

Australian Energy Market Commission

CONSULTATION PAPER

National Electricity Amendment (Compensation Arrangements following application of an Administered Price Cap and Administered Floor Price) Rule 2015

Rule Proponent(s)
COAG Energy Council

7 May 2015

**RULE
CHANGE**

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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.

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1 Introduction

1.1 Purpose of this consultation paper

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

This consultation paper has been prepared to facilitate public consultation on the rule change request.

This paper:

- sets out the background to, and summary of, the rule change request;
- sets out a proposed assessment framework to be used by the Commission in assessing the rule change request
- identifies a number of questions and issues to facilitate consultation on the rule change request;
- includes indicative drafting of the proposed rule, for the purpose of attaining stakeholder feedback;
- outlines the process for making submissions.

Submissions on this consultation paper are due by no later than 4 June 2015.

2 Background to the rule change request

The rule change request originates from the 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 COAG Energy Council considered that there is a need to improve the compensation arrangements which are set out in the NER so that these arrangements are functioning effectively.²

This chapter sets out the following background information to the rule change request:

- a summary of the current compensation arrangements due to the application of an administered price cap or administered floor price;
- the AEMC's assessment of Synergen's compensation claim; and
- the AEMC's review of arrangements for compensation following an administered price, market price cap or market floor price.

2.1 Current arrangements for compensation due to application of an administered price cap or administered floor price

The compensation provisions in clause 3.14.6 of the NER are a component of the broader market price cap, cumulative price threshold, administered price cap, administered floor price framework, which is designed to protect customers from extended periods of high prices. This framework is illustrated in Figure 2.1 below. Further detail on the current compensation provisions are provided in Chapter 2 of the AEMC review.³

The application of an administered price cap or administered floor price may cause some participants to incur a loss. In the case of an administered price cap, this may occur where the participant's direct or opportunity costs are in excess of \$300/MWh at which the pool price is capped. While there are not many participants with costs in excess of \$300/MWh, the potential for them to incur a loss may create a disincentive to supply energy during an administered price period, which may have a negative impact on system reliability. Accordingly, clause 3.14.6 of the NER allows participants to claim compensation for costs, through a process administered by the AEMC.

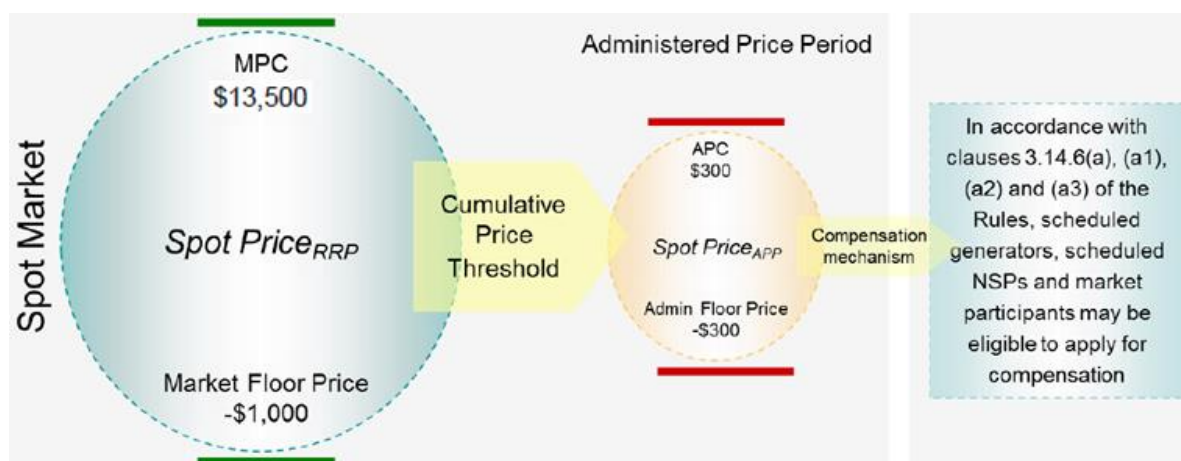
1 Final Report available on the AEMC's website:
<http://www.aemc.gov.au/Markets-Reviews-Advice/Review-of-Arrangements-for-Compensation-following>

2 COAG Energy Council, rule change request, covering letter, 17 October 2013, p.1.

3 AEMC, 2013, Final Report – Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price, p4-7.

2 Compensation Arrangements following application of an Administered Price Cap and Administered Floor Price

Figure 2.1 Compensation mechanism in an administered price period



2.2 AEMC's assessment of Synergen compensation claim

Administered pricing events have occurred rarely in the National Electricity Market (NEM). To date, administered pricing periods have only been applied five times in the history of the NEM. Claims for compensation following administered pricing are even less common, with only one claim for compensation made since the start of the NEM.

