Australian Energy Market Commission

RULE CHANGE

FINAL RULE DETERMINATION

National Electricity Amendment (Compensation arrangements following application of an administered price cap and administered floor price) Rule 2016

Rule Proponent(s)
COAG Energy Council

4 February 2016

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About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

Executive Summary

The Australian Energy Market Commission (Commission or AEMC) has made a final rule to change the compensation arrangements following the application of an administered price cap or administered floor price. The final rule improves the way eligibility for compensation is determined and the overall compensation assessment process.

This rule has been made in response to a rule change request from the COAG Energy Council which proposed a number of ways in which these compensation arrangements, including the process followed by the AEMC in assessing and awarding compensation, could be improved.

Background

Wholesale spot prices in the National Electricity Market (NEM) are able to vary within a range of -$1,000 to $13,800 per MWh. This allows market participants the potential to earn a return on assets, and provides a framework within which investment signals can be provided. Persistent high or low prices can create risk for participants which could impact the stability of the market. To limit this variation, at times of extreme prices an administered price cap and/or administered price floor can be applied.

The potential for market participants such as generators – particularly those with high costs – to incur a loss during these administered price periods may create a disincentive for them to supply energy and ancillary services. This could in turn have a negative impact on the reliability and security of the electricity system. To minimise these disincentives, the National Electricity Rules (NER) allow participants to claim compensation where they incur a loss during administered price periods. The AEMC manages this compensation process.

Administered price periods occur rarely. Until September 2015, there had only been five administered price periods in the history of the NEM, which were all triggered in the energy market and therefore applied in both the energy and ancillary services markets. In October 2015, the first ever application of an administered price limit event in an ancillary services market occurred. Over October and November 2015, there were a total of 16 administered price periods in the NEM, which all applied only in ancillary services markets. There has only been one claim for compensation arising from such a period.

The NER provides for matters such as the purpose of compensation; what types of participants may claim compensation; when compensation is payable, what process the AEMC must use to determine the amount of compensation; and how the compensation paid is recovered from consumers. The COAG Energy Council has proposed changes in each of these areas.

More preferable rule

The Commission has made a final rule in response to the rule change request. The final rule is a more preferable rule.

The key features of the final rule are set out below.

Eligibility criteria

Under the current arrangements, eligibility to claim compensation is assessed on a trading interval basis. This can encourage generators to cycle their units on and off if they become ineligible for compensation in a trading interval, reducing the efficiency of operation. Under the final rule, compensation is assessed over the entire period from when the administered price cap first sets the dispatch price to the end of the trading day, and is based on the difference between total costs and total spot market revenues. This should reduce the incentive for generators to cycle units on and off in a specific trading interval and enhance the reliability of the electricity system.

Purpose of compensation

The NER currently provide that the objective of compensation is to maintain incentives for participants to both supply energy and other services during an administered price period and to invest in plant that provides services during peak periods. Under the final rule, the only objective for compensation relates to supplying energy and ancillary services and consuming load. This change improves clarity and certainty. The compensation arrangements do not provide for recovery of capital costs and as such will not contribute to investment incentives.

Eligibility for ancillary services

Frequency control ancillary services are important for maintaining the frequency of the electricity system within the normal operating band. In the draft rule determination, it was proposed that eligibility for ancillary service providers to claim compensation be removed. The basis for this draft decision was that allowing compensation in these instances might weaken the protection for consumers from high prices afforded by the administered price cap, and the historic infrequency of administered price caps occurring in ancillary services markets. However, due to a material change in circumstances following the draft determination, there was an additional round of consultation on this specific aspect. The material change in circumstances was due to the occurrence of administered price cap events in ancillary service markets (as described above), which suggested that such events may not be as rare in the future as the Commission had anticipated at the time of making the draft determination.

The Commission considered that potential exists for ancillary service providers to incur a net loss during an administered price period. However, there is a price and security trade-off that needs to be considered in this regard. While allowing such compensation may weaken the financial protection provided for consumers by an administered price cap, reduced incentives to provide ancillary services could contribute to significant reliability and security impacts, which could have costs for

consumers. Therefore, the Commission considered that it is better to maintain incentives to supply ancillary services during an administered price period. Therefore, the final rule includes eligibility for ancillary service providers to claim compensation.

Assessment process

The current arrangements set out the process by which the AEMC is to assess any compensation claim. The final rule improves the flexibility, efficiency and transparency of the assessment process, including by removing the requirement on the AEMC to appoint an expert panel to advise on claims for compensation. Instead, the AEMC is provided with flexibility as to when it uses expert assistance. This specific change is additional to what the rule change request proposed.

Other elements

Other elements include amending the process by which costs are recovered from consumers to improve certainty, and extending eligibility for compensation to non-scheduled generators.

National Electricity Objective

The final rule contributes to the achievement of the National Electricity Objective. Where it differs from the rule change request it better contributes to the National Electricity Objective than the rule change request. The final rule:

- enhances the reliability and security of the electricity system;
- increases the transparency and reduces the administration costs of the assessment process; and
- contributes to efficient recovery of compensation costs from consumers.

Contents

1 COAG Energy Council's rule change request

This chapter provides an overview of the rule change request, background information, the current arrangements for compensation during an administered price period, the proposed arrangements in the rule change request, and the rule making process.

1.1 The rule change request

On 17 October 2013, the Council of Australian Governments' Energy Council (COAG Energy Council) (Rule Proponent) made a request to the Australian Energy Market Commission (Commission) to amend provisions in the National Electricity Rules (NER) in relation to compensation arrangements following the application of an administered price cap or an administered floor price (rule change request).

The amendments in the rule change request originate from AEMC recommendations made to the COAG Energy Council in the AEMC's 2013 Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Price Floor (the review).[1]

The rule change request proposed a number of amendments to address issues with the current compensation arrangements during an administered price period. It proposed to amend the purpose of compensation, introduce a new process for determining which parties are eligible to claim compensation, change the way in which the AEMC assesses compensation claims and change the way in which AEMO recovers the cost of compensation from market customers.

The rule change was expected to improve reliability for consumers during administered price periods, improve the efficiency and transparency of the compensation assessment process, while minimising regulatory complexity associated with the recovery of compensation costs.

1.2 Background information

This section provides background information on the current arrangements for compensation during an administered price period, the Synergen compensation claim and the AEMC review.

1.2.1 The compensation mechanism during an administered price period

The compensation provisions in clause 3.14.6 of the NER are a component of the broader framework involving the market price cap, market floor price, cumulative

1 Final Report available on the AEMC's website: http://www.aemc.gov.au/Markets-Reviews-Advice/Review-of-Arrangements-for-Compensation-following

price threshold, administered price cap and administered floor price. This framework is designed to protect customers from extended periods of high prices.

The National Energy Market (NEM) is a gross, energy-only market. The potential for volatility of spot prices for both energy and ancillary services is an important aspect of market design and operation. The ability of prices to move from -$1,000/MWh up to $13,800/MWh[2] is designed to allow generators and other market participants to earn a reasonable return on assets and recover fixed costs, providing a signal for investment.

However, this volatility also creates risk for parties who participate in the wholesale market. A persistently high spot price can lead to participant financial distress and, in extreme cases, may impact the stability of the wider market.

While the management of risk by individual market participants is an essential and unavoidable aspect of participating in the NEM, the NER contain a number of mechanisms designed to help manage risks to individual market participants and systemic market wide risks.

The design of this area of the NEM has undergone several changes since its creation in 1998. Currently, the NER contain several mechanisms that together make up an overall package for managing the risks posed by periods of sustained high prices:

- a spot market price cap and a market floor price which apply during the normal functioning of the market;

- a rolling cumulative price threshold that applies over a seven day period. The cumulative price threshold is currently set at $207,000 and is calculated by the cumulative sum of spot prices in a region across a rolling seven day period.[3] If the total exceeds the cumulative price threshold, an administered price period commences in which the spot price is collared in the region between the administered floor price of -$300 per MWh and the administered price cap of $300 per MWh, and cannot exceed these limits for the entirety of the administered price period;[4] and

- a compensation mechanism for eligible parties who have incurred losses due to the application of an administered price period.

The application of the administered price cap may cause some participants to incur a loss, where the participant's direct or opportunity costs are in excess of $300 per MWh. While we understand there are not many participants with costs in excess of $300 per MWh, the potential for them to incur a loss may create a disincentive to supply energy or ancillary services during an administered price period. Accordingly, the NER allows

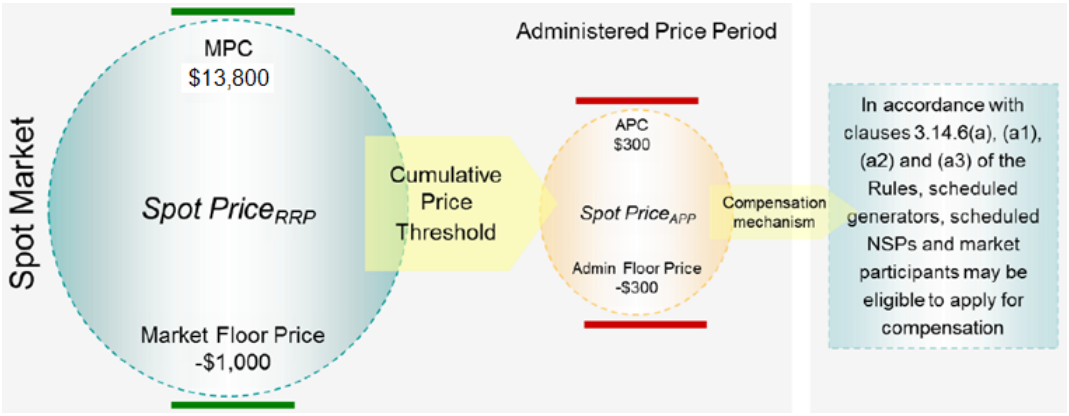
2 Current Market Price Cap, see *Schedule of Reliability Settings*, 12 February 2015, www.aemc.gov.au.

3 Ibid.

4 The administered price period continues until the rolling seven day cumulative price threshold drops back below the level of the cumulative price threshold. The administered price period ceases at the end of the trading day in which the price drops below the cumulative price threshold.

these participants to claim compensation for direct and opportunity costs incurred during an administered price period. The current process is shown in Figure 1.1 below.

Figure 1.1 Current compensation mechanism during an administered price period



The AEMC is responsible for assessing claims for compensation following application of an administered price cap and administered floor price.

1.2.2 AEMC's assessment of Synergen's compensation claim

Administered pricing events have occurred rarely in the NEM. To date, an administered pricing period has only been declared five times in the history of the NEM. Claims for compensation are even less common.

The only claim for compensation following an administered price cap or administered floor price event under the NER was lodged by Synergen Power Pty Ltd (Synergen) in relation to the operation of its Snuggery and Port Lincoln generation units, during an administered price cap event in 2009.[5]

While assessing this claim, the AEMC identified a number of issues with the existing compensation provisions during an administered price period in the NER.[6] These issues related to which parties should be eligible to claim compensation and in what circumstances this was appropriate. The AEMC also identified issues relating to the processes for assessing compensation claims.

Following its final decision on the Synergen claim published in September 2010, the AEMC decided to initiate a review of the arrangements for determining compensation under clause 3.14.6 and 3.15.10 of the NER. A summary of the AEMC's review is outlined below in section 1.2.3.

5 AEMC, *Final Decision, Compensation claims from Synergen Power Pty Ltd*, 8 September 2010.

6 Ibid.

1.2.3 AEMC review of compensation arrangements following an administered price, market price cap or market floor price

The AEMC reviewed the arrangements for compensation set out in clauses 3.14.6 and 3.15.10 of the NER and published its final report in 2013. The final report noted that, while compensation claims are rare, it is important that the NER are clear regarding how these claims are assessed. This will help deliver fair compensation to claimants who continue to supply energy to consumers during an administered price period and help restrict the payment of compensation to those situations where it is likely to deliver beneficial reliability outcomes for consumers.[7]

The recommendations from this review were designed to improve the function of the compensation frameworks, in order to promote more efficient market outcomes. The key recommendations were:

- **Purpose of compensation:** Amend the purpose clause such that the sole purpose is to maintain incentives for participants to supply energy during an administered price period;
- **Eligibility to claim compensation - who should be eligible:** Maintain eligibility for market generators, scheduled load and scheduled network service providers and remove eligibility for ancillary service providers;
- **Eligibility to claim compensation - eligibility criteria and market suspension:** Introduce new eligibility criteria based on net losses over the eligibility criteria and remove references to market suspension;
- **The AEMC's assessment process:** Include a requirement to publish notices to inform the market about a claim; only require public consultation for claims involving opportunity costs; and provide the AEMC with discretion to appoint a varying sized expert panel, depending on the complexity of a claim; and
- **Recovery of compensation costs:** Amend the process such that compensation costs are recovered from market customers in proportion to their total energy consumption during the compensation eligibility period.

