Christiaan Zuur
Australian Energy Market Commission
Level 5, 201 Elizabeth Street
Sydney NSW 2000

By online lodgement

24 January 2013

Dear Christiaan,

Re: Draft Report "Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price" (AEMC reference EPR0026)

GDF SUEZ Australian Energy (GDF SUEZ) appreciates the work carried out by the Australian Energy Market Commission (Commission) in preparation of the draft report "Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price" (draft report).

As noted in the draft report, the 2010 compensation claim by Synergen Power is the only such claim in the national electricity market to date, and it was the Synergen claim that highlighted the need to carry out this review. GDF SUEZ as owner and operator of Synergen Power therefore has first-hand experience of many of the issues discussed in the draft report.

In preparing this submission we have adopted the same heading structure as the Commission's draft report.

Purpose of compensation

The National Electricity Rules (Rules) in clause 3.14.6(c)(1)[1] make it clear that the objectives of the compensation payments are to maintain incentives for both investment in peaking plant as well as supply of energy and other services. However Rules clause 3.14.6(c)(2) requires that the compensation payable be based only on direct costs and opportunity costs. Based on the definitions provided in the draft report this is essentially compensation for fuel, operating costs and a narrow class of generators who may be energy limited.

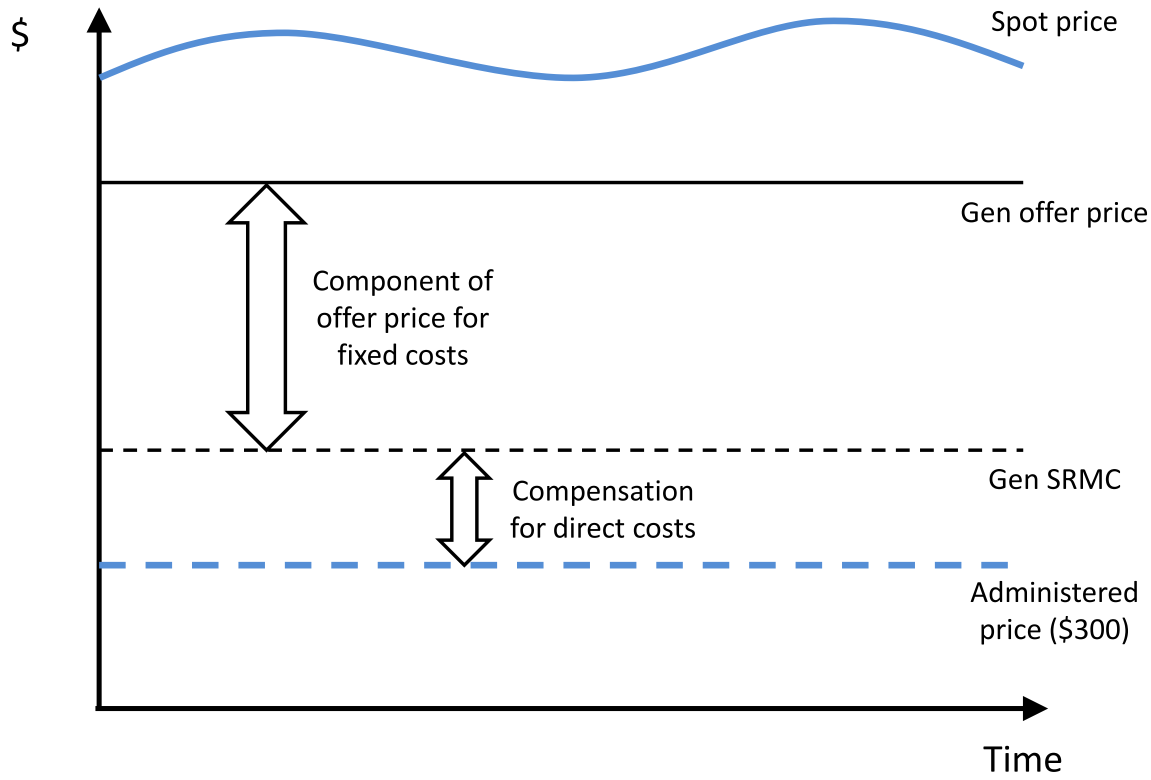
There appears to be an inherent contradiction between these two Rule clauses with one making it clear that the objective of compensation includes the maintenance of investment signals, but the other limiting compensation payments to only direct and opportunity costs.

GDF SUEZ notes that the Commission has recognised in the draft report that the purpose of compensation, albeit a secondary purpose, is to ensure that investment signals are not weakened. However the draft report also retains the limitation that compensation payments would be confined to only direct costs and opportunity costs. Such an approach by the Commission retains the ambiguity inherent in the Rules, leaving participants unsure exactly what is proposed.