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 in 2009.

While assessing the claim, the AEMC identified a number of issues with the existing compensation provisions during an administered price period in the NER.⁴

Following its final decision on the Synergen claim published in September 2010, the Commission decided to initiate a review of the arrangements for determining compensation under clause 3.14.6 of the NER. It also considered that clause 3.15.10 of the NER, which describes the arrangements for the recovery of the cost of compensation, should be reviewed.⁵

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

The COAG Energy Council's rule change request is based on recommendations made in the AEMC's Review of Arrangements for Compensation following an Administered Price, Market Price Cap or Market Floor Price (the review), which was completed in May 2013.

⁴ AEMC, Final Decision, Compensation claims from Synergen Power Pty Ltd, 8 September 2010

⁵ Ibid.

In the final report of the review, the Commission noted that despite the fact that compensation claims have been rare, it is important that the rules are clear as to how these claims are assessed.⁶

The AEMC review recommended changes to the NER in the following areas:⁷

- clarifying the purpose of compensation;
- eligibility to claim compensation - who should be eligible;
- eligibility to claim compensation - eligibility criteria and market suspension;
- the AEMC's assessment process; and
- recovery of compensation costs.

⁶ AEMC, Final report, Review of Compensation Arrangements following an Administered Price, Market Price Cap or Market Floor Price, 16 May 2013, p.i.

⁷ Ibid, p.1

⁴ Compensation Arrangements following application of an Administered Price Cap and Administered Floor Price

3 Details of the rule change request

This Chapter provides a summary of the proposed amendments to the NER set out in the rule change request. Detail regarding the current rules, issues with the current rules and the rationale for the proposed rule changes is provided in the COAG Energy Council's rule change request, titled *Compensation arrangements following application of an administered price cap and administered floor price*.⁸

Further supporting information is available in the AEMC's *Review of Arrangements for Compensation following an Administered Price, Market Price Cap or Market Floor Price* (the review), which provided the recommendations upon which the COAG Energy Council's rule change request are based.

3.1 Clarifying clauses defining the purpose of compensation

The rule change proposes that clause 3.14.6 be amended to introduce a new description of the purpose of compensation, which clarifies that the sole purpose is to maintain incentives for participants to supply energy during an administered price period. It is proposed that any reference in the purpose clause to the maintenance of incentives for participants to invest in plants that provide services during peak periods should be removed.

3.2 Clarifying references to market suspension

The rule change proposes that references to market suspension be removed from the eligibility criteria for compensation in clause 3.14.6 of the NER. Market suspension should not act as a trigger for eligibility to claim compensation under clause 3.14.6 as there is already a process for participants to claim compensation under market suspension in clause 3.15.7 of the Rules.⁹ Therefore it is 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 that is not captured in clause 3.15.7.

3.3 Clarifying eligibility to claim compensation

It is proposed that the Rules be amended to introduce new eligibility criteria to claim compensation following the application of an administered price cap or administered floor price, based on market conditions. Under these new criteria, participants will be eligible to claim compensation over the course of the "eligibility period" (shown in Figure 3.1 below) which is defined as:

⁸ COAG Energy Council, Rule change request and proposal – Compensation arrangements following application of an administered price cap and administered floor price, 16 October 2013. <http://www.aemc.gov.au/getattachment/32b4a1fc-9aee-4de7-8495-69f1d466f499/Rule-change-request.aspx>

⁹ Ibid, p5.

- the period from the first trading interval when the spot price is actively capped by the administered price cap until the last trading interval of that day, or
- the period from the first trading interval when the spot price is actively limited by the administered floor price until the last trading interval of that day.

A participant may only claim where it has incurred total costs during the eligibility period that exceed the total revenue it received from the spot market during that period. Cost may only be due to direct and opportunity costs. The new criteria are proposed to replace the existing criteria for determining eligibility, based on the differences between dispatch offer and spot price.

