost recovery when there is more than one region impacted by the APC at one time

Cost recovery for administered pricing compensation is governed by clause 3.15.10 of the NER. Once the Commission makes a final decision on an administered pricing compensation claim, AEMO is responsible for the cost recovery and payment processes.⁸⁸

The cost recovery calculations are set out in NER 3.15.10 and depend on the 'cost recovery region' (or 'home' region), which is the region in which the spot price was set by the APC itself. It is noted that the cost recovery region can be different to the region where the participant claiming compensation is located. The reason for this is due to price scaling. As explained earlier in this chapter, price scaling applies to regions that are interconnected to a region that has the spot price being set by the APC. When the spot price is being set by administered pricing in one region, it is necessary for price scaling to apply to the power flows towards the capped region. When price scaling is applied, it can trigger the eligibility for administered pricing compensation. These claimants located in the price scaled region will have any compensation awarded recovered from the cost recovery region (the region where the spot price was set by the APC). This would be different to the region they are located in.⁸⁹

In June 2022, spot prices were set by the APC in one or more different regions in different trading intervals across each eligibility period from 13 June (when the CPT was exceeded in all 4 mainland regions) until 15 June (market suspension).

⁸⁸ Clause 3.15.10(a).

⁸⁹ Clause 3.15.10(a0).

The Commission is aware that the current Rules do not clearly indicate how compensation should be allocated where there are multiple 'home' regions at different times during an eligibility period.

The Commission considers that this issue may be related to the concept of an eligibility period for administered pricing compensation. If administered pricing compensation was calculated on the basis of trading intervals, the problem of having multiple cost recovery regions may not occur. This is because it would be less likely for there to be multiple cost recovery regions when the eligibility period lasts only as long as a trading interval, rather than the much longer period (typically a full trading day) under the administered pricing compensation framework.

Other options for addressing this issue may include a different methodology for cost recovery.

6.4.2

Compensation cost allocation

Currently, the compensation frameworks in the NEM are funded by market customers.⁹⁰ Generally, the compensation costs are allocated on the basis of proportional consumption of each market customer during the relevant period of the intervention. More details on the cost recovery mechanisms can be found in Appendix A.

The Commission is interested in stakeholder views on the appropriateness of these arrangements. We note that a rule change request has been submitted from Tilt Renewables, regarding the cost recovery process for capacity directions.⁹¹ The rule change request seeks to correct an alleged inefficient cost allocation that exists within the NER, whereby cost recovery for capacity directions is partially covered by generators. Tilt Renewables suggests that customers are the beneficiaries of capacity directions due to enhanced reliability and should therefore be financially responsible for the outcome. These issues will be considered in this area of the review.

QUESTION 9: COST RECOVERY

1. Do stakeholders consider that cost recovery provisions for administered pricing could be clarified with respect to situations where there are multiple "home regions"?
2. Do stakeholders have any thoughts on the existing cost allocation mechanisms for the compensation frameworks?

⁹⁰ Compensation cost recovery is set out in the following NER clauses: Directions compensation – Clause 3.15.8, Administered pricing compensation – Clause 3.15.10, Market suspension compensation – Clause 3.15.8A.

⁹¹ Tilt Renewables, *\$0 Floor Price to claims from the NEM Participant Compensation Fund as a Result of a Scheduling Error rule change request*, February 2023. See <https://www.aemc.gov.au/rule-changes/recovery-funds-capacity-directions>

6.5 There may be benefits associated with providing guidance on the standard of information that should be provided to support a claim

The Commission considers that it may be beneficial to provide more guidance on the information that is necessary to support a claim for administered pricing compensation. As part of the process for assessing the claims from June 2022, there was significant engagement with participants to provide information that supports the claims being made. Having this information earlier in the process may reduce the time taken to process any future claims.

