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Mr Andrew Pirie
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Pirie

RE: Compensation following directions for services other than energy and market ancillary services

ERM Power Retail Pty Ltd (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) consultation paper on compensation following directions for services other than energy and market ancillary services rule change.

About ERM Power

ERM Power (ERM) is a subsidiary of Shell Energy Australia Pty Ltd (Shell Energy). ERM is one of Australia's leading commercial and industrial electricity retailers, providing large businesses with end to end energy management, from electricity retailing to integrated solutions that improve energy productivity. Market-leading customer satisfaction has fuelled ERM Power's growth, and today the Company is the second largest electricity provider to commercial businesses and industrials in Australia by load[1]. ERM also operates 662 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland, supporting the industry's transition to renewables.

http://www.ermpower.com.au
https://www.shell.com.au/business-customers/shell-energy-australia.html

General comments

ERM considers that the rule change proposal is flawed in a number of areas. Combined, these flaws mean that the rule change is unlikely to be an improvement to current arrangements, is likely to stymie the development of competitive markets for these services and fails to meet the National Electricity Objective (NEO). We call on the AEMC to make no rule change with respect to this proposal.

The determination of the fair payment price (FPP) is meant to provide a "fair price" not a cost-based price for providing the directed service. Once set, the FPP applies to all Directions for the same service for the next 12 months, not just the initial Direction for which the FPP determination has been triggered. Should the Directed Participants costs be higher than the FPP as determined, then the Directed Participant and any future Directed Participants directed to provide the same service, may claim additional compensation to cover their actual costs.

The FPP determination is not about the costs of providing the service based on the costs of the initial Directed Participant, but what is the "fair price" for providing the service. As the AEMC notes, the origins of the FPP were to provide a fair price for providing services, set at a level that would neither incentivise withdrawing capacity in order to be directed, nor result in abnormal profits. If the FPP is higher than the costs of a Directed Participant and any future Directed Participants directed to provide the same service, then this is immaterial as the Participant(s) has received the "fair price" for the service provided.

[1] Based on ERM Power analysis of latest published information.

AEMO, as the rule change proponent, incorrectly assert that the determination of the Fair Price Payment (FPP) by the independent expert is intended as a payment to cover costs incurred in complying with a Direction. The rule change proposal would see the calculation of the FPP corrupted, in that the independent expert would have access to the costs of the initial Directed Participant to consider as part of their determination.

To some extent, we see this as an attempt to hardwire the proposed unit commitment for security (UCS) concept detailed in the Energy Security Board's System Services and Ahead Markets paper, which proposes that market participants would provide AEMO with their costs, These costs would then be used to determine the dispatch of services for system security and reliability purposes. This model is still in the early stage of development and under wide consultation as part of the post-2025 review of the National Electricity Market (NEM). It would be premature to introduce this model into the NEM now without a detailed consideration of the full potential impacts.

In ERM Power's view, market-based responses best serve the needs of consumers as a whole. This is why the NEM uses markets for energy and ancillary services. In the absence of a competitive market, then a regulated response may be necessary, which is effectively the purpose of the existing FPP.

At present, the existing rule and the rule change proposal contain inequities which potentially prevent generators from covering their costs in some instances. For example, the system restart ancillary services (SRAS) rules have changed to allow procurement of system restart restoration support ancillary services (SRRSAS). AEMO could request a tenders for SRRSAS in which would require a power station to reserve a specific level of diesel fuel and demineralised water at all times to provide the specified SRRSAS as well as change staffing arrangements to support 24 hour, 7 day operation or short time duration staff recall times.

Generator A tenders for the provision of this service based on the fair price of provision. However, AEMO may determine that the tendered price is too high and can instead decide to rely on the ability to issue a Direction.

AEMO could then argue that there is currently no fair price for the provision of the Directed service and that Generator A should only receive the costs of any fuel consumed and the costs of additional staffing if Directed to supply the service. Generator A on the other hand would argue that the fair price for provision of the service is the tender price or the contract price paid to other contracted participants.

