

A few
words.

21 July 2010

The Chairman
Australian Energy Market Commission
Level 16, 1 Margaret Street
SYDNEY NSW 2000

By email to submissions@aemc.gov.au

Dear Chairman,

AEMC Draft Decision - Compensation Claim from Synergen Power (EPR0016)

AGL welcomes the opportunity to comment on this compensation claim.

Retailers are significant stakeholders in the compensation process as the compensation payable is to be recovered from Market Customers in the affected region. AGL has a significant customer base in SA and therefore will be required to fund a large portion of the compensation.

We therefore have an interest in ensuring that, during an intervention in the market such as in an Administered Price Period (APP);

- generators are compensated for continuing to supply energy to ensure a reliable supply to consumers and to facilitate investment, **the "long term" objective** and
- the cost of the compensation paid by Market Customers is minimised by competition, **the short term objective**. This objective supports the long term objective to ensure that compensation and new investment is at an economically efficient level.

Meeting both of these objectives is in the long term interest of consumers and is consistent with the NEM objective.

For an APP these objectives are provided for by clause 3.14.6 and, specifically for generators, 3.14.6(a), which allows generators to claim for compensation during an APP if generators are dispatched when the capped pool price is less than their dispatch offer.

The Rule, as drafted, provides for the normal operation of the competitive market to continue during an APP to ensure that the compensation paid is at an efficient level. That this is intended to be the case is demonstrated in the following relevant documents:

- The AEMC Guidelines¹ for the determination of compensation, in the summary paragraph to Section 5 "Objectives of paying compensation", state:
"The payment of compensation recognises (the) regulatory risk that participants may face in the market. It also ensures that participants are not disadvantaged by continuing to participate in the market during high stress periods, such as an administered price period or other event"

¹ AEMC Guidelines - The Determination of Compensation following the application of the Administered Price Cap, Market Price Cap, Market Floor Price or Administered Floor Price.

With respect to this paragraph we note that;

- compensation is payable because of the regulatory risk that participants face ie the application of price caps and floors, because
 - **participants are continuing to participate** in the market during high stress periods.
- The AEMO Briefing Paper² in Section 3 “Operation during an administered Price Period in a Region”, the AEMO describes the operation of the market in an APP as “*Market prices and dispatch of generation continue to be calculated normally*”. The only change to normal market operation identified is that; “*the administered price cap (APC) and floor are invoked to apply upper and lower limits on the published dispatch prices for energy and market ancillary services*”.

The AEMO's interpretation of the operation of the market during an APP is that **market prices and dispatch of generation should continue normally**.

The Panel's decision is not consistent with the AEMC guidelines nor the AEMO briefing paper. Nor is it an interpretation of the Rules which is consistent with the NEM objective because the proposed changed interpretation of the term “dispatch offer”:

- allows a generator the option to remove itself from the competitive process by removing the incentive to make cost reflective dispatch offers after initially being dispatched in an APP, and
- absolves it from minimising direct costs and start up costs under competitive market pressure during an APP, and
- maximises the compensation payable by allowing generators to make a compensation claim when pool price is well below their true cost of operation.

None of these outcomes are consistent with competitive market outcomes and the normal operation of the NEM nor are they consistent with the NEM objective. The reasoning is discussed in detail later in this submission.

We therefore do not share the Commissions view that there is ambiguity in the term “dispatch offer” in clause 3.14.6(a).

Further in accepting the Panels recommendation in its draft decision the Commission is proposing a significant change to the Rules outside the normal Rule change process by accepting a compensation claim based on a change to the definition of the term “dispatch offer” which is to apply during an APP.

Whether or not the compensation provisions provide sufficient incentive for generators to operate during an APP³ (Synergen appear to claim that they do not) is a separate issue that could be considered by the Commission in a review of clause 3.14.6 either through a Review or a Rule change process, both of which allow appropriate consultation with all stakeholders. Further in AGL's view it is not appropriate to make a compensation claim based on a proposed Rule change.

We do support the Commissions proposal to review the confidentiality provisions to address the information asymmetry between claimants and Market Participants who are paying the compensation. The confidentiality provisions make it difficult to determine the basis for and the quantum of the claim.

² The AEMO Briefing Paper – Operation of the Administered Price Provisions in the National Electricity Market.

³ It should be noted that the APP only comes into force after the CPT has been reached, allowing a generator to have made sufficient return to cover the fixed costs of plant.