The compensation guidelines specify the information to be provided from the claimant, but do not specify the standard of information that should be provided in order for the Commission to properly consider claims for compensation. The standard of information provided for claims from the June event included:

- fuel supply contracts or proof of transactions for fuel
- relevant sections of maintenance plans or technical documents regarding maintenance and start-up costs, and
- evidence to justify technical or commercial limitations for opportunity cost claims.

The Commission notes that the NER requires participants to submit information to substantiate claims for additional directions compensation as well as additional market suspension compensation.⁹²

QUESTION 10: INFORMATION TO SUPPORT A CLAIM

1. Do stakeholders have suggestions for NER requirements and/or guidelines changes that could provide greater clarity for administered pricing compensation claimants?
2. Do stakeholders have views on the level of evidence that is required to substantiate claims under the current compensation frameworks?

⁹² Clauses 3.15.7B(b) and 3.14.5B(c) of the NER, respectively.

A

A.1

OVERVIEW OF COMPENSATION FRAMEWORKS

Directions compensation framework

What is the objective of the framework?

The NER does not explicitly state an objective for the directions compensation framework. The Commission has previously stated that the purpose of the directions compensation framework is for participants to recover the costs associated with complying with a direction.⁹³ The Commission has further stated that directions should be a last-resort mechanism and should not be relied upon as a primary mechanism to procure services or system needs. However, as the system transitions and each region undergoes changes in generation mix, directions may be used at times to manage security.⁹⁴

Where is it set out in the Rules?

The calculation of directions compensation is governed by clauses 3.15.7, 3.15.7A and 3.15.7B of the NER. The cost recovery for directions compensation is governed by clause 3.15.8 of the NER.

Which party is responsible for administering the framework?

AEMO is responsible for the directions compensation framework.

Which party is responsible for determining the claim?

AEMO determines claims for additional compensation in certain circumstances.⁹⁵ AEMO also determines claims for services other than energy or market ancillary services in certain circumstances.⁹⁶

If a participant makes a claim for providing services other than energy or market ancillary services that is equal to or greater than \$20,000, AEMO must refer this claim to an independent expert.⁹⁷

If a participant also makes an additional compensation claim and the combined claim is equal to or greater than \$100,000, AEMO must refer this claim to an independent expert.⁹⁸

Who can be compensated and what for?

Currently, participants who are directed for the following services can be compensated through the directions compensation framework:⁹⁹

93 AEMC, *Investigation into intervention mechanisms in the NEM*, 2019. See <https://www.aemc.gov.au/sites/default/files/2019-08/Investigation%20into%20intervention%20mechanisms%20in%20the%20NEM%20-%20Final%20report%20-%20published%20version.PDF>.

94 AEMC, *Improving security frameworks for the energy transition*, Directions paper, p. 91. See <https://www.aemc.gov.au/sites/default/files/2023-08/ERC0290%20%E2%80%93%20Improving%20security%20frameworks%20for%20the%20energy%20transition.pdf>.

95 Clause 3.15.7B(c)(2) of the NER.

96 NER clause 3.15.7A(k).

97 NER clause 3.15.7A(h). AEMO must also refer a claim if it considers that the claim is unreasonable or it considers that the assessment of the claim involves issues of complexity or difficulty.

98 NER clause 3.15.7B(c).

99 NER clause 3.15.7(a2).

- energy
- any market ancillary service
- a direct substitute for energy and FCAS energy, and
- a service where energy or market ancillary services are provided incidentally, including inertia, voltage control and system strength.

Directed participants that do not provide a service in this list but instead provide an 'other compensable service' is entitled to "fair payment compensation."¹⁰⁰ Examples of this include:

- directions for batteries to maintain a particular state of charge and bid regulation FCAS to zero, to provide headroom
- directions for units to provide System Restart Ancillary Services (SRAS).

What is the mechanism for calculation and payment?