Figure 3.1 The compensation "eligibility period"

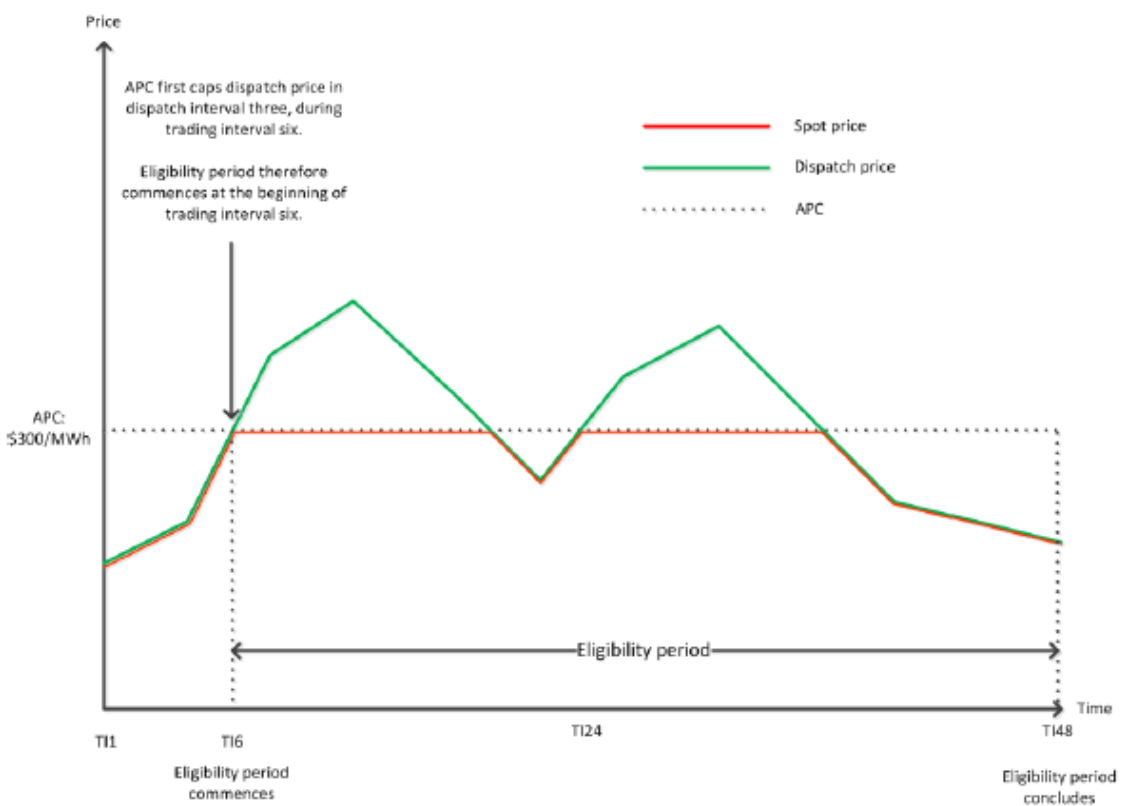


Table 3.1 below outlines the current and proposed new eligibility criteria for different types of participants. In summary, this shows that the rule change proposes to maintain eligibility to claim compensation for all market generators¹⁰, scheduled load and scheduled network service providers, extend eligibility to non-scheduled market generators under clause 3.14.6 of the NER and remove eligibility for ancillary service providers.

No change is proposed to the eligibility criteria for semi-scheduled generators, who will continue to be ineligible for compensation.

¹⁰ A market generator is defined as a generator who has classified at least one generating unit as a market generating unit in accordance with Chapter 2 of the NER and who is also registered by AEMO as a market generator under Chapter 2 (Chapter 10 of the NER).