The COAG Energy Council rule change request is based on these recommendations.

1.3 Current arrangements

This section summarises the current arrangements for compensation due to the application of an administered price cap or administered floor price.

7 AEMC, *Final Report, Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor price*, 16 May 2013, p.i.

1.3.1 Purpose of compensation

The NER currently define the purpose of paying compensation as maintaining the incentives for market participants to invest in plant that provides services during peak periods and to supply energy and other services during an administered price period.

1.3.2 Eligibility criteria

The NER specify the types of market participants that are currently eligible to apply for compensation as a result of an administered price period and the circumstances in which this can occur. Currently scheduled generators, scheduled network service providers, scheduled loads and ancillary services providers are eligible to claim for compensation. They are eligible for compensation if there is a difference between the price specified in their dispatch offer and the spot market price, calculated for each trading interval when the administered price cap or floor applies. Table 1.1 below summarises the specific circumstances in which each of these participant types are eligible to claim compensation.

Table 1.1 Current criteria for eligible participants

Participant type	NER clause	Eligibility criteria
Scheduled generator (market)	3.14.6(a)	If, due to the application of an administered price cap during either an administered price cap or market suspension, the spot price payable in any trading interval is less than the price specified in their dispatch offer.
Scheduled network service provider	3.14.6(a1)	If, due to application of an administered price cap, the market price, the market floor price or an administered floor price, the revenue receivable in any trading interval is less than the minimum requirements specified by its dispatch offer.
Market participant (in respect of a scheduled load)	3.14.6(a2)	If, due to the application of an administered floor price during either an administered price period or market suspension, the spot price in any trading interval is greater than the price specified in the dispatch bid.
Market participant (in respect of an ancillary service generating unit or load)	3.14.6(a3)	If, due to the application of an administered price cap, the ancillary service price in any dispatch interval is less than the price specified in the relevant market ancillary service offer.

1.3.3 AEMC processes for assessing compensation claims

The AEMC is the body which manages the compensation claim process and determines the compensation payable. It is assisted by a panel of experts who are appointed by the dispute resolution adviser provided for in the NER and guided by a

set of compensation guidelines made by the AEMC which set out the methodology that will be used to calculate compensation.

The NER currently describe the processes and timing to be followed by the AEMC when assessing compensation claims. This includes the roles and responsibilities of the dispute resolution adviser and the panel. The NER set out the following steps in assessing claims for compensation following the application of an administered price period:

- the claimant submits a claim for compensation to the AEMC;
- the dispute resolution adviser establishes a three member panel to review all types of claims (direct and opportunity costs);
- the panel reviews the claim and provides a draft report to the AEMC;
- the AEMC reviews the panel's draft report and publishes it and its own draft report;
- public consultation occurs on the draft reports for all types of claims (direct and opportunity costs);
- the panel provides a final report to the AEMC; and
- the AEMC reviews the panel's final report and publishes it and its own final report.

The current rules do not require the AEMC to publish any notices to inform the market as to the initiation or progress of a compensation claim.

The dispute resolution adviser is also required to establish a three member panel to assist the AEMC in developing the compensation guidelines.

The current role of the panel is to make recommendations to the AEMC as to whether compensation should be payable by AEMO in relation to all claims and if so, the amount of the claim. The panel must publish draft and final recommendations.

The current role of the AEMC is to review the participant's compensation claim and the panel's recommendations in relation to the claim. It must determine where compensation should be paid and the amount of compensation payable. The AEMC must also develop and publish the compensation guidelines.

More information on the current compensation assessment process is included in chapter 6 of this final determination.

1.3.4 Recovery of compensation costs

Any compensation determined to be payable to a claimant under the compensation assessment process in clause 3.14.6 is recovered from market customers. The NER

currently requires AEMO to recover the cost of compensation from market customers who purchased electricity in a region where the spot price was affected by administered pricing.[8] AEMO determines the amounts payable by market customers according to their individual share of total energy consumption, on a trading interval basis.

1.4 Proposed arrangements in rule change request

In the rule change request, the COAG Energy Council considered that there is a need to improve the compensation arrangements. The proposed solution seeks to resolve issues relating to the purpose of compensation, eligibility criteria, the compensation assessment process and the cost recovery process, as outlined below.

1.4.1 Amending clauses defining the purpose of compensation

The rule change request proposed that clause 3.14.6 be amended such that the sole purpose of compensation is to maintain incentives for participants to supply energy during an administered price period. The rule change request noted that incentives to invest in plant that provide services during peak periods are intended to be provided through the occurrence of high wholesale spot prices during the normal functioning of the market, and not through the compensation mechanism. The rule change request therefore proposed to remove from the purpose of compensation the incentive to invest in plant that provides services during peak periods.

1.4.2 Amending eligibility criteria and removal of references to market suspension

The rule change request proposed a number of changes to the eligibility criteria and the removal of references to market suspension. The rationale for each of these changes is outlined below.

New criteria based on the eligibility period

The rule change request noted the following issues with the current eligibility criteria:

- Compensation is based on the difference between the spot price and the price specified in a dispatch offer. The reference to "dispatch offer" is ambiguous, as it is not clear whether this refers to one price band or all ten price bands in a dispatch offer. It also does not recognise that capacity may be rebid between the ten price bands in a dispatch offer;

- It is unclear whether any energy capacity must actually be associated with a price specified in a dispatch offer in order for the participant to be eligible; and

8 Market customers are defined under clause 2.3.4 of the NER.

- Generators are only eligible when their dispatch offer is greater than the administered price cap and the spot price is at the level of the administered price cap, during an administered price period.

To address these issues, the rule change request proposed to introduce new criteria which allow market participants to claim compensation when their total costs exceed their total revenue from the spot market over an entire "eligibility period". This starts from the first trading interval when the spot price is set by the administered price cap or administered floor price, until the last trading interval of that day. This is intended to recognise the operational characteristics of generators, which are at a clear risk of incurring a loss if they are dispatched during an administered price period and have high direct or opportunity costs.[9]

The new criteria based on net losses over the eligibility period also avoids ambiguities that result from references to dispatch offers.

The new criteria applies to all participants that are eligible in the final rule, that is scheduled and non-scheduled generators, market participants (scheduled load) and scheduled network service providers.

Include eligibility for non-scheduled market generators

The rule change request noted the potential for non-scheduled market generators to incur direct or opportunity costs due to the application of an administered price cap, if they choose to operate and export power during an administered price period. This may create disincentives for these participants to supply energy. It therefore proposed to extend eligibility for compensation to non-scheduled market generators.

Remove eligibility for ancillary service providers

The rule change request considered that ancillary services providers are unlikely to incur costs in an administered price period, and therefore, should not be eligible for compensation under clause 3.14.6. The rule change request considered that ancillary service providers have not faced a disincentive to supply ancillary services as any losses caused by being asked to provide energy entitles the service provider to compensation as a scheduled generator or scheduled load.

Amend eligibility criteria in an export price capped region

Administered price caps in one region can have a flow on effect to spot prices in other regions, which are limited where power is flowing from the second region into the first. The rule change request considered that market generators and scheduled loads, located in 'export' regions where the spot price has also been limited, should be eligible to claim compensation if they incur a net loss over the eligibility period. The rule change request therefore proposed to amend the existing eligibility criteria regarding

9 The opportunity cost of a particular choice refers to the value of the best alternative. This is defined as the foreclosure of opportunities to use scarce resources more profitable at another point in time. AEMC, *Compensation Guidelines under Clause 3.14.6 of the National Electricity Rules, Amended Guidelines*, 17 February 2015, p15.

compensation in export price capped regions, such that eligibility is based on the eligibility period and not individual trading intervals.

Amend eligibility criteria for scheduled network service providers

The rule change request proposed to amend the eligibility criteria for scheduled network service providers, which are currently eligible to claim compensation due to the application of an administered price cap, market price cap, market floor price or an administered floor price. It proposed to remove eligibility due to the application of a market price cap, market floor price and administered floor price, such that these participants are only eligible to claim compensation as a result of an administered price cap.

Removal of references to market suspension

The rule change request noted that market suspension does not result in the application of an administered pricing under the NER. There is already a process for participants to claim compensation under market suspension in clause 3.15.7. Therefore references to compensation as a result of market suspension in clause 3.14.6 should be clarified to only apply to any loss of revenue from the spot market that is not captured in clause 3.15.7.

1.4.3 Amending AEMC processes for assessing compensation claims

The rule change request noted that the current compensation assessment process lacks flexibility and transparency and may result in an inefficient assessment process. The following changes were proposed to address these issues:

- require the AEMC to publish notices on its website advising of receipt of a compensation claim and formal commencement of assessment of the claim;
- allow the AEMC to appoint a varying sized panel of between one and three experts, depending on the complexity of the claim;
- specify a different timeframe for assessment depending on whether it is a direct or opportunity cost claim, as well as allowing the AEMC to extend the timeframe for assessment, under certain predefined conditions;
- a public consultation process would only be required for claims involving opportunity costs and not for direct cost only claims;
- remove the requirement to publish a draft report for direct cost only claims; and
- include greater obligations on the AEMC to publish its methodology for determining opportunity costs.

The Commission's Consultation Paper proposed a specific change to the compensation assessment process that was additional to the change in the rule change request (ie a

more preferable rule). The nature of the more preferable rule is detailed in section 1.5 and chapter 6 of this final determination.

1.4.4 Amending the process to recover compensation costs

The rule change request noted that the current rules are unclear as to the appropriate process to be followed by the AEMC and AEMO in recovering the costs of compensation from market customers. It is not clear if compensation should be recovered based on energy consumption on a trading interval basis or another approach, and whether compensation costs should be shared by customers in multiple regions.

To clarify the rules, the rule change request proposed that compensation costs be recovered based on a customer's energy consumption over the eligibility period in the region in which the spot prices were set by the administered price cap or administered floor price.

1.5 Consultation Paper - additional changes

The Commission's Consultation Paper sought stakeholder feedback on a potential additional change to the compensation assessment process under clause 3.14.6 in addition to the changes described in the rule change request.