In the first instance, participants automatically receive the 90th percentile spot price for energy or market ancillary services over the preceding 12 months.¹⁰¹ If this is not sufficient to cover the participant's costs of complying with the direction, directed participants may also choose to lodge a claim with AEMO for additional compensation to recover their direct costs.¹⁰² Direct costs include fuel, staff and maintenance costs that were incurred by the participant by complying with the direction.¹⁰³

Participants that are directed and provide other compensable services such as those listed above can lodge a claim to AEMO to receive fair payment compensation, which must take into account:¹⁰⁴

- relevant contractual arrangements that specify a price for the relevant service
- the loss of revenue incurred by the directed participant as a result of providing the other compensable service under direction
- the net direct costs incurred, including:
 - fuel costs
 - incremental maintenance costs
 - incremental manning costs
 - acceleration costs of maintenance work
 - delay costs for maintenance work, and
 - other costs incurred to comply with the direction.

What is the mechanism for cost recovery?

¹⁰⁰ Clause 3.15.7(a1)(2).

¹⁰¹ NER clause 3.15.7(c).

¹⁰² NER clause 3.15.7B(a).

¹⁰³ Clause 3.15.7B(a3).

¹⁰⁴ NER clause 3.15.7A(g).

Compensation costs for directions are funded by market customers. Compensation cost recovery has regard to the relative benefit each region receives as a result of the direction and the proportional consumption of each customer.¹⁰⁵

A.2 Administered pricing compensation framework

What is the objective of the framework?

The objective for the payment of compensation under clause 3.14.6 of the NER is to maintain the incentive for:

- scheduled generators, non-scheduled generators and scheduled network service providers to supply energy
- ancillary service providers to supply ancillary services
- market participants with scheduled load to consume energy
- demand response service providers to supply wholesale demand response during price limit events.

Where is it set out in the Rules?

Administered pricing compensation is covered by clause 3.14.6 of the NER. The cost recovery for administered pricing compensation is governed by clause 3.15.10 of the NER.

Which party is responsible for administering the framework?

The Commission is responsible for administered pricing compensation claims.¹⁰⁶

Who can be compensated and what for?

The list in the objective section above specifies which parties can be compensated and what for. The Rules state that the compensation must be based on direct costs and opportunity costs.¹⁰⁷

What is the mechanism for calculation and payment?

The Commission publishes a set of guidelines that specifies:¹⁰⁸

- the types of opportunity costs that a person can claim, and
- the methodology that the Commission uses to calculate the amount of any compensation payable, including the methodology for calculating direct costs and opportunity costs.

The guidelines provide more details regarding what is considered under direct and opportunity cost claims.

The NER defines direct costs as the costs directly incurred by the claimant due to a price limit event.¹⁰⁹ The guidelines specify that direct costs are:

¹⁰⁵ NER clause 3.15.8.

¹⁰⁶ NER clause 3.14.6.

¹⁰⁷ NER clause 3.14.6(a) and (d).

¹⁰⁸ AEMC, *Compensation guidelines*. See 2022, <https://www.aemc.gov.au/sites/default/files/2022-11/Final%20compensation%20guidelines%20Dec%202022.pdf>.

¹⁰⁹ Clause 3.14.6(a), definition of 'direct costs.'

- fuel costs
- operation and maintenance costs that are directly attributable to the pattern of operation to provide energy, wholesale demand response or market ancillary services during the relevant eligibility periods, and
- wear and tear costs directly attributable to the pattern of operation during the relevant trading intervals.

The guidelines specify that the following are excluded from consideration as direct costs, unless the claimant can demonstrate a compelling case based on extraordinary circumstances:

- repair costs in the event of plant or equipment failure
- all other direct costs that cannot be attributed to the operation of the unit during the price limit event, including start-up costs outside the price limit event, and
- for demand response services providers, costs for business operations at a wholesale demand response unit that cannot be directly attributed to the provision of wholesale demand response or market ancillary services during the price limit event.

