

Australian Energy Market Commission

## DRAFT RULE DETERMINATION

# NATIONAL ELECTRICITY AMENDMENT (COMPENSATION FOLLOWING DIRECTIONS FOR SERVICES OTHER THAN ENERGY AND MARKET ANCILLARY SERVICES) RULE

AEMO

24 SEPTEMBER 2020

DETERMINATION

## INQUIRIES

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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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## SUMMARY

- 1 The Australian Energy Market Commission (AEMC or Commission) has made a draft rule to amend compensation arrangements in the National Electricity Rules (NER) for participants directed to provide services other than energy and market ancillary services (hereafter referred to as "non-market services"). "Non-market services" includes, for example, a direction for a generator to remain in service as a synchronous condenser to provide voltage support or a direction for a battery to maintain a specific state of charge.<sup>1</sup>
- 2 The Commission's draft determination is to make a more preferable draft rule. The draft rule reduces administrative burden on AEMO and registered participants by amending the compensation framework for non-market services directions from two-steps to one-step, and makes other amendments that improve transparency, predictability, consistency and the allocation of risk. In doing so, the long-term interests of consumers will be promoted.
- 3 The Commission seeks feedback from stakeholders on the draft rule and draft determination, including implementation timing and transitional provisions. Submissions are invited by 5 November 2020 via the AEMC website (see section 1.4). A final determination is due on 17 December 2020.

### **Intervention mechanisms and non-market services**

- 4 The consideration of this rule change request is part of a wider Commission work program updating frameworks for interventions in the NEM.
- 5 Intervention mechanisms are tools that are available to AEMO in circumstances where the market response has been inadequate to maintain a reliable and secure power system, or in response to unexpected events. Broadly speaking, intervention mechanisms available to AEMO include the reliability and emergency reserve trader (RERT)<sup>2</sup>, directions and instructions.<sup>3</sup>
- 6 AEMO may direct participants to provide one or a combination of different services, including:
  - energy
  - market ancillary services
  - voltage control
  - system strength
  - other services (which we have defined as "non-market services" in this draft rule determination).
- 7 On 19 September 2019, AEMO submitted a rule change request in relation to compensation following directions for non-market services.
- 8 In recent years, directions for non-market services have been rare relative to the number of

1 IES Advisory Services, *AEMO directions to participants in South Australian on 2 and 4 February 2020, Final determination*, 19 August 2020.

2 Rule 3.20 of the NER.

3 Clause 4.8.9 of the NER.

directions for energy or market ancillary services. Between April 2017 and 30 June 2020, more than 540 directions were issued by AEMO, of which fewer than 50 were directions for non-market services. In recent years, directions for non-market services have included directions for:

- a generating unit to reduce output in response to a shortage of contingency FCAS, thus providing a substitute for FCAS
- a generator to operate as a synchronous condenser to provide voltage control
- a battery to maintain a state of charge and bid regulation FCAS to zero.

9 Non-market services are services for which a dispatch price or ancillary services price is not determined by the dispatch algorithm operated by AEMO (NEM Dispatch Engine or NEMDE). This differs from the provision of energy or market ancillary services where there is a dynamic price for these services in the wholesale spot market. As non-market services do not have a 'market price', their price is typically determined through contracts between AEMO and the participant providing the service.

### **Current compensation framework for directions for non-market services**

10 The entitlement of directed participants to receive compensation was included in the National Electricity Code (the predecessor of the NER) in 2000 following a review of directions by NEMMCO and NECA (predecessors of AEMO and the Commission). That review concluded that directed participants should receive a "fair payment" that would cover the cost incurred by the participant in complying with the direction while minimising inequitable impacts on other market participants.<sup>4</sup>

11 Under the current rules, when participants are directed to provide non-market services, they may be compensated under the "fair payment price" framework set out in clause 3.15.7A of the NER. A directed participant that was entitled to compensation under clause 3.15.7A may also lodge a claim under clause 3.15.7B for additional compensation if it is still out of pocket following the initial compensation calculation process.

12 AEMO considers that this two-step compensation process is an unnecessary delay in finalising compensation for participants directed to provide non-market services and proposed a one-step process in its rule change request.

### **The changes between the current arrangements and the draft rule**

The Commission has determined to make a more preferable draft rule that is consistent with AEMO's high level objective of moving from a two-step process to a one-step process for non-market service directions. However, the Commission's draft rule varies from AEMO's proposed rule in a number of respects in order to create a more effective one step-process.

The Commission assessed three policy options in reaching this draft determination. These options were the current two-step process, the one-step process proposed in the rule change request, and the more preferable one-step process in the draft rule.

13 Table 1 below describes the differences between, and the Commission's assessment of, the

<sup>4</sup> NEMMCO and NECA, Final Report – Power system directions in the National Electricity Market, 2000, p. i, p.6.

three policy options.

14 The Commission considered the more preferable one-step process is likely to better contribute to the achievement of the NEO.

15 The draft rule improves transparency and predictability, clarity, administrative efficiency and risk allocation.

**Table 1:** Comparison of current two-step process, the proponent's one-step process and alternative one-step process

	<b>OPTION 1 - CURRENT TWO STEP PROCESS</b>	<b>OPTION 2 - PROPOSED ONE STEP PROCESS</b>	<b>OPTION 3 - MORE PREFERABLE ONE STEP PROCESS</b>
<b>Characteristic of policy option</b>			
<b>Determining whether compensable service provided</b>	Compensation is provided where the direction for services other than energy and market ancillary services are determined in accordance with clause 3.15.7A(a1). No AEMO reporting requirement on whether this test is met.		Includes additional criteria to Options 1 and 2.  Adds the need for AEMO to notify the directed participant of its determination and the reasons for its determination, and adds the ability for the directed participant to challenge AEMO's determination.
<b>Steps to determine compensation</b>	Step 1 - Compensation based on fair payment price.  Step 2 - If the directed participant is still out of pocket after the fair payment price, it can make an additional claim.	One step process where compensation based on fair payment price.	One step process where compensation based on fair payment compensation.
<b>Information used to determine compensation</b>	Other relevant pricing methodologies in Australia and overseas, relevant contractual arrangements, and principles around market prices for fair	Other relevant pricing methodologies in Australia and overseas, relevant contractual arrangements, and principles around	Removes need to take into account other relevant pricing methodologies in Australia and overseas and principles around market prices.

	OPTION 1 - CURRENT TWO STEP PROCESS	OPTION 2 - PROPOSED ONE STEP PROCESS	OPTION 3 - MORE PREFERABLE ONE STEP PROCESS
	payment price.  Net direct costs and loss of revenue for additional claim.	market prices for fair payment price.  Given only one step, there is no ability to take into account net direct costs or loss of revenue.	Fair payment compensation based on net direct costs, loss of revenue and relevant contractual arrangements.
Entity that determines compensation	Independent expert determines fair payment price.  AEMO or independent expert determine additional claim.	Independent expert determines fair payment price.	AEMO or independent expert determine fair payment compensation.
Minimum compensation threshold	No minimum for fair payment price.  \$5000 minimum for additional claim.	No minimum for fair payment price.	No minimum if compensable service provided. \$5000 minimum if no compensable service provided.
Fair payment price applies for same service for the next 12 months	Yes		No
Assessment framework against the National Electricity Objective (NEO)			
Transparency, predictability and consistency	Limited transparency as no requirement for AEMO to notify directed participant when AEMO decides whether compensable service was provided. Current clause 3.15.7A(a1), that classifies the type of direction, is unclear and complex for AEMO to administer.		Improves transparency and provides clear and predictable arrangements, thereby reducing uncertainty for directed participants.
Administrative efficiency	Administrative time and costs are relatively high considering materiality of compensation for non-market service directions.	Lower administrative time and cost compared to current arrangements.	Lower administrative time and cost compared to current arrangements.

	<b>OPTION 1 - CURRENT TWO STEP PROCESS</b>	<b>OPTION 2 - PROPOSED ONE STEP PROCESS</b>	<b>OPTION 3 - MORE PREFERABLE ONE STEP PROCESS</b>
<b>Risk allocation</b>	Directed participants able to be made 'whole' and best placed to manage risk.	Risk that directed participant left out of pocket as can't recover direct costs or loss of revenue and no additional claim.	Allocates risk to those parties best able to manage them. Directed participant able to be made 'whole'.

Source: AEMC

16

The key changes between the current arrangements and the draft rule are set out below and are explained further in chapters 3, 4 and 5:

- The draft rule clarifies the test for how AEMO classifies directions as either: a direction for energy or a market ancillary service which is compensated under clause 3.15.7; or a direction for non-market services which is compensated under clause 3.15.7A.
- The current arrangements in relation to compensable services are amended. AEMO is required under the draft rule to determine whether the directed participant was required to provide a service in order to comply with a direction. The draft rule also adds a requirement for AEMO to notify the directed participant of its determination of whether or not a compensable service was provided, and provides for the directed participant to make a submission in response to AEMO's determination.
- The factors to be taken into account when AEMO or the independent expert determine fair payment compensation are simplified by removing the need to consider other and overseas markets and principles around market prices. Instead, the calculation of compensation is to take into account: net direct costs and loss of revenue incurred by the directed participant as a result of the provision of the service under direction; and relevant contractual arrangements.
- AEMO is provided with discretion to determine fair payment compensation or direct cost claims when the compensation amount is less than \$20,000 and AEMO considers that the claim is not unreasonable and does not involve issues of complexity or difficulty. In all other circumstances the independent expert must determine compensation.
- The process of applying of the fair payment price for the same service directed within the next 12 calendar months is removed and replaced with the determination of compensation on a case by case basis.
- No minimum compensation threshold is applied if the directed participant provided a compensable service. A minimum claim threshold of \$5,000 applies where the directed participant did not provide a compensable service but incurred direct costs.

#### **The new compensation framework in the draft rule**

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The new compensation framework is summarised below and shown in Figure 1.

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*Classifying the type of service that was directed, which determines the relevant*

*compensation framework*

- A direction classified as 'energy or market ancillary services' includes a service that is a direct substitute for energy or market ancillary services and a service provided incidental to the provision of energy or market ancillary services. The directed participant is compensated under clause 3.15.7 based on the 90th percentile price in the relevant region in the preceding 12 month period for the service or services directed, and potentially also clause 3.15.7B for any additional costs.
- A direction for any other service is classified as a direction for 'non-market services' and is entirely compensated through the new clause 3.15.7A.

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*Determining whether a compensable service was provided*

- If the direction is for non-market services, AEMO must determine whether a compensable service was provided and notify the directed participant of its determination and the reasons for its determination. If AEMO determines that no compensable service was provided, the directed participant can provide a written submission to AEMO setting out its reasons for why it considers that a service was provided. AEMO then makes a final determination.

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*Determining the amount of compensation through a one-step process*

- If AEMO determines that a compensable service was provided, the directed participant is eligible for fair payment compensation (FPC). Fair payment compensation is determined by taking into account any or all of net direct costs, loss of revenue and relevant contractual arrangements in a one-step process (all in clause 3.15.7A) that involves draft and final determinations. No minimum claim threshold applies.
- If AEMO determines that a compensable service was not provided, the directed participant can make a claim for direct costs (only), if it incurred direct costs of at least \$5,000. Compensation is determined in one-step process (all in clause 3.15.7A) that involves draft and final determinations.
- AEMO has discretion to determine fair payment compensation or direct cost claims when the compensation amount is less than \$20,000 and AEMO considers that the claim is not unreasonable and does not involve issues of complexity or difficulty. In all other circumstances the independent expert must determine compensation.

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Figure 1 below shows the amended compensation arrangements in this draft rule. This includes the compensation frameworks following directions for:

- 'energy and market ancillary services', and
- 'non-market services'.

**Implementation**

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The Commission's draft rule includes transitional provisions. The transitional provisions provide that if AEMO issues a direction for non-market services prior to the commencement of the rule, and the process for determining the amount of compensation has commenced but not been completed, then the determination of compensation must be completed under old chapter 3. In these circumstances, any fair payment price would not apply to the same

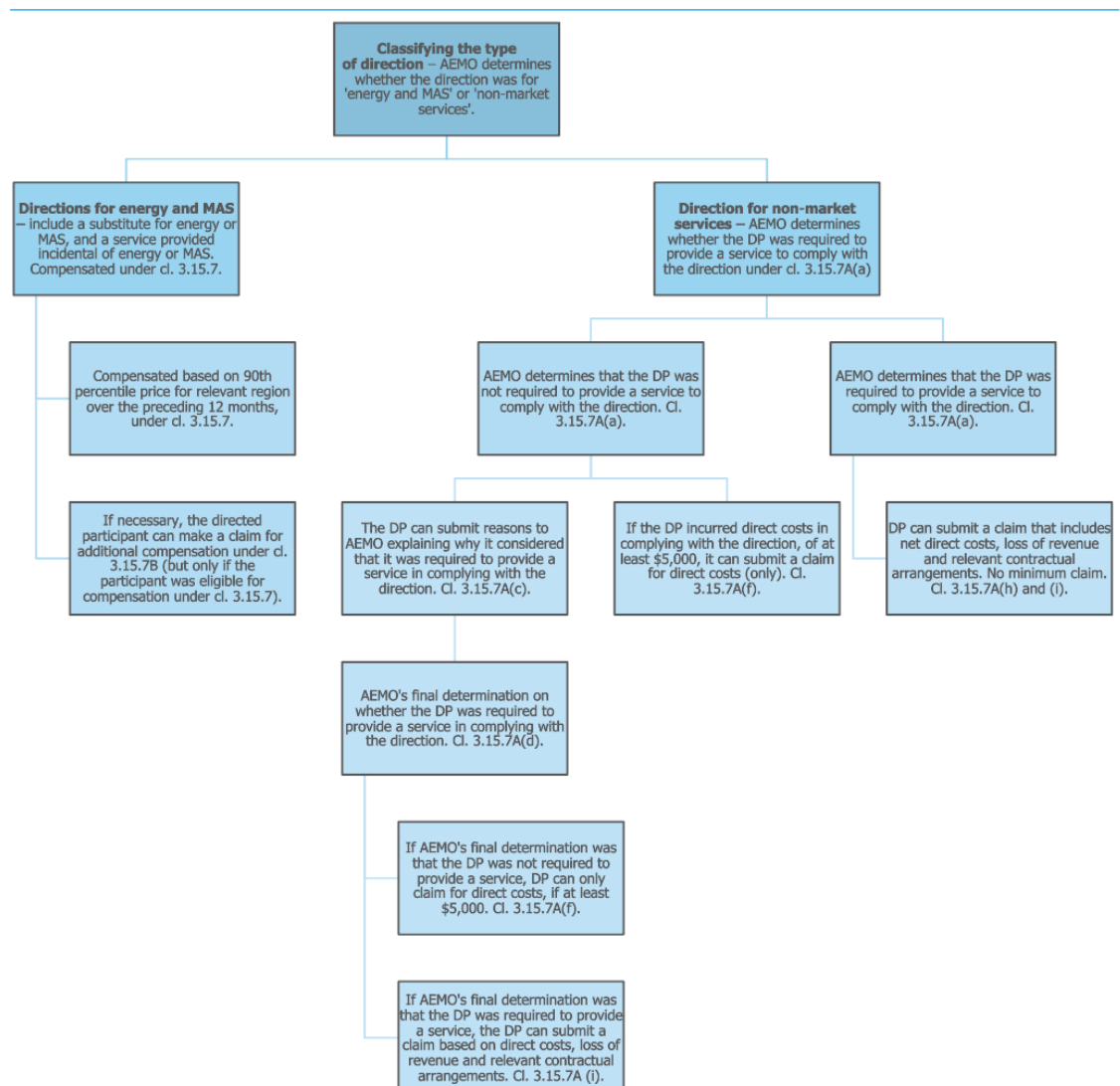


service directed in the 12 months after the fair payment price was determined.

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The Commission seeks stakeholder feedback regarding other potential additional transitional provisions that may be included in the final rule. Feedback is also requested on implementation timing.

**Figure 1: Draft rule - amended compensation frameworks following directions for services in the NER**



Source: AEMC, based on clause 3.15.7, 3.15.7A and 3.15.7B in this draft rule determination.