Table 3.1 Proposed eligibility criteria

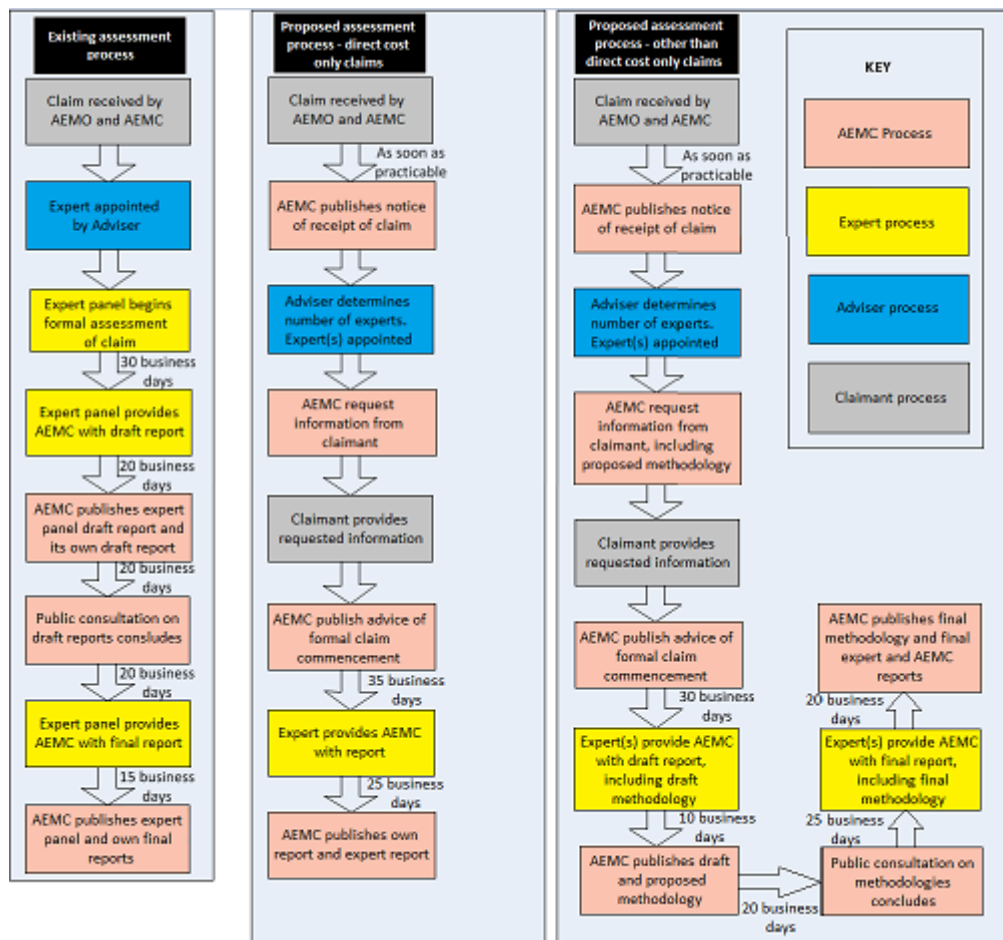
Participant type	Current eligibility	Proposed eligibility	Eligibility criteria
Market Generator (Scheduled)	Yes. 3.14.6(a)	Yes. 3.14.6(b)(1)	<p>Current: If the resultant spot price payable is less than the price specified in the dispatch offer for that trading interval.</p> <p>Proposed: If, due to application of an administered price cap, their total costs incurred exceed total spot market revenue during the eligibility period.</p>
Market Generator (Non-Scheduled)	Not in 3.14.6	Yes. Extend to 3.14.6(b)(1)	<p>Proposed: If, following the application of an administered price cap, their total costs incurred exceed total spot market revenue during the eligibility period.</p>
Scheduled network service provider	Yes. 3.14.6(a1)	Yes. 3.14.6(b)(3)	<p>Current: If the resultant revenue receivable is less than the minimum requirement specified by the network dispatch offer for that trading interval.</p> <p>Proposed: If, following an administered price cap, their total costs incurred in transporting power towards the APC capped region exceed total spot market revenue during the eligibility period.</p>
Scheduled load	Yes. 3.14.6(a2)	Yes. 3.14.6(b)(2)	<p>Current: If the resultant spot price is greater than the price specified in the dispatch bid for that trading interval.</p> <p>Proposed: If, following the application of an administered floor price, their total costs incurred exceed total spot market revenue during the eligibility period.</p>
Ancillary service providers	Yes. 3.14.6(a3)	No	<p>Current: If the resultant ancillary service price is less than the price specified in the relevant market ancillary service offer for a dispatch interval.</p> <p>Proposed: Not eligible.</p>

3.4 AEMC processes for assessing compensation claims

The rule change proposes to address issues identified with the current assessment process by increasing the flexibility of the compensation claim assessment process.

The existing and proposed assessment processes are outlined in Figure 3.2 below.

Figure 3.2 Existing and proposed AEMC claim assessment processes



The key differences between the existing and proposed assessment processes shown in Figure 3.2 are:

- the existing assessment process requires the AEMC to appoint a panel of three experts, while the proposed assessment processes allow the AEMC to appoint between one and three experts, depending on the complexity of the claim;
- the existing assessment process includes a public consultation process for all claims. This is included in the proposed assessment process for opportunity cost claims but not for direct cost only claims;
- the proposed process does not include the requirement to publish draft reports for direct cost only claims, whereas the current process does;
- the proposed assessment process for opportunity cost claims includes greater obligations on the AEMC to publish its methodology for determining opportunity costs; and
- some of the time periods differ, as detailed in Figure 3.2.