In the Consultation Paper, the Commission sought feedback on whether the compensation assessment process could be further streamlined, by removing the roles of the dispute resolution adviser and panel. The Commission asked stakeholders to consider whether removing the requirement to use an expert could increase the flexibility and efficiency of the process by providing the AEMC with discretion to draw on external expertise as required, as it does in general for rule changes and reviews, rather than requiring it to use an expert panel in every case.[10]

The Commission suggested removal of the dispute resolution adviser as, in the circumstances of a compensation assessment process following an administered price period, it was not clear if the additional time required in the process through involvement of the dispute resolution adviser was justified by any benefits this offers.[11]

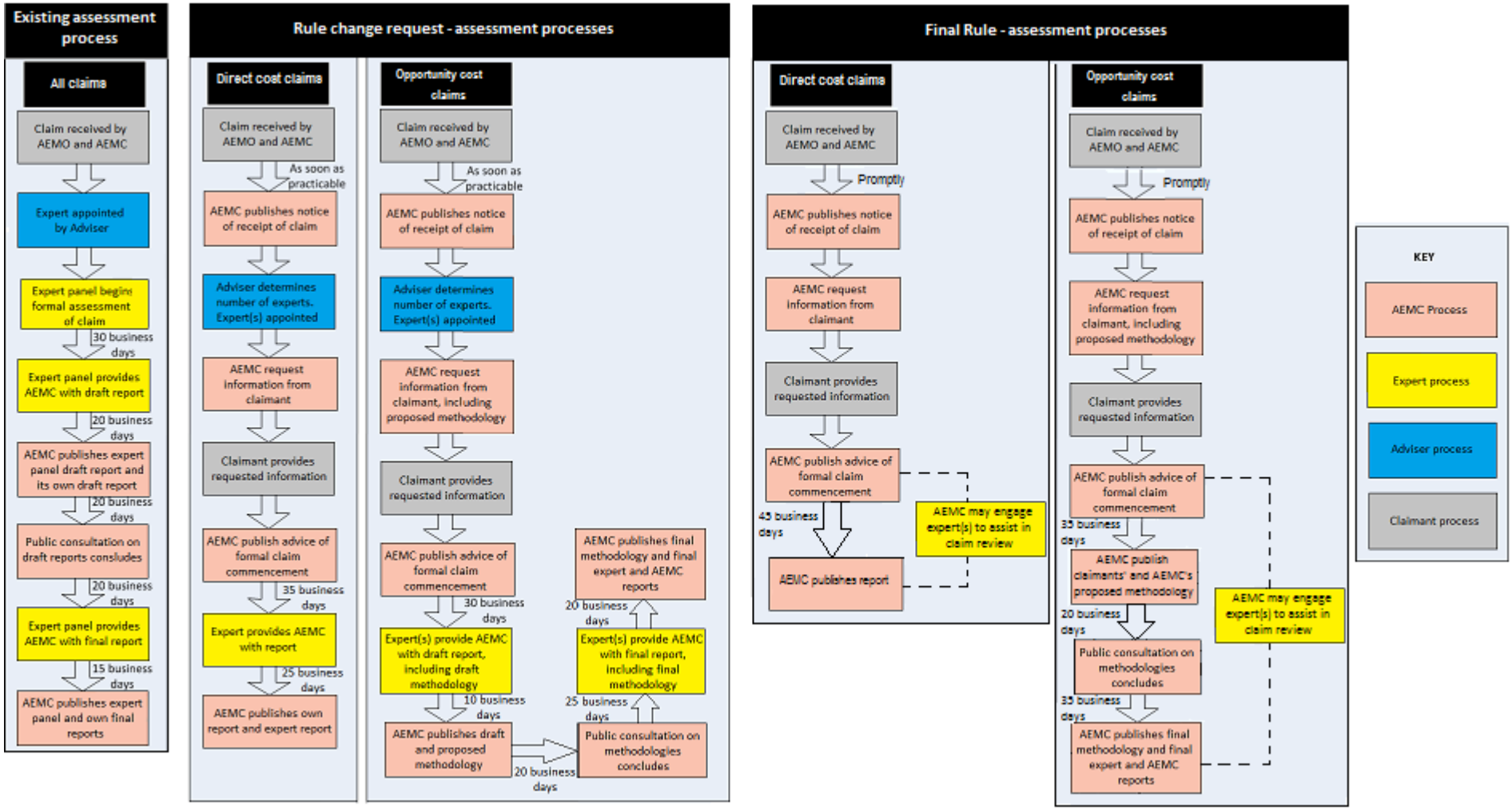
Figure 1.2 below compares the compensation assessment process between the existing rules, the rule change request and the suggested process in the consultation paper.[12]

10 AEMC, *Consultation Paper - Compensation Arrangements following application of an Administered Price Cap and Administered Floor Price*, 7 May 2015, p13.

11 Ibid.

12 The suggested process in the consultation paper is the compensation assessment process as reflected in the Commission's final rule.

Figure 1.2 Compensation assessment processes - existing, rule change request and final rule



1.6 The rule making process

1.6.1 Consultation paper

On 7 May 2015, a consultation paper prepared by AEMC staff identifying specific issues and questions for consultation was published. Submissions closed on 4 July 2015. Three submissions in response were received.

1.6.2 Draft determination

On 13 August 2015, the Commission published a draft determination and draft rule (which was a more preferable rule) in respect of the rule change. Submissions on the draft determination and draft rule closed on 24 September 2015. Two submissions in response were received.

In the draft rule determination, the Commission decided to remove eligibility for compensation for ancillary services providers following the application of an administered price limit event. The basis for this decision was:

- allowing compensation may weaken the protection for consumers from high prices afforded by an administrative price cap, particularly where the compensation is based on opportunity loss after high prices occurred in the energy market; and
- the historic infrequency of administered price caps occurring in ancillary services markets.

Further detail on this draft rule determination decision is provided in section 5.1.3.

1.6.3 Additional consultation paper

The statutory deadline for making a final rule determination for this rule change was 5 November 2015. However, on 5 November 2015, due to the material change in circumstances outlined in section 5.1.4, the Commission decided to extend the period of time for making a final rule determination under section 107 of the National Electricity Law (NEL).[13] The extended period of time allowed for an additional round of consultation in respect of the draft rule determination decision to remove eligibility for ancillary service providers to claim compensation.

On 26 November 2015, the Commission published an Additional Consultation Paper which raised a number of issues relating to the potential for an administered price limit event occurring again in ancillary services markets and the potential for ancillary services providers to incur a net loss. It also considered the extent to which eligibility

13 *Notice under National Electricity Law*, 5 November 2015, http://www.aemc.gov.au/getattachment/41cfd06a-18a5-46d4-8f73-c5e4c79cd88d/Notice-under-National-Electricity-Law.aspx

for compensation creates incentives for ancillary services providers to provide ancillary services. Five submissions in response were received.

All submissions submitted throughout this rule making process are available on the AEMC website. A summary of issues raised in submissions and the Commission's response to each issue is contained in Appendix A.

2 Final rule determination

In this chapter the Commission considers the rule making test and assessment framework used for this rule change request. It also outlines the summary of reasons for the final determination.

The Commission's final rule determination is to make a rule which is a more preferable rule (final rule). The final rule specifies the purpose of compensation, introduces new eligibility criteria, removes references to market suspension and amends the compensation assessment process and the process to recover compensation costs.

This Chapter outlines:

- the Commission's rule making test for changes to the NER;
- the Commission's assessment framework for considering the rule change request; and
- the Commission's reasons for making the final rule. Further information on the legal requirements for making this final rule determination are set out in Appendix B.

2.1 Rule making test

Under the NEL the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the National Electricity Objective (NEO). It may only make a more preferable rule where the Commission is satisfied that having regard to the issues in the rule change request, the more preferable rule will, or is likely to, better contribute to the achievement of the NEO than the proposed rule.[14] This is the decision making framework that the Commission must apply.

The NEO is:

> "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."

For this rule change request, the Commission considered that the relevant aspects of the NEO are efficient operation and use of electricity services for the long-term interests of consumers, with respect to the price of electricity and the reliability and security of the national electricity system.

14 National Electricity Law Section 91A.

2.2 Assessment framework

To determine whether the final rule is likely to contribute to the achievement of the NEO, the Commission has considered the following matters.

2.2.1 The reliability and security of the electricity system

A reliable electricity system is one that has a high likelihood of supplying all consumer needs and underpins economic activity and investment decisions. A secure electricity system is one that is being operated or managed such that all vital technical parameters such as voltage, equipment loading and power system frequency are all within design limits and are stable. The contribution of the rule change request to maintaining reliability of supply of electricity and the reliability and security of the national electricity system is to be tested.

The rule change request relates in part to the application of eligibility criteria which recognise the operational characteristics of those market participants which are most likely to be affected by an administered price cap or administered floor price and its impact on productive efficiency (ie producing electricity at least cost). In addition, a key benefit of paying compensation following an administered price cap or administered floor price event is the reliability benefit to relevant customers, because participants will have an improved incentive to supply energy and consume load across an administered price period.

2.2.2 Transparency and administration costs

The rule change may increase transparency and lower administration costs through the proposal to improve the efficiency of the compensation claim assessment process.

Reducing administration costs as part of the assessment process should contribute to the achievement of the NEO through a reduction in costs flowing through to stakeholders. Greater transparency should mean more active stakeholder involvement and regulatory decisions which better take into account stakeholder concerns.

2.2.3 Efficient recovery of compensation claim costs

Where generators receive compensation for operating during an administered price period, the costs involved must be allocated to and recovered from customers. The most efficient way these costs can be recovered is by allocating them to customers in proportion to the benefit the customers receive from generators continuing to supply energy during an administered price period. This outcome is consistent with allocative efficiency. In addition, when assessing the cost recovery mechanism the level of granularity should also be considered. This should provide an appropriate balance between efficient allocation and a reasonably simple and transparent approach.

2.3 Summary of reasons

Having regard to the issues raised in the rule change request, the Commission is satisfied that the final rule will, or is likely to, contribute to the achievement of the NEO for the following reasons:

- the new description of the purpose of compensation will make it clear that the objective of paying compensation is to maintain the incentive for market generators and scheduled network service providers to supply energy during an administered price period;
- the new eligibility criteria based on net losses over an entire eligibility period, rather than specific trading intervals, should reduce incentives for generators to cycle their units on and off in a specific trading interval;
- the inclusion of eligibility for non-scheduled market generators will reduce the disincentive they face to supply energy during an administered price period;
- it clarifies how compensation costs are calculated and allocated to market customers, while minimising the regulatory and administrative burden on AEMO; and
- it clarifies that the compensation guidelines may define the types of opportunity costs in relation to which a person may make a claim for compensation. This should improve the transparency of decision-making in the compensation assessment process.

In addition, the Commission is satisfied that the final rule will better contribute to the achievement of the NEO than the rule change proposal because the final rule:

- includes eligibility for ancillary service providers to make a claim for compensation following the application of an administered price period;
- makes further amendments to the purpose of compensation which clarify that "other services" refers to ancillary services;
- makes clear the incentive that should be provided for ancillary services providers to provide ancillary services and scheduled loads to consume energy during an administered price limit event;
- removes the mandatory roles of the expert and dispute resolution adviser from the compensation assessment process which is likely to result in a more timely, efficient and flexible process by removing duplication and limiting the number of different parties involved;
- extends the definition of price limit events for scheduled loads and scheduled network service providers;

- clarifies references to "spot price" which have been replaced with "dispatch price" in the definition of price limit event, relevant region and cost recovery region;
- removes references to market suspension from the relevant provisions; and
- clarifies that compensation costs are to be recovered from customers in the cost recovery region, which is the home region in which the dispatch price or ancillary service price is set by administered pricing.

In addition, it is noted that the final rule contains some drafting matters that are different from the proposed rule.

The final rule made by the Commission is published with this final rule determination.

Further detail on the final rule can be found in sections 3 to 7 below.

3 Clarifying the purpose of compensation

This chapter considers the aspect of the rule change request that sought to amend the purpose of compensation.

3.1 Context and stakeholder views

The COAG Energy Council's rule change request proposed that the NER be amended to introduce a new description of the purpose of compensation. This would clarify that the sole purpose of compensation is to maintain incentives for participants to supply energy during an administered price period.

3.1.1 Maintaining a supply incentive in the purpose clause

GDF Suez, EnergyAustralia[15] and Origin[16] all supported retaining in the purpose clause the existing incentive to supply energy during an administered price period.

The South Australian Department of State Development (SADSD) supported including in the purpose clause a reference to suppling ancillary services during an administered price period.[17]

3.1.2 Removing investment incentive in purpose clause

Stakeholder views differed on whether the purpose of compensation should also be to maintain an incentive to invest in plant that provides services during peak periods. EnergyAustralia supported the removal of this from the purpose clause on the basis that the cumulative price threshold sets the balance between investment incentives and risk and provides sufficient opportunity to recoup long-term costs outside administered prices.[18]

GDF Suez did not support the removal of the investment signal and states that generators would not be incentivised to invest in plant simply by being assured they will not suffer a loss.[19]

GDF Suez noted that the level of the market price cap and cumulative price threshold are established for the whole of the NEM based on investment signals, and are not specific to any given participant or set of circumstances. It suggested that while the market price cap and cumulative price threshold might be sufficient to maintain the necessary signal for investment in peaking generation in many circumstances, it is

15 EnergyAustralia submission, 5 June 2015, p1.

16 Origin Energy submission, 4 June 2015, p1.

17 SADSD submission, 10 December 2015, p1.

18 EnergyAustralia submission, 5 June 2015, p1.

19 GDF Suez submission, 4 June 2015, p2.

possible that for a specific set of circumstances around an administered pricing event, these pricing signals may be inadequate.[20]

In response to the draft determination, GDF Suez was concerned that the draft rule would eliminate any opportunity for generators to claim compensation for revenue foregone that was required to support investment in peaking generators. It suggested that it would be better to leave the opportunity for investment claims to be made, with generators required to explain the reasons why any claim is warranted.[21]

GDF Suez questioned why the AEMC was removing the investment purpose from the rules when there had not been a history of claims that were found to be unwarranted. It suggested that the rule change was seeking to resolve an issue that is not impacting on the NEM.[22]

3.2 Assessment

3.2.1 Maintaining a supply incentive in the purpose clause

Energy services

Maintaining an incentive to supply energy during an administered price period is central to the purpose of compensation. An administered price period generally occurs following periods where the supply / demand balance may be tight. It is therefore important to encourage generators to continue to supply in such market circumstances in order to promote the reliable supply of electricity to customers. This element of the purpose of compensation should therefore be retained.