## CONTENTS

<b>1</b>	<b>The rule change request</b>	<b>1</b>
1.1	AEMO's rule change request	1
1.2	The rule change process	3
1.3	Consultation on draft rule determination	3
<b>2</b>	<b>Background</b>	<b>4</b>
2.1	Current arrangements	4
2.2	Related projects	10
<b>3</b>	<b>Draft rule determination</b>	<b>15</b>
3.1	Draft rule determination	15
3.2	Rule making test	17
3.3	Assessment framework	18
3.4	Summary of reasons	18
<b>4</b>	<b>Determining the category of directed service and eligibility to claim compensation</b>	<b>21</b>
4.1	Classifying the category of directed service	21
4.2	Determining when a directed participant is eligible for compensation	26
<b>5</b>	<b>Framework for determining compensation amount for directions for non-market services</b>	<b>30</b>
5.1	Compensation process is streamlined to a one stage process	30
5.2	Entity that determines compensation	40
5.3	Application of fair payment price for same service for 12 months	43
5.4	Application of minimum claim thresholds	44
5.5	Minor and consequential amendments to the NER	45
	<b>Abbreviations</b>	<b>47</b>

## APPENDICES

<b>A</b>	<b>Summary of other issues raised in submissions</b>	<b>11</b>
<b>B</b>	<b>Legal requirements under the NEL</b>	<b>51</b>
B.1	Draft rule determination	51
B.2	Power to make the rule	51
B.3	Commission's considerations	51
B.4	Civil penalties	52
B.5	Conduct provisions	52
<b>C</b>	<b>Summary of "other services" directions between 2016 and 2020</b>	<b>53</b>
<b>D</b>	<b>Step-by-step guide to the new framework</b>	<b>55</b>
D.1	Overview of new compensation framework following directions	55
D.2	Process to classify the type of service that was directed	56
D.3	Process to determine whether a compensable service was provided	57
D.4	Process to determine fair payment compensation	58

## TABLES

Table 1:	Comparison of current two-step process, the proponent's one-step process and alternative one-step process	iii
Table 5.1:	Time taken to finalise compensation following directions for other services, 2016 to 2020	34
Table 5.2:	Comparison of current two-step process, the proponent's one-step process and alternative one-step process	37
Table A.1:	Summary of other issues raised in submissions	48
Table C.1:	Summary of "other services" directions between 2016 and 2020	53

## FIGURES

Figure 1:	Draft rule - amended compensation frameworks following directions for services in the NER	vii
Figure 2.1:	Current compensation framework for directions for other services in the NER	9
Figure D.1:	Draft rule - amended compensation framework following directions for services in the NER	56

# 1 THE RULE CHANGE REQUEST

This chapter provides an overview of the rule change request which is the subject of this draft rule determination. It provides:

- a summary of the issues and proposed solution in AEMO's rule change request, as outlined by the rule change proponent
- information on the rule making process
- information on consultation on this draft rule determination.

## 1.1 AEMO's rule change request

On 19 September 2019, AEMO (proponent) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) in relation to the compensation framework following directions for services other than energy and market ancillary services ('other services'). In this draft rule determination, the name for these services has changed from 'other services' to 'non-market services'.

The proponent included a proposed rule in its rule change request.<sup>5</sup>

The rule change request may be found on the AEMC website, [www.aemc.gov.au](http://www.aemc.gov.au).

### 1.1.1 Issues with the current arrangements

The proponent considers that there are issues with the current arrangements for compensation following directions for non-market services, as explained below.

AEMO considers that the current two-step process is not necessary for participants to recover their costs. The first compensation stage involves an independent expert determining a FPP under clause 3.15.7A. If the directed participant considers that the FPP does not cover their out of pocket costs, they can make a claim for additional compensation through a second step under clause 3.15.7B.<sup>6</sup> AEMO notes that clause 3.15.7A(c)(2)(iv) states that the independent expert must produce a draft report on FPP and that it must request submissions from interested parties, which would include the directed participant.<sup>7</sup> AEMO suggests that, if the directed participant felt that the FPP draft determination did not recover their costs, the directed participant could make a submission to raise that concern, allowing the independent expert to factor this into its FPP final determination.<sup>8</sup>

AEMO also considers that the current two stage compensation process delays the time to finalise compensation. AEMO notes that there is a risk that the independent expert may be unable to finalise compensation within the 30-week settlement period for routine revised statements.<sup>9</sup>

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5 AEMO, rule change request, p. 5.

6 AEMO, rule change request, p. 3.

7 AEMO, rule change request, p. 3.

8 Ibid, p. 3.

9 This is a reasonable endeavours obligation for AEMO to complete within approximately 30 weeks. Ibid, pp. 3-4.

AEMO notes that the current wording of clause 3.15.7B invites directed participants to submit an additional claim for compensation if they consider that their costs have not been recovered through clause 3.15.7A. AEMO suggests that this provides participants directed for non-market services to have a second or third opportunity to raise concerns regarding their cost recovery. AEMO considers that the participant does not require this additional opportunity.<sup>10</sup> AEMO suggests that, following receipt of submissions on the FPP draft determination, the independent expert will always have sufficient information to make the FPP final determination.<sup>11</sup> Therefore, inviting additional compensation claims in clause 3.15.7B would not resolve any difference of views between the directed participant and the independent expert on what constitutes a FPP.<sup>12</sup>

### 1.1.2

#### **Proposed solution - remove additional compensation claims for non-market services**

In order to address the issues raised in relation to the current compensation framework following directions for non-market services, AEMO proposes to change the process for determining compensation for non-market services from two steps to one step, such that the FPP and additional compensation can be determined at the same time. AEMO's proposal is outlined below.

The current two-step compensation framework for non-market services directions would be replaced with a single step process, in which the FPP and additional compensation could be determined at the same time.<sup>13</sup>

The proponent's proposed rule is intended to give effect to this change by removing references to clause 3.15.7A and clause 3.15.7A(f) from clause 3.15.7B(a).<sup>14</sup>

The proponent suggests that its proposed rule would still allow a participant directed for non-market services to recover its costs.<sup>15</sup>

The proponent suggests that the independent expert should receive the directed participant's cost and loss information in a new single step compensation process.<sup>16</sup> However, the Commission notes that the rule change request does not propose any amendments to clause 3.15.7A to allow for this.

According to the proponent, the proposed changes would contribute to the NEO as they:<sup>17</sup>

- strike a fair balance between the interests of market participants and consumers with respect to the cost of electricity
- maintain the efficient operation of electricity services for the long-term interests of consumers with respect to price and security of supply.

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<sup>10</sup> AEMO, rule change request, p. 3.

<sup>11</sup> Ibid, p. 3.

<sup>12</sup> Ibid, p. 3.

<sup>13</sup> AEMO, rule change request, p. 3.

<sup>14</sup> Ibid, p. 4.

<sup>15</sup> AEMO, rule change request, p. 3.

<sup>16</sup> AEMO, rule change request, p. 3.

<sup>17</sup> AEMO, rule change request, p. 4.

## 1.2 The rule change process

On 11 June 2020, the Commission published a notice advising of its commencement of the rule making process and consultation in respect of the rule change request.<sup>18</sup> A consultation paper identifying specific issues for consultation was also published. Submissions closed on 16 July 2020.

The Commission received nine submissions as part of the first round of consultation. The Commission considered all issues raised by stakeholders in submissions. Issues raised in submissions are discussed and responded to throughout this draft rule determination. Issues that are not addressed in the body of this document are set out and addressed in Appendix A.

## 1.3 Consultation on draft rule determination

The Commission invites submissions on this draft rule determination, including the Commission's more preferable draft rule, by **5 November 2020**.

Any person or body may request that the Commission hold a hearing in relation to the draft rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than **1 October 2020**.

Submissions and requests for a hearing should quote project number ERC0287 and may be lodged online at [www.aemc.gov.au](http://www.aemc.gov.au).

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<sup>18</sup> This notice was published under s.95 of the National Electricity Law (NEL).

## 2 BACKGROUND

This chapter provides background information related to the rule change request which is the subject of this draft determination. It provides:

- an overview of current arrangements in the NEM
- information on related projects.

### 2.1 Current arrangements

This section provides an overview of current arrangements in the NEM, including:

- intervention mechanisms, intervention pricing and compensation frameworks
- types of services that can be directed
- compensation for directions for services

#### 2.1.1 Intervention mechanisms, intervention pricing and compensation frameworks in the NEM

Intervention mechanisms are tools that are available to AEMO in circumstances where the market response has been inadequate to maintain a reliable and secure power system, or in response to unexpected events. Broadly speaking, intervention mechanisms available to AEMO include the reliability and emergency reserve trader (RERT)<sup>19</sup>, directions and instructions.<sup>20</sup> This rule change request only relates to directions and does not relate to the RERT or instructions.

##### **Reliability and Emergency Reserve Trader (RERT)**

The RERT allows AEMO to contract for reserves (generation or demand side capacity that is not otherwise available to the market) ahead of a period when available supply is projected to be insufficient to meet the reliability standard.<sup>21</sup>

The primary intervention mechanism used by AEMO to manage reliability when the market response is inadequate is the RERT. The RERT allows AEMO to contract for reserves (generation or demand side capacity that is not otherwise available to the market) ahead of a period when available supply is projected to be insufficient to meet the reliability standard. It has been activated in November 2017 (one day), January 2018 (one day), January 2019 (two days), December 2019 (one day) and January 2020 (three days).<sup>22</sup>

There are three types of RERT based on how much time AEMO has to procure the RERT prior to the projected reserve shortfall occurring, as outlined below.

- The interim reliability reserve which replaces long-notice RERT on a temporary basis (which provided for between ten weeks' and twelve months' notice of a projected reserve

<sup>19</sup> Rule 3.20 of the NER.

<sup>20</sup> Clause 4.8.9 of the NER.

<sup>21</sup> Where the RERT has been procured for reliability purposes, it can also then be used, where practicable, for the maintenance of power system security. Clause 3.20.2 of the NER. See also section 7 of the RERT guidelines developed and published by the Reliability Panel under clause 3.20.8 of the NER.

<sup>22</sup> Various AEMO RERT reports are available at: <https://aemo.com.au/en/energy-systems/electricity/emergency-management/reliability-and-emergency-reserve-trader-rert/rert-reporting>.

shortfall). On 19 August 2020 the Energy Security Board (ESB) published a set of changes to the NER to establish an out of market capacity reserve (the Interim Reliability Reserve). The interim reliability reserve delivers further reliability by establishing an interim out-of-market capacity reserve and amending triggering arrangements for the Retailer Reliability Obligation (RRO). These measures would allow AEMO to procure reserves for contract terms of up to three years, replacing the long notice RERT until 2025. They aim to keep unserved energy to no more than 0.0006% in any region in any year.<sup>23</sup>

- medium-notice RERT: between ten weeks' and one week's notice of a projected reserve shortfall.
- short-notice RERT: less than seven days' notice of a projected reserve shortfall.

### **Directions and instructions**

Clause 4.8.9 of the NER allows AEMO to intervene in the market by issuing directions or clause 4.8.9 instructions if AEMO is satisfied that it is necessary to maintain or re-establish the power system to a secure, satisfactory or reliable operating state. Section 116 of the National Electricity Law (NEL) also allows AEMO to issue directions to take certain action if AEMO considers that it is necessary to maintain power system security or for reasons of public safety.

In contrast to the RERT, directions and instructions are a non-voluntary regulatory tool: a registered participant must use its reasonable endeavours to comply with a direction regardless of the financial implications unless to do so would, in their reasonable opinion, be a hazard to public safety, materially risk damaging equipment, or contravene any other law.<sup>24</sup>

Clause 4.8.9(a1) distinguishes between:

- directions which require registered participants to take action in relation to scheduled plant or a market generating unit, and
- instructions which require a registered participant to take some other action, i.e. not in relation to scheduled plant or a market generating unit.<sup>25</sup>

In the period between April 2017 and 30 June 2020, more than 540 directions have been issued by AEMO. The majority of these directions have been issued to maintain system security in South Australia in response to inadequate system strength. Some of these directions were directions for non-market services, as described in Appendix C of this draft rule determination.

Reliability directions occur infrequently reflecting that, when the supply demand balance is tight, it is generally more profitable for generators to participate in the market voluntarily and receive the spot price, rather than be directed and then compensated under the framework established by the NER.

<sup>23</sup> COAG, Energy Council, Energy Security Board, *Interim Reliability Reserve - decision paper*, July 2020.

<sup>24</sup> Clause 4.8.9(c) of the NER.

<sup>25</sup> Scheduled plant is defined in chapter 10 of the NER as 'in respect of a Registered Participant, a scheduled generating unit, a semi-scheduled generating unit, a scheduled network service or a scheduled load classified by or in respect to that Registered Participant in accordance with Chapter 2'.



In relation to reliability, the NEM historically has largely delivered a high level of reliability, but as the supply/demand balance grows tighter, there have been increasing concerns about reliability. Use of the RERT is becoming more common, and if the supply/demand balance grows tighter higher levels of unserved energy may occur in coming years.

### **Intervention pricing and compensation frameworks**

When AEMO intervenes in the market, it is required to comply with a number of principles and processes. If the "regional reference node test" set out in clause 3.9.3(b) is met, AEMO is required to implement intervention pricing when it activates the RERT or issues a direction. Intervention pricing is a practice designed to reduce market distortion and preserve investment signals by setting prices across the NEM at the level which AEMO considers would have applied but for the intervention. Intervention pricing does not apply in relation to directions for non-market services as there is no market price signal to preserve for these services. Therefore, intervention pricing is not relevant for the rule change request discussed in this draft determination.

The NER also set out a compensation framework under which compensation may be payable to directed participants and to affected participants. A directed participant is a participant which is directed to provide services. Broadly speaking, affected participants are those who are dispatched differently due to activation of the RERT or issuance of a direction.<sup>26</sup> The rule change request discussed in this draft determination only relates to compensation for directed participants, and does not relate to compensation for affected participants.

In the majority of cases, compensation for directed and affected participants is calculated automatically in the first instance. For example, when a participant is directed to provide energy or market ancillary services, it is compensated based on the 90th percentile price for the relevant region over the preceding 12 months.<sup>27</sup> The determination of compensation following directions for non-market services adopts a different approach and is discussed in section 2.1.3 below.

#### **2.1.2**

#### **Types of services that can be directed**

At the time of issuing a direction, AEMO does not specify the type of service that is being directed, only the action to be taken by the directed participant. AEMO will advise the participant of the physical deliverable requirement and the technical reason for the direction only.<sup>28</sup> The type of service, or more specifically, the cost recovery methodology to apply, is determined by AEMO after the situation which precipitated the direction is resolved.<sup>29</sup>

AEMO may direct participants to provide one or a combination of different services, including:

<sup>26</sup> Chapter 10 of the NER defines "affected participant" as a scheduled generator or scheduled network service provider which is dispatched differently as a result of an intervention event. The definition also includes "eligible persons", being settlement residue distribution (SRD) unit holders who are entitled to receive an amount from AEMO where there has been a change in flow of a directional interconnector. Affected participants are compensated under clause 3.12.2 of the NER. Market customers with scheduled loads are also entitled to compensation if they are dispatched differently as a result of an intervention event. While they are compensated under the same provision as affected participants, and in a similar manner, they are not defined as "affected participants".

<sup>27</sup> Clause 3.15.7 of the NER.

<sup>28</sup> AEMC, *National Electricity Amendment (Cost recovery for other services directions) Rule 2010*, 13 March 2010, p. 3.

<sup>29</sup> *Ibid*, p. 3.

- energy
- market ancillary services
- voltage control
- system strength
- other services (which we have defined as 'non-market services' in this draft rule determination).

The rule change request in this draft determination relates to compensation following directions for "other services", which are explained further below.

### **Directions for "other services"**

Services are only defined in the Rules in terms of their compensation and/or cost recovery mechanisms. While "energy" and "market ancillary service" are defined terms in the Rules, "energy direction" and "market ancillary service direction" (or similar) are not defined. Furthermore, "other" (which we have defined as 'non-market services' in this draft rule determination) is only defined by virtue of the service not being compensated as an energy direction or a market ancillary service direction and then only in terms of the relevant cost recovery mechanism.<sup>30</sup> That is, a directed participant will be compensated using the fair payment process set out in clause 3.15.7A if the direction is considered not to be a direction for energy or market ancillary services under the "carve out" test set out in clause 3.15.7A(a1). If the direction is considered to be a direction for energy or market ancillary services, the directed participant will be compensated in accordance with clause 3.15.7 (see further below).

Services other than energy and market ancillary services include services that could have been (but were not) contracted for as non-market ancillary services (NMAS) as described below:

- **Network Support and Control Ancillary Services (NSCAS)** that are primarily used to:<sup>31</sup>
  - control the voltage at different points of the electrical network to within prescribed standards
  - control the power flow on network elements to within the physical limitations of those elements
  - maintain transient and oscillatory stability within the power system following major power system events
- **System Restart Ancillary Services (SRAS)** that are reserved for contingency situations in which there has been a complete or partial system blackout and the electrical system must be restarted.

Other services are services for which a dispatch price or ancillary service price is not determined by the dispatch algorithm operated by AEMO (NEM Dispatch Engine or NEMDE). This differs from the provision of energy or market ancillary services where there is a

<sup>30</sup> National Electricity Rules, Chapter 10 - Glossary, Version 139.

<sup>31</sup> AEMO, *Guide to Ancillary Services in the National Electricity Market*, April 2015, p. 4.

dynamic price for these services in the wholesale spot market. As other services do not have a 'market price', their price is typically determined through contracts between AEMO and the participant providing the service.