3.5 Recovery of compensation costs

The COAG Energy Council considers that the current rules are relatively unclear as to the appropriate process to be followed by the AEMC and AEMO in recovering the cost of compensation from market customers after the amount of compensation has been determined by the AEMC.

It is proposed that the Rules are amended to require the following:

- the AEMC should determine the total compensable amount for each claimant, for each eligibility period;
- AEMO should recover the total compensable amount for each eligibility period from market customers in the region in which the APC actively capped the spot market price or the AFP actively limited the spot price; and
- the total compensable amount should be recovered from market customers by reference to their total energy consumption during the eligibility period.

4 Assessment framework

This AEMC must assess proposed changes to the NER based on whether the proposed rule, will, or is likely to, contribute to the achievement of the National Electricity Objective (NEO), as set out in Section 7 of the National Electricity Law (NEL).

Section 7 of the NEL states:

- "The objective of this Law 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."

Based on a preliminary assessment of this rule change request, the most relevant aspects of the NEO, for the purpose of this rule change request, are the efficient operation and use of electricity services for the long-term interests of consumers, with respect to the price and reliability of supply of electricity and the reliability of the national electricity system.

To determine whether the proposed rule, if made, is likely to promote the NEO, the following principles may be taken into account.

4.1 The reliability of the electricity system

Reliability of electricity supply underpins national economic activity and investment decisions. It is proposed to test the contribution of the rule change request to maintaining reliability of supply of electricity and the reliability of the national electricity system. 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 (i.e. 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.

4.2 Improve transparency and reduce administration costs

Reducing administration costs and regulatory burden should contribute to the NEO through a reduction in costs flowing through to consumers. Greater transparency should mean better stakeholder involvement and regulatory decisions which better take into account stakeholder concerns. The rule change relates to the transparency of the compensation claim assessment process by requiring public notices to be published for the receipt of a claim and commencement of formal assessment. The proposal to remove the role of the adviser and expert from the assessment process or to allow a

smaller number of experts to be engaged for simpler claims relates to proportionate regulation, such that the administrative burden is no greater than necessary and there is an appropriate balance between regulatory certainty and flexibility.

4.3 Efficient recovery of compensation claim costs

Greater allocative efficiency can be achieved by allocating the costs amongst customers such that their marginal benefits equal their marginal costs (price). The rule change relates to the efficiency of the compensation cost recovery process such that costs are allocated to customers in proportion to the benefit they receive from its payment. In assessing the cost recovery mechanism the appropriate level of granularity should also be considered.

5 Issues for consideration

This chapter sets out a number of issues for consultation. Stakeholders are encouraged to make written submissions to the AEMC on these issues, as well as any other relevant aspects of the rule change request or this consultation paper.

The issues take into account the assessment framework, potential changes required to implement the proposed rule change and the fact that stakeholder's views have already been considered in the AEMC recommendations which formed the basis of the COAG Energy Council's rule change request.

5.1 General issues

The COAG Energy Council rule change request is based on the *Review of Arrangements for Compensation following an Administered Price, Market Price Cap or Market Floor Price* (the review), in which the AEMC considered in depth policy considerations and undertook stakeholder consultation. In coming to a conclusion on the COAG Energy Council's rule change request, the stakeholder consultation undertaken in the review and the policy positions reached in the review, as well as the material provided in the rule change request, will be taken into account.

Recent changes in circumstances may affect what the appropriate policy positions are. Changes that might affect these policy considerations could relate to matters of government policy, regulation, technology, operating environment or wholesale market, among others. Stakeholder views are sought on whether any such changes have occurred since the review was completed.

Question 1

(a) Have there been any recent changes in circumstances which may impact the policy positions reached in the final report of the review and the COAG Energy Council rule change proposal?

5.2 Specific issues

Stakeholder feedback is sought on the various components of the rule change request. These are listed in section 2.3 of this Consultation Paper and have not been described in their entirety here. However, set out below are some particular issues on which comment is sought.

5.2.1 Compensation assessment process

Current arrangements

Under the current arrangements, when there is a claim for compensation, the dispute resolution adviser appoints an expert panel. This is reflected in the Existing Arrangements section of Figure 3.2 and the current rules.

Rule change request

One element of the rule change request focuses on improving flexibility in the compensation claims process. Within this proposed new process, roles are retained for the dispute resolution adviser and the expert. This is reflected in the Proposed Assessment Process in Figure 3.2, and the indicative drafting of the proposed new rule.