Ancillary services

Under the current NER, the purpose clause includes an incentive to supply "other services" during an administered price limit event.

In the draft rule determination, it was proposed that eligibility for ancillary service providers to claim compensation be removed. Therefore, there was no need to maintain an incentive for "other services" (ie ancillary services) to be supplied during an administered price period in the purpose of compensation, so these words were removed from the purpose clause.

However, as discussed in sections 5.2 and 5.3, the final rule includes eligibility for ancillary services providers to claim compensation. Therefore, there is a need to include an incentive to supply ancillary services during an administered price period

20 GDF Suez submission, 24 September 2015, p1.

21 Ibid, p2.

22 Ibid, p2.

in the purpose of compensation. The final rule specifically refers to ancillary services in the purpose clause.[23]

3.2.2 Removing investment incentive in purpose clause

Investment signals during the normal market function and an administered price period

The signal to invest in generation plant is provided through the prices the market delivers under the normal functioning of the market. These include the market price cap, market price floor and cumulative price threshold. For example, when the supply and demand balance is tight generators have the opportunity to receive high spot prices up to the market price cap.

These mechanisms are regularly reviewed by the Reliability Panel in accordance with clause 3.9.3A of the rules. The Reliability Panel most recently assessed these settings in its review of reliability settings and standards that was released on 16 July 2014.[24]

The levels of the market price cap and cumulative price threshold are set to incentivise sufficient generation capacity to deliver the reliability standard. The reliability standard is based on the maximum amount of electricity expected to be at risk of not being supplied and is currently set at 0.002 per cent of annual energy consumption for the associated NEM region or regions.[25]

Types of compensation costs to be recovered

Including the investment signal in the purpose clause could imply that capital costs could also be recovered through the compensation mechanism. If capital costs were included in the existing rules or final rule, this would reallocate part of the risk associated with the decision to invest in plant from generators to market customers. This risk is more appropriately borne by generators who are better placed to manage it through natural profit and risk incentives.

In addition, it is noted that the type of costs (ie direct and opportunity costs) which can be claimed through compensation as defined in clause 3.14.6(d) do not include capital costs under the current arrangements. Removing the incentive to invest in plant from the purpose of compensation will address this potential contradiction.

The Commission recognises that there have not been any compensation claims for investment costs relating to administered price periods. However while the purpose of compensation remains as it currently is, ambiguity persists as the purpose clause could imply that capital costs could also be recovered through the compensation mechanism.

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23 NER clause 3.14.6(c)(2) is different from the current rule which refers to "other services" in the purpose clause.

24 Reliability Panel AEMC, *Final Report - Reliability Standard and Reliability Settings Review 2014*, 16 July 2014.

25 Australian Energy Market Commission, *Final Report - Reliability Standard and Reliability Settings Review 2014*, 16 July 2014, pi.

Removing the incentive to invest in plant from the purpose clause removes this ambiguity.

3.2.3 Consequential changes

The final rule includes an additional change to the NER relating to the purpose of compensation.

To reflect the objective of encouraging scheduled load to continue to consume during administered price periods, the final rule amends the purpose clause to provide specifically for scheduled load.

3.3 Conclusion

The Commission considers that the final rule will contribute to the achievement of the NEO by promoting the reliability and security of the national electricity system.

Having an incentive to supply energy, ancillary services and scheduled load during an administered price period is central to the purpose of compensation and improving reliability and security outcomes during an administered price period.

The compensation arrangements do not provide for recovery of capital costs and as such will not contribute to investment incentives. They therefore do not provide an investment incentive, and it is not appropriate for them to do so because generators are better able to manage investment risk than customers. Investment incentives are provided by other mechanisms in the NER, including the level of the market price cap and cumulative price threshold.

4 Clarifying eligibility criteria and removal of references to market suspension

This chapter considers the aspect of the rule change request that sought to clarify the criteria for eligibility to claim compensation.

As there was additional consultation relating to eligibility for ancillary services providers to claim compensation, this aspect of the rule change request is considered in chapter 5.

4.1 New criteria based on the eligibility period

4.1.1 Context and stakeholder views

The rule change request proposed to replace the existing criteria in the NER with new criteria based on compensation for market participants over the eligibility period. This would have the effect of reducing the disincentive to supply or consume energy during the administered price period.

EnergyAustralia agreed that the new criteria are likely to be effective in incentivising operational decisions to supply energy across an administered price limit event. While this could produce some inefficiencies through the dispatch of high cost plant, the reliability benefits are likely to offset any short term productive inefficiencies.[26] GDF Suez also supported the proposed new criteria based on the eligibility period as it overcomes ambiguities with the current eligibility criteria.[27]

4.1.2 Assessment

Problem with existing criteria

There are two broad problems with the existing eligibility criteria.

First, there is some ambiguity in the criteria, in particular regarding the term "dispatch offer". The existing criteria refer to the difference between the price specified in dispatch offers and the spot price, however as there are ten prices included in any dispatch offer, the term "price specified in the dispatch offer" could be interpreted to refer to any of these ten prices. Therefore, the current eligibility criteria could mean that any participant who includes a price in its dispatch offer, which is higher than the spot price, could be eligible to claim compensation.

It is unclear whether any energy capacity must actually be associated with a price specified in a dispatch offer in order for a participant to be eligible for compensation.

It is also unclear whether the reference to "dispatch offer" includes rebids.

26 EnergyAustralia submission, 4 June 2015, p1.

Second, the existing criteria focus on trading intervals. Eligibility for generators during an administered price period is limited to those trading intervals when their dispatch offer is greater than the administered price cap and the spot price is at the level of the administered price cap.

The problem with this is that as the spot price moves up and down during an administered price period, a generator may move from being eligible in one trading interval to ineligible in the next trading interval.

For example, if the spot price dips below $300 then the administered price cap cannot apply and a generator would not be eligible for compensation. Alternatively, even if the administered price cap applies, if the generator's dispatch offer is less than the price cap, it would not be eligible for compensation.

This can be a problem because it can result in "unit cycling". Generators generally avoid turning their plant on and off (ie unit cycling) due to plant and cost implications of this behaviour.[28] Unit cycling can also create reliability risks for the market as a whole by increasing the wear and tear on plants and the risk of plant failure.[29] Such plant failure could have a material impact on supply reliability for customers, particularly during a period of high demand.

If the market dispatch curve falls below a generator's offer, it may no longer be in merit and be ordered to switch off by the NEM dispatch engine. If the generator considers that the dispatch curve would rise again, it may prefer to continue operating at a minimum level to avoid unit cycling. It would achieve this by rebidding its minimum capacity into lower price bands. However, if compensation were not available in a trading interval in the event it rebid capacity in this way, there may be an incentive for the generator just to switch off and then switch on again, causing inefficient unit cycling.

Solution

The eligibility criteria in the final rule are based on the new concept of an eligibility period, which could comprise multiple trading intervals. This eligibility period starts from the first dispatch interval when the dispatch price or ancillary service price is set by the administered price cap or administered floor price, and continues until the last dispatch interval of the last trading interval of that day. The new approach allows market participants to claim compensation when their total costs exceed their total spot market revenue over the eligibility period.[30] This has two positive effects.

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27 GDF Suez submission, 24 September 2015, p1.

28 AEMC, *Final Report - Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price*, p29.

29 AEMC, *Final Report - Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price*, p30.

30 Any revenue or costs incurred by a generator in periods prior to the commencement of an eligibility period would be excluded from the calculation of the generator's compensable costs.

First, it avoids the focus on the difference between dispatch offers and spot prices which creates confusion in the current arrangements.

Second, it allows market participants to rebid capacity from higher into lower price bands and claim compensation if they incur a net loss over the eligibility period, rather than in respect of particular trading intervals. This reduces the disincentive for a generator to cycle off its plant in a trading interval during an administered price period when the spot price is lower than its costs. Instead it is eligible for compensation based on the difference between its total costs and total revenues over the entire eligibility period. The new criteria therefore recognise the operational characteristics of generators and will help promote beneficial reliability outcomes for customers.

There could be some disadvantages of the new approach. Allowing generators to rebid capacity to lower price bands and remain eligible for compensation through the eligibility period may result in productive inefficiencies. Such as:

- bidding in this manner may not be efficient, in that peaking units may displace other lower cost generators in the merit order;[31] and
- allowing a rebid generator to remain eligible may also reduce the incentives on all generators to adopt a load-following operational pattern, which is undesirable as generators should operate their units in a flexible manner in order to follow variations in load.

However, the reliability benefits of allowing generators to rebid capacity and remain eligible for compensation are likely to outweigh these inefficiencies. This reflects the fact that cycling of units can have negative consequences for individual generators and can create supply reliability risks for the market as a whole.

4.2 Extending eligibility to non-scheduled generators

4.2.1 Context and stakeholder views

The rule change request considered that the eligibility criteria in clause 3.14.6 of the NER should be extended to include eligibility for non-scheduled generators. There is a possibility that some non-scheduled market generators could incur direct or opportunity costs due to the application of an administered price cap, and therefore should be eligible for compensation.

GDF Suez supported extending the eligibility criteria to include non-scheduled market generators as this category of generators could incur costs due to an administered pricing event.[32]

31 This assumes that a "cost reflective" bid includes only short run variable and operating costs and does not factor in the opportunity costs of unit cycling.

32 GDF Suez submission, 24 September 2015, p1.

4.2.2 Assessment

The eligibility criteria should be extended to include non-scheduled market generators as this will reduce the disincentive they face to supply energy during an administered price period and potentially improve reliability outcomes. Non-scheduled generators do not participate in central dispatch and do not submit a dispatch offer,[33] but are potentially subject to direction by AEMO under clause 4.8.9. While they can be compensated for being directed under clause 3.15.7, the amount of compensation potentially awarded is less certain. For this reason there is merit in providing for them to be able to access compensation through clause 3.14.6 and this is reflected in the final rule which includes non-scheduled generators as registered participants that are eligible to claim compensation.

4.3 Amend eligibility criteria in an export price capped region

4.3.1 Context and stakeholder views

The most likely situation in which a scheduled generator will incur a loss is where that generator is located in the same region in which the administered price period applies. In this case, the administered price cap is setting the spot market price in the "home region". However, generators located in a region where the administered price cap is not directly applied may also incur a loss, due to the effect of price scaling.

Price scaling is the process whereby the spot price in a region exporting power to the home region (the "exporting region") is capped at a level equal to the administered price cap, adjusted for losses. The price cap in the export region only applies where these two regions are linked by a regulated interconnector.

The rule change request considered that market generators (both scheduled and non-scheduled) and scheduled loads, located in 'export' regions where the spot price has been limited through the application of clause 3.14.2(e), should be eligible to claim compensation if they incur a net loss over the eligibility period. The rule change request therefore proposed to amend the existing criteria in clause 3.14.6 to provide for generators in export price capped regions to be eligible for compensation. There were no stakeholder submissions in relation to eligibility criteria in an export price capped region.

4.3.2 Assessment

The application of an administered price cap in an exporting region may result in market generators incurring a loss, due to the effect of price scaling. Market generators should therefore be eligible to claim compensation, given that the export of power

33 The fact that non-scheduled generators do not make a dispatch offer would effectively prevent them from being eligible to claim under the existing criteria, which are based on the difference between dispatch offer price and the spot price. However, no such barrier exists under the recommended eligibility criteria, given that it contains no reference to dispatch offers.

from their region provides improved reliability for customers in the home region in which the spot price is capped by the administered price cap.