Between 2005 and 2008, directions for "other" services accounted for some 90 per cent of issued directions, and approximately 99 per cent of total compensation paid. During this period, directions for network support made up the bulk of "other" services directions.<sup>32</sup>

Since the commencement of the updated NSCAS framework in 2012,<sup>33</sup> which provided AEMO the ability to acquire NSCAS for system security, the number of other services directions has reduced. More recently, directions for services other than energy and FCAS have been infrequent.<sup>34</sup>

Between 2016 and 2020, directions for other services have included directions for:

- a generating unit to reduce output in response to a shortage of contingency FCAS, thus providing a substitute for FCAS
- a generator to operate as a synchronous condenser to provide voltage control
- a battery to maintain a state of charge and bid regulation FCAS to zero.

Information on compensation for other services directions between 2016 and 2020 is provided in Appendix C.

### 2.1.3

#### Compensation following directions for services

Figure 2.1 provides an overview of the current compensation framework following directions for services, as set out in NER clauses 3.15.7, 3.15.7A and 3.15.7B. Further detail on the current arrangements, and amendments to these arrangements made by the draft rule, are included in chapters 3, 4 and 5 of this draft rule determination.

The current compensation arrangements are summarised below.

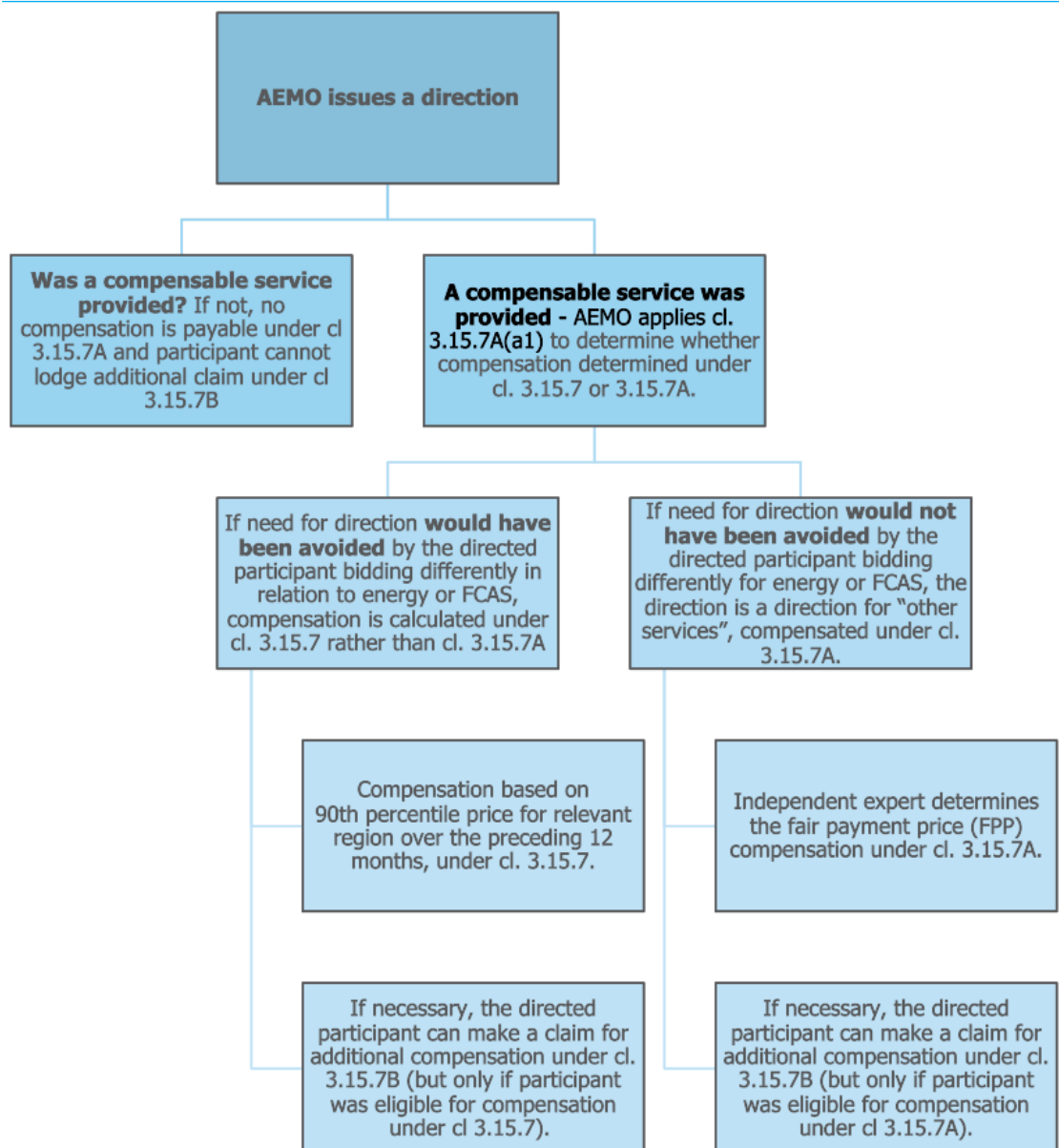
- **Directions for energy or market ancillary services** - compensated under clause 3.15.7, and if necessary, the directed participant can make an additional claim through clause 3.15.7B.
- **Directions for other services** - if AEMO determines that a compensable service was provided, the directed participant is eligible for compensation through the FPP in clause 3.15.7A, and if necessary, the directed participant can make an additional claim through clause 3.15.7B.

<sup>32</sup> Ibid p. 3.

<sup>33</sup> AEMC 2011, *Network Support and Control Ancillary Services*, Rule Determination, 7 April 2011, Sydney.

<sup>34</sup> It is noted that energy directions comprise not only directions for energy itself, but also directions for system strength and inertia. See clause 3.15.7A(a1) of the NER which is discussed in section 4.1.

**Figure 2.1:** Current compensation framework for directions for other services in the NER



Source: AEMC, based on NER clauses 3.15.7, 3.15.7A and 3.15.7B.

Compensation for other services directions is recovered from Market Customers, Market Generators, and Market Small Generation Aggregators in proportion to their customer energy, generator energy, and small generation aggregator energy respectively.<sup>35</sup>

<sup>35</sup> NER clause 3.15.8(g)

## 2.2 Related projects

This section provides information on:

- the intervention review and rule changes completed by the Commission
- intervention related rule changes currently being considered by the Commission
- other relevant energy market developments that may interact with this rule change.

### 2.2.1 Intervention review and rule changes completed by the Commission

This rule change is part of a wider Commission work program updating the interventions framework in the NEM. This work program commenced with the *Investigation into intervention mechanisms and system strength in the NEM*<sup>36</sup> and a number of associated rule change requests which have been submitted to action the recommendations made in that investigation. These elements of the Commission's work program are introduced in this section.

#### Investigation into intervention mechanisms in the NEM

In response to the increasing use of intervention mechanisms, the Commission commenced an investigation into intervention mechanisms and system strength in the NEM with the release of a consultation paper in April 2019.<sup>37</sup>

The interventions investigation examined a number of issues relating to intervention mechanisms, including intervention pricing, compensation for directed and affected participants, mandatory restrictions, counteractions, the hierarchy of intervention mechanisms and price setting during RERT events. A final report, referred to in this draft determination as the *Interventions investigation final report (IIFR)*, was published in August 2019, with the Commission noting that further consultation would be undertaken when recommended rule change requests were submitted.<sup>38</sup>

#### Rule changes recently completed by the Commission

A number of recommendations in the *Interventions investigation final report* have already been actioned. These include the following rule changes:

- **Application of the regional reference node test to the reliability and emergency reserve trader** — Changes to the regional reference node test set out in clause 3.9.3 of the NER were made in December 2019.<sup>39</sup> The RRN test is used to determine whether AEMO should implement intervention pricing. Under the revised RRN test, intervention pricing is to be implemented where an AEMO intervention event is for the purpose of obtaining a service for which there is a market price (i.e. energy or market ancillary services, or a service which is a direct substitute for these). Where the purpose of an intervention is to obtain a service for which a price is not determined by the dispatch

36 AEMC, *Investigation into intervention mechanisms and system strength in the NEM, Consultation paper*, 4 April 2019.

37 AEMC, *Investigation into intervention mechanisms and system strength in the NEM, Consultation paper*, 4 April 2019.

38 AEMC, *Investigation into intervention mechanisms in the NEM, Final report*, August 2019.

39 AEMC, *Application of the regional reference node test to the reliability and emergency reserve trader, Rule determination*, 19 December 2019.

algorithm — i.e. there is no market price (e.g. voltage control or system strength), intervention pricing will not apply. This recognises that, in such circumstances, there is no relevant market price signal to preserve.

- **Application of compensation in relation to AEMO interventions rule** — Changes were also made to the circumstances in which affected participant compensation is payable in connection with an intervention event. Under the revised approach, affected participant compensation is only payable in circumstances where an AEMO intervention event triggers intervention pricing in accordance with the revised RRN test.<sup>40</sup>
- **Threshold for participant compensation following market intervention** — As part of the same package of rule changes, the compensation threshold applicable to compensation payable to directed participants and affected participants was also amended. Under the revised approach, the \$5,000 compensation threshold applies per intervention event rather than per trading interval (as was previously the case). This minimises the potential for directed and affected participants to incur loss as a result of AEMO intervention events.<sup>41</sup>
- **Changes to intervention mechanisms** — On 10 September 2020, the Commission made a final rule to change three elements of the interventions framework in the NER. In particular, the rule:
  - removed the mandatory restrictions framework set out in rule 3.12A of the NER
  - removed the requirement on AEMO to use "counteractions" in order to confine the impact of an intervention event to a single region and, if possible, a single participant
  - formalised the arrangements for apportioning and recovering compensation costs following RERT activations, thereby addressing a gap in the NER.<sup>42</sup>
- **Removal of intervention hierarchy** — Also on 10 September 2020, the Commission made a final rule to remove the intervention hierarchy set out in clause 3.8.14. This prescriptive hierarchy required AEMO, during conditions of supply scarcity, to activate the RERT first and then if necessary issue directions or clause 4.8.9 instructions. The Commission determined that this could result in higher than necessary costs to consumers and should be replaced with a principle of using the intervention mechanism, or combination of mechanisms, that is effective while minimising direct and indirect costs.<sup>43</sup>

## 2.2.2

### Other intervention rule change currently being considered by the Commission

In addition to the above changes, and the rule change which is the subject of this draft determination, AEMO has submitted two rule change requests concerning the compensation payable to market participants which are dispatched differently as a result of an AEMO intervention event which triggers intervention pricing.

<sup>40</sup> AEMC, *Application of compensation in relation to AEMO interventions, Rule determination*, 19 December 2019.

<sup>41</sup> AEMC, *Threshold for participant compensation following market intervention, Rule determination*, 19 December 2019.

<sup>42</sup> AEMC, *Changes to intervention mechanisms, Rule determination*, 10 September 2020.

<sup>43</sup> AEMC, *Removal of intervention hierarchy, Rule determination*, 10 September 2020.

On 11 June 2020, the AEMC initiated two rule change requests on *Compensation for scheduled loads affected by interventions* and *Affected participant compensation for FCAS losses* through a consolidated and standard rule change process. A consultation paper for this rule change was published on 11 June 2020. A draft determination was published on 24 September 2020 and a final determination is planned for publication on 17 December 2020.<sup>44</sup>

### 2.2.3 Other relevant energy market developments

The following energy market developments that are being considered by the AEMC and/or the Energy Security Board (ESB) have the potential to impact the future application of intervention and compensation frameworks in the NEM. The AEMC has been mindful of these developments in the rule change process.

#### Post 2025 market design

In March 2019, the COAG Energy Council (now the ministerial forum of Energy Ministers) requested the Energy Security Board to advise on a long-term, fit for purpose market framework to support reliability, modifying the NEM as necessary to meet the needs of future diverse sources of non-dispatchable generation and flexible resources including demand side response, storage and distributed energy resource participation. The post 2025 program has been established as a pathway to a fit for purpose market design for the NEM. The ESB will provide advice to Energy Ministers on changes to the existing market design, or recommend an alternative market design, to enable the provision of the full range of services to customers necessary to deliver a secure, reliable and lower emissions electricity system at least cost by mid-2021.

There are seven core market design initiatives being progressed:<sup>45</sup>

- **Resource adequacy mechanisms** — the focus of this work is on whether existing mechanisms are sufficient to support the changing needs of the system (particularly new investment) in the next 10-15 years, or whether other complementary measures are needed.
- **Ageing thermal generator strategy** — there are a number of existing measures that would reduce the uncertainty around the timing of exit of ageing thermal generation in the NEM over the coming decades.<sup>46</sup> The ESB will consider whether additional measures are needed during the transition period as thermal generators retire.
- **Essential system services** — the focus of this work is to develop a framework to enable the market to progress to more sophisticated ways to deliver system services as the system changes, and as technology and market conditions allow.
- **Scheduling and ahead mechanisms** — In 2025, the system is expected to be more complex, with variable and changing patterns of demand and supply creating challenges

<sup>44</sup> For more information, see: <https://www.aemc.gov.au/rule-changes/compensation-market-participants-affected-intervention-events>

<sup>45</sup> Energy Security Board, *Post 2025 Market Design*, Consultation Paper, 7 September 2020, pp. 7-10.

<sup>46</sup> These include measures to ensure that essential system services are available, the 42 month notice of closure, and Retailer Reliability Obligations may be triggered. Energy Security Board, *Post 2025 Market Design*, Consultation Paper, 7 September 2020, p. 8.



to keep the system balanced. Changes to market arrangements are being considered that introduce greater visibility and certainty of resources on the system ahead of real time.

- **Two-sided markets** — A two-sided market is a market model that promotes direct interaction between suppliers and customers. The focus is on getting the market framework right to accommodate different customer needs and provide appropriate customer protections for consumers. The intention is a progressive shift to a two-sided market that better rewards the value provided to the system by flexible demand and supply.
- **Valuing demand flexibility and integrating Distributed Energy Resources (DER) markets** — to maximise the value for consumers of DER there is a need for technical, regulatory and market arrangements to support their effective integration.
- **Transmission access and the coordination of generation and transmission investment** — the shift to locate generation in different places is a challenge for the existing transmission network, connections to it, and how it is accessed and used. A combination of regulatory and market arrangements are needed to support efficient and timely investment to deliver efficient outcomes to consumers and investors.

The next phase of the ESB Post 2025 work program is to evaluate potential solutions. Option(s) for future market design will be developed with input from stakeholders, with design options released for consultation around late December 2020 or early 2021.<sup>47</sup>

There are interactions between these workstreams under 2025 and the interventions work program. The Commission and the ESB as well as the AER and AEMO are coordinating on these pieces of work. For example, in the recent consultation paper on the scheduling and ahead mechanisms workstream, the ESB noted its support for implementing a unit commitment for security (UCS) approach to support scheduling system services under contract (rather than a spot market) and systemise how AEMO issues directions to market participants to provide greater certainty.<sup>48</sup> This would aim to provide confidence that critical resources will be available to deliver secure and reliable electricity supply in real-time.

The ESB notes that the need for the UCS is illustrated by the frequent use of directions to maintain system strength in South Australia.

The ESB notes that even if the UCS process was in place AEMO would still have the capability to issue an ad hoc intervention outside the process if an unexpected system gap arises.<sup>49</sup> However, the implementation of the UCS process will likely greatly reduce the need for such ad hoc directions.

### **AEMC system services work program**

In coordination with the ESB's work, the AEMC is progressing a number of rule change requests which focus on the issue of how best to procure and value system services such as system strength, inertia, frequency response and operating reserves.<sup>50</sup>

47 Energy Security Board, *Post 2025 Market Design*, Consultation Paper, September 2020, p. 12.

48 Energy Security Board, *Post 2025 Market Design*, September 2020, p. 74.

49 Energy Security Board, *Post 2025 Market Design*, September 2020, p. 80.

50 AEMC, *System services rule changes*, Consultation paper, 2 July 2020.



These rule changes complement and are interdependent with the issues being explored by the ESB in its ongoing post-2025 market design program. The AEMC is working closely with the ESB and other market bodies, particularly AEMO, on these rule change requests. The rule changes provide us with an opportunity to complement the thinking and assessment done in the ESB work program. It allows us to address the issues in a cohesive way, as well as addressing system security issues that are more urgent in nature.

## 3 DRAFT RULE DETERMINATION

This chapter provides a description of:

- the draft rule determination and the main features of the draft rule
- the rule making test for changes to the NER
- the assessment framework for considering the rule change request
- summary of reasons for the draft rule determination.