[1] 3.14.6(c) The *AEMC* must, in accordance with the *transmission consultation procedures*, develop and *publish* guidelines ('**compensation guidelines**') that:
(1) identify the objectives of the payment of compensation under this clause as being to maintain the incentive for:
(i) *Scheduled Generators*, *Scheduled Network Service Providers* and other *Market Participants* to invest in *plant* that provides services during peak periods; and
(ii) *Market Participants* to supply *energy* and other services during an *administered price period*;

As explained in our previous submission to this consultation[2], peak generators rely on these unpredictable short periods of time when the market price is at high levels, in order to recover their fixed and capital costs. This is in fact a key design feature of an energy only market such as the NEM.

The following diagram aims to show the components of a peak generator offer price, and the impact of the administered price and the proposed compensation.



The offer price for a peak generator will typically include a substantial component over and above the generators SRMC, which is intended to ensure that during the short period that they generator is likely to be dispatched, it recovers sufficient revenue to cover its short run as well as its long run costs. This component is indicated in the above diagram.

When administered pricing is in place, the peak generator is dispatched as its offer price is below the spot price; however market settlement is capped at the administered price of $300 per MWh. The proposed approach for compensation would (as understood by GDF SUEZ) reinstate the component of direct costs as shown in the diagram. However it is clear from the diagram that the peak generator is denied the legitimate component of its offer intended to cover its costs over and above its short run costs.

The fixed cost component is vital to the financial sustainability of the peaking generator. Failure to compensate for this component will act as a disincentive for new investment in peaking plant and is inconsistent with the design of an energy only market.

[2] See International Power GDF SUEZ submission at: http://www.aemc.gov.au/Media/docs/International%20Power%20GDF%20SUEZ%20Australia-62c82c8a-87eb-44b0-84b6-7da269969a2b-0.PDF

Some have argued that the Cumulative Price Threshold (CPT) which is currently $193,500, allows a peak generator to receive sufficient revenue to cover its long run costs during the period of high prices leading up to the point that the administered price is set. In response to this, GDF SUEZ makes the following points:

- In 1999 the Reliability Panel sought to set the CPT at $300,000 which was based on an open cycle gas turbine recovering three years of annual fixed costs[3]. The ACCC decided to set the CPT at a much lower value to limit exposure of market participants to high prices for extended periods.
- Extreme high price events are rare, and may be expected to occur only once every few years. It is therefore likely that a peak generator will be seeking to recover sufficient revenue during an extreme price event to cover multiple years of fixed costs.
- Given that the CPT has been set at a lower value than that required to provide a reasonable investment signal, it follows that compensation should include a component to restore the investment signal.

Compensation claim assessment process and public consultation

GDF SUEZ agrees that the AEMC is the appropriate body to administer the price compensation provisions of the Rules, as it possesses the experience and capacity for discretionary decision making necessary to fulfil this role.

The proposed changes to improve the compensation claim assessment process are supported as they provide a more realistic timeframe for provision of information. GDF SUEZ agrees with the position that public consultation should only be required where a compensation claim seeks compensation for opportunity costs, as the claimant would need to put forward their methodology for determining their opportunity costs.

Eligibility for scheduled generators to claim compensation

GDF SUEZ supports the Commissions proposed approach for determination of the eligibility period for compensation, as it recognises the period of time in which participants suffer a potential financial loss.

As noted earlier in this submission, GDF SUEZ remains concerned with the statements in section 6.2 and 6.3.2 of the draft report which establish that compensation is limited to the direct costs and opportunity costs. This runs counter to the Commission's finding that the secondary purpose of compensation is to provide an incentive to invest.

Eligibility for other classes of market participant

GDF SUEZ agrees with the Commission's findings that ancillary service loads and generators do not need to be eligible to claim compensation. However, we note that a scheduled generator that is also an ancillary service provider can seek compensation for direct and opportunity costs, and that these might include some costs associated with impact on ancillary services. As noted by the Commission, the purpose of compensation includes maintaining the incentive for the participant to supply energy services during an administered price. This would include the desire that the participant continue to provide ancillary services.

GDF SUEZ notes the proposal to remove references to market suspension from the eligibility criteria. The arguments for this decision are understood, however we remain concerned that as far as we are aware, there are no other provisions in the Rules to deal with compensation under market suspension.

[3] NEM Reliability Settings: VoLL, CPT and Future Reliability Review, AEMC Reliability Panel. December 2008, page nine: http://www.aemc.gov.au/Media/docs/Rule%20Change%20Proposal%20To%20The%20AEMC-f6e40480-5301-4088-9df8-00fecda72281-0.pdf

Cost recovery

GDF SUEZ supports the view that cost recovery based on calculations for individual trading intervals does not properly capture the nature of the costs to be compensated. We therefore support the Commission’s proposal to calculate the total costs across the eligible period, and then allocate these total costs across customers based on their energy consumption during the eligibility period.

I hope that the comments contained in this submission are helpful to the Commission in their deliberations on this matter. Should you have any enquiries regarding this matter please do not hesitate to contact me on 03 9617 8331.

Yours sincerely,

Chris Deague
Senior Market Specialist
GDF SUEZ Australian Energy