A similar (inverse) situation may apply for scheduled loads. The NER allows for the price in any region with a flow away from a region in which the spot price is capped by administered pricing to be equal or greater than the administered floor price. Therefore, scheduled loads in regions impacted in this way may incur net losses over the eligibility period. Scheduled loads should therefore be eligible to claim compensation, given that the import of power into their region provides improved reliability for customers in the home region in which the spot price is limited by the administered floor price.

4.4 Amend eligibility criteria for scheduled network service providers

4.4.1 Context and stakeholder views

A scheduled network service provider acts as a merchant carrier of electricity between regions. It submits a network dispatch offer, which defines the minimum price difference that must exist between the two regions before the scheduled network service provider will transport power from one region to another. It therefore earns revenue through "buying" electricity in a lower priced region and "selling" this power in a higher priced region.

Under the existing clause 3.14.6(a1), scheduled network service providers are eligible to claim compensation due to the application of an administered price cap, market price cap, market floor price or an administered floor price.

The rule change request proposed that scheduled network service providers should only be eligible to claim compensation due to the application of an administered price cap. There were no stakeholder submissions in relation to this rule change request.

4.4.2 Assessment

References to eligibility for scheduled network service providers to claim compensation following the application of a market price cap, market floor price and administered floor price, should be removed.

Scheduled network service providers should be eligible to claim compensation due to the application of an administered price cap in a region into which it is transporting power. If an administered price cap applies in the region to which the scheduled network service provider is transporting power, the price in the region from which the power is flowing will not be scaled or adjusted to the level of the administered price cap. This could result in the scheduled network service provider incurring a compensable loss, for example if it was transporting power from an uncapped region at $600 per MWh toward an administered price capped region at $300 per MWh.

The purpose of compensation is to maintain incentives to supply energy during an administered price period, whereas the market price cap and market floor price occur during the normal function of the market. As these situations occur outside of the constraints of the administered price period, they should be removed from the eligibility criteria.

The application of an administered floor price may affect scheduled network service provider revenue, in the situation where the scheduled network service provider is exporting power from a negatively priced region into another region. However, providing compensation in these circumstances is unlikely to improve reliability outcomes. Therefore, compensation is not warranted in these circumstances.

4.5 Removal of references to market suspension

4.5.1 Context and stakeholder views

The rule change request proposed to remove references to market suspension. It states that market suspension should not act as a trigger for eligibility to claim compensation under clause 3.14.6, as it does not result in the application of an administered price period. There were no stakeholder submissions in relation to the proposal to remove references of market suspension.

4.5.2 Assessment

References to market suspension should be removed from clause 3.14.6. At times of market suspension the NER already provide in clause 3.14.5 for a mechanism for prices to be set in a certain way. The administered price cap does not apply during periods of market suspension. On this basis, references to compensation as a result of the application of the administered price cap during a period of market suspension in clause 3.14.6 are redundant and should be removed.

The final rule is an improvement on the rule change request which proposed that references to compensation as a result of market suspension in clause 3.14.6 should be clarified to only apply to any loss of revenue from the spot market that is not captured under clause 3.15.7.[34] However, given that administered pricing does not apply during periods of market suspension the final rule omits references to market suspension entirely rather than carving out amounts recovered under clause 3.15.7 from compensation amounts as proposed in the rule change request.

34 COAG Energy Council, *Compensation arrangements following application of an administered price cap and administered floor price, rule change request and proposal*, 16 October 2013, p5.

4.6 Amending references from "spot price" to "dispatch price"

4.6.1 Context and stakeholder views

Under the current NER, compensation for scheduled generators and scheduled loads is specified in relation to the "spot price" while compensation for scheduled network service providers is in relation to "revenue receivable".[35]

In the draft rule, compensation for scheduled network service providers was changed from a reference to "revenue receivable" to "spot price".

The Additional Consultation Paper proposed amendments to the final rule to clarify references to "spot price", which were included in the draft rule. It proposed that the term 'spot price" be replaced with the term "dispatch price" in the definition of price limit and relevant region in clause 3.14.6 and in the definition of cost recovery region in clause 3.15.10.[36] No stakeholder submissions were received on these amendments.

4.6.2 Assessment

Spot price refers to the price for electricity in a trading interval at a regional reference node and is based on the time weighted average of the dispatch prices at the regional reference node for each of the dispatch intervals in a trading interval.[37] Dispatch price refers to the price determined for each regional reference node by the dispatch algorithm each time it is run by AEMO.[38]

The draft rule referred to the "spot price" for a dispatch interval. However, the price set in each 5 minute dispatch interval is the dispatch price and not the spot price. Therefore the amendments to clarify references to “spot price” by replacing them with the term dispatch price are an improvement on the draft rule.

4.7 Conclusion

The Commission considers that the final rule will contribute to the achievement of the NEO by promoting the reliability of the national electricity system.

The new criteria based on the eligibility period will promote beneficial reliability outcomes as it better reflects the operational characteristics of generators than the current NER.

35 NER Clause 3.14.6(a), (a1) and (a2).

36 AEMC, *Additional Consultation Paper, National Electricity Amendment (Compensation arrangements following application of an administered price cap and administered floor price) rule 2016*, 26 November 2015, p14.

37 NER Clause 3.9.2(h)

38 NER Chapter 10, p1153

References to the term "spot price" have been replaced with the term "dispatch price" in the definition of price limit event, relevant region and cost recovery region in the final rule.

Extending eligibility to non-scheduled market generators will potentially reduce the disincentives they face to supply energy during an administered price period and enhance reliability. Amendments to the eligibility criteria relating to price scaling in export price capped regions and scheduled network service providers are also warranted.

References to market suspension are removed as an administered price cap does not apply at times of market suspension.

5 Eligibility for ancillary services providers

This chapter considers the aspect of the rule change request that sought to remove eligibility for ancillary service providers to claim compensation.

5.1 Context and stakeholder views

This section describes the eligibility for ancillary service providers to claim compensation under the current NER,[39] what was proposed in the rule change request, the draft determination, the issues raised in the Additional Consultation Paper and stakeholder submissions in response to the Additional Consultation Paper.

5.1.1 Current NER

Under the existing NER, ancillary service generating units and ancillary service loads are eligible to claim compensation relating to the application of an administered price limit event.[40]

5.1.2 Rule change request

The rule change request proposed to remove eligibility for ancillary services providers. It considered that the application of an administered price limit event in ancillary services markets would not result in ancillary services providers incurring a loss and facing a disincentive to supply these services. This is because any loss would be linked to providing energy which would entitle the service provider to compensation as a scheduled generator or scheduled load.[41]

5.1.3 Draft rule determination

The draft rule determination considered that eligibility for ancillary service providers should be removed. The assessment was based on the situations discussed below in which an administered price limit event may apply in ancillary services markets. There were no stakeholder submissions in relation to eligibility for ancillary services providers in the first or second rounds of consultation for this rule change.

39 This only relates to the provision of Frequency Control Ancillary Services (FCAS) during an administered price limit event. It does not relate to the provision of other ancillary services such as System Restart Ancillary Services (SRAS) and Network Support and Control Ancillary Services (NSCAS)

40 NER clause 3.14.6(a3)

41 COAG Energy Council, *Compensation arrangements following application of an administered price cap and administered floor price, rule change request and proposal*, 16 October 2013, p4.

Administered price limit event in both energy and ancillary services markets

In its draft determination, the Commission considered that administered price limit events in both the energy and ancillary services markets were the most likely type of administered price limit event. This was due to the fact that all administered price limit events in the NEM until that date had been triggered by a breach of the cumulative price threshold in the energy market, which results in the application of an administered price cap in both the energy and ancillary services markets.

The Commission in its draft determination considered that, in this event, there is no clear risk that ancillary service generating units and ancillary service loads can incur a loss or face a disincentive to supply these services. For a generator that provides a frequency control ancillary services (FCAS) raise service, it would receive a payment through the ancillary services market for keeping capacity in reserve, and would not incur any costs, as it is not actually generating electricity with this capacity. To the extent it did generate energy it would be entitled to make a claim for compensation as a scheduled generator if its costs were greater than its revenues over the eligibility period.

Administered price limit event in ancillary services market only

The Commission considered in the draft determination, that the application of an administered price cap only in the ancillary services market was less likely, as this event had at the time, never happened in the NEM. In this event, if the uncapped energy price is higher than the capped ancillary services price, a generator could potentially face a reduction in revenue, as its output in the energy market could be reduced to provide reserve capacity in the ancillary services market.

The Commission stated in its draft determination that compensation should not be available in this event as it would be based on the difference between the capped price in the ancillary services market and the uncapped price in the energy market, which could be high. Allowing compensation in these circumstances could weaken the protections provided to customers by the administered price cap in ancillary services markets by allowing access to the energy market price. The administered price cap can protect consumers from the effects of extreme prices in the wholesale market, which would otherwise be borne by retailers and then may be passed on to consumers directly or through higher contract prices to recognise the level of risk.

For this reason, and given that this was expected to be an event that occurs rarely, the Commission's decision in the draft determination was that eligibility for ancillary service providers should not apply in this event.

5.1.4 Material change in circumstances

On 13 August 2015, when the draft rule determination was published, there had only been five administered price limit events in the history of the NEM. All of these

administered price limit events were triggered in the energy market and therefore applied in both the energy and ancillary services markets.[42]

On 12 October 2015, the first ever application of an administered price limit event in an ancillary services market occurred. The rolling sum of the uncapped ancillary lower regulation FCAS prices in the South Australian region exceeded six times the cumulative price threshold of $207,000. As a result, the administered price cap of $300/MWh applied in all ancillary services markets in South Australia for the remainder of that day, but not the energy market. Over the period of time from 12 October 2015 until 26 November 2015, the cumulative price threshold was subsequently breached on 15 additional occasions, such that the administered price cap applied on 16 days in all South Australian ancillary services markets.

The Commission considered this to be a material change in circumstances which warranted an extension to the time for the Commission to make a final determination, in order to allow for further consultation on issues about compensation ought to be available for the ancillary service market alone. Due to changing conditions in the market, the events in South Australia may not be as rare in the future as the Commission had anticipated at the time of making the draft determination. The changing conditions relate to inertia and frequency control requirements in regions of the NEM which have a high proportion of large-scale renewable and embedded generation.

AEMO had commented that as more thermal synchronous generators withdraw from the NEM, there is a risk that there may be insufficient inertia and FCAS available to be shared across all regions.[43] This analysis is also supported by the recent Electricity Statement of Opportunities, in which AEMO noted an emerging opportunity for the provision of FCAS in South Australia.[44]

5.1.5 Additional consultation paper

On 26 November 2015, the Commission published an Additional Consultation Paper to facilitate stakeholder feedback on a number of issues, including:

- the likelihood of an administered price limit event occurring again in an ancillary service market, but not at the same time in the energy market;
- the potential for ancillary service providers to incur a net loss during an administered price limit event; and

42 NER Clause 3.14.2(d2)

43 Australian Energy Market Operator, *National Transmission Network Development Plan*, November 2015, p4

44 This is related to a combination of the recent high FCAS prices, conditions of a credible separation risk normally existing for 5-10 per cent of the time during planned maintenance or upgrades of the interconnector and the impending withdrawal of thermal generation from this region. Australian Energy Market Operator, *Electricity Statement of Opportunities*, 26 October 2015, p4.

- the trade-off between the price of electricity and the security of the electricity system in respect of allowing compensation for ancillary service providers following the application of an administered price cap.

5.1.6 Stakeholder submissions on additional consultation paper

Five stakeholder submissions were received in response to the Additional Consultation Paper.

AEMO, EnergyAustralia, St Vincent de Paul Society (SVdPS) and SACOSS considered that ancillary service providers have the potential to incur a loss during an administered price limit event.