### 3.1 Draft rule determination

The Commission's draft rule determination is to make a draft rule which is a more preferable draft rule. The draft rule made by the Commission is published with this draft rule determination. The draft rule is described below:

- It clarifies the test for how AEMO is to classify directions as either: a direction for 'energy or market ancillary services' and compensated under clause 3.15.7; or a direction for non-market services and compensated under clause 3.15.7A. This includes setting out the criteria for what constitutes energy or market ancillary services.
- It changes the name of compensation paid under clause 3.15.7A from the Fair Payment Price (FPP) to Fair Payment Compensation (FPC), reflecting the focus on compensation to make the directed participant 'whole'.
- It provides that AEMO must, in its reasonable opinion, determine whether a directed participant that was issued a direction for the provision of non-market services was required to provide a service in order to comply with the direction - in which case it is eligible to claim FPC under clause 3.15.7A.
- It places an obligation on AEMO to notify the directed participant in writing of its determination in relation to whether the directed participant was required to provide a service in order to comply with the direction, and to set out its reasons for its determination.
- It provides for the directed participant to make a submission in response to AEMO's determination, setting out why the participant considers that a service was required to be provided when complying with the direction.
- It provides that AEMO must notify the directed participant of its final determination following the receipt of the submission referred to above.
- It clarifies that if a directed participant was not required to provide a service in order to comply with a direction for non-market services, it is not entitled to FPC under clause 3.15.7A, nor to claim additional costs under clause 3.15.7B, however it may submit an itemised claim for its direct costs incurred in complying with the direction (if the costs were above \$5000).
- It simplifies the factors to be taken into account when AEMO or the independent expert determine FPC by removing the need to consider other and overseas markets and principles around market prices. Instead, the calculation of compensation is to take into account: net direct costs and loss of revenue incurred by the directed participant as a

result of the provision of the service under direction; and relevant contractual arrangements.

- It provides AEMO with discretion to determine FPC or direct cost claims when the compensation amount is less than \$20,000 and AEMO considers that the claim is not unreasonable and does not involve issues of complexity or difficulty. In all other circumstances the independent expert must determine compensation.
- It creates consistency in the process to be followed by the independent expert in determining FPC under clause 3.15.7A with the process followed by the independent expert in relation to the determination of compensation for other intervention claims.
- It removes the application of the FPP for the same service directed within the next 12 calendar months and replaces it with the determination of compensation on a case by case basis.
- It removes the ability for a directed participant entitled to compensation under clause 3.15.7A to make a claim under clause 3.15.7B as this is no longer required.

The proponent considered that:<sup>51</sup>

- if the rule change was made, AEMO could apply the proposed rule immediately as transitional provisions are not required
- there are no implementation costs for AEMO or market participants to implement the proposed rule.

The Commission's draft rule includes transitional provisions. The transitional provisions provide that if AEMO issues a direction for non-market services prior to the commencement of the rule in this rule change, and the process for determining the amount of compensation under old clause 3.15.7A or clause 3.15.7B has commenced but not been completed, then the determination of compensation must be completed under old chapter 3. In these circumstances, any FPP would not apply to any future occurrences of the same service directed in the 12 months after the FPP was determined.

The Commission seeks stakeholder feedback regarding other potential transitional provisions that may be included in the final rule. This could include transitional provisions to deal with the situation where a direction for non-market services straddles the commencement date (i.e. a direction for non-market services that starts before the rule commencement date and finishes after the rule commences). Additional transitional provisions may be required to avoid uncertainty.

The Commission seeks feedback from stakeholders on implementation timing and transitional provision in the draft rule.

The Commission's reasons for making this draft determination are set out in section 3.4 and chapters 4 and 5 of this draft determination.

Further information on the legal requirements for making this draft rule determination is set out in Appendix B.

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<sup>51</sup> AEMO, rule change request, p. 4.

## 3.2

## Rule making test

### 3.2.1

### Achieving the NEO

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).<sup>52</sup> This is the decision-making framework that the Commission must apply.

The NEO is:<sup>53</sup>

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.

### 3.2.2

### Making a more preferable rule

Under s. 91A of the NEL, the Commission may make a rule that is different (including materially different) to a proposed rule (a more preferable rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule will or is likely to better contribute to the achievement of the NEO.

In this instance, the Commission has made a more preferable rule. The reasons are summarised below.

### 3.2.3

### Making a differential rule

Under the Northern Territory legislation adopting the NEL, the Commission may make a differential rule if, having regard to any relevant MCE statement of policy principles, a different rule will, or is likely to, better contribute to the achievement of the NEO than a uniform rule. A differential rule is a rule that:

- varies in its term as between:
  - the national electricity system, and
  - one or more, or all, of the local electricity systems, or
- does not have effect with respect to one or more of those systems

but is not a jurisdictional derogation, participant derogation or rule that has effect with respect to an adoptive jurisdiction for the purpose of s. 91(8) of the NEL.

As the draft rule related to parts of the NER that do not apply in the Northern Territory, the Commission has not assessed the draft rule against additional elements required by the Northern Territory legislation.<sup>54</sup>

<sup>52</sup> Section 88 of the NEL.

<sup>53</sup> Section 7 of thence.

<sup>54</sup> From 1 July 2016, the NER, as amended from time to time, apply in the NT, subject to derogations set out in regulations made under the NT legislation adopting the NEL. Under those regulations, only certain parts of the NER have been adopted in the NT. (See the AEMC website for the NER that applies in the NT.) National Electricity (Northern Territory) (National Uniform Legislation) Act 2015.

### 3.3 Assessment framework

In assessing the rule change request against the NEO the Commission considered the rule change request against the following criteria:

- **Transparency and predictability** - does the proposed approach provide clear and predictable arrangements for participants affected by interventions, thereby reducing uncertainty?
- **Efficiency** - is the proposed approach efficient in terms of administrative costs and timing for participants? Does it send clear operational and investment signals to participants?
- **Risk allocation** - risk allocation and the accountability for investment and operational decisions should rest with those parties best placed to manage them. Does the proposed approach appropriately allocate risk to those parties best able to manage them?
- **Consistency** - do the rules adopt a consistent approach where appropriate?

### 3.4 Summary of reasons

The Commission has elected to make a draft more preferable rule on the basis that the more preferable rule will or is likely to better contribute to the achievement of the NEO than the rule proposed by AEMO in its rule change request. In making its draft rule determination and more preferable draft rule, the Commission made some changes to the proposed rule submitted by the proponent. These changes are in order to improve transparency and predictability, clarity, administrative efficiency and risk allocation.

This section summarises the Commission's reasons for making the draft more preferable rule including consideration of how it better contributes to the achievement of the NEO than the proposed rule.

Reasons are summarised for each of the principles applied by the Commission in assessing the rule change request against the NEO. Further detail on the Commission's reasons for making the draft rule in each of these areas are presented in Chapter 4 and 5.

#### **Transparency and predictability**

The draft more preferable rule provides clear and predictable compensation arrangements, thereby reducing uncertainty for directed participants. It clarifies how directions are to be classified as either a direction for 'energy or market ancillary services' or a direction for non-market services, and this then determines the relevant compensation framework. The draft rule amends the eligibility test for whether a compensable service was provided by the directed participant, to support clear and predictable arrangements.

The draft rule improves transparency by adding an obligation on AEMO to notify the directed participant in writing, explaining whether or not a compensable service was provided in a direction. It adds the ability for the directed participant to make submissions in response to AEMO's decision that a compensable service was not provided. The draft rule requires draft and final determinations of the FPC to be published by either AEMO or the independent expert, reflecting the transparency of the current compensation arrangements.

## **Efficiency**

The draft more preferable rule reduces the administrative burden associated with determining compensation for directions for non-market services. The draft rule streamlines the process to determine compensation by moving from a two-step process to a one-step process, reducing administrative time and cost, and therefore supporting the finalisation of compensation within the 30 week timeframe for routine settlement revision. The draft rule simplifies the factors to be taken into account by AEMO or the independent expert in determining compensation for non-market services directions, by removing the need to consider pricing methodologies in other and overseas markets and principles around market prices.

The draft rule provides discretion for AEMO to determine compensation in circumstances where the compensation amount is less than \$20,000 and AEMO considers that the claim is not unreasonable and does not involve issues of complexity or difficulty. This reduces administrative costs as AEMO's costs are expected to be less than the costs for an independent expert.

The draft more preferable rule does not change operational or investment signals for participants in the NER.

## **Risk allocation**

The draft more preferable rule appropriately allocates risk to those parties best able to manage them. The draft rule provides that a directed participant can be made 'whole' through the FPC, which is assessed on a case by case basis. The removal of the application of the same compensation (formerly FPP) to all future occurrences of the same service directed in the ensuing 12 months, removes the potential for over-compensation (where additional costs flow through to consumers) or under-compensation (where the directed participant is left out of pocket). This is particularly important given that the draft rule removes the right of participants compensated under clause 3.15.7A to lodge a claim for additional compensation under clause 3.15.7B. Given this, it would not be appropriate to apply a previously determined FPP to a subsequently directed participant if the amount of the FPP would leave the subsequently directed participant out-of-pocket.

The draft more preferable rule provides that, where a directed participant did not provide a compensable service, but incurred direct costs of at least \$5,000 in complying with the direction, it will be eligible to make an itemised claim for compensation. This recognises that directed participants may incur costs in complying with a direction even if no compensable service has been provided.

## **Consistency**

The draft rules adopt a consistent approach to other arrangements in the NER, where appropriate. The compensation frameworks for directions for energy and market ancillary services and directions for non-market services are consistent in their purpose that the directed participant is not left out of pocket. However, the one-step compensation process for non-market services directions in the draft rule differs from the two-step compensation framework for directions for energy and market ancillary services. This is considered

appropriate given that initial compensation for energy and market ancillary services directions determined in clause 3.15.7 is based on the 90th percentile price and does not take into account the particular costs incurred by a directed participant, as does the amended approach under clause 3.15.7A.

The draft rule also creates consistency in the process to be followed by AEMO or the independent expert in determining FPC under clause 3.15.7A with the process followed by the independent expert in relation to the determination of compensation for other intervention claims.

## 4 DETERMINING THE CATEGORY OF DIRECTED SERVICE AND ELIGIBILITY TO CLAIM COMPENSATION

This chapter describes the following aspects of the Commission's draft determination:

- The draft rule clarifies the test for how AEMO is to classify directions as either: a direction for energy or a market ancillary service which is compensated under clause 3.15.7; or a direction for non-market services which is compensated under clause 3.15.7A.
- The current arrangements in relation to compensable services are amended such that AEMO is required to determine whether the directed participant was required to provide a service in order to comply with a direction.

### 4.1 Classifying the category of directed service

This section summarises current arrangements, stakeholder views and the Commission's analysis and conclusion on the way in which the directed service is classified, which determines whether the relevant compensation framework to apply is set out in clause 3.15.7 or 3.15.7A.

#### 4.1.1 Current arrangements

Under the current rules, AEMO classifies the type of direction by applying clause 3.15.7A(a1), which classifies a direction in one of the two categories outlined below.

- **A direction for energy or market ancillary services:** compensation is determined under clause 3.15.7 based on the 90th percentile price in the relevant region in the preceding 12 months and, if the directed participant considers that it is still out of pocket, the directed participant can make an additional claim through clause 3.15.7B, or
- **A direction for 'other services':** compensation is determined through the fair payment price in clause 3.15.7A and, if the directed participant considers that it is still out of pocket, the directed participant can make an additional claim through clause 3.15.7B.

Current NER clause 3.15.7A(a1) is shown below.

#### **Current NER clause 3.15.7A(a1)**

In this clause 3.15.7A, a *direction* is a *direction* for services other than *energy* and *market ancillary services* to the extent that the need for the *direction* could not have been avoided by the *central dispatch* process had there been a *dispatch bid*, *dispatch offer* or *rebid* made consistent with the requirements of clauses 3.8.6, 3.8.6A, 3.8.7, 3.8.7A or 3.8.8(d) (whichever is applicable) for *dispatch of plant* relevant to that *direction* for one or more of the following services:

- (1) *energy*; and
- (2) *any one service of the market ancillary services*.



AEMO may only classify a direction as an "other" services direction if the need for the direction could not have been avoided by the directed participant submitting valid dispatch bids, dispatch offers or rebids for energy or FCAS.<sup>55</sup>

For example, a synchronous generator bids unavailable and is directed by AEMO to synchronise and follow dispatch targets in order to provide fault current (system strength), inertia or voltage control as a by-product of the generation of energy. If the generator had bid available to generate energy, it could have avoided the need for the direction. In this case, the test in clause 3.15.7A(a1) would be met so that the directed participant would be compensated under clause 3.15.7 based on the 90th percentile energy or ancillary service price for the 12 months immediately preceding the direction in the relevant region.<sup>56</sup> In addition, the directed participant may apply for additional compensation through clause 3.15.7B.<sup>57</sup>

Clause 3.15.7A(a1) was re-drafted by the Commission in 2010 to be defined by reference to the kind of service it is replacing (i.e. a service that could be "hypothetically offered"), rather than replacing an actual offer in place.<sup>58</sup>

In the consultation paper for this rule change request, the Commission asked stakeholders whether clause 3.15.7A(a1) was clear, whether clause 3.15.7A(a1) had been applied consistently, and whether there would be benefit in clarifying how directions are classified. This relates to the rule change request as it determines whether the relevant compensation framework to apply is set out in clause 3.15.7 or 3.15.7A.

#### 4.1.2

#### Stakeholder views

Stakeholders had mixed views on whether clause 3.15.7A(a1) was clear and whether it had been applied consistently.

- CS Energy<sup>59</sup> and Stanwell<sup>60</sup> considered that clause 3.15.7A(a1) was not clear, which had resulted in it being applied inconsistently.
- AGL considered that clause 3.15.7A(a1) could be clearer and there would be merit in amending it to improve consistency.<sup>61</sup>
- ERM Power considered that clause 3.15.7A(a1) was generally clear in its intended application, but it was open to interpretation by AEMO. ERM Power suggested an alternative approach to that currently set out in the rules would be to consider the resulting outcome from the direction: i.e. did it result in the provision of additional active energy output, the provision of market ancillary services, or a substitute for the provision of market ancillary services<sup>62</sup>

<sup>55</sup> NER clause 3.15.7A(a1)

<sup>56</sup> NER clause 3.15.7(c).

<sup>57</sup> NER clause 3.15.7B(a2).

<sup>58</sup> AEMC, *National Electricity Amendment (Cost Recovery for other services directions)*, 13 March 2010, p. 14.

<sup>59</sup> CS Energy submission, p. 3.

<sup>60</sup> Stanwell submission, p. 3.

<sup>61</sup> AGL submission, p. 2.

<sup>62</sup> ERM submission, pp. 2-3.

- CS Energy considered that clause 3.15.7A(a1) was not appropriate for the current and changing mix of services provided by participants.<sup>63</sup>
- AGL and Tesla<sup>64</sup> noted that regulatory and structural market changes may change the frequency and application of directions by AEMO for other services. For example if the ESB implements a day ahead market there could be increased visibility of the sufficiency of energy, FCAS and the provision of other system services in pre-dispatch.

#### 4.1.3

#### Commission's analysis and draft determination

The Commission considers that there are issues with the clarity of current clause 3.15.7A(a1) and how it has been applied. The Commission's more preferable draft rule therefore clarifies clause 3.15.7A(a1).

The Commission considers that clause 3.15.7A(a1) is unclear and complex for AEMO to administer. Clause 3.15.7A(a1) requires AEMO to potentially consider a wide range of hypothetical bids, offers and rebids that could have been made by the directed participant. Based on this hypothetical analysis, if the directed participant could have made different bids, offers or rebids that would have avoided the need for the direction, it is compensated under the framework for energy or market ancillary services directions in 3.15.7. If the directed participant could not have avoided the need for the direction through different bids, offers, or rebids, it is compensated for "other services" under clause 3.15.7A.

The lack of clarity in clause 3.15.7A(a1) and need for hypothetical analysis may have contributed to variable application of this clause by AEMO. For example, AEMO classified some directions for voltage control services as directions for energy or market ancillary services and another direction for voltage control as "other services".<sup>65</sup> In the direction to Tumut 3, Unit 2 in January 2019 for voltage control that was classified as a direction for "other services",<sup>66</sup> it is not clear why the generator that was directed to operate in synchronous condenser mode could not have made an alternative offer to provide energy (and voltage control incidentally to the provision of energy) that would have avoided the need for the direction, such that the directed participant was compensated under clause 3.15.7, as opposed to clause 3.15.7A.<sup>67</sup>

Leaving aside questions of interpretation, the Commission understands the practical issue of compensating a generator operating in synchronous condenser mode under clause 3.15.7 is that the directed participant has not provided any energy, so there is no volume of energy to multiply against the 90th percentile price for energy in the region in the preceding 12 month period, to determine the amount of compensation under clause 3.15.7 (i.e. 0 MW x 90th

<sup>63</sup> CS Energy submission, p.4.

<sup>64</sup> Tesla submission, p. 2.

<sup>65</sup> Voltage control directions were issued to Newport and Mortlake in November 2018; Newport was again directed for voltage control in September 2019; Mortlake was directed once for voltage control in March 2020. In all cases, compensation was calculated in accordance with clause 3.15.7.

<sup>66</sup> IES Advisory Services, *AEMO Direction to a NSW participant on 24 Jan 2019 to operate a unit as a synchronous condenser*, Final report, 17 July 2019.

<sup>67</sup> Uncertainty around how to apply clause 3.15.7A(a1) may be due to the wording of this clause. While the phrase "dispatch of plant" refers to the hypothetical test (i.e. if NEMDE had dispatched the plant in accordance with a hypothetical offer, would that have avoided the need for the direction?), it may be interpreted as referring to whether the plant actually generated as a result of the direction. The latter approach is not the intent of the provision.

percentile price = \$0 compensation). As a result, the directed participant would not be able to lodge a claim for additional compensation under clause 3.15.7B as it would not have been eligible for compensation under clause 3.15.7.

