

Terms of Reference

Review into electricity compensation frameworks EPR0095

Overview

Under section 45 of the National Electricity Law (NEL), the Australian Energy Market Commission (AEMC or Commission) has initiated a review (the Review) into the operation and effectiveness of the rules relating to electricity compensation frameworks. The Review will focus on compensation arrangements for directions, administered pricing and market suspension events, to ensure the frameworks lead to efficient outcomes on a standalone basis, as well as when working together.

What are the compensation frameworks in the NER?

The electricity compensation frameworks are set out in the National Electricity Rules (NER). These are:

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

Each of these compensation frameworks serves a different purpose and has a different objective. The objectives of the following compensation frameworks are as follows:

- **Directions compensation framework:** for participants to recover the costs associated with complying with a direction.¹
- **Administered pricing compensation framework:** to maintain the incentive, during periods where claimants are eligible for administered pricing compensation, to supply relevant services in the market.²
- **Market suspension compensation framework:** to maintain the incentive, during market suspension periods, to supply relevant services in the market.³

The events of June 2022 have prompted the AEMC to self-initiate this review

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. 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.

¹ The Commission has previously noted that the NER does not explicitly state an objective for the directions compensation framework. See AEMC, *Investigation into intervention mechanisms in the NEM*, Final report, 2019, <https://www.aemc.gov.au/sites/default/files/2019-08/Investigation%20into%20intervention%20mechanisms%20in%20the%20NEM%20-%20Final%20report%20-%20published%20version.PDF>.

² The objective of the administered pricing compensation framework is set out in clause 3.14.6 of the NER.

³ The objective of the market suspension compensation framework is set out in clause 3.14.5A of the NER. It is noted that its objective is similar to the objective of the administered pricing compensation framework.

Significant amounts of compensation payments were made to participants following the June events. During the June events and the following compensation assessment processes, several issues were identified with the directions, administered pricing and market suspension compensation frameworks and how they worked together.

Objective

The purpose of this review is to determine how the current frameworks in the rules related to directions, administered pricing and market suspension compensation could be improved to achieve better market outcomes. The Commission considers that in relation to the compensation frameworks, better market outcomes include improved reliability, security and cost outcomes for consumers. These can be achieved by setting the appropriate incentives to encourage participation in the market rather than relying on interventions to manage dispatch during periods of market stress.

Scope

The Review stems from the events of June 2022. These events have identified a range of issues, particularly associated with the administered pricing compensation framework and its interaction with the directions and market suspension frameworks.

The Commission considers that there is value in considering issues with these three compensation frameworks in a collective manner. The Commission is, therefore, seeking stakeholder input on these identified issues as well as other areas of the directions, administered pricing and market suspension compensation frameworks that stakeholders consider may lead to improved market outcomes.

The Review seeks to investigate three categories of issues:

Objectives and methodology: Are there changes or improvements to the way the compensation frameworks are designed that would 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 the incentives provided by the compensation schemes
 - 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: Which 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.

Issues relating to directions compensation raised in the *Improving security frameworks for the energy transition* rule change will be considered in this review. This is based on feedback from stakeholders that the issues be considered as part of a broader review.

The scope of the Review will be finalised following the first round of consultation, which calls for stakeholder input on issues related to these areas.

The Review will identify and assess key issues and risks in the current regulatory framework and provide recommendations on solutions to address these issues.

The Review report will set out the appropriate pathway for implementation of any recommended changes. The Commission notes that the National Gas Rules (NGR) also set out the current process for determining compensation claims for Australian Energy Market Operator (AEMO) directions in the East Coast Gas System (ECGS), as well as for administered pricing periods (APP).⁴ These frameworks are not in scope for the Review, however, the Commission will consider the economic principles and administrative arrangements that apply in the NGR, as well as the alignment and interaction of the gas and electricity compensation frameworks where appropriate.

Consultation and Engagement

In conducting the Review, the Commission will be guided by the National Electricity Objective (NEO). Consumer outcomes will be the key consideration when making recommendations in this review.

The Commission will take account of any related work underway, including work coordinated by the other market bodies and jurisdictions.

The Commission may take a staged approach to the Review. The approach will be finalised along with the scope following the first round of consultation, once the full range of issues for consideration is known.

The approach to the Review is intended to be flexible so that the approach can be adjusted if necessary following stakeholder consultation. It may be that in the interests of time, the Review is unable to consider all issues raised during consultation. If this is the case, the Commission will set out its rationale and plan for managing any outstanding issues, which could be addressed at a later stage.

In developing its advice, the Commission will work closely with AEMO and the AER. AEMO is currently responsible for various areas of the compensation frameworks and has raised some issues in its submission to the *Improving security frameworks for the energy transition* rule change.⁵ The AER has made some suggestions for potential reform options following the events of June 2022.⁶

⁴ The Commission is currently considering changes to the framework for gas compensation and dispute resolution in the *Compensation and dispute resolution frameworks* rule change.

⁵ <https://www.aemc.gov.au/sites/default/files/2023-10/12%2020230928%20Submission%20Improving%20security%20frameworks%20for%20the%20energy%20transition.pdf>.

⁶ AER, *June 2022 market events report*. See <https://www.aer.gov.au/wholesale-markets/compliance-reporting/june-2022-market-events-report>.

Public workshops and forums to gather feedback may be undertaken over the course of the Review, with reference groups created if required.

The Commission will consult with:

- state, Territory and Commonwealth officials
- market participants
- network and generation operators, and
- consumer groups.

Deliverables and timing

The output of the Review will be a report that may include:

- recommended changes to the NER
- recommendations for any required changes to other regulatory instruments such as guidelines and procedures
- advice on implementation, including the timing and sequencing of required changes.

At a minimum, the Commission will seek to:

- publish a consultation paper in Q4 2023
- publish a draft report in early Q2 2024
- publish a final report before the end of 2024.

Subject to the outcome of the consultation paper, the AEMC may publish further papers if necessary.