The NER defines opportunity costs as the value of opportunities foregone by the claimant due to the price limit event as defined in the compensation guidelines.¹¹⁰ The guidelines specify that an opportunity cost is the value of the best alternative opportunity for eligible participants during the application of a price limit event or at a later point in time. The opportunity cost is the foreclosure of this alternative opportunity to use scarce capacity or resources more profitably at the same point in time or later.

What is the mechanism for cost recovery?

Costs of administered pricing compensation are recovered from market customers. Compensation is recovered on the basis of the cost recovery region, which is a region where the spot price was set by the APC. Costs are allocated on the basis of each market customer's proportional consumption in the relevant period.¹¹¹

A.3

Market suspension compensation framework

What is the objective of the framework?

The objective of the market suspension compensation framework is similar to the administered pricing compensation framework. Its objective is to maintain the incentive for:¹¹²

- scheduled generators to supply energy
- ancillary service providers to supply market ancillary services, and
- demand response service providers to supply wholesale demand response during market suspension pricing schedule periods.

¹¹⁰ Clause 3.14.6(a), definition of 'opportunity costs.'

¹¹¹ NER clause 3.15.10.

¹¹² NER clause 3.14.5A.

Where is it set out in the Rules?

The market suspension compensation framework is covered by clauses 3.14.5A and 3.14.5B of the NER. The cost recovery for market suspension compensation is covered by clause 3.15.8A of the NER.

Which party is responsible for administering the framework?

AEMO is responsible for administering the market suspension compensation framework.¹¹³

AEMO may, but is not required to, refer a claim for additional compensation that is greater than \$50,000 to an independent expert.¹¹⁴

Who can be compensated and what for?

The list in the objective section above specifies which parties can be compensated and what for. The Rules specify that participants can apply for additional compensation for direct costs incurred.

What is the mechanism for calculation and payment?

The market suspension compensation framework follows two steps, similar to the directions compensation framework.

In the first instance, eligible participants automatically receive a payment that is equal to the costs of the specific plant that is being compensated (determined by a formula set out in the Rules) minus the revenues that the plant has earned during the relevant market suspension pricing schedule period.¹¹⁵ The formula is an assessment of costs, and takes into account:¹¹⁶

- fuel costs, and
- variable operating and maintenance costs.

As set out in clause 3.14.5A(e) of the NER, there is an additional 15% premium to account for variations in the actual values represented in AEMO's database.

If this compensation is not adequate to cover the participant's costs, the participant can apply for additional compensation from AEMO. This compensation is for direct costs, which are:¹¹⁷

- fuel costs
- incremental maintenance costs in connection with the relevant generating unit
- incremental manning costs in connection with the relevant generating unit, and
- other direct costs reasonably incurred in connection with the relevant generating unit, where such costs are incurred to enable the generating unit to supply energy or market ancillary services during the market suspension period.

What is the mechanism for cost recovery?

¹¹³ NER clause 3.14.5A.

¹¹⁴ NER clause 3.14.5B(f).

¹¹⁵ Clause 3.14.5A(d).

¹¹⁶ NER clause 3.14.5A(e).

¹¹⁷ NER clause 3.14.5B(d).

Compensation costs for market suspension compensation are funded by market customers. Compensation cost recovery has regard to the relative benefit each region receives as a result of the direction and the proportional consumption of each customer.¹¹⁸

¹¹⁸ NER clause 3.15.8A.

ABBREVIATIONS

| | |
|------------|-------------------------------------|
| AEMC | Australian Energy Market Commission |
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| Commission | See AEMC |
| NEL | National Electricity Law |
| NEM | National Electricity Market |
| NEO | National Electricity Objective |
| NER | National Electricity Rules |
| NERL | National Energy Retail Law |
| NERO | National Energy Retail Objective |
| NERR | National Energy Retail Rules |
| NGL | National Gas Law |
| NGO | National Gas Objective |
| NGR | National Gas Rules |