To address these issues, the draft rule amends clause 3.15.7A(a1) by:

- removing the need for AEMO to take into account hypothetical bids, offers and rebids in classifying a direction; and
- clarifying the classification of the direction based on the type of services required to comply with a direction for energy or market ancillary services.

This is similar to the approach suggested by ERM Power in its submission to the consultation paper.

In the draft rule, the current clause 3.15.7A(a1) has been deleted and replaced with new clauses 3.15.7(a1) and (a2), as detailed below.

#### **NER clause 3.15.7(a1) in the draft rule**

(a1) AEMO must compensate each Directed Participant for the provision of:

- (1) energy or market ancillary services pursuant to a direction, under this clause 3.15.7 and clause 3.15.7B, as the case may be; and
- (2) services, other than energy or market ancillary services, pursuant to a direction (a non-market service), in accordance with the fair payment compensation for those services determined under clause 3.15.7A.

#### **NER clause 3.15.7(a2) and (a3) in the draft rule**

(a2) For the purpose of paragraph (a1) a Directed Participant provides energy or market ancillary services if it was directed to provide one or more of the following services:

- (1) energy;
- (2) any one of the market ancillary services;
- (3) a service that is a direct substitute for energy or a market ancillary service; or
- (4) a service that was provided by the Directed Participant incidental to the provision of energy or market ancillary services.

(a3) For the avoidance of doubt, any component of a direction that satisfies paragraph (a2) is to be considered for compensation under this clause 3.15.7 and clause 3.15.7B, as the case may be. Any other component of the direction that does not satisfy paragraph (a2) is to be considered for compensation under clause 3.15.7A.

The effect of these new provisions is to make clear what services are to be considered energy and market ancillary services, and that such services are to be compensated under clause 3.15.7 (and if necessary clause 3.15.7B). All other services provided in response to a direction are to be compensated under clause 3.15.7A.

Similar to the wording of the regional reference test in clause 3.9.3(b)(2), new clause 3.15.7(a2)(3) refers to "a service that is a direct substitute for energy or a market ancillary service". This would cover the situation where, for example, a generator is directed to reduce its output in order to address a shortage of contingency FCAS. A situation such as this was the subject of an independent expert report in which Synergies Economic Consulting concluded that a South Australian power station had, by reducing its output in compliance with a direction, provided "a substitute for the provision of market ancillary services by normal means".<sup>68</sup>

New clause 3.15.7B(a2)(4) refers to "a service that was provided by the Directed Participant incidental to the provision of energy or market ancillary services". This has the effect that compensation will be determined under clause 3.15.7 if a directed participant generates energy in the course of complying with a direction issued for the purpose of (for example) obtaining fault current, voltage control or inertia. However, compensation will be determined under clause 3.15.7A if a generator is directed to operate in synchronous condenser mode in order to provide such services and hence does not generate energy.

Compared to the current NER, the draft rule classifies more clearly the type of service that was required in order for the directed participant to comply with the direction. It clarifies regulatory arrangements for participants, is easier for AEMO to administer, is not expected to change operational or investment incentives for participants and is flexible to cater for new system service markets that may be developed in future. This contributes to the assessment framework criteria of transparency and predictability and the achievement of the NEO. These benefits are explained further below.

- New clauses 3.15.7(a1) and (a2) are clearer in classifying the type of service that was required to be provided in order for the directed participant to comply with the direction, which determines the relevant compensation framework. This clarifies regulatory arrangements for directed participants.
- The new provisions are easier for AEMO to apply as AEMO would not need to consider a wide range of potential alternative hypothetical bids, offers and rebids that could have been made by the directed participant.
- The new provisions are not expected to change operational or investment incentives for participants as when directions will occur is generally not known in advance and the draft rule change relates only to classifying the type of service provided under a direction.
- There would always be an amount of energy or market ancillary service provided as a result of complying with a direction for energy or market ancillary services, to which the 90<sup>th</sup> percentile price could be applied under clause 3.15.7.
- The rules are flexible to cater for potential future market mechanisms for essential system services, such as inertia or voltage control, that are currently being considered by the Energy Security Board (ESB) and the system service rules being considered by the AEMC.

<sup>68</sup> Synergies Economic Consulting, *Final Report on additional compensation claims arising from AEMO directions on 1 December 2016*, August 2017, p. 13.

## 4.2 Determining when a directed participant is eligible for compensation

This section summarises current arrangements, stakeholder views and the Commission's analysis and conclusion on the determination of whether a directed participant is eligible for compensation following a direction.

### 4.2.1 Current arrangements

Under the current arrangements, if a direction is for energy and market ancillary services, the directed participant is eligible for compensation in 3.15.7 (and can make an additional claim in 3.15.7B).<sup>69</sup> If the direction is a direction for non-market services, the directed participant must have also been required to provide a service in order to comply with the direction to be eligible for compensation (hereafter referred to as a compensable service in this draft determination). This is because clause 3.15.7A(a) states that AEMO must compensate each directed participant *for the provision of services* pursuant to a direction other than energy and market ancillary services, at the fair payment price of the services determined in accordance with clause 3.15.7A.

Several independent expert reports that have been prepared for AEMO on the payment of compensation under clause 3.15.7A have considered in detail the question of whether or not a "service" was provided in the course of complying with a direction. For example, in the above example relating to contingency FCAS, the independent expert found that a service had been provided (being a substitute for the provision of FCAS by normal means). In other cases, the same independent expert found that no service had been provided - for example, in the case of directions to a power station in Victoria.<sup>70</sup> Given that no "service" had been provided, no compensation was found to be payable.

More recently, AEMO has itself made the determination as to whether a compensable service was provided rather than engaging an independent expert to do so. Under the current rules, there is no requirement for AEMO to notify the directed participant of its decision. If AEMO determines that no compensable service was provided by the directed participant, the directed participant is not eligible for compensation under either clause 3.15.7A or 3.15.7B.

Currently clause 3.15.7B(a) provides that a directed participant can only lodge a claim for additional compensation if it was eligible for compensation under clause 3.15.7 or 7A. Further, clause 3.15.7B(a)(1) refers to compensation for loss of revenue and additional net direct costs incurred by the directed participant "as a result of the provision of the services under direction". Again, if no service was provided, no additional compensation can be claimed or paid.

In the consultation paper, stakeholders were asked if the current test for whether or not a compensable service was required to be provided was clear and whether AEMO should be required to notify the directed participant of its decision regarding whether a compensable

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<sup>69</sup> NER clause 3.15.7A(a)

<sup>70</sup> Synergies consulting, *Final report on additional compensation claims arising from AEMO directions on 1 December 2016*, August 2017.

service was provided. This is relevant to this rule change request as it relates to the clarity and transparency of the process to determine whether a directed participant provided a compensable service.

#### 4.2.2

##### Stakeholder views

Stakeholders noted issues of transparency, consistency and predictability with the current arrangements.

- AGL and ERM considered that if a participant has incurred costs in complying with a direction it should be compensated,<sup>71</sup> even when no service had been required to be provided, consistent with the treatment of other directed participants in the NER.<sup>72</sup>
- AGL,<sup>73</sup> and Stanwell<sup>74</sup> suggested that AEMO should publish a determination and directed participants should be able to challenge AEMO's decision with the AER or through chapter 8 dispute resolution.

#### 4.2.3

##### Commission's analysis and draft determination

The draft rule amends the current arrangements in relation to compensable services. AEMO is required under the draft rule to determine whether the directed participant was required to provide a service in order to comply with a direction. The draft rule also adds a requirement for AEMO to notify the directed participant of its determination of whether or not a compensable service was provided.

##### Amending eligibility criteria to claim compensation

The Commission notes that currently if a compensable service has not been provided by the directed participant, that participants may be left out of pocket if it has incurred costs as a result of complying with a direction. There have been recent directions for non-market services (i.e. Mortlake power station in December 2016) where it was determined that the directed participant did not provide a service that could be compensated under clause 3.15.7A. In such cases, if the directed participant is not entitled to compensation under either clause 3.15.7 or clause 3.15.7A, it cannot seek additional compensation under clause 3.15.7B.<sup>75</sup>

Stakeholders considered that, while a directed participant may not provide a compensable service when complying with a direction, it may incur costs in complying with that direction for which it should be compensated.<sup>76</sup> The potential for such a situation to arise was also recognised by an independent expert in its fair payment price determination relating to Pelican Point.<sup>77</sup> While it found in its report that no service had been provided and hence no

<sup>71</sup> ERM Power submission, p. 2.

<sup>72</sup> AGL submission, p. 3.

<sup>73</sup> AGL submission, p. 2.

<sup>74</sup> Stanwell submission, p. 4.

<sup>75</sup> NER clause 3.15.7B(a).

<sup>76</sup> AGL submission, p. 3; and ERM Power, p. 2.

<sup>77</sup> Synergies Economic Consulting, *Final report on compensation related to directions that occurred on 1 December 2016*, June 2017, p. 22.

compensation was payable, it stated: "We are mindful that generators can incur costs as a result of reducing output or, particularly, shutting down. Most markets provide a mechanism whereby generators that are compelled to change their operations can recover the costs of doing so if market revenues are insufficient."<sup>78</sup>

The Commission notes that a key purpose of compensation is that the directed participant is not left out of pocket. If, for example, AEMO needed a generator to desynchronise quickly in response to a direction, the generator may not provide a compensable service, but may incur direct costs through additional or accelerated maintenance costs. In such cases it may be reasonable for the directed participant to be compensated for its direct costs.

The draft rule amends the current arrangements in terms of when a directed participant that has complied with a direction for non-market services is eligible for compensation as outlined below. If AEMO determines that the directed participant did not provide a compensable service, the directed participant is not entitled to FPC under clause 3.15.7A, or to make a claim under clause 3.15.7B. However, it can make a claim for compensation if it incurred direct costs as a result of complying with the direction (if those costs are above a minimum threshold of \$5,000).

Therefore, in the draft rule, a directed participant that has complied with a direction for non-market services, is eligible to claim

- FPC under clause 3.15.7A if AEMO determines that it was required to provide a service in complying with the direction (FPC includes any loss of revenue and direct costs incurred), or
- its direct costs (if any, and they are more than \$5000) if AEMO determines that it was not required to provide a service in order to comply with the direction.

The Commission considered this to be an appropriate allocation of risk, therefore contributing to the assessment framework principle and the achievement of the NEO.

### **Adding requirement for AEMO to notify the directed participant on whether compensable service was provided**

Currently, when AEMO determines whether a compensable service was provided, there is no requirement for AEMO to notify the directed participant of the outcome, or the reasons for its determination. There is a lack of transparency over how AEMO determines whether or not a compensable service has been provided. In addition, if AEMO determines that a directed participant did not provide a compensable service, the directed participant is unable to challenge that determination.

To address these issues, the draft rule introduces the following:

- A new obligation on AEMO to notify the directed participant in writing, and to provide its reasons for its determination on whether or not a compensable service was provided.<sup>79</sup>

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<sup>78</sup> Synergies Economic Consulting, *Final report on compensation related to directions that occurred on 1 December 2016*, June 2017, p. 22.

<sup>79</sup> Draft rule, NER clause 3.15.7A(b).

- An ability for directed participants to make a submission to AEMO setting out the directed participant's reasons for why it considers that a compensable service was provided. AEMO must then make a final determination on whether a compensable service was provided.<sup>80</sup>

This contributes to the assessment framework principle of transparency and predictability and the achievement of the NEO.

Further information on these amendments is detailed in chapter 6 of this draft rule determination.

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<sup>80</sup> Draft rule, NER clause 3.15.7A(c).



## 5 FRAMEWORK FOR DETERMINING COMPENSATION AMOUNT FOR DIRECTIONS FOR NON-MARKET SERVICES

This chapter describes the following aspects of the Commission's draft determination:

- The process to determine compensation is streamlined by moving from a two-step process to a one-step process.
- The factors to be taken into account when AEMO or the independent expert determine FPC are simplified by removing the need to consider other and overseas markets and principles around market prices.
- AEMO is provided with discretion to determine FPC or direct cost claims when the compensation amount is less than \$20,000 and AEMO considers that the claim is not unreasonable and does not involve issues of complexity or difficulty. In all other circumstances the independent expert must determine compensation.
- The process of applying of the FPP for the same service directed within the next 12 calendar months is removed and replaced with the determination of compensation on a case by case basis.
- No minimum compensation threshold is applied if the directed participant provided a compensable service. A minimum claim threshold of \$5,000 applies where the directed participant did not provide a compensable service but incurred direct costs.

### 5.1 Compensation process is streamlined to a one stage process

This section describes current arrangements, stakeholder views and the Commission's analysis and draft determination on whether to apply a one or two stage compensation process and the information used to determine compensation.

#### 5.1.1 Current arrangements

There is currently a two stage process to determine compensation following other services directions (re-named as non-market services in this draft determination), as outlined below.

##### **Step 1 — Determine fair payment price (FPP)**

Under clause 3.15.7A, AEMO must appoint an independent expert to determine the FPP compensation, taking into account:<sup>81</sup>

(i) other relevant pricing methodologies in Australia and overseas, including but not limited to:

- other electricity markets;
- other markets in which the relevant service may be utilised; and
- relevant contractual arrangements which specify a price for the relevant service; and

<sup>81</sup> NER clause 3.15.7A(c)(1)

(ii) the following principles:

- disregard the disinclination of the provider to provide the services and the urgency with which the services were needed;
- treat the directed participant as willing to supply at the market price that would be expected to prevail for the service under similar supply and demand conditions; and
- deem the FPP to be that which would prevail in a market for the service under similar supply and demand conditions.

The independent expert must publish a draft report that sets out its draft determination of the FPP, the methodology and assumptions used to determine the FPP and request submissions from interested parties.<sup>82</sup> The independent expert must then publish a final report that sets out the final determination of the FPP.<sup>83</sup>

## **Step 2 — Claim for additional compensation**

If a directed participant considers that, after the determination of the FPP in clause 3.15.7A, it is still out of pocket as a result of the provision of the directed service, it may make a claim for additional compensation under clause 3.15.7B. In this case, clause 3.15.7B(a) confines compensation to:

- the aggregate of the loss of revenue and additional net direct costs incurred by the directed participant in respect of a scheduled generating unit, semi-scheduled generating unit or scheduled network services, as the case may be, as a result of the provision of the service under direction; less
- the amount notified to that directed participant pursuant to clause 3.15.7(e)<sup>84</sup> or clause 3.15.7A(f)<sup>85</sup>; less
- the aggregate amount the directed participant is entitled to receive in accordance with clause 3.15.6(c)<sup>86</sup> for the provision of a service rendered as a result of the direction.

In its rule change request, AEMO considered that the two-step process is not necessary for directed participants to recover their costs and delays the finalisation of compensation, creating a risk that the routine revision settlement process is not completed within approximately 30 weeks of the direction.<sup>87</sup> AEMO's proposal in its rule change request is that the two-step compensation framework for non-market services directions is replaced with a single step process.<sup>88</sup>

The current two step compensation may involve up to four compensation determinations:

<sup>82</sup> NER clause 3.15.7A(c)(2)

<sup>83</sup> NER clause 3.15.7A(c)(3)

<sup>84</sup> Cl. 3.15.7(e) — AEMO must, in accordance with the intervention settlement timetable, advise each directed participant in writing of the amount the directed participant is entitled to receive pursuant to clause 3.15.7(c) or clause 3.15.7(d).

<sup>85</sup> Cl. 3.15.7A(f) — Within 1 business day of calculating the compensation payable pursuant to clause 3.15.7A(a) by application of clause 3.15.7A(e) or pursuant to clause 3.15.7A(d), AEMO must advise the relevant directed participant in writing of the amount of compensation.

<sup>86</sup> Cl. 3.15.6(c) — A directed participant is entitled to the trading interval amount resulting from any service, other than the service the subject of the AEMO intervention event, rendered as a consequence of that event.

<sup>87</sup> This is a reasonable endeavours obligation on AEMO. NER clause 3.12.1(a)(2)

<sup>88</sup> AEMO, rule change request, p. 3.

- draft determination of the FPP
- final determination of the FPP
- draft determination of the additional claim (if required)
- final determination of the additional claim (if required).

### 5.1.2

#### Stakeholder views

##### One or two stage process to determine compensation

Stakeholders had mixed views on whether to retain two separate compensation processes or move to a one step process.

- PIAC,<sup>89</sup> Stanwell and Tesla supported a streamlined process, providing the directed participant has the opportunity to engage prior to the final determination<sup>90</sup> and challenge the decision.<sup>91</sup>
- ERM Power considered that the FPP is meant to provide a "fair price" and is not about the costs of providing the service (which is the basis for additional claims).<sup>92</sup>
- CS Energy and Snowy Hydro wanted to retain two separate processes, to avoid conflating the determination of fair payment with backstop costs so the participant is not out of pocket.<sup>93</sup>
- Snowy Hydro considered that compensation based on direct costs moves towards short-run marginal cost (SRMC) pricing and would result in less generation investment.<sup>94</sup>

##### Factors to be taken into account to determine compensation

Stakeholders had mixed views on the relevance of pricing methodologies in other and overseas markets to determine FPP.