A number of stakeholders commented on the trade-off between the price of electricity and the security of the electricity system during an administered price period. EnergyAustralia, GDF Suez, SVdPS and SACOSS considered that removing eligibility for ancillary service providers to claim compensation may reduce incentives to provide FCAS during an administered price period.[45]

EnergyAustralia and GDFSuez considered that removing eligibility for ancillary service providers to claim compensation could be a barrier for potential new entrants to the FCAS market.[46]

SVdPS, SACOSS and the SADSD were conscious of potential compensation costs that would be recovered from market customers and the potential impact on the reliability and security of the electricity system if there is a reduced incentive to provide ancillary services during an administered price period.[47] SVdPS and SACOSS agreed with the AEMC that, where a lack of regulation FCAS contributes to significant reliability impacts, such as blackout, the costs for consumers could be very high and potentially higher than the amount of compensation that could be recovered if ancillary services providers were eligible to claim compensation.[48]

All stakeholders considered that ancillary service providers should be eligible to make a claim for compensation following an administered price limit event.[49]

45 EnergyAustralia submission, 7 December 2015, p1; GDF Suez submission, 10 December 2015, p2; SVdPS and SACOSS submission, 10 December 2015, p1.

46 EnergyAustralia submission, 7 December 2015, p1; GDF Suez submission, 10 December 2015, p2)

47 SVdPS and SACOSS submission, 10 December 2015, p1; SADSD submission, 10 December 2015, p2).

48 SVdPS and SACOSS submission, 10 December 2015, p1.

49 EnergyAustralia submission, 7 December 2015, p1; SADSD submission, 10 December 2015, p1; SVdPS and South Australian Council of Social Services (SACOSS) submission, 10 December 2015, p1; GDF Suez submission, 10 December 2015, p2; AEMO submission, 23 December 2015, p1;

5.2 Assessment

5.2.1 Likelihood of administered price limit events in ancillary services markets

The Commission's decision to remove eligibility for ancillary services providers to claim compensation in the draft determination was in part based on the low likelihood of an administered price limit event being applied only in an ancillary service market. As at the date of the draft determination, this had not occurred.

After the draft determination was published however, the first ever application of an administered price limit event in an ancillary services market occurred.

Due to changing conditions in the market, outlined above, the Commission considers that the application of an administered price limit event in ancillary services markets (only) may not be as rare in the future as previously thought. This is due to changing conditions in the NEM, as outlined in section 5.1.4.

There were no stakeholder views on the likelihood of administered price limit event occurring again in ancillary service markets in the NEM.

5.2.2 Potential for ancillary services providers to incur a loss during an administered price limit event

Under the new eligibility criteria outlined in this final determination and the final rule, a market participant is eligible to make a claim for compensation if it incurs a net loss over the eligibility period. This is based on whether a market participant's total costs (ie direct and/or opportunity cost) exceed their total revenue over the eligibility period. The compensation guidelines outline the types of costs for which ancillary service providers can make a claim for compensation. These guidelines will be amended after this final determination to reflect the final rule, which may include amending the definition of direct and opportunity costs.

There are a large number of different scenarios in which potential exists for a loss to be incurred relating to the provision of ancillary services during an administered price period. This is due to the fact that there are eight different types of FCAS which can each be provided by scheduled generators and scheduled loads, during circumstances when the spot price is capped in one or both of the energy and ancillary services markets, and the uncapped energy price may be higher or lower than the capped ancillary services price.

The Commission considers that potential exists for ancillary service providers to incur a net loss during an administered price limit event. This position is supported by AEMO, SVdPS, SACOSS and EnergyAustralia.[50]

50 AEMO submission, 23 December 2015, p1; SVdSP and SACOSS submission, 10 December 2015, p1; Energy Australia submission, 7 December 2015, p1.

5.2.3 Trade-off between weakened price protection and potential for reduced incentives to provide ancillary services during an administered price limit event

There is a trade-off between the price and security of the electricity system that needs to be considered in respect of compensation for ancillary services providers following the application of an administered price limit event.

On the one hand, allowing compensation may weaken the financial protection provided to market customers by an administered price cap, if compensation were allowed for opportunity costs based on the price differential between the uncapped energy price and capped ancillary service price.[51] As this compensation is recovered from market customers it may flow through to higher prices for retail customers. On the other hand, allowing ancillary service providers to claim such compensation may provide a number of important benefits. It may improve incentives to provide ancillary services during an administered price limit event, improve reliability of electricity supply and/or the security of the electricity system and reduce the need for AEMO to issue directions.

The costs that could be recovered in compensation by an ancillary service provider could be high. However, there could also be high costs for consumers if there are reduced incentives to provide regulation FCAS. Where a lack of regulation FCAS contributes to significant reliability and security impacts, costs for consumers could be very high, and potentially higher than the amount of compensation that could be recovered if eligibility were allowed.

The Commission's view is that, based on this trade-off, it is better to include eligibility for ancillary service providers to claim compensation following an administered price limit event in order to maintain incentives to provide ancillary services during an administered price limit event.

5.3 Conclusion

The Commission considers that ancillary service providers should be eligible to claim compensation following the application of an administered price limit event. This is reflected in the final rule.

51 This is not allowed under the current definition of opportunity cost which is defined in the compensation guidelines. The definition of opportunity cost will be reviewed when the compensation guidelines are amended to reflect the final rule, through the process outlined in section 8.

6 AEMC processes for assessing compensation claims

This chapter considers the aspect of the rule change request that sought to amend the compensation assessment process. This involves amendments to timeframes and processes, requirements for public notices, draft reports and public consultation; and the removal of the dispute resolution adviser and expert from the assessment process.

6.1 Context and stakeholders

Described in this section are the current arrangements for the compensation assessment process, along with what the rule change request proposed, the more preferable rule, and stakeholder submissions to the Consultation Paper and the draft determination.

6.1.1 Current arrangements

The current arrangements for the assessment of compensation claims involve strict timeframes and include roles and responsibilities for the panel, dispute resolution adviser and the AEMC. The current arrangements are detailed above in section 1.3.3 and Figure 1.2.

6.1.2 Rule change request

The rule change request considered that the current compensation assessment process is relatively inflexible, lacks transparency and may result in an inefficient process. It proposed to require public notices for all claims; only require public consultation for claims involving opportunity costs; provide discretion to the AEMC to appoint a varying sized panel; and extend the timeframe for assessment, under certain conditions.

6.1.3 Consultation Paper

In the Consultation Paper, the Commission asked stakeholders to provide feedback on a proposal to further streamline the compensation assessment process, beyond what the rule change request proposed, by removing the roles of the dispute resolution adviser and expert panel.

6.1.4 Stakeholder submissions on Consultation Paper

Origin agreed with the rule change request that the assessment process should provide flexibility between an assessment of direct costs that are unlikely to be contentious, and opportunity costs that are inherently more complex.

Origin and EnergyAustralia each supported aspects of the more preferable rule in the Consultation Paper. Origin[52] supported the removal of the role of the dispute resolution adviser from the compensation process, as this would be consistent with AEMO's role in nominating an expert to determine compensation for directed participants.[53] EnergyAustralia supported the removal of the statutorily mandated role of the expert and for the AEMC to draw upon expert advice only when necessary.[54]

6.1.5 Stakeholder submissions on Draft Determination

Resolve Advisors raised a number of issues and proposed changes in relation to the compensation assessment process in the draft rule determination. Resolve Advisors submitted that:

- consistent with general administrative law principles, it is useful if there is a separation between the person making the rules and the person reviewing a decision under the rules;[55]
- separation is no less efficient than delegating the decision-making function to a person other than the AEMC (ie the expert(s)) and in this instance, maintaining separation is more efficient;[56]
- it would be useful to reduce the time and cost involved with double handling;
- therefore the AEMC ought to be removed from the process of deciding compensation;
- there is merit in having a process that is consistent with other compensation processes in Chapter 3 of the NER. The compensation claims assessment process should use the existing resources, processes and machinery already available for compensation claims arising from scheduling errors under the NER;[57]
- the dispute resolution adviser should replace some of the functions performed by the AEMC, including publishing notices and managing the claim process;[58] and
- using external expertise in assessing a compensation claim allows costs to be transparent, directly calculated and included as part of the claim, rather than being an indirect cost to the market through the AEMC.[59]

52 Origin submission, 4 June 2015, p2.

53 AEMO is responsible for determining compensation for directed participants under clause 3.15.7 of the NER.

54 EnergyAustralia submission, 5 June 2015, p1.

55 Resolve Advisers Pty Ltd submission, 1 October 2015, p3.

56 Ibid, p2.

57 Ibid, p3.

58 Ibid, p5.

6.2 Assessment

This section outlines the assessment of amendments to the compensation assessment process, involving the rule change request to publish notices relating to a claim, the need for public consultation, extensions of time, the more preferable rule to remove the role of expert and dispute resolution adviser and the use of an alternative compensation mechanism. It clarifies the obligations for the AEMC to consult with the claimant during the assessment process and provides information on the definition of opportunity costs in the Compensation Guidelines.

6.2.1 Body that determines compensation

Resolve Advisors proposed that there would be advantages in removing the role of the AEMC in deciding compensation, and expanding the role of the expert panel selected by the dispute resolution adviser.

The Commission acknowledges that a separation between the entity making a rule and the entity applying a rule can be preferable in some circumstances. However in this case there does not appear to a conflict between the AEMC's role in making rules and guidelines, on the one hand, and its role in deciding compensation on the other. This distinguishes these circumstances from, for example, the compensation regime for scheduling errors, which allows compensation from a fund for a scheduling error by AEMO. It is also clearly within the Commission's statutory role to perform functions conferred on it under the rules.[60]

The assessment process is likely to be more efficient and flexible when the AEMC makes the decision on compensation and draws on expert assistance when it considers it necessary. The removal of the requirement on the AEMC to appoint an expert or expert panel for the purposes of assessing a compensation claim will not prevent the AEMC from engaging external experts when it considers this necessary or appropriate to supplement its internal expertise. This is consistent with the approach applied by the AEMC for rule changes and market reviews.

The administrative cost is likely to be lower for the AEMC to make the decision, instead of an expert. In either the draft rule or the alternative process proposed by Resolve Advisors, the AEMC is necessarily involved in a number of stages of the compensation assessment process.

For a simple direct cost claim, when the AEMC has sufficient internal capability to assess a claim, the decision on compensation could be made solely by the AEMC. For more complex claims involving opportunity costs, the AEMC could engage an external expert(s) to supplement its internal expertise.

As a result, the remainder of this section 5.2 is based on the AEMC continuing its current role of deciding compensation.

59 Ibid, p4.

60 See for example section 34(3)(c) of the NEL.

6.2.2 Requirement to publish notices

The current NER lack transparency regarding the progression of assessment of a claim. As some time is likely to be spent gathering all necessary information and assessing it, this could mean that the first information stakeholders receive regarding a compensation claim is when the AEMC publishes its draft report, which may be some time after the original claim was received.

Including a requirement to publish notices for the initial receipt of a claim and the commencement of formal assessment will improve the transparency of the process. For claims involving opportunity costs, this may increase stakeholder involvement in the public consultation process and therefore improve assessment decisions.

6.2.3 Public consultation

Direct cost only claims

The current requirement for public consultation for all types of compensation claims is inflexible and may lead to inefficient assessment processes. For direct cost only claims, this requirement is likely to add little value, as much of the information provided may be confidential and unable to be shared and assessed through public consultation.[61]

Third parties are also unlikely to be able to add real value in the assessment of direct costs. The most likely areas for direct costs are operational labour or fuel costs and the views of third parties may be subjective and based on incomplete information. They would add little material value to the process of verifying the total costs actually incurred by the claimant and the final compensation amount to be awarded.

The need for public consultation may increase the administrative costs of assessing less contentious direct cost claims. The removal of this requirement therefore promotes efficient outcomes by reducing the administrative burden on stakeholders.

Other than direct cost only claims

There is likely to be value associated with public consultation for claims involving opportunity costs. Such claims will involve the development of a methodology for calculating opportunity costs and consultation on that methodology will be valuable. Public consultation should allow for an enhanced examination of the costs and benefits associated with these types of compensation claims.

6.2.4 Extension of time

The current NER set out strict timeframes for the assessment of compensation claims. This may impede the AEMC's ability to undertake adequate assessment of compensation claims, where new or more complex issues may be identified during

61 AEMC, *Final Report - Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price*, 16 May 2013, p17.

assessment of a compensation claim, or the AEMC faces a material change in circumstances.

