

13 March 2009

Dr John Tamblyn
Chairman
Australian Energy Market Commission
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Dear John

Modification to the Compensation Payment Methodology for Other Services

NEMMCO requests the AEMC consider making a Rule under section 91 of the *National Electricity Law*. The proposed Rule seeks to modify the compensation payment methodology for Directed Participants for services other than energy and market ancillary services, i.e. 'other services'.

A description of the proposed Rule change, statement of the issues concerning the existing Rules, and how the proposed Rule addresses those issues consistent with the national electricity objective is contained in Attachment A. A draft of the proposed Rule is set out in Attachment B.

NEMMCO would be pleased if you could have these matters considered by the AEMC. For further details, please do not hesitate to contact John Wormald on (02) 9239 9107.

Yours sincerely



Murray Chapman
Acting General Manager Market Operations

Enc. Attachment A: Request for Rule change
Attachment B: Draft version of the proposed Rule

ATTACHMENT A

1. Statement of Issues

This section identifies the issues with clause 3.15.8(g) of the National Electricity Rules (**Rules**) regarding the methodology used to compensate Directed Participants for directions for services other than energy or market ancillary services (**other services**) and NEMMCO's proposed solution to these issues.

1.1 Rules Requirements

Under the Rules, if NEMMCO considers it necessary it may direct a Registered Participant responsible for scheduled plant or a market generating unit to act to maintain or re-establish the power system to a secure operating state, a satisfactory operating state or a reliable operating state.¹ NEMMCO can issue directions for:

- energy services;
- market ancillary services; and
- other services.

If NEMMCO issues a direction, NEMMCO must pay the Directed Participant compensation for the service provided in response to the direction.

There are three processes to recover compensation for the direction corresponding to the three types of directed services:

1. Energy - the regional benefits test is first applied to determine the proportion of the cost that should be recovered from each region. Once this is determined the cost allocated to a region is recovered from Market Customers in proportion to the energy consumed in that region.²
2. Market ancillary services - cost of the direction is recovered from Market Customers and Market Generators in the same manner as costs are normally recovered for that particular ancillary service.³ It should be noted that contingency ancillary services have been recovered on a regional basis for many years, and regulation services are recovered regionally from 1 January 2009.
3. Other services - costs of the direction are recovered from all Registered Participants in the same proportion as the largest single fixed component of Participant Fees.⁴

The current breakdown of recovery with respect to participant class for each class of direction is set out in the following table.

Direction Type	Market Customer	Market Generator
Energy	100%	-
Contingency FCAS (Raise)	-	100%
Contingency FCAS (Lower)	100%	-
Regulation FCAS	54%	46%
Other	57%	43%

¹ Refer to clause 4.8.9 of the Rules.

² Refer to clause 3.15.8(b) of the Rules.

³ Refer to clause 3.15.8(f) of the Rules.

⁴ Refer to clause 3.15.8(g) of the Rules.

The percentages relating to Regulation FCAS and other services can vary from time to time, as they are based on current causer pays settlement factors and current participant fee allocation.

Other Services

To date, other services have included directions for:

- Network support to remove a localised power system security violation that is remote from the regional reference node;
- Reactive power, where the delivery of reactive power and any attendant change in active power is considered to be one all-inclusive service;
- Reduction in generation;
- Manual or local frequency control; and
- Increase in a scheduled load.

The following table shows the historical frequency, classification and materiality of directions. In particular, it demonstrates that directions for other services have accounted for approximately 90 per cent of issued directions and approximately 99 per cent of the total compensation paid.

Year	Energy		Market Ancillary Services		Other Services					
					Network Support		Manual Frequency Control		Reactive Power	
	No.	\$	No.	\$	No.	\$	No.	\$	No.	\$
2002	1	21,3055	-	-	3	2,124,995	-	-	-	-
2003	-	-	-	-	9 ⁵	4,392,556	-	-	1 ⁶	0
2004	1	1,958	-	-	8	2,065,688	1	953,692	-	-
2005	-	-	3	523	48 ⁷	3,021,575	2	200,000	-	-
2006	1	2	3	31	40 ⁸	2,666,467	-	-	-	-
2007	5	-	-	-	9	317,265	3	1,611,550	-	-
2008	-	-	-	-	-	-	-	-	4	-
Total	8	215,015	6	554	117	14,588,546	6	2,765,242	5	0

⁵ Compensation for one of these directions was resolved under a network service agreement.

⁶ NEMMCO determined that an independent expert couldn't determine compensation in a reasonable time. Further, NEMMCO determined that the compensation claim did not meet the materiality threshold set out in clause 3.15.7B(a4), hence, it was not required to pay the compensation claim.

⁷ Directions for each region in 2005: NSW – 12; SA – 31; and Qld – 5. 30 of the 31 SA directions were related to the 132kV line between Keith to Snuggery; as a result of ElectraNet reinforcing the network in the Keith to Snuggery region directions in this area have not been required.

⁸ NEMMCO issued these directions to Directlink to maintain system security in northern NSW. Since this time, the network in northern NSW has been upgraded and Directlink became a regulated interconnector which provides energy between NSW and Qld without direction.

1.2 The Issue with the Current Provisions

NEMMCO considers that the compensation recovery methodology set out in clause 3.15.8(g) of the Rules relating to other services is inappropriate. There are two reasons for this:

1. The current methodology does not take into account the regions to which the benefits of the direction accrue. Thus, the costs are inappropriately allocated between regions. This results in the costs being inequitably recovered from Registered Participants across all regions that do not benefit from the direction. Typically, only Registered Participants trading within the region involved in the direction benefit through improved system security.
2. The methodology is inconsistent with that for energy and market ancillary services directions. Given the frequency at which other services directions have been issued to date, and the materiality of such transactions, it is important that the compensation methodology used for other services provides an equitable recovery mechanism that is consistent with the methodology used for energy and market ancillary services directions.

2. Statement of Issues

This section provides a description of the proposed Rule developed by NEMMCO, NEMMCO's right to submit the proposed Rule change to the AEMC, and the power that NEMMCO considers that the AEMC has to consider this proposed Rule.

2.1 Description of Proposed Rule

The proposed Rule seeks to amend the current methodology used to determine compensation for directed other services to make it consistent with the methodology used for determining compensation for energy and market ancillary services directions. NEMMCO proposes that clause 3.15.8(g) should be amended so that directions for 'other services' are recovered from:

1. The regions that benefit from the direction by applying a regional benefits test in accordance with clauses 3.15.8(b), (b1) and (b2) of the Rules.
2. The Market Customers and Market Generators in the affected region in proportion to their 'relevant energy'.⁹

The 'relevant energy' of Market Customers and Market Generators in a region is approximately equal. The main cause of variation is the net import or export of power that may occur at the time of the direction. Thus if the region is a net exporter, the share of recovery costs for a direction in that region will be up to 55% for Market Generators, and down to 45% if the region is a net importer. These allocations are comparable with the current allocation based on participant fees.

⁹ 'Relevant energy' of a Market Participant is the sum of the generator energy and (the absolute value of) the customer energy recorded in the metering data for that participant in the period of the direction. Generator energy and customer energy are terms used in clause 3.16.6A for recovering ancillary service costs.

2.2 NEMMCO's Right to Submit this Proposal

NEMMCO is requesting that the AEMC make this proposed Rule in accordance with section 91 of the *National Electricity Law (NEL)*.

NEMMCO has the following relevant functions under the NEL:

- to operate and administer the NEM; and
- to promote the development and improve the effectiveness of the operation and administration of the NEM.

Under section 91(1) of the NEL, the AEMC may make a Rule at the request of any person, the MCE or the Reliability Panel. As such, NEMMCO may request the AEMC make a Rule.

2.3 Power of the AEMC to Make the Proposed Rule

The subject matter about which the AEMC may make Rules is set out in section 34 of the NEL and Schedule 1 to the NEL.

NEMMCO considers that the proposed Rule falls within the subject matter that the AEMC may make Rules about. The proposed Rule is within the matters set out in parts 7 and 8 of Schedule 1 to the NEL, as it relates to the payment of money for any service provided under the Rules in respect of which the Rules require payment and the methodology and formulae involved in setting the prices for the relevant services.

3. How the proposed Rules contribute to the National Electricity Objective (NEO)

Before the AEMC can make a Rule change it must apply the rule making test set out in the NEL, which requires it to assess whether the proposed Rule will or is likely to contribute to the NEO. Section 7 of the NEL states 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, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.

NEMMCO submits that the proposed Rule is likely to contribute towards the NEO because it promotes a more appropriate allocation of compensation costs between regions and ensures costs are passed through to the Market Participants who benefit directly from consequences of the direction. This is made more important because other services account for the majority of directions and approximately 99 percent of the compensation paid. NEMMCO submits that it is more efficient and equitable for compensation costs of directions to be borne by the Market Participants the benefit accrues to rather than Registered Participants across all regions.

Further, the proposed Rule ensures that the methodology used to compensate all directed services is consistent, which promotes good regulatory practice. Thus, NEMMCO submits that the proposed Rule improves the consistency and efficiency of the Rules which, in turn, fosters an environment of efficient investment and use of electricity services.

4. Expected Benefits and Costs of the Proposed Rule

NEMMCO expects that the Registered Participants in the region(s) not affected by the direction would benefit from the proposed Rule because the costs of the direction would not be recovered from them. The Market Customers and Market Generators in the directed region, and ultimately their customers, would bear higher costs because they would no longer be shared across the NEM, but as detailed earlier, this would result in a better allocation of costs.

NEMMCO would not incur any direct costs from the implementation of the proposed Rule.

GLOSSARY

Term or Abbreviation	Explanation
AEMC	Australian Energy Market Commission
NEM	National Electricity Market
NEO	The national electricity objective as stated in section 7 of the NEL.
NEL	National Electricity Law
Rules	National Electricity Rules

ATTACHMENT B – DRAFT RULE

This Draft is based on National Electricity Rules Version 24

Clause 3.15.8 Funding of Compensation for Directions

- (g) Any compensation payable by NEMMCO pursuant to clauses 3.12.2 and 3.15.7 not recovered under clauses 3.15.8(b) and 3.15.8(e) must be recovered from ~~Registered Participants~~ in the same proportion as the largest single fixed component of ~~Participant fees.~~ Market Customers and Market Generators. NEMMCO must, in accordance with the intervention settlement timetable, calculate a figure for each Market Customer and each Market Generator in each region applying the following formula:

$$\underline{MCP} = \frac{\underline{TGE - TCE}}{\underline{RATGE - RATCE}} \times \frac{\underline{RB}}{\underline{\sum RB}} \times \underline{CRA} \times -1$$

Where:

MCP is the amount payable or receivable by a Market Customer or Market Generator under this clause 3.15.8(g);

TGE, TCE are respectively the generator energy, customer energy figures (defined in clause 3.15.6A and noting that customer energy is typically negative) in respect of the period of the relevant direction in that region;

RATGE, RATCE are respectively the aggregates the generator energy and customer energy figures (defined in clause 3.15.6A) for all Market Generators and Market Customers in respect of the period of the relevant direction in that region;

RB is the regional benefit determined by NEMMCO under clause 3.15.8(b1); and

CRA is the compensation recovery amount.