- CS Energy and PIAC considered that the comparison to other electricity markets<sup>95</sup> and alternative pricing methodologies had not been useful and should be removed<sup>96</sup>
- AGL noted that experience in other markets may not always translate well to the NEM, however the energy market transition shows that unusual or unprecedented events may occur, for which there is no reference point in the NEM. Therefore, experience from another jurisdiction may be valuable.<sup>97</sup>
- AGL considered that direct costs and loss of revenue must continue to be assessed on a case by case basis.<sup>98</sup>

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89 PIAC submission, p. 1.

90 Tesla submission, p. 2.

91 Stanwell submission, p. 1.

92 ERM Power, p. 1.

93 ERM Power, p. 2; and Snowy Hydro, p. 1.

94 Snowy Hydro submission, p. 2.

95 CS Energy submission, p. 5.

96 PIAC submission, p. 2.

97 AGL submission, p. 3.

98 AGL submission, p. 4.

- Origin considered that a direction to a generator or battery to cease exports should include opportunity costs<sup>99</sup>.
- NEOEN suggested that compensation should include the 'value' of the service, contract position losses and long term cost of capital.<sup>100</sup>

### 5.1.3

#### Commission's analysis and draft determination

The Commission's draft rule combines the two step compensation process into a single step process and amends the factors to be taken into account by AEMO or the independent expert in determining compensation. This is consistent with the one step process proposed by AEMO in its rule change proposal, with some amendments.

The Commission analysed and compared the following three policy options:

- Option 1 - Current two-step compensation process
- Option 2 - Proponent's one-step compensation process
- Option 3 - Alternative one-step compensation process

The Commission's comparison of these three policy options is described below and summarised in the table 5.2.

#### Option 1 - Current two-step compensation process

There are issues with the administrative efficiency of the current two-step compensation process and the factors to be taken into account in determining compensation, as discussed below.

##### *Administrative efficiency*

The current two-step compensation process is not administratively efficient in terms of time or cost.

- Administrative cost - up to four compensation determinations may and have been required to finalise compensation, with the costs of paying the independent expert for up to four determination reports flowing through to consumers. The Commission considers that this is not efficient where the amount of compensation is small (see section 5.2 for more information on the entity that determines compensation).
- Administrative time - there is a risk that the two-step compensation process is not finalised within the 30 week timeframe for intervention settlement routine revisions. Table 5.1 below shows that, of the directions for other services between 2016 and 2020, the two directions that involved all four compensation stages (for Pelican Point and Mortlake), took approximately 36 weeks to complete. This is longer than the 30 week timeframe and it would be difficult for AEMO to finalise compensation within 30 weeks if the two-step process was retained. The Commission notes that, for recent directions for other services to batteries in February 2020, AEMO obtained approval from the AER to run the FPP and additional claim processes in parallel.<sup>101</sup>

<sup>99</sup> Origin submission, p. 1.

<sup>100</sup> NEOEN submission, pp. 1-2.

<sup>101</sup> IES, *AEMO directions for participants in South Australia on 2 and 4 February 2020*, Final determination, 19 August 2020.

**Table 5.1: Time taken to finalise compensation following directions for other services, 2016 to 2020**

DATE	DP	FPP	ADDITIONAL CLAIM LODGED	APPROXIMATE TIME TO FINALISE COMPENSATION
1 December 2016	Pelican Point	Yes	Yes	Approx. 36 weeks two stages (four determinations).
	Mortlake	Yes	Yes	
24 Jan 2019	Tumut 3	Yes	No	Approx. 24 weeks for one stage (two determinations).
16 Nov 2019	Canunda	Yes	No	Approx. 16 weeks for one stage (two determinations).
2 and 4 Feb 2020	Multiple directions to batteries in South Australia	Yes (AEMO obtained approval from the AER to run FPP and additional claims in parallel).		Approx. 24 weeks for one stage.

Source: AEMC, based on independent expert reports.

### *Pricing methodologies to determine FPP compensation*

Currently, in determining the FPP, the independent expert must consider pricing methodologies in other and overseas markets. This provides the independent expert with flexibility, however it adds complexity, administrative burden and has the potential to create perverse outcomes. The draft rule removes other and overseas pricing methodologies from the factors to be taken into account in determining compensation.

On the one hand, AGL submitted that experience in other markets may be valuable given that the NEM is undergoing a significant transition and unprecedented events may arise.<sup>102</sup>

On the other hand, having regard for international pricing approaches adds administrative burden and cost and in no case has regard for international pricing approaches been determinative of the amount of compensation paid to directed participants under clause 3.15.7A. In addition, in two FPP determinations, the independent expert expressed concern that applying compensation approaches from other markets may not be appropriate where other measures designed to minimise the extent of compensation are not in place. The independent expert concluded that applying approaches from other markets "could widen the scope for generator gaming in ways that are difficult to predict".<sup>103</sup>

<sup>102</sup> AGL submission, p. 3.

<sup>103</sup> Synergies, *Final report on compensation relating to directions that occurred on 1 December 2016*, June 2017, p. 18, and Synergies, *Independent Expert Report - Compensation for directions 16 November 2019*, Final report, 3 March 2020, p. 18.

In each of the independent expert reports published to date where compensation has been paid, the amount of FPP compensation has been determined by reference primarily to the costs and revenue losses incurred by the directed participant, having regard for the circumstances at the time - not based on approaches in other markets.<sup>104</sup> In addition, some independent expert reports have concluded, following an examination of international pricing approaches, that a key principle in other markets is to ensure that a directed participant can recover its costs.<sup>105</sup>

The Commission does not consider that applying pricing approaches adopted in other markets to the NEM is appropriate. This is because the approach that is used in the NEM needs to be appropriate to, and accommodate, the regulatory framework in the NEM. Applying an approach from overseas jurisdictions risks creating unintended consequences.

In addition, given the proposal to remove access to additional compensation claims under clause 3.15.7B, a key consideration in designing the new one-step framework is to ensure that directed participants are not out of pocket, having regard for the costs incurred in a particular instance. This is a more important consideration than the pricing approaches adopted in other markets. It also aligns with the original intention behind the inclusion of the compensation framework in the National Electricity Code (the predecessor of the NER): namely, that directed participants should receive a "fair payment" that would cover the cost incurred by the participant in complying with the direction while avoiding perverse incentives and minimising inequitable impacts on other market participants.<sup>106</sup>

#### *Principles for determining FPP compensation*

Currently, in determining FPP compensation, the entity that determines compensation needs to consider pricing methodologies (discussed above) and the following two principles (among others):

- the directed participant is to be treated as willing to supply at the market price that would otherwise prevail for the directed services the subject of the direction in similar demand and supply conditions; and
- the FPP is the market price for the directed services the subject of the direction that would otherwise prevail in similar demand and supply conditions.

The Commission notes that these principles have not been relevant to the calculation of FPP compensation in past independent expert reports and the draft rule removes these provisions. The focus of clause 3.15.7A in the draft rule is on the amount of compensation required for 'fair payment' to make the directed participant 'whole' (based on direct costs, loss of revenue and relevant contractual arrangements), as opposed to the market price for

<sup>104</sup> For example, the independent expert reports concerning the 1 December 2016 direction to Pelican Point and the February 2020 directions to South Australian batteries calculated compensation based on the loss of revenue incurred by the participant (in the case of Pelican Point) and, for the SA batteries, the costs and loss of revenue incurred by the batteries. In both cases, loss of revenue was calculated by comparing actual output/consumption with what would have occurred but for the intervention event, based on intervention pricing run dispatch targets. Pricing approaches in other markets had no material impact on the final outcome.

<sup>105</sup> For example, in the IES report concerning the direction issued on 24 January 2019, the report noted that "PJM rules compensate directed participants based on the additional net direct cost while CAISO rules do not compensate the directed participant": *ibid*, p. 8. The conclusion in that report aligned with the approach in PJM.

<sup>106</sup> NEMMCO and NECA, Final Report – Power system directions in the National Electricity Market, 2000, pp. i, 6 and 29.

the directed service (which is theoretical given the current absence of dynamic markets for 'other' services).

### **Option 2 - The proponent's proposed one step compensation process**

As noted above, the Commission considers that the current two-step process to finalise compensation is administratively inefficient. While the Commission supports the general intent of the rule change proposal for a one-step process (Option 2), the following issues were identified with the rule change proposal, which are addressed in the more preferable one-step process (Option 3).

- There is a risk that a directed participant could be left out of pocket, counter to the purpose of the compensation framework. While the proponent suggests that its proposed rule would allow a participant directed for non-market services to recover its costs, and the independent expert should receive the directed participant's cost and loss information in a new single step compensation process,<sup>107</sup> the Commission notes that the rule change request does not propose any amendments to clause 3.15.7A to allow for this. The rule change request retains the current pricing methodologies for determining the FPP in clause 3.15.7A,<sup>108</sup> and does not allow for the recovery of direct costs or loss of revenue that are currently included in the additional claim process in clause 3.15.7B.
- There is a lack of transparency over how AEMO determines whether a compensable service was provided by a directed participant, as explained in Table 5.2.
- There is a risk that a directed participant could be over-compensated or under-compensated as the rule change proposal did not change the current application of the FPP for the same service for the ensuing 12 month period, as explained in section 5.3.

### **Option 3 - Alternative one-step compensation process**

The Commission's more preferable draft rule is an alternative one-step process for determining compensation that addresses the issues identified with the current arrangements (Option 1) and the rule change proposal (Option 2). Table 5.2 below explains the differences between the three policy options and provides the Commission's assessment of each policy option.

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<sup>107</sup> AEMO, rule change request, p. 3.

<sup>108</sup> Ibid, p. 5.

**Table 5.2:** Comparison of current two-step process, the proponent's one-step process and alternative one-step process

	<b>OPTION 1 - CURRENT TWO STEP PROCESS</b>	<b>OPTION 2 - PROPOSED ONE STEP PROCESS</b>	<b>OPTION 3 - MORE PREFERABLE ONE STEP PROCESS</b>
<b>Characteristics of policy option</b>			
<b>Determining whether compensable service provided</b>	Compensation is provided where the direction for services other than energy and market ancillary services are determined in accordance with clause 3.15.7A(a1). No AEMO reporting requirement on whether this test is met.		Includes additional criteria to Options 1 and 2.  Adds the need for AEMO to notify the DP of its determination and the reasons for its determination and adds the ability for the DP to challenge AEMO's determination.
<b>Steps to determine compensation</b>	Step 1 - Compensation based on FPP.  Step 2 - If the DP is still out of pocket after the FPP, it can make an additional claim.	One step process where compensation based on FPP.  Given only one step, no ability to make an additional claim.	One step process where compensation based on FPC.  Given only one step, no ability to make an additional claim.
<b>Information used to determine amount of compensation</b>	Other relevant pricing methodologies in Australia and overseas, relevant contractual arrangements and principles around market prices for FPP.  Net direct costs and loss of revenue for additional claim.	Other relevant pricing methodologies in Australia and overseas, relevant contractual arrangements, and principles around market prices for FPP.  Given only one step, there is no ability to take into	Removes need to take into account other relevant pricing methodologies in Australia and overseas and principles around market prices.  FPC based on net direct costs, loss of revenue and relevant contractual



	OPTION 1 - CURRENT TWO STEP PROCESS	OPTION 2 - PROPOSED ONE STEP PROCESS	OPTION 3 - MORE PREFERABLE ONE STEP PROCESS
		account net direct costs or loss of revenue.	arrangements.
Entity that determines compensation	Independent expert determines FPP.  AEMO or independent expert determine additional claim.	Independent expert determines FPP.	AEMO or independent expert determine FPP.
Minimum compensation threshold	No minimum for FPP.  \$5000 minimum for additional claims.	No minimum for FPP.	No minimum for FPC.  \$5000 minimum if no compensable service provided.
FPP applies for same service for next 12 months	Yes		No
Assessment framework against the NEO			
Transparency and predictability	Limited transparency as no requirement for AEMO to notify DP when AEMO decides whether a compensable service was provided. Current cl. 3.15.7A(a1) to classify type of direction is unclear and complex for AEMO to administer.		Improves transparency and provides clear and predictable arrangements, thereby reducing uncertainty for DPs.
Administrative efficiency	Administrative time and costs are relatively high considering materiality of compensation for other services directions.	Lower administrative time and cost compared to current arrangements.	Lower administrative time and cost compared to current arrangements.
Risk allocation	DP able to be made 'whole' and best placed to manage risk.	Risk that DP left out of pocket as can't recover direct cost or loss or revenue and no additional	Allocates risk to those parties best able to manage them. DP able to be made 'whole'.

	<b>OPTION 1 - CURRENT TWO STEP PROCESS</b>	<b>OPTION 2 - PROPOSED ONE STEP PROCESS</b>	<b>OPTION 3 - MORE PREFERABLE ONE STEP PROCESS</b>
		claim.	

Source: [AEMC](#)

The Commission considers that the alternative one-step process is more preferable than the current two-step process as it reduces the administrative burden. It reduces the maximum number of compensation determinations from four determinations to two, improving timeliness and AEMO's ability to meet the 30 week settlement routine revision statement under clause 3.12.1(a)(2). It also reduces the maximum number of reports that need to be developed by an independent expert from four reports to two, reducing the costs of which flow through to consumers.

The alternative one-step process is more preferable than the current arrangements and rule change proposal for the following reasons:

- It improves transparency and predictability by adding an obligation on AEMO to notify the directed participant when it determines whether a compensable service was provided, as explained in section 4.2.
- It adds the ability for the directed participant to make a submission in response to AEMO's decision that the directed participant did not provide a compensable service, as explained in section 4.2.
- The risk that a directed participant is over-compensated or under-compensated has been reduced as the application of the FPP for the same service for the ensuing 12 month period has been deleted, as explained in section 5.3.

In addition, the alternative one-step process is more preferable than the rule change proposal as it provides that a directed participant is not left out of pocket. In the alternative one-step process, the factors to be taken into account in determining the FPC include net direct costs and loss of revenue, which are not included in the proponent's one-step process.

In response to stakeholder comments, the Commission notes the following in relation to the alternative one-step process in the draft rule.

- It is flexible and provides the opportunity for the directed participant to engage at the start of the compensation process by providing a claim. In the case where a directed participant, that provided a compensable service, has a claim that is likely to be small, the directed participant has the option of not submitting a claim, in which case after 15 business days AEMO will have discretion to determine the amount of compensation. This recognises the point raised by stakeholders regarding the administrative cost of developing a claim for the directed participant, which could be comparable with the amount of compensation for smaller claims.
- It provides the opportunity for the directed participant to make a submission in response to the FPC draft determination, to the entity that determines compensation (AEMO or the independent expert, as explained in section 5.2).

- The fact that compensation is based on direct costs (among other factors) is not expected to change incentives to invest in generation. Under both the current arrangements and the draft rule, the purpose of compensation is to make the directed participant 'whole' and in both cases direct costs incurred in complying with the direction can be taken into account if the directed participant is eligible to receive compensation.
- The Commission considers that it is not appropriate for directions compensation frameworks to compensate participants for the "value" of a directed service, as this could provide perverse incentives for generators to withhold capacity to try to be directed.

The Commission considers that the alternative one step process better contributes to the NEO than the rule change proposal, because it improves transparency and risk allocation.

## 5.2 Entity that determines compensation

This section summarises current arrangements, stakeholder views and the Commission's analysis and draft determination on the entity that determines compensation.

### 5.2.1 Current arrangements

Under current clause 3.15.7A, if AEMO determines that a direction is a direction for other services and a compensable service has been provided, it must appoint an independent expert to determine the FPP.<sup>109</sup> Under current clause 3.15.7B, if a claim for additional compensation is equal to or greater than \$20,000 and the additional intervention claim that includes the claim is equal to or greater than \$100,000, AEMO must refer the claim to an independent expert.<sup>110</sup> Claims that do not exceed these thresholds are processed in house by AEMO. The cost of engaging an independent expert flows through to customers and therefore relates to the issue of administrative efficiency in the rule change request.

The consultation paper noted that, if additional compensation claims were removed and the information that needed to be taken into account to determine compensation was simplified to remove the need to consider other Australian and overseas markets,<sup>111</sup> and instead only take into account direct costs and loss of revenue,<sup>112</sup> the determination of compensation would be easier. The consultation paper asked stakeholders whether, in these circumstances, AEMO could be provided with the option, but not the obligation, to determine compensation.

### 5.2.2 Stakeholder views

Stakeholders had mixed views about AEMO replacing the independent expert as the entity that determines compensation.

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<sup>109</sup> NER clause 3.15.7A(b1)

<sup>110</sup> NER clause 3.15.7B(c)(2)

<sup>111</sup> AEMC, *National Electricity Amendment (Compensation following directions for services other than energy and market ancillary services)*, Consultation paper, 11 June 2020, p. 32

<sup>112</sup> This draft rule determination also requires the entity that determines compensation to take into account relevant contractual arrangements.