Should you have any questions in relation to this submission, please contact Roger Oakley, Manager Wholesale Markets Regulation, at roakley@agl.com.au or on (03) 8633 7665.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'A. Cruickshank', is positioned below the closing text.

Alex Cruickshank
Head of Energy Regulation

AEMC Draft Decision - Compensation Claim from Synergen Power (EPR0016)

The Synergen Submission of particulars of a claim - dated the 18 August

Synergen state in paragraph 2.1 that *“Clearly the principal objectives in the case of scheduled generatorsare to maintain the incentive for scheduled generators to supply energy and other services (as a short term objective) and to invest in plant that provides services during peak periods (as a longer term objective)”*. We would agree with this statement subject to the proviso that incentives to supply energy are subject to competitive market conditions, however the modification proposed by Synergen effectively suspends the normal competitive market operation.

In their submission, Synergen has claimed in Section 2.1 paragraph (b) that, to be consistent with the objectives of the AEMC Guidelines for the payment of compensation, the conduct of the relevant market participant, in particular the variation of dispatch offers during an APP must also be considered. The claim is that to maintain the incentive for scheduled generators, 3.14.6(a)4 should be modified to take into account *“the conduct of the relevant market participant ... (in particular the variation of dispatch offers) that is undertaken in the delivery or pursuit of the objectives under clause 3.14.6 of the Rules and the Guidelines”*.

The modification proposed is that in the calculation of compensation a distinction be made between dispatch offers;

1. that have not been varied,
where compensation would be paid when the spot price for that trading interval is less than the dispatch offer for that trading interval, and those
2. that have been varied,
where compensation would be paid when the spot price for that trading interval is less than the “original” dispatch offer, (the “original” dispatch offer is the dispatch offer for the interval prior to the first re-bid or variation.)

The proposed change provides a generator that has been dispatched in the circumstances in case 1, the option to make a re bid or variation say to a low or negative dispatch offer which will ensure that the generator is dispatched for all remaining periods of the APP if it maintains that offer. This change would allow it to remain in operation and claim compensation for all the subsequent trading intervals despite pool price being greater than the actual dispatch offer in a trading interval and even when pool price is less than the APC.

The proposed change to the Rules:

- allows a generator the option to remove itself from the competitive process by removing the incentive to make cost reflective dispatch offers, and
- absolves it from minimising operational and start up costs and
- maximises the compensation payable by allowing generators to make a compensation claim when pool price is well below their true cost of operation.

⁴ 3.14.6 Compensation due to the application of an administered price, market price cap or market floor price

(a) *Scheduled Generators* may claim compensation from AEMO in respect of *generating units* if, due to the application of an *administered price cap* during either an *administered price period* or *market suspension*, the resultant *spot price* payable to *dispatched generating units* in any *trading interval* is less than the price specified in their *dispatch offer* for that *trading interval*.

None of these outcomes are consistent with the competitive market outcomes, the normal operation of the NEM nor are they consistent with the NEM objective.

That the proposed Rule change and the claim are not consistent with the NEM objective is supported by the following papers which make it clear that normal market operation is to continue during an APP.

The AEMO Briefing Paper⁵ – Operation of the Administered Price Provisions in the National Electricity Market.

In Section 3 “Operation during an administered Price Period in a Region” of the AEMO briefing paper, the AEMO describes the operation of the market in an APP as *“Market prices and dispatch of generation continue to be calculated normally”*. The only change to normal market operation identified is that; *“the administered price cap (APC) and floor are invoked to apply upper and lower limits on the published dispatch prices for energy and market ancillary services”*.

In section 6 “Compensation” the AEMO states that the effect of clause 3.14.6 is that; *“During an administered price period, some generators may be dispatched in offer bands that are priced higher than the APC. A generator in this position is entitled to apply to AEMO and the AEMC for administered price compensation.”* This means it is the dispatch offer in each trading interval being greater than the APC that is relevant, not dispatch offers from other trading intervals.

It is quite clear in the AEMO Briefing paper that normal competitive operation of the market should continue during an APP including during the variation to dispatch offers.

The AEMC Guidelines for the determination of compensation⁶

Section 5.0 of the guidelines on which the panel relies in making its draft decision is as follows:

“The payment of compensation recognises (the) regulatory risk that participants may face in the market. It ensures that participants are not disadvantaged by continuing to participate in the market during high stress periods, such as an administered price period or other event”

With respect to this paragraph we note that;

- compensation is payable because of the regulatory risk that participants face, ie the application of price caps and floors, because
- **participants are expected to be continuing to participate in the market during high stress periods.**

In Section 10.1 Basic calculation, the Guidelines make it clear that compensation is determined for each trading interval for which a claim is being made, there is no suggestion that normal operation of the market should be suspended.

