



Australian Energy Market Commission

EXPLANATORY STATEMENT

REVIEW OF COMPENSATION GUIDELINES TO INCLUDE WHOLESALE DEMAND RESPONSE

26 AUGUST 2021

GUIDELINES

INQUIRIES

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ABOUT THE AEMC

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

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SUMMARY

1 The Australian Energy Market Commission (AEMC or Commission) has made a draft decision on amendments to the compensation guidelines that are developed by the AEMC in accordance with clause 3.14.6 of the National Electricity Rules (NER). The compensation guidelines support the operation of clause 3.14.6 of the NER which describes how compensation may be determined by the AEMC if a claim is made by an eligible party following the application of an administered price cap or administered floor price.

2 Draft amendments have been made to these compensation guidelines to reflect the final rule of the Wholesale demand response mechanism (WDRM)¹ and the final rule of the Fast frequency response market ancillary service.² In addition, other minor draft amendments have been made to the compensation guidelines.

3 **Purpose of the compensation guidelines**

4 The purpose of the compensation guidelines is to:

- set out how the AEMC may consider whether compensation should be paid and the amount of compensation payable under the NER; and
- provide guidance for potential claimants and the Australian Energy Market Operator (AEMO) on the information required to be provided in support of a claim for compensation. Potential claimants include scheduled and non-scheduled generators, scheduled network service providers, scheduled loads, ancillary service providers and demand response service providers (DRSPs).

5 Under clause 3.14.6(n) of the NER, in making a final decision on a claim for compensation, the AEMC "must apply the compensation guidelines unless it is satisfied that there are compelling reasons not to do so". This means that, in most cases it is likely that the AEMC would apply the compensation guidelines in making a final decision on a claim for compensation. However, the AEMC is not bound to apply the compensation guidelines and there may be circumstances in which there are compelling reasons not to apply them in deciding on a claim for compensation.

6 **Draft decision on amendments to the compensation guidelines**

7 The following draft amendments have been made to the compensation guidelines:

- added the DRSP as a new type of participant that is eligible to make a claim for compensation;
- clarified the types of direct and opportunity costs that can be claimed by a DRSP;
- provided guidance around the need for a DRSP to demonstrate how it has incurred direct or opportunity costs and the factors the AEMC may take into account in assessing a compensation claim from a DRSP; and

1 AEMC, *National Electricity Amendment (Wholesale demand response mechanism) Rule 2020*, 11 June 2020.

2 AEMC, *National Electricity Amendment (Fast frequency response ancillary service) Rule 2021*, 15 July 2021.

- clarified that compensation may be payable relating to the provision of the two new types of Frequency Control Ancillary Services (FCAS) - the *very fast raise service* and the *very fast lower service* - when these new spot markets commence on 9 October 2023.

- 8 In making draft amendments to the compensation guidelines, the AEMC has had regard to the national electricity objective (NEO). The changes to the compensation guidelines reflect new rules and provide additional clarity for eligible participants when submitting compensation claims and the AEMC when assessing compensation claims.
- 9 These amendments could impact the amount of compensation that would be able to be claimed by eligible participants under clause 3.14.6. Compensation is recovered from market customers in the region in which the administered pricing period was applied.

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1 BACKGROUND

This section sets out background information on:

- the compensation mechanism during an administered price limit event
- the purpose of the compensation guidelines
- the final rule on the wholesale demand response mechanism; and
- the final rule on fast frequency response market ancillary services.

1.1 The compensation mechanism during an administered price limit event

The compensation provisions in clause 3.14.6 of the NER are a component of the broader reliability framework including the market price cap, market floor price, cumulative price threshold, administered price cap and administered floor price. This framework helps to protect customers from extended periods of high prices.

For more information on this broader framework and the compensation mechanism, refer to chapter 3 of the Draft amended compensation guidelines.³

1.2 Purpose of the compensation guidelines

The purpose of the compensation guidelines is to:

- set out how the AEMC may consider whether compensation should be paid and the amount of compensation payable under the NER; and
- provide guidance for potential claimants and AEMO on the information required to be provided in support of a claim for compensation.