- PIAC<sup>113</sup> supported compensation being determined by AEMO, as it could reduce costs compared to the independent expert performing this role. PIAC and Stanwell<sup>114</sup> supported AEMO determining compensation, provided it was subject to the same level of transparency as the independent expert. Stanwell's support was contingent on whether an appeal mechanism was available for directed participants under a new single step compensation process.<sup>115</sup>
- AGL were concerned about the transparency and independence of AEMO determining compensation. As there is no dynamic market price for other services, it suggested that an independent expert was better placed to determine the value provided by those services to the market.<sup>116</sup>
- ERM Power did not support AEMO determining compensation as directed participants would need to provide cost based information to AEMO to determine compensation for services that in future may be subject to tenders for NSCAS or SRAS. ERM Power's view was that, at the moment, this cost information is only provided to the independent expert on a confidential basis.<sup>117</sup>

### 5.2.3

#### Commission's analysis and draft determination

The Commission's draft rule provides AEMO with discretion to determine compensation in circumstances where the compensation amount is under \$20,000 and AEMO considers that the claim is not unreasonable and does not involve issues of complexity or difficulty. In all other circumstances, compensation is to be determined by an independent expert. The new arrangements are administratively efficient, transparent, provide increased opportunities for directed participant input, and reflect similar compensation arrangements in the current NER.

In its draft rule, the Commission has simplified the factors to be taken into account in determining compensation, as explained in section 5.1. This includes removing the need for the entity that determines compensation to take into account methodologies in other Australian markets or overseas markets and reducing the number of principles that need to be considered.<sup>118</sup> In the draft rule, compensation is to be determined through a single step process, based only on loss of revenue, direct costs and relevant contractual arrangements. This is similar to the information used to determine compensation in the current additional claim process in clause 3.15.7B.<sup>119</sup> AEMO currently has the ability to determine additional compensation claims under clause 3.15.7B.

Given the above, the Commission considers that it would be more preferable to provide AEMO with discretion to determine compensation in limited circumstances. These circumstances are where all of the following conditions apply:

- the amount of compensation is less than \$20,000, and

<sup>113</sup> PIAC submission, p. 2.

<sup>114</sup> PIAC, submission, p. 2.; Stanwell, submission, p. 6.

<sup>115</sup> Stanwell submission, p. 6.

<sup>116</sup> AGL submission, p. 3.

<sup>117</sup> ERM Power, p. 5.

<sup>118</sup> The draft rule removes NER clause 3.15.7A(c)(1)(ii)(C) and (D).

<sup>119</sup> The exception to this is relevant contractual arrangements, which are not specifically included in current clause 3.15.7B.

- AEMO considers that the compensation claim is not unreasonable, and
- AEMO considers that the compensation claim does not involve issues of complexity or difficulty.

This means that AEMO must refer to the IE the determination of compensation where any of the following apply:

- the amount of compensation is greater than \$20,000, or
- AEMO considers that the compensation claim is unreasonable, or
- AEMO considers that the compensation claim involves issues of complexity or difficulty.

The draft rule provides AEMO with this discretion as it is administratively efficient, transparent, challengeable, and is similar to other current arrangements in the NER. This contributes to meeting the assessment framework principles and the NEO.

The draft rule has a number of benefits. It is expected that the administrative cost to determine compensation would be lower for AEMO, compared to paying an independent expert. This is especially the case where the amount of compensation is relatively small (less than \$20,000), which was the case for a number of directions for other services between 2016 and 2020.<sup>120</sup> It is transparent as the draft rule requires that the entity that determines compensation for other services directions (AEMO or the independent expert as the case may be) is required to publish its draft and final determinations of the FPC.

The draft rule process provides increased opportunity for directed participant input as the directed participant is able to submit a claim at the outset and, if the directed participant does not agree with the FPC draft determination, it can make a submission in response to the FPC draft determination.

The draft rule arrangements are similar to current compensation arrangements in the NER for additional compensation claims. The \$20,000 threshold is reflected in the current NER clause 3.15.7B(c)(1). This clause allows AEMO to refer a claim to an independent expert if the claim is equal to or greater than \$20,000 and the "additional intervention claim" is equal to or greater than \$100,000.<sup>121</sup> In its draft rule the Commission has applied a \$20,000 threshold so AEMO has discretion to assess claims under \$20,000, if they are also not unreasonable or complex. Given the relatively small compensation amounts (less than \$20,000) paid for a number of directions for other services between 2016 and 2020, the Commission considered that the \$20,000 threshold was appropriate. The draft rule does not apply the \$100,000 criteria that is currently also applied where there are multiple additional claims relating to the one intervention event in clause 3.15.7B(c)(1). The criteria relating to the reasonableness of the claim is reflected in the current NER. Clause 3.15.7B(d) allows AEMO to determine compensation where AEMO considers that the claim is not unreasonable and requires AEMO to refer the matter to an independent expert where AEMO considers that the claim is unreasonable.

<sup>120</sup> For example, compensation was less than \$20,000 for directions to Tumut 3, unit 2 on 24 January 2019 and directions to South Australian batteries on 2 and 4 February 2020.

<sup>121</sup> The "additional intervention claim" is defined in clause 3.12.2(k) of the NER as the total of the additional compensation claims lodged by affected participants and directed participants in respect of an AEMO intervention event or series of related AEMO intervention events.

The Commission notes stakeholder concern about providing cost based information to AEMO for services that in future may be subject to requests for tenders for NSCAS or SRAS. However, the Commission notes that directed participants currently need to provide cost based information for additional claims in clause 3.15.7B for direct costs, which can currently be determined by AEMO in some circumstances.<sup>122</sup> Therefore, the draft rule preserves the ability of AEMO to process claims in-house but adopts a lower financial threshold of \$20,000 above which claims must be referred to an independent expert.

## 5.3 Application of fair payment price for same service for 12 months

This section summarises current arrangements, stakeholder views and the Commission's analysis and draft determination on whether the FPP should apply to all future occurrences where the same service is directed within the subsequent 12 month period.

### 5.3.1 Current arrangements

Under the current arrangements, a FPP determined for a service applies to all future occurrences where the same service is directed within the next 12 calendar months.<sup>123</sup> The Commission notes that, given the infrequent nature of directions for non-market services (as shown in table 5.1 above), this provision has never been triggered in practice. That is, no direction for a non-market service has been issued within 12 months of a previous direction for the same non-market service.

In the consultation paper the Commission asked stakeholders whether, if the NER were amended so that compensation for other services directions is determined in a single step process (as proposed in AEMO's rule change request) based on direct costs and loss of revenue,<sup>124</sup> this new framework could co-exist with a requirement for the same FPP to apply for the same service directed in the ensuing 12 months period.

### 5.3.2 Stakeholder views

Stakeholders considered that, if the two compensation processes for other services directions were combined into a single step process, the FPP should not apply to all future occurrences where the same service is directed within the next 12 calendar months:

- ERM Power consider that the FPP should be determined on an individual basis for each direction, as each generator has different sets of costs for providing these services.<sup>125</sup>
- AGL consider that the only way the 12 month application of the same FPP for the same service could apply is if it remains possible to separately calculate the FPP and direct costs/loss of revenue components in the determination of compensation.<sup>126</sup>

<sup>122</sup> Given the two-pronged nature of the financial threshold outlined above, AEMO can process additional compensation claims with a value of up to \$100,000 if there is only claim in respect of an AEMO intervention event.

<sup>123</sup> NER clause 3.15.7A(e)

<sup>124</sup> The draft rule amends the NER so that compensation is determined in a single step process based on direct costs, loss of revenue and relevant contractual arrangements.

<sup>125</sup> ERM submission, p. 3.

<sup>126</sup> AGL submission, p.4.

### 5.3.3 Commission's analysis and draft determination

The Commission's draft rule removes the application of the same FPC (currently known as the FPP) for the same service directed within the next 12 calendar months. In the draft rule the FPC would instead be determined on a case by case basis for each direction.

In response to the submission from AGL, the Commission notes that no FPP compensation determined to date under clause 3.15.7A has been in the form of a "price per unit of service provided" which could then be applied to subsequent directions to provide the same service. On the contrary, the compensation paid has been determined based on the costs incurred by the directed participant in the particular circumstances of the intervention event (e.g. having regard to the prevailing spot price, or changes in the dispatch targets of the particular participant). Such amounts do not lend themselves to repeat application to subsequent directions for the same service.

As outlined in section 5.1 of this draft determination, the draft rule amends the compensation framework from a two step process to a single step process, where compensation is determined based on direct costs, loss of revenue and relevant contractual arrangements. Under the new one-step process in the draft rule, if the same FPP applied for all future occurrences of the same service being directed in the ensuing 12 month period, the determination of the FPC (based on a directed participant's specific direct costs, loss of revenue or relevant contractual arrangement) may result in the following outcomes<sup>127</sup>:

- A directed participant could be under-compensated if they were directed for the same service in the ensuing 12 month period and had higher out of pocket costs due to their specific direct costs, loss of revenue and/or relevant contractual arrangements. As there is no additional claim process in the draft rule, the directed participant would not be made 'whole'.
- A directed participant could be over-compensated if they were directed for the same service in the ensuing 12 month period and had lower out of pocket costs due to their specific direct costs, loss of revenue and/or relevant contractual arrangements. This additional compensation cost would flow through to consumers.

To avoid these sub-optimal outcomes, the draft rule removes the application of the FPP for the same service for the ensuing 12 months, so that the FPP is always determined on a case by case basis. The Commission recognises that a case by case determination of the FPP would in theory increase administrative costs compared to current arrangements, however it is important to provide that a directed participant is not left out of pocket in the draft rule. This improves risk allocation and contributes to promoting the long-term interests of consumers.

## 5.4 Application of minimum claim thresholds

This section summarises current arrangements and the Commission's analysis and determination on the application of minimum compensation claim thresholds.

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<sup>127</sup> NER clause 3.15.7A(e)



#### 5.4.1 Current arrangements

Under current arrangements in the NER:

- no minimum compensation threshold applies to the initial calculation of directed participant compensation for energy or market ancillary services (90<sup>th</sup> percentile price) or other services (FPP)
- a \$5,000 minimum compensation threshold applies per intervention event to affected participant compensation payments, affected participant adjustment claims, and directed participant additional compensation claims.

The application of thresholds relates to the issue of administrative efficiency raised in the rule change request.

The rationale for the threshold is that, if the amount is less than \$5,000, this amount is immaterial and does not justify the costs of determining a compensation payment.<sup>128</sup>

In the consultation paper, the Commission did not specifically ask stakeholders about minimum claim thresholds and no stakeholders commented on them.

#### 5.4.2 Commission's analysis and draft determination

The draft rule is intended to provide that a directed participant is not out of pocket and that minimum thresholds are applied, where reasonable, to provide administrative efficiency. This meets the assessment framework criteria and contributes to the NEO.

Under the draft rule, no minimum compensation threshold applies if the directed participant provided a compensable service. This recognises that directed participants may be out of pocket by small amounts per direction and the potential exists for a specific participant to be directed on multiple occasions over time. If a compensation threshold were to be applied, this could leave a directed participant out of pocket by a material amount over time and this is not considered to be in the long term interest of consumers. For example, the recent directions for other services to batteries in February 2020 resulted in FPP compensation amounts of less than \$5,000.<sup>129</sup> This reflects the current arrangements for FPP in clause 3.15.7A, where no minimum claim threshold applies, noting that current clause 3.15.7A is not directly comparable with the amended clause 3.15.7A in the draft rule.

A minimum claim threshold of \$5,000 applies where the directed participant did not provide a compensable service but incurred direct costs. This reflects the current arrangements for additional claims in clause 3.15.7B where a minimum threshold of \$5,000 applies, which is equivalent with this scenario.

### 5.5 Minor and consequential amendments to the NER

In addition to the amendments to the NER set out in sections 3.4, chapter 4 and chapter 5 of this draft rule determination, the draft rule makes the following minor and consequential amendments to the NER. It:

<sup>128</sup> SW Advisory & Endgame Economics, *Review of Intervention Pricing - Final Report prepared for AEMO*, 4 October 2017, p. 51.

<sup>129</sup> IES, AEMO directions for participants in South Australia on 2 and 4 February 2020, Final determination, 19 August 2020.



- renames the category of directions for services other than energy and market ancillary services to be directions for non-market services
- clarifies the role of the independent expert in determining the FPP by adding references to clause 3.15.7A in clause 3.12.3
- makes minor drafting changes to clause 3.12.2 and 3.12.3
- makes consequential amendments to clause 3.15.7B to reflect that the entire process to determine the amount of compensation for non-market services directions is covered in clause 3.15.7A - references to the determination of compensation for non-market services directions have been deleted from clause 3.15.7B
- makes consequential amendments to clause 3.15.10C (Intervention and Market Suspension Pricing Schedule Period Settlements) to reflect updated clause references in clause 3.15.7A.

The draft rule also amends the definition of *Referred directed participant* in Chapter 10 by adding a reference to clause 3.15.7A. This reflects that a directed participant can have a claim referred to an independent expert under clause 3.15.7A for the determination of compensation for non-market services directions. The definition of *Referred directed participants* retains the reference to a claim being referred to an independent expert to determine additional compensation claims for directions for energy and market ancillary services.

## ABBREVIATIONS

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
COAG	Council of Australian Governments
Commission	See AEMC
ESB	Energy security board
FCAS	Frequency control ancillary services
FPC	Fair payment compensation
FPP	Fair payment price
IIFR	Interventions investigation final report
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National electricity objective
NSCAS	Network support and control ancillary service
RERT	Reliability and emergency reserve trader
RRN	Regional reference node
RRO	Retailer reliability obligation
SRAS	System restart ancillary services
UCS	Unit commitment for security
SRMC	Short-run marginal cost

## A SUMMARY OF OTHER ISSUES RAISED IN SUBMISSIONS

This appendix sets out the issues raised in the first round of consultation on this rule change request and the AEMC's response to each issue. If an issue raised in a submission has been discussed in the main body of this document, it has not been included in this table.

**Table A.1:** Summary of other issues raised in submissions

STAKEHOLDER	ISSUE	AEMC RESPONSE
CS Energy, p. 1 and Stanwell, p. 2.	Suggested that the AEMC focus resources on developing market mechanisms for 'other services' and integrate with ESB work on valuing essential system services, as opposed to administrative improvements.	The Commission notes the importance of this ESB work, that the AEMC, AEMO and the AER are contributing to as part of the ESB. The draft rule is consistent and coordinated with this work on valuing essential system services as it is flexible to incorporate potential future market mechanisms for these services.
Tesla, p. 2.	Suggested that amendments in this and other intervention rule changes being considered by the AEMC should align with the future direction of the market (i.e. ESB work program).	As above.
PIAC, pp. 1-2.	Suggested applying a beneficiary pays principle to allocate compensation costs to parties who benefit from it.	Compensation costs are recovered consistent with cost recovery for the original service. Where a direction is to obtain energy, compensation costs are borne by market customers and thus consumers, consistent with a beneficiary pays approach. Compensation costs associated with FCAS and other services directions are borne by the parties who pay for the original service (generators, small

STAKEHOLDER	ISSUE	AEMC RESPONSE
		generation aggregators and/or consumers) - consistent with both causer pays and beneficiary pays principles, depending on the nature of the service obtained.
CS Energy, p. 5.	Considered that the current level of confidentiality provided by the entity that determines compensation needs to be maintained. If there is a conflict of interest arising from the choice of an entity, then it should exclude that entity from being eligible for compensation.	The draft rule retains the requirement for an independent expert to enter into a confidentiality deed. AEMO is required under the NEL to keep confidential information provided to it in confidence.  The draft rule provides the directed participant with the ability to object to the independent expert that determines compensation: see clause 3.12.3(a1).
ERM, p. 3.	ERM does not agree with the Commission's view in the consultation paper that a direction to Tumut 3 to operate as a generating unit operating at 0 MW load could have been issued in place of a direction to operate as a synchronous condenser. In generating mode, the unit would need to operate at its minimum load to avoid rough running and would therefore have been classified as a direction for energy and FCAS.	To clarify, the Commission notes that this relates to the application of current clause 3.15.7A(a1), which takes into account whether it was possible for the directed participant to have made hypothetical alternative bids, offers or rebids that could have avoided the need for the direction. Had Tumut 3 made an offer to generate energy (above its minimum load) it would have produced voltage control as a by-product of generating energy, so avoiding the need for the direction to be issued. Applying clause 3.15.7A(a1) in this way would have resulted in the direction to Tumut 3 being

STAKEHOLDER	ISSUE	AEMC RESPONSE
		classified as a direction for energy or FCAS and so compensated under clause 3.15.7.
NEOEN, p. 1.	NEOEN suggested that constraints formulated to restrict market participation to acquire a service should be classified as a direction.	The access arrangements in the NEM mean that, while generators have a right to connect, they do not have a right to be dispatched. Accordingly, no compensation is payable for being constrained off as a result of a constraint, or for being constrained on out of merit order because of a network constraint.