Providing the AEMC with discretion to extend the timeframe for assessment, under predefined conditions, would therefore help to improve the compensation assessment process. The final rule defines the conditions when an extension of time can occur as when the AEMC considers it reasonably necessary to enable it to properly assess a claim due the complexity or difficulty of assessing the claim or due to a material change in circumstances.

6.2.5 Removing the requirement to appoint an expert

The requirement in the rule change request for the AEMC to appoint a varying sized expert panel provides greater flexibility than current NER which require the appointment of three experts. However, the requirement for the AEMC to still appoint at least one expert may result in an inefficient assessment process if the AEMC has sufficient internal capability to assess a claim. This would equally be the case for the process proposed by Resolve Advisors.

The final rule, which provides the AEMC with discretion regarding the need to appoint any experts, increases the flexibility and efficiency of the process. Eliminating the requirement to use an expert should improve the efficiency and timeliness of the assessment process, allowing the AEMC to draw on expert assistance as needed and as it does for its other functions. There is currently duplication in the assessment process as a number of prescribed functions around the role of the expert must also be performed by the AEMC. For example, the expert and the AEMC are both required to form a view on the eligibility of a claimant to claim compensation and the amount of compensation that should be paid. Involving assessment by two parties, one subsequent to the other, adds time to the process.

The removal of the requirement for the second party to assess the claim translates to a reduction in the total time required to complete the assessment process in the more preferable rule. The final rule will reduce the time required to assess compensation claims by a minimum of 15 days, as explained below:

- for direct cost only claims, the time required from formal commencement of the claim until publication of the final report is reduced from 60 days (proposed rule in the Consultation Paper) to 45 days (more preferable rule); and

- for other than direct cost only claims, the time required from the formal commencement of the claim until publication of the final report and final methodology is reduced from 105 days (proposed rule in the Consultation Paper) to 90 days (more preferable rule).

6.2.6 Removing the dispute resolution adviser

In addition, the role of the dispute resolution adviser is redundant if the requirement to use an expert is removed, as is the case in the final rule. The only function of the

dispute resolution adviser in the current rules is to appoint the expert panel. As with the AEMC's other functions, the AEMC can decide whether it needs to use an expert(s) and which expert is best placed to assist.

Resolve Advisors suggested that the dispute resolution adviser could perform some of the functions carried out by the AEMC in the draft rule, including publishing notices and managing the process. There does not appear to be a clear reason why the AEMC could not carry out these functions, as it regularly performs similar functions for rule change processes. In addition, efficiencies can be achieved by limiting the number of different parties involved.

6.2.7 Obligation to consult with the claimant

It is noted that the new compensation assessment process in the final rule requires the Commission to consult with the claimant on whether compensation should be provided in relation to the claim, and if so, the amount of this compensation. In the final rule, these obligations are contained in clause 3.14.6(k) for direct cost only claims and clause 3.14.6(p) for other than direct cost only claims.

6.2.8 Definition of opportunity cost in Compensation Guidelines

In addition, the new compensation assessment process in the final rule includes a provision that the compensation guidelines must define the types of opportunity costs which a person may make a claim for compensation. In the final rule, this is outlined in 3.14.6(e)(1). This will provide greater guidance on the opportunity costs that may be recovered to improve the clarity and transparency of the compensation assessment process.

6.3 Conclusion

The Commission considers that the final rule will better contribute to the achievement of the NEO than the proposed rule and the proposal from Resolve Advisors. The removal of the role of the advisor and the requirement to use an expert will improve the efficiency, flexibility and timeliness of the compensation assessment process relative to the rule change request. In addition, greater efficiency in the process can be achieved through the final rule compared to the proposal from Resolve Advisors, bearing in mind there does not appear to be a conflict of interest in the AEMC deciding the amount of compensation.

Including a requirement to publish notices will improve the transparency of the assessment process. The removal of the requirement for public consultation for direct cost claims will minimise the administrative burden. The removal of the expert and dispute resolution adviser will also improve the timeliness of the assessment processes.

7 Recovery of compensation costs

In this chapter the Commission considers the aspect of the rule change request that sought to amend the process to recover compensation claim costs from customers.

7.1 Context and stakeholder's views

7.1.1 Recovery of costs from eligibility period

The rule change request noted that the current rules are unclear as to whether compensation costs should be recovered based on consumption by market customers in those trading intervals where the spot price is set by the administered price cap or administered floor price, or across all trading intervals in an administered price period.

Origin and EnergyAustralia supported the rule change proposal to recover compensation costs based on the eligibility period as it aligned with the time period compensation is available to generators[62], and provided transparency around when a participant would be eligible for compensation.[63]

7.1.2 Recovery of costs from same region only

The rule change request also considered that the current rules are unclear as to whether compensation costs should be shared by customers in multiple regions.

Origin and EnergyAustralia supported the rule change request proposal to recover compensation costs from customers in the same region in which the wholesale spot price is capped or limited. It was considered that customers in the same region as the generator were generally the beneficiaries of improved reliability during an administered price period.[64]

7.1.3 Recovery of costs for ancillary service providers

AEMO noted that the cost recovery arrangements under the current NER need to be amended to reflect the inclusion of eligibility for ancillary service providers to claim compensation.[65] AEMO suggested that the costs of compensation could either be recovered based on customer's energy consumption during the eligibility period, as per the final rule, or through AEMO's existing methodology relating to ancillary service transactions, as outlined in clause 3.15.6A of the NER.[66]

62 EnergyAustralia submission, 5 June 2015, p1.

63 Origin submission, 4 June 2015, p2.

64 EnergyAustralia submission, 5 June 2015, p1.

65 AEMO submission, 23 December 2016, p1.

66 Ibid.

7.2 Assessment

7.2.1 Recovery of costs from eligibility period

The existing cost recovery processes may create complexities due to its highly granular approach. Under the current arrangements, AEMO is required to recover the amounts payable by market customers according to their individual share of total energy consumption, on a trading interval basis. This granular approach may improve the likelihood that the total compensable amount is allocated to those parties who received the greatest benefit, however it could be complex to administer.

The rule change request, which proposed that costs are recovered over the entire eligibility period, provides an appropriate balance between efficient allocation and a reasonably simple and transparent approach. It recognises that customers benefit from reliable supply throughout the entire eligibility period and not just in the trading intervals when the spot price is set by the administered price cap or administered floor price. It minimises complexity and is likely to reduce administration costs. It is also straightforward and transparent and may reduce the likelihood of disputes regarding cost allocation following a compensation claim.

The new cost recovery process also aligns with the time compensation is available to generators. That is, it aligns with the new eligibility criteria which allow market participants to claim compensation across the eligibility period.

7.2.2 Recovery of costs from same region only

The current criteria are unclear as to whether costs are to be recovered only from market customers in the region in which the spot price is capped or limited, or other regions affected by administered pricing.

The final rule clarifies the rules by stating that compensation is all to be recovered from market customers in the same region in which the dispatch price or ancillary service price is set by the administered price cap or administered floor price (the "home region" referred to in section 4.4.1 above). Recovering all costs in this manner is appropriate as the payment of compensation should be borne by customers in the home region, given that these customers are the primary recipients of the enhanced reliability associated with generators continuing to operate during an administered price period. This means that even though prices in other regions may be affected by administered pricing (the "export region" described in section 4.4.1 above), any compensation for generators in those regions is still to be recovered from customers in the home region.

The same cost recovery arrangements apply in the situation in which there were multiple claimants in the same region within one eligibility period. If this occurred, the sum of the compensation claim amounts is to be recovered from market customers in that region.

It is also possible that an administered price period may apply in two regions simultaneously. In this case, the administered price cap may set the spot price in both regions, triggering separate eligibility periods in each region. If this occurred, market customers in the same region as the claimant would bear the compensation costs awarded to that participant.

The Commission considers that in the situation where two compensation claims are approved for an individual market participant relating to the same eligibility period which applies in different regions, that these compensation amounts[67] should be recovered separately by AEMO through the cost recovery process. In the final rule, the cost of compensation is recovered from market customers who consumed energy in the region in which the administered price limit event applied. Therefore, when compensation is to be recovered from two different regions, it will need to be recovered from the customers in each region based on their energy consumption during the eligibility period.

7.2.3 Recovery of costs for ancillary service providers

Under the current NER, the cost of compensation for ancillary service providers is recovered from all market customers in the region in which the administered price cap applied based on their energy consumption in the trading intervals in which the spot price was affected by the administered price cap.[68]

The draft rule removed eligibility for ancillary service providers to claim compensation and therefore removed cost recovery arrangements for ancillary service providers.

The final rule includes eligibility for ancillary services to claim compensation and therefore includes cost recovery arrangements for ancillary service providers. In the final rule, compensation for ancillary services providers is recovered from all market customers in the region in which the administered price cap applied based on their energy consumption over the eligibility period. AEMO considered that this method is straight-forward and a workable arrangement for it to recover compensation costs for ancillary service providers.[69]

AEMO also proposed in its submission an alternative cost recovery arrangement based on clause 3.15.6A of the NER. The Commission notes that clause 3.15.6A does not include the compensation claim cost which has been approved through the compensation assessment process based on direct and/or opportunity costs incurred by the ancillary service provider. Although it might be possible to amend clause 3.15.6A to include the amount of compensation to be recovered, the Commission considers that it would be simpler to recover compensation from market customers based on their energy consumption, as per the approach for other market participants

67 The AEMC would separately assess these compensation claims and if a net loss had been incurred would determine two separate amounts of compensation.

68 NER Clause 3.15.10

69 AEMO submission, 23 December 2015, p1

in the final rule. As outlined above, AEMO has confirmed that this method is straight-forward and workable.[70]

7.3 Conclusion

The final rule clarifies and amends the process to recover compensation costs. It will contribute to the achievement of the NEO with respect to the efficiency of the supply of electricity.

The Commission considers that the process to recover compensation costs for ancillary service providers should be based on market customer's energy consumption over the eligibility period in the region in which the administered price limit event is applied, as per the cost recovery arrangements for other market participants.

70 AEMO submission, 23 December 2015, p1.

8 Transitional arrangements

As a result of the Commission's final rule, certain aspects of the compensation guidelines as currently drafted will no longer be appropriate and additional matters will need to be covered.

The guidelines will therefore need to be amended before the final rule commences. In order to amend the guidelines the AEMC must follow the transmission consultation procedures.

There will need to be a period of time between when the final rule is made and when it commences. To accommodate the transmission consultation procedures, the final rule includes transitional rules to provide for eight months for the compensation guidelines to be amended prior to the commencement of the final rule. The final rule will therefore commence on 29 September 2016.

In addition to the changes to the guidelines, AEMO's cost recovery process will need to be amended to reflect the final rule. AEMO has advised that its systems can be updated to reflect the final rule.[71]

71 AEMO has advised that changes to its systems to reflect the new cost recovery arrangements are not likely to be implemented until the end of 2016. However, to avoid a delay in the commencement of the new rule, AEMO has stated that it could develop an interim solution for the recovery of compensation costs from market customers which could be used prior to the implementation of its market system changes. AEMO submission, 23 December 2015, p1.