Under the current rules, it is possible that AEMO could Direct a generator to hold a specific level of diesel fuel and demineralised water, to ensure the provision of an SRAS, but then determine that this was not a compensable service and under the current and rule change proposal a generator could not make a claim for additional costs such as the holding costs and maintenance costs of holding the fuel and water under clause 3.15.7B.

For these reasons, ERM Power does not support the rule change as proposed, but agrees that changes are required to compensation arrangements for services other than energy and market ancillary services. If a participant has incurred costs in complying with a direction, then we consider that "fair" compensation should be payable. This change should be implemented regardless of the remainder of this rule change.

The discussion that follows refers to the questions posed in the consultation paper.

Application of clause 3.15.7A (a1)

ERM Power considers that clause 3.15.7A (a1) is generally clear in its intended application, but it remains somewhat open to AEMO interpretation. According to the clause, if the directed service could have been provided via a bid or offer able to be dispatched by NEMDE, then it is not a direction for a service other than energy or market ancillary services.

The complexity lies in the case of a generating unit that can operate in synchronous condenser mode where the provision of some services – system strength, inertia or voltage control or support – could be provided when operating in either generating or synchronous condenser mode. Ultimately, whether or not the service is classified as energy and market ancillary services or not would all come down to the wording of the direction issued by AEMO.

We consider that the Commission's view as set out in the Paper is incorrect: that a Direction to Tumut 3 to operate as a generating unit operating at zero 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 should therefore receive the normal Directions operating costs, (clause 3.15.7), based on their prevailing energy output.

An alternative approach to that currently set out in the rules would be to consider the resulting outcome from the Direction with regards to the provision of additional active energy output or provision of supply to one of the market ancillary services or a substitute for the provision of supply to one of the market ancillary services.

In this case, we propose that clause (a1) be reworded to:

> *(a1) In this clause 3.15.7A, a direction is a direction for services other than energy and market ancillary services if the resulting outcome of the direction is not the provision of additional active energy output or provision of supply to any one service of the market ancillary services or a substitute for the provision of supply to any one service of the market ancillary services.*

Administrative efficiency

The question of administrative efficiency needs to be considered in conjunction with Question 10 relating to applying the FPP for the same service for 12 months. The FPP currently sets the fair price for the provision of the service for the next 12 months. If the rule change as proposed is made then the 12 month setting of the FPP should be removed as it would be problematic to establish the FPP for a service for 12 months based on the costs of one sole generator. Logically, each and every direction would need to be considered on an individual basis as each generator will have a different set of costs for providing these services. This may result in even higher administrative costs to market customers who incur these costs as well as for the independent expert. We contend that the current process, which sets the FPP for a 12 month period, allows other Directed Participants to transparently understand the fair price they will be paid and only lodge a claim for additional compensation if their costs are higher. In this case the FPP may be sufficient for all future Directions for the same service and additional independent expert determinations for claims for additional compensation may not be actually required.

Single step compensation process

We also disagree that the combined single-step compensation process would be more efficient than the existing two-step process. This is because under a single-step process the FPP would need to be determined for each individual direction over 12-month period based on the directed participants' individual costs. As highlighted above, this would create a far greater administrative burden than the existing process whereby a participant may only apply for additional compensation if it considers that the FPP falls short of its costs.

ERM Power agrees with the suggestion that AEMO should publish a determination where they have determined that a compensable service has or has not been provided. This would provide a greater degree of transparency to existing arrangements. In its determination, AEMO should be required to include their reasons for reaching their conclusion. This could be based on a list of reasonings contained in either the Rules or an AEMO Guideline which set out reasons for which AEMO can determine that no compensable service has been supplied.

ERM Power also considers that the proposed alternative wording in clause In clause 3.15.7B(a)(1) – "as a result of compliance with the direction" – to be suitable and likely to achieve its aim.

Risk allocation

It is unclear that there has been an inconsistency of approach as implied in the Paper as the actual wording for each Direction with regards to the directed service has not been supplied.