## B LEGAL REQUIREMENTS UNDER THE NEL

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

### B.1 Draft rule determination

In accordance with s. 99 of the NEL the Commission has made this draft rule determination in relation to the rule proposed by AEMO.

The Commission's reasons for making this draft rule determination are set out in section 3.4 and Chapter 4 and 5 of this draft determination.

A copy of the more preferable draft rule is attached to and published with this draft rule determination. Its key features are described in section 3.1 of this draft determination.

### B.2 Power to make the rule

The Commission is satisfied that the more preferable draft rule falls within the subject matter about which the Commission may make rules. The more preferable draft rule falls within s. 34 of the NEL as it relates to:

- the operation of the NEM;
- the activities of persons (including Registered Participants) participating in the NEM.

### B.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NEL to make the rule
- the rule change request
- submissions received during first round consultation
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the NEO.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.<sup>130</sup>

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.<sup>131</sup> The more preferable draft rule is compatible with AEMO's declared network functions because it leaves those functions unchanged.

<sup>130</sup> Under s. 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 was formerly called the COAG Energy Council and is now the ministerial forum of Energy Ministers.

<sup>131</sup> Section 91(8) of the NEL.

## B.4 Civil penalties

The Commission cannot create new civil penalty provisions. However, it may recommend to the ministerial forum of Energy Ministers (formerly COAG Energy Council)<sup>132</sup> that new or existing provisions of the NER be classified as civil penalty provisions.

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

## B.5 Conduct provisions

The Commission cannot create new conduct provisions. However, it may recommend to the ministerial forum of Energy Ministers (formerly COAG Energy Council) that new or existing provisions of the NER be classified as conduct provisions.

The draft rule does not amend any rules that are currently classified as conduct provisions under the NEL or National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the ministerial forum of Energy Ministers (formerly COAG Energy Council) that any of the proposed amendments made by the draft rule be classified as conduct provisions.

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<sup>132</sup> On 29 May 2020, the Prime Minister announced the establishment of the National Federation Reform Council and the disbanding of COAG. New arrangements for the former COAG Energy Council will be finalised following the National Cabinet Review of COAG Councils and Ministerial Forums which is due to provide recommendations to National Cabinet by September 2020. The Prime Minister has advised that, while this change is being implemented, former Councils may continue meeting as a Ministerial Forum to progress critical and/or well developed work.

## C SUMMARY OF "OTHER SERVICES" DIRECTIONS BETWEEN 2016 AND 2020

Table C.1 below provides a summary of other services directions and compensation outcomes between 2016 and 2020.

**Table C.1:** Summary of "other services" directions between 2016 and 2020

DATE	PARTICIPANT	DIRECTION	FPP COMPENSATION IN CL. 3.15.7A	ADDITIONAL CLAIM UNDER CL. 3.15.7B
<b>1 Dec 2016</b>	Pelican Point power station (Engie/Mitsui)	Direction to largest operating SA generating unit to reduce output to level consistent with available contingency FCAS to maintain secure operating state.	Independent expert determined no compensation payable as no service had been provided.	IE determined that a service had in fact been provided (a substitute for FCAS) and awarded \$254,703 compensation for loss of revenue for reduced energy and FCAS provision.
	Mortlake power station (Origin Energy)	Direction to Mortlake to shut down in order to restore the power system to a secure state.	No compensation was awarded as no service had been provided.	No compensation was awarded as no service had been provided.
<b>24 Jan 2019</b>	Tumut 3 unit 2 (Snowy Hydro)	Direction to synchronise Tumut 3, unit 2 to remain in service as a synchronous condenser to provide voltage control.	IE awarded compensation of \$16,874.30. Based on historical contract for service that had expired.	No additional compensation claim lodged under clause 3.15.7B.
<b>16 Nov 2019</b>	Canunda wind farm (Engie/Mitsui)	Direction for generator to reduce its output to zero and disconnect to stop a system strength constraint from binding during SA islanding event.	No compensation as participant didn't provide a service.	No additional compensation claim lodged under clause 3.15.7B.
<b>2 and 4</b>	Battery	Five directions to	AEMO was granted approval from the AER	



DATE	PARTICIPANT	DIRECTION	FPP COMPENSATION IN CL. 3.15.7A	ADDITIONAL CLAIM UNDER CL. 3.15.7B
<b>Feb 2020</b>	Energy Storage Systems	batteries to maintain a state of charge and bid regulation FCAS to zero.	to run the FPP and additional processes in parallel.  The five FPP compensation amounts were \$1,493.94, \$10,282.20, \$89.47, \$512.75 and \$10,533.79.	
<b>Early 2020</b>	Non-scheduled wind farms in SA	A number of directions to keep non-scheduled wind farms off-line during SA islanding from 31 January to 17 Feb 2020.	AEMO did not engage an IE to determine FPP compensation as the participant did not provide a service.	Directed participants cannot claim compensation under clause 3.15.7B if they are not eligible for compensation under either clause 3.15.7 or 3.15.7A.

Source: AEMC, based on AEMO intervention reports. AEMO communications, *Appointment of independent expert*, 28 April 2020.

## D STEP-BY-STEP GUIDE TO THE NEW FRAMEWORK

Chapters 4 and 5 of this draft rule determination set out the Commission's reasons for amending the compensation framework following directions for non-market services. This appendix provides a step-by-step guide as to how the new compensation framework in the draft rule would be applied. This chapter includes:

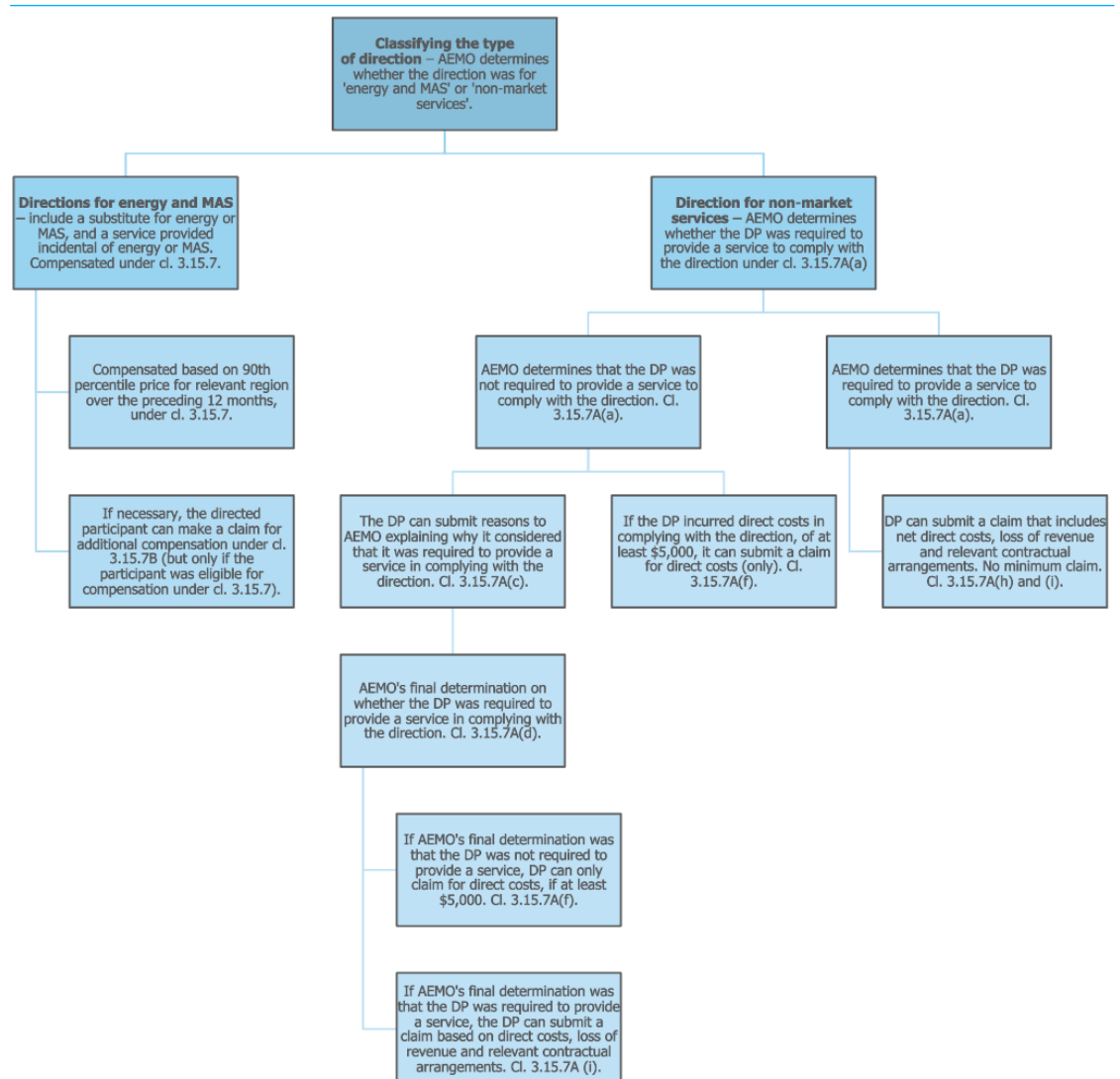
- an overview of the new compensation framework following directions
- the process to classify the type of service that was directed
- the process to determine whether a compensable service was provided
- the process to determine compensation following directions
- costs of implementing the draft rule.

### D.1 Overview of new compensation framework following directions

Figure D.1 below shows the amended compensation framework for direction in this draft rule. This includes:

- the compensation framework following directions for 'energy and market ancillary services', and
- the compensation framework for 'non-market services'.

**Figure D.1: Draft rule - amended compensation framework following directions for services in the NER**



Source: AEMC, based on clause 3.15.7, 3.15.7A and 3.15.7B in this draft rule determination.

The processes to classify the type of direction, the determination of whether a compensable service was provided, and the determination of compensation, are explained below in sections D.2 to D.4.

## D.2 Process to classify the type of service that was directed

Under the draft rule, the process to classify the type of service that was required to be provided in order to comply with a direction, determines the relevant compensation framework. AEMO will apply clause 3.15.7(a2) to classify the type of service that was

directed. This will result in the direction being classified into one of the two categories outlined below.

**1. Direction for 'energy or market ancillary services'** if the directed participant was directed to provide one or more of the following services:<sup>133</sup>

- energy;
- any one of the market ancillary services;
- a service that is a direct substitute for an energy or market ancillary service; or
- a service that was provided by the Directed participant incidental to the provision of energy or market ancillary services (for example voltage control).

If AEMO determined that the direction was for one of these services, the directed participant would be compensated under clause 3.15.7 and potentially also 3.15.7B for any additional out of pocket costs.

**2. Direction for 'non-market services'** - if the direction was to provide any service other than those listed above in the category of 'energy and market ancillary services' the directed participant would receive FPC under clause 3.15.7A.<sup>134</sup> If AEMO determined that the direction was in the category of 'non-market services', AEMO would subsequently need to determine whether a compensable service was required to be provided by the directed participant in order to comply with the direction, as explained in section D.3 below.

## D.3 Process to determine whether a compensable service was provided

In order to be eligible for FPC under clause 3.15.7A, a directed participant must have been required to provide a service in order to comply with the relevant direction. By way of contrast, directed participants that were directed to provide energy or market ancillary services are automatically eligible to receive compensation under clause 3.15.7 because those participants are always required to provide a service in complying with the relevant direction.

Under the draft rule, AEMO must first determine pursuant to clause 3.15.7(a), whether, in its reasonable opinion, the directed participant was required to provide a service in order to comply with the relevant direction. The possible outcomes of AEMO's determination under clause 3.15.7A(a) are outlined below.

**AEMO determines that a service was required to be provided by the directed participant to in order to comply with the direction.** AEMO must notify the directed participant of its determination within 10 business days of issuing the direction, and provide reasons for its determination. In this case the directed participant would be eligible to receive compensation.

**AEMO determines that no service was required to be provided by the directed participant in order to comply with the direction.** AEMO must notify the directed

<sup>133</sup> Draft rule, NER clause 3.15.7(a2)(1)

<sup>134</sup> Draft rule, NER clause 3.15.7(a2)(2).

participant of its determination within 10 business days of issuing the direction, and provide reasons for its determination.<sup>135</sup> If the directed participant does not agree with AEMO's determination, the directed participant has 10 business days to provide a written submission to AEMO setting out its reasons why it considers that a service was required to be provided in order for the directed participant to comply with the direction.<sup>136</sup> In response to this written submission, AEMO has 10 business days to notify the directed participant of its final determination of whether a service was required to be provided by the directed participant in order to comply with the direction.<sup>137</sup> If AEMO's final determination is that no service was required to be provided, the directed participant is not entitled to FPC under clause 3.15.7A or additional costs under clause 3.15.7B, however it can apply for compensation in relation to its direct costs incurred, as set out in section D.4 below.

## D.4 Process to determine fair payment compensation

This section sets out in more detail the process to determine the amount of compensation for directions for 'energy and market ancillary services' and 'non-market services'.

### D.4.1 Directions for energy or market ancillary services

A directed participant that was directed to provide energy or market ancillary services is firstly compensated under clause 3.15.7 based on the 90th percentile price in the relevant region over the preceding 12 month period for the service or services that were directed.

If that directed participant considers that it is still out of pocket after receiving compensation under clause 3.15.7, the directed participant can make an additional claim for compensation under clause 3.15.7B in relation to lost revenue and additional net direct costs.

### D.4.2 Directions for non-market services

Under the new one-step compensation process in the draft rule, compensation for non-market services directions is entirely determined through clause 3.15.7A. The ability to make a claim for additional compensation under clause 3.15.7B has been removed because the directed participant is able to be "made whole" under clause 3.15.7A.<sup>138</sup>

The eligibility to claim fair payment compensation and factors that can be taken into account to determine the amount of compensation in the draft rule, by AEMO or the independent expert, are outlined below.

**A service was required to be provided by the directed participant in order to comply with the direction.** In this case the directed participant is eligible to receive fair payment compensation, which is determined by taking into account any or all of the following (if relevant):<sup>139</sup>

<sup>135</sup> Draft rule, NER clause 3.15.7A(b)

<sup>136</sup> Draft rule, NER clause 3.15.7A(c)

<sup>137</sup> Draft rule, NER clause 3.15.7A(d)

<sup>138</sup> The ability for a directed participant to make a claim for additional compensation for directions for energy and market ancillary services is retained, as per the current NER.

<sup>139</sup> Draft rule, NER clause 3.15.7A(i)

- relevant contractual arrangements which specify a price for the relevant service;
- loss of revenue incurred by the directed participant in respect of the plant as a result of the provision of the service under direction;
- net direct costs incurred by the directed participant in respect of that plant, including:
  - fuel costs in connection with the relevant *generating unit* or *scheduled network services*;
  - incremental maintenance costs in connection with the relevant *generating unit*, *load* or *scheduled network services*;
  - incremental manning costs in connection with the relevant *generating unit*, *load* or *scheduled network services*;
  - acceleration costs of maintenance work in connection with the relevant *generating unit*, *load* or *scheduled network services*, where such acceleration costs are incurred to enable the *generating unit*, *load* or *scheduled network services* to comply with the *direction*;
  - delay costs for maintenance work in connection with the relevant *generating unit*, *load* or *scheduled network services*, where such delay costs are incurred to enable the *generating unit*, *load* or *scheduled network services* to comply with the *direction*; and
  - other costs incurred in connection with the relevant *generating unit*, *load* or *scheduled network services*, where such costs are incurred to enable the *generating unit*, *load* or *scheduled network services* to comply with the *direction*.

No minimum claim threshold applies if AEMO determines that a service was required to be provided by the directed participant in complying with the direction.

After AEMO has notified the directed participant that it did provide a compensable service in order to comply with the direction, the directed participant has the following options.

**1. Lodge a claim to AEMO** within 15 business days of receipt of the notice, providing information about the directed participant's claim (i.e. relevant contractual arrangements, direct costs and/or loss of revenue), or

**2. Not lodge a claim.** If the directed participant has provided a compensable service, there is no requirement for the directed participant to submit a claim.<sup>140</sup> If AEMO does not receive a claim within 15 business days, AEMO has the discretion to determine the claim itself rather than referring it to an independent expert (if it is below \$20,000, is not in AEMO's opinion unreasonable, or does not in AEMO's opinion involve issues of complexity or difficulty).

**No service was required to be provided by the directed participant in order to comply with the direction.** If AEMO's final determination is that no service was required to be provided by the directed participant in complying with the direction, the directed

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<sup>140</sup> If the directed participant did not provide a compensable service, the directed participant must lodge a claim in order to seek compensation for direct costs incurred.

participant can only make a claim for compensation if it incurred direct costs of at least \$5,000.<sup>141</sup> The directed participant is not entitled to compensation on the basis of relevant contractual arrangements or loss of revenue.

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<sup>141</sup> Draft rule, NER clause 3.15.7A(e)