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AFP	Administered Floor Price
APC	Administered Price Cap
COAG Energy Council	Council of Australian Government's Energy Council
Commission	See AEMC
CPT	Cumulative Price Threshold
FCAS	Frequency Control Ancillary Services
MCE	Ministerial Council on Energy
MFP	Market Floor Price
MPC	Market Price Cap
NEL	National Electricity Law
NEO	National Electricity Objective
NSCAS	Network Support and Control Ancillary Services
SACOSS	South Australia Council of Social Services
SADSD	South Australian Department of State Development
SRAS	System Restart Ancillary Services
SVdPS	St Vincent de Paul Society

A Summary of issues raised in submissions

A.1 Consultation paper submissions

Stakeholder	Issue	AEMC Response
General		
EnergyAustralia	EnergyAustralia was not aware of any recent changes that may have impacted the rule change proposal.	Noted.
GDF Suez	GDF Suez suggested that the circular process of AEMC review, leading to a rule change request which is then assessed by the AEMC, gives a sense that there is little scope to influence the AEMC's thinking at this time.	The AEMC takes into account all submissions received during consultation on a rule change, including those that relate to a previous review on a related matter. As indicated in the Consultation Paper, in this consultation the AEMC has been particularly interested in submissions that raise matters based on changes in circumstances following the review.
Purpose of compensation		
EnergyAustralia Origin Energy	EnergyAustralia agreed that the purpose of compensation should be to incentivise generation in the short term. The cumulative price threshold ensures sufficient opportunity to recoup long-term costs. Origin Energy acknowledged that the proposal could produce some inefficiencies through the dispatch of high cost plant but the reliability benefits are likely to offset these.	See section 3.2.
GDF Suez	GDF Suez suggested that the incentive to invest should remain in the purpose clause as avoiding a loss is not a sufficient incentive for peaking generator investment.	The incentive for peaking generator investment is provided through the normal function of the market and is not intended to be provided through the compensation mechanism. The normal function of the market provides the opportunity for peaking generators to achieve high spot market prices up to the market price cap of $13,800 per

Stakeholder	Issue	AEMC Response
		MWh when the supply and demand balance is tight. Including the investment signal in the purpose clause and extending the types of costs that can be recovered to include a contribution to capital costs, would reallocate the part of the risk associated with the decision to invest in plant from generators to market customers. This risk is more appropriately borne by generators who are better placed to manage it through natural profit and risk incentives.
Eligibility criteria		
EnergyAustralia	EnergyAustralia agreed that the proposed new criteria based on the eligibility period is likely to be effective in incentivising operational decisions to supply energy through an administered price event.	See section 4.1.
AEMC processes for assessing compensation claims		
EnergyAustralia	EnergyAustralia was comfortable with the AEMC drawing on expert advice only when necessary.	See section 6.2.
Origin Energy	Origin agreed that the compensation process should provide flexibility between an assessment of direct costs and opportunity costs.	See section 6.2.
Origin Energy	Origin considered that the Commission is the correct body for appointing an expert to determine compensation claims, and not the dispute resolution advisor.	See section 6.2.
Recovery of compensation costs		
EnergyAustralia	EnergyAustralia and Origin supported cost recovery from the eligibility period as it is transparent and aligns with the time	See section 7.2.

Stakeholder	Issue	AEMC Response
Origin Energy	compensation is available to generators.	
EnergyAustralia Origin Energy	EnergyAustralia and Origin supported the recovery of compensation costs from the same region in which the administered price period was applied.	See section 7.2.
Indicative draft of proposed rule		
EnergyAustralia	EnergyAustralia are not aware of any issues in the drafting of the rule.	Noted.

A.2 Draft rule determination submissions

Stakeholder	Issue	AEMC Response
Purpose of compensation		
GDF Suez	GDF Suez noted that the level of the market price cap and cumulative price threshold are established for the whole of the NEM based on investment signals, and are not specific to any given participant or set of circumstances. It suggested that while the market price cap and cumulative price threshold might be sufficient to maintain the necessary signal for investment in peaking generation in many circumstances, it is possible that for a specific set of circumstances around an administered pricing event, these pricing signals may be inadequate.	The levels of the market price cap and cumulative price threshold are set to incentivise sufficient generation capacity to deliver the reliability standard. The reliability standard is regularly set by the Reliability Panel and is based on the maximum amount of electricity expected to be at risk of not being supplied. Currently, it is set at 0.002 per cent of annual energy consumption for the associated NEM region or regions.[72] It is noted that the Reliability Panel recommended that the AEMC or the Panel (as appropriate) review the form of the cumulative price

72 Australian Energy Market Commission, *Final Report - Reliability Standard and Reliability Settings Review 2014*, 16 July 2014, pi.

Stakeholder	Issue	AEMC Response
		threshold, including the link between the market price cap and cumulative price threshold, prior to the next reliability standard and settings review which is due to commence in 2017.[73]
GDF Suez	GDF Suez was concerned that the draft rule eliminates any opportunity for generators to claim compensation for revenue foregone that was required to support investment in peaking generators. It suggested that it is better to leave the opportunity for investment claims to be made, with generators required to explain the reasons why any claim is warranted.	The final determination decision is to remove the investment signal from the purpose clause. The signal to invest in generation plant is provided through the prices the market delivers under the normal function of the market. This provides the opportunity for generators to receive high spot prices up to the market price cap when the supply and demand balance is tight. Further explanation is provided in section 3.2.2.
GDF Suez	GDF Suez questioned why the AEMC was removing the investment purpose from the rules when there has not been a history of claims that were found to be unwarranted. It suggested that the rule change is seeking to resolve an issue that is not impacting on the NEM.	While there have not been any claims, the potential exists in the current rules for such claims to be made.
Eligibility criteria		
GDF Suez	GDF Suez supported the proposed new criteria based on the eligibility period as it overcomes the ambiguities with the current eligibility criteria.	See section 4.1.
GDF Suez	GDF Suez supported extending the eligibility criteria to include non-scheduled market generators as this category of generators could incur costs due to an administered pricing event.	See section 4.2.

73 Reliability Panel AEMC, *Reliability Standard and Reliability Settings Review 2014 – Final Report*, 16 July 2014, p2.

Stakeholder	Issue	AEMC Response
AEMC processes for assessing compensation claims		
Resolve Advisors	Resolve Advisors suggested that it is useful if there is a separation between the person making the rules and the person making a decision under the rules (because it avoids any suggestion of bias). Resolve Advisors suggested that the role of the AEMC should be removed from the decision on compensation as the AEMC has a role in setting the Compensation Guidelines and updating the compensation rules in the NER.	See section 6.2.1.
Resolve Advisors	Resolve Advisors suggested that it is more efficient to delegate the decision-making function to a person other than the AEMC (ie the expert(s)) for compensation claims relating to an administered price period. Resolve Advisors proposed that the AEMC remain in the compensation assessment process to receive the claim, notify the dispute resolution adviser of the claim, provide any additional information about the claim, and to raise any concerns it has with the methodology proposed as an assistant to the experts.	See section 6.2.1.
Resolve Advisors	Resolve Advisors suggested that there is merit in having a process that is consistent with other compensation claims in Chapter 3. This allows the market to build capacity in the process of evaluating such claims, which is especially the case given the small number of claims for compensation in the NEM. Resolve Advisors proposed that, instead of the compensation assessment outlined in the draft rule, the process should use the existing resources, processes and machinery already available for compensation claims arising from scheduling errors under the NER.	Compensation arising from the application of the administered pricing period appears different from other claims for compensation under chapter 3. In particular, the decision-maker for the compensation claim would not have been involved in the need for compensation coming about. In addition, scheduling error claims involve the awarding of compensation from the participant compensation fund which is managed by the Dispute Resolution Panel. It determines the level of compensation for which a participant is entitled by taking account of various factors in clause 3.16.2 of the NER, including the balance of the fund and the potential for future liabilities arising during the year.

Stakeholder	Issue	AEMC Response
		In comparison, compensation claim costs relating to an administered price period are recovered from customers by AEMO who adjust customer's wholesale electricity costs. This process does not require a person to manage a fund balance over time.
Resolve Advisors	Resolve Advisors suggested that the dispute resolution adviser should replace some of the functions performed by the AEMC in the compensation assessment process, including publishing notices and managing the claim process.	There does not appear to be a clear reason why the dispute resolution adviser needs to be involved in the assessment process. There is no compensation fund that needs to be managed over time by a person. Efficiencies can be achieved by limiting the number of different parties involved.
Resolve Advisors	Resolve Advisors suggested that using external expertise in assessing the compensation claim allows costs to be transparent, directly calculated and included as part of the claim, rather than being an indirect cost to the market through the AEMC.	It is acknowledged that the AEMC's costs may be less transparent than costs incurred through the use of external experts, however these costs should be minimised where the AEMC undertakes this work internally. As discussed in the body of this report, there are other reasons why assessment by the AEMC, with assistance from experts when necessary, is preferable to the requirement to involve experts in the assessment of a claim.

A.3 Additional consultation submissions

Stakeholder	Issue	AEMC Response
Purpose of compensation		
GDF Suez	GDF Suez requested that the AEMC reconsider the points made by GDF Suez in its previous submissions on this rule change. These points related to maintaining an investment incentive in the purpose of compensation.	For the reasons outlined in section 3.2, the AEMC has maintained its position in the draft determination to remove the investment incentive from the purpose of compensation.

Stakeholder	Issue	AEMC Response
SADSD	The SADSD supported including in the purpose clause a reference to supplying ancillary services during an administered price period.	See section 3.2.1.
Eligibility for ancillary service providers		
AEMO, SVdPS and SACOSS, SADSD, EnergyAustralia and GDF Suez.	Supported including eligibility for ancillary service providers to claim compensation following the application of an administered price limit event.	See section 5.2.
EnergyAustralia	EnergyAustralia suggested that there may be situations where generators offering raise services may be incentivised to reduce the amount of ancillary services offered during an administered price limit event. It suggested that a potential solution to address this issue may be to cap ancillary service prices at the maximum of the administered price cap and the spot price in the energy market.	The AEMC considered that the proposed solution is not appropriate. If the administered price cap applies only in the ancillary services market and the spot price in the energy market is higher than the administered price cap, allowing ancillary services providers to receive revenue based on the maximum of these prices weakens the price protection provided by the administered price cap. In this case the administered price cap would not apply when the energy price was higher than it. The compensation guidelines will be amended to reflect the final rule. This may include setting out the types of opportunity costs that can be claimed, which may allow opportunity costs based on the price differential between the energy and ancillary services market. If any such change was made, it would impact the compensation that could be claimed during an administered price limit event, which is different from the revenue which is received during an administered price limit event.
Recovery of compensation costs		
AEMO	AEMO noted that the cost recovery arrangements under the current NER need to be amended to reflect the inclusion of	See section 7.2.3.

Stakeholder	Issue	AEMC Response
	eligibility for ancillary service providers to claim compensation. AEMO suggested that the costs of compensation could either be recovered based on customer's energy consumption during the eligibility period, as per the final rule, or through AEMO's existing methodology relating to ancillary service transactions, as outlined in clause 3.15.6A of the NER.	

B Legal requirements under the NEL

This appendix sets out the relevant legal requirements under the NEL for the AEMC to make this final rule determination.

B.1 Final rule determination

In accordance with sections 102 and 103 of the NEL the Commission has made this final rule and associated final determination in relation to the rule proposed by the COAG Energy Council.

The Commission's reasons for making this final rule are set out in this rule determination.

A copy of the final rule is attached to and published with this final rule determination.

B.2 Power to make the rule

The Commission is satisfied that the final rule falls within the subject matter about which the Commission may make rules. The final rule falls within section 34 of the NEL as it relates to the operation of the national electricity system for the purposes of the reliability of that system.[74] Further, the final rule falls within the matters set out in Schedule 1 to the NEL because it relates to the setting of prices for electricity and services purchased through the wholesale exchange operated and administered by AEMO, including maximum and minimum prices (clause 7); and the methodology and formulae to be applied in setting prices (clause 8).

B.3 Power to make a more preferable rule

Under section 91A of the NEL the Commission may make a rule that is different (including materially different) from a market initiated proposed rule, if the Commission is satisfied that, having regard to the issue or issues that were raised by the market initiated proposed rule, the final rule will or is likely to better contribute to the achievement of the NEO.

As discussed in Chapter 2, the Commission has determined to make a more preferable final rule. The reasons for the Commission's decision are set out in Chapter 2.

B.4 Commission's consideration

In assessing the rule change request the Commission considered:

- the Commission's powers under the NEL to make the rule;

74 Section 34(a)(ii) of the NEL

- the rule change request;
- the fact that there is no relevant Ministerial Council on Energy (MCE) Statement of Policy Principles;[75]
- submissions received during first, second and third round consultation; and
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the achievement of the NEO; and the ways in which the more preferable rule will, or is likely to, better meet the NEO than the proposed rule.

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of Australian Energy Market Operator (AEMO)'s declared network functions.[76] The final rule is compatible with AEMO's declared network functions because it is unrelated to, and does not affect the performance of, AEMO's declared network functions.

B.5 Civil penalties and conduct provisions

The final rule does not amend any clauses that are currently classified as civil penalty or conduct provisions under the NEL or National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the COAG Energy Council that any of the proposed amendments made by the final rule be classified as civil penalty or conduct provisions.

75 Under section 33 of the NEL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for Energy. On 1 July 2011 the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated Council is now called the COAG Energy Council.

76 See section 91(8) of the NEL.