In the case of Pelican Point, it was not directed to manage network flows but to reduce the frequency control ancillary service (FCAS) procurement in SA on the basis of a shortfall in available FCAS. While AEMO could have co-optimised and dispatched the currently in-service generating units down to provide additional FCAS resources in SA this would have impacted both energy and FCAS prices and resulted in extra generation resources needing to be scheduled into the market. Under the rules prevailing at the time, intervention pricing wasn't strictly applied to FCAS prices due to the Direction to Pelican Point to reduce output.

With regards to Mortlake and the non-scheduled wind farms, any generator can be constrained off due to prevailing network conditions without being paid constrained off payments. The provisions of clause 2.2.3 (c) allows non-scheduled generators to be subject to network constraints.

Further, while it's true that Tumut 3 could have been Directed to generate and provide voltage support services, the costs for an energy direction would most likely been higher due to the need to operate at minimum stable load. A direction to operate in synchronous condenser mode is a Direction for a service for which bids and offers do not exist and a synchronous condenser service can't be supplied when operating in generating mode and therefore should be a Direction for a services other than energy and market ancillary services.

Finally, we agree with the Commission's view that clause 3.15.7A will also require significant amendments if the proposed rule is to be made as the rule change proposal only suggests amendments to clause 3.15.7B to remove the ability of "other services" directed participants to lodge a claim for additional compensation.

Information to determine the FPP

ERM Power agrees that the comparison to other electricity markets should be removed from 3.15.7A (c)(1).

> *(1) that the independent expert must, in determining the fair payment price of the relevant service for the purposes of clause 3.15.7A, take into account:*
>
> > *(i)other relevant pricing methodologies in Australia and overseas, including but not limited to:*
> >
> > *a) ~~other electricity markets~~;*
> >
> > *b) other markets in which the relevant service may be utilised; and*
> >
> > *c) relevant contractual arrangements which specify a price for the relevant service;*

However, we do consider that the rules should also allow inclusion of "offers made to any AEMO tender process for the provision of the same service in response to a request for tenders to an non market ancillary service". While these offers may not have been accepted by AEMO, they reflect the "fair price" at which market participants are prepared to supply the Directed service.

In the case of the Tumut 3 Direction, the "fair price" was determined based on the price as set out in a previous NSCAS contract between AEMO and Snowy Hydro for the provision of that same synchronous condenser service. It could have also been set by Snowy Hydro's latest tendered offer which AEMO determined not to accept.

Entity that determines compensation

The Commission queries whether, if the provision for additional claims for compensation is removed, the use of an independent expert can be removed and AEMO allowed to assess the claim. As some of these services could be subject to future requests for tenders for non-market ancillary service such as NSCAS of SRAS, this would be a poor outcome for market participants for AEMO to have details of "cost-based" information. At the moment these details are only provided to the independent expert on a confidential basis. ERM Power therefore rejects any change to these arrangements. The use of an independent expert is important to ensure that commercial-in-confidence data on costs remains separate from the market operator.

Other considerations

In discussing "market prices" the AEMC appears to take a very narrow view of the definition of a market, implying that a "market price" can only relate to the nine physical spot markets. While the AEMC is correct that these nine physical markets are "dynamic", additional open markets exist for other services such as network support and control ancillary services (NSCAS) and system restart ancillary services (SRAS) via AEMO's open tendering process. Indeed, bids and offers for NSCAS and SRAS are more relevant to the determination of a "fair price" than the physical spot markets. This is because generally, a Direction to a market participant for services other than energy and market ancillary services would generally be for the supply of NSCAS or SRAS type services.

We also believe that 3.15.7A requires an additional clause to explain what happens in the event that AEMO determines under clause 3.15.7A (b) that an independent expert could not reasonably be expected to determine a fair payment price for the services provided pursuant to the direction within a reasonable time period. In this case the rules should be clear that a claim for compensation under Clause 3.15.7B is still permitted. We propose the following addition:

> *(b2)* Where *AEMO* in accordance with the *intervention settlement timetable* and any guidelines developed by *AEMO* in accordance with the *Rules consultation procedures*, determine in *AEMO*'s reasonable opinion, an independent expert could not reasonably be expected to determine a fair payment price for the services provided pursuant to the *direction* within a reasonable time period, then the *directed participant* shall remain entitled to claim compensation under clause 3.15.7B.

Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

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