1.3 Final rule on wholesale demand response mechanism

On 11 June 2020, the Commission made a final rule to facilitate wholesale demand response in the NEM, principally through implementing a wholesale demand response mechanism (WDRM).⁴

Prior to the commencement of the WDRM, that is scheduled to commence on 24 October 2021,⁵ the AEMC must review and where necessary amend and publish the compensation guidelines to take into account the WDRM rule.⁶ In practice, this requires the AEMC to add DRSPs to the compensation guidelines as a new type of participant that is eligible to claim compensation, and review the guidelines to ensure they adequately deal with compensation for DRSPs.

³ AEMC, *Draft amended compensation guidelines*, 26 August 2021.

⁴ AEMC, *Wholesale demand response mechanism, final determination*, 11 June 2020.

⁵ The start date of the WDRM rule depends on the start date of Five minute settlement rule. There is currently a rule change request on potential options to delay the commencement of five minute settlement, if this is determined to be necessary. For more information see: AEMC, *Contingency arrangements for five minute settlement implementation*, Consultation paper, 5 August 2021.

⁶ Clause 11.125.6(d) of the NER, introduced by the WDRM rule.

1.4 Final rule on fast frequency response market ancillary services

On 15 July 2021, the Commission made a final rule to introduce two new market ancillary services to help control system frequency and keep the future electricity system secure, fostering innovation and delivering lower costs for consumers.⁷ These new market ancillary services are **very fast raise** and **very fast lower** and will operate in a timeframe of two seconds or less, which is more rapid than the existing frequency control ancillary services. These new ancillary services will help control power system frequency following sudden and unplanned generation or power system outages, known as contingency events.⁸

The new ancillary services are scheduled to commence operation on 9 October 2023.

⁷ AEMC, *Fast frequency response mechanism*, final determination, 15 July 2021.

⁸ Ibid, p.i.

2 DRAFT AMENDMENTS TO THE COMPENSATION GUIDELINES TO INCORPORATE WHOLESALE DEMAND RESPONSE

This section covers draft amendments made to the compensation guidelines to incorporate wholesale demand response. This includes amendments related to:

- the new type of participant that is eligible to make a claim for compensation;
- direct costs; and
- opportunity costs.

2.1 New type of eligible participant

The WDRM rule introduced a new participant category, the DRSP, and provides eligibility for the DRSP to make a claim for compensation under clause 3.14.6 of the NER.⁹ The draft amended compensation guidelines reflect this change by adding the DRSP as a new type of claimant. This means that, if a DRSP incurs a net loss over an eligibility period¹⁰, it may make a claim for compensation.

2.2 Direct costs

The draft amended compensation guidelines clarify that a DRSP may make a claim for compensation for direct costs relating to the provision of either wholesale demand response or FCAS.

The draft amended compensation guidelines include the following draft changes in relation to direct costs that may be claimed:

- **Fuel costs** - a DRSP could make a claim for these costs, for example associated with a backup diesel generator providing demand response by supporting their load behind the meter;
- **Operation and maintenance costs** - for example staff and operating systems associated with providing energy, wholesale demand response or ancillary services during an administered price limit event. A DRSP would need to demonstrate that these costs were necessary to provide the relevant service, and additional to the typical operational costs incurred by the operator of the wholesale demand response unit when it is not providing wholesale demand response.
- **Wear and tear** - a DRSP could make a claim for these costs, for example cycling wholesale demand response units up and down, to provide wholesale demand response or ancillary services, which results in damage or reduced lifetime of the equipment.

⁹ New clause 11.125.6(d) of the NER, AEMC, *Wholesale demand response mechanism*, Rule Determination, 11 June 2020.

¹⁰ The eligibility period starts from the first trading interval when the spot price is set by the administered price cap or administered floor price, until the last trading interval of that day. NER clause 3.14.6(a).

- **Exclusions** - are cost categories that are not permissible to claim unless the claimant can demonstrate a compelling case based on extraordinary circumstances. For DRSPs