⁵ The AEMO Briefing Paper – Operation of the Administered Price Provisions in the National Electricity Market_5/2/2009

⁶ The AEMC Guidelines - The Determination Of Compensation Following The Application Of The Administered Price Cap, Market Price Cap, Market Price Floor Or Administered Floor Price - 30 June 2009

In section 10.2.5 “Exclusions”, it is stated that start-up costs that are incurred during the APP are not excluded from a claim. It is clear that normal market operation is to prevail and if restart is required during an APP, to respond to pool price changes, participants are able to claim start-up costs.

The AEMC guidelines are quite clear normal competitive operation of the market is to apply during an APP.

The intent of clause 3.14.6(a)

The intent of clause 3.14.6(a) is quite clear – compensation should only be payable within an administered price period when the spot price in any trading interval is less than their dispatch offer for that trading interval.

The Rule is consistent with the NEM objective because when an administered price period applies;

- compensation is paid to generators when the pool price is less than their dispatch offer, and
- the normal competitive market applies and the plant that offers the lowest dispatch offer in each trading interval is dispatched.

This means the market operates as normal and despite the APC generators continue to be driven to make dispatch offers and rebids that make trade offs between operating and start up costs to minimise their costs and maximise their revenue.

The quantum of the Synergen claim - dated the 18 August

The basis for the Synergen claim is that in this particular event the claimant, after initially being scheduled based on a high priced dispatch offer, reduced their dispatch offer to a much lower or negative price, the stated objective being to minimise start up costs i.e. make a trade off between running and start up costs. In effect the claimant made the decision (intentionally or in error) and as they have the right to do, that their revenue could be maximised and their costs minimised by operating continuously during the APP, despite the pool price outcome relative to their dispatch offers.

A review of the market outcomes resulting from this bidding behaviour suggests that the compensation payable based on the correct interpretation of the rule with low or negative dispatch offers would be significantly less than claimed. This is as would be expected when examining the pool price outcomes, because there were very few trading intervals where the claimants dispatch offer (being very low or negative) was greater than the capped spot price.

Subsequently the claimant has attempted to increase the compensation payable by recasting their behaviour as a reasonable and responsible approach⁷ to the furtherance of the objective for the payment of compensation, i.e. encouraging high priced generators to generate during an APP to provide a safe and reliable supply and being paid for operation during the APP to encourage future investment.

After making dispatch offers below their true cost (their own decision) and after being dispatched accordingly, which minimised the cost of compensation payable through the

⁷ Amended and restated and further amended, submission of particulars of a claim dated 18 August 2009 pursuant to paragraph (a) of clause 3.14.6 of the National Electricity Rules, Page 7

competitive market process as the Rules envisage, they claim that the Rules should be amended so that compensation can be paid for all dispatch intervals in the APP.

The justification for this appears to be that the above outcome better meets the NEM objectives because:

- the outcome has reduced start up and direct costs, compared to the outcome of a hypothetical case with multiple stop start events which is claimed would have resulted in a much higher compensation claim⁸,
- strict interpretation of the Rule provides insufficient compensation to encourage generators to be available at times of APP's and therefore will not encourage future investment.

Whether or not the first claim is true is irrelevant as it is clear that from a consumer's viewpoint that assessment of the claim in accordance with the rules which encourage competitive provision of generation will provide the least cost outcome for consumers. There is nothing in the Rules which suggests that it is necessarily a worthy objective to minimise start up costs and we note that start up costs are claimable under the guidelines. Synergen may have been entitled higher compensation if it had made cost reflective dispatch offers, was scheduled accordingly and compensated for start-up costs.

In relation to the second point, that the claimant is not satisfied with the amount of compensation payable is not a consequence of any ambiguity in the Rules but appears to be as a consequence of their bidding behaviour i.e. making dispatch offers below their true cost or a failure to bid to maximise their profit.

We therefore cannot agree with the Commission that there is any ambiguity in the Rules in relation to the meaning of the term "dispatch offer" that justifies an increase in the quantum of the claim sought by the by the claimant.

We do however agree that the confidentiality provisions should be reviewed to address the information asymmetries between claimants and Market Participants that are paying the compensation.

⁸ Synergen Claim dated 18 August 2009, Page 7