Possible additional changes

We have considered further means of providing for flexibility in the compensation assessment process. There may be additional changes possible. This section discusses whether the expert and the dispute resolution adviser could be removed from the process. These changes have not been reflected in the indicative drafting of the proposed new rule.

Under the current arrangements, there are a number of prescribed functions around the role of the expert. In some cases these are similar to the functions that must be performed by the AEMC. For example, in assessing compensation claims, the expert and the AEMC are both required to apply the compensation guidelines, with the AEMC only able to avoid doing so if there are compelling reasons for this. Involving an expert therefore adds additional time to the process. Eliminating the requirement to use an expert could increase the efficiency of the process. Instead, the AEMC could have the discretion to draw on external expertise as this is required, as it does in general for rule changes and reviews.

If the requirement to use an expert is retained, providing for the dispute resolution adviser to appoint the expert offers independence that may be appropriate where the ultimate decision-maker could be affected in another capacity by the decision. For example, this might be the case where the decision-maker had some liability for any compensation arising out of the claim. In the current case, however, the claim for compensation has no impact on the AEMC, and is recovered from market participants. In these circumstances it is not clear if the additional time involved in the process through involvement of the dispute resolution adviser is justified by any benefits this offers. Stakeholder's views are sought on whether the dispute resolution adviser role is required in the compensation assessment process.

Question 2

(a) Is the expert needed? Or could this be removed from the rules, leaving the AEMC to draw on external expertise as needed?

(b) If an expert is needed, should it be appointed by the dispute resolution adviser or could it be the AEMC which does this directly?

5.2.2 Recovery of compensation costs

Under the current arrangements, AEMO recovers compensation costs from market customers who purchased electricity from a region where the spot price was affected by administered pricing. AEMO determines the amounts payable by market customers according to their individual share of total energy consumption in those trading intervals where the price is capped or limited by an administered price cap or administered floor price. This granular approach may improve the likelihood that the total compensable amount is allocated to those parties who received the greatest benefit, however it would be more complex to administer.

Instead, the rule change proposes that compensation costs are recovered based on customer's energy consumption across all trading intervals in the compensation eligibility period, in the region in which the spot price is capped or limited. This approach aligns with the proposed new eligibility criteria based on the eligibility period and considers that the primary benefit of compensation is borne by customers in the home region in which the spot price is capped or limited.

Stakeholders expressed divergent views on these matters in the AEMC review. Further feedback is sought from stakeholders on the most efficient cost recovery process in terms of granularity and the region(s) from which compensation is to be paid, considering the low likelihood and materiality of compensation claims and the administrative burden on AEMO of any changes required to its systems and processes.

Question 3

(a) Are there key principles that should guide the decision on how to recover compensation costs in the most efficient way? Should costs be recovered from customer's energy consumption in the specific trading intervals in which the administered price cap or administered floor price is breached or all trading intervals in the eligibility period? Should costs be recovered from customers in all regions affected by an administered price cap or administered floor price or only the home region in which it was first applied?

5.3 Indicative draft of proposed new rule

It is noted that the COAG Energy Council did not provide drafting of the proposed rule in its rule change request. In order to facilitate consultation on the proposed rule,

indicative drafting of the proposed rule is provided in a separate document which is available on the AEMC website. The indicative drafting of the proposed rule is based on the features of the proposed rule change as set out in the COAG Energy Council's rule change request. This does not predetermine the outcome of the rule change request or the drafting of the rule, however to the extent the underlying policy changes, this will be reflected in the rule drafting.

Question 4

(a) Please provide any issues, comments or suggestions regarding the indicative drafting of the proposed rule.

6 Lodging a submission

The Commission has published a notice under section 95 of the NEL for this rule change request inviting written submissions. Submissions are to be lodged online or by mail by 4 June 2015 in accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on rule change request.¹¹ The Commission publishes all submissions on its website, subject to a claim of confidentiality.

All enquiries on this project should be addressed to Andrew Pirie on (02) 8296 7867.

6.1 Lodging a submission electronically

Electronic submissions must be lodged online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code ERC0176. The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic submission, the Commission will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

6.2 Lodging a submission by mail

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Or by Fax to (02) 8296 7899.

The envelope must be clearly marked with the project reference code: ERC0176.

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the Commission will issue a confirmation letter.

If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

¹¹ This guideline is available on the Commission's website.

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 Governments' Energy Council
Commission	See AEMC
CPT	Cumulative price threshold
CPI	Consumer price index
MFP	Market floor price
MPC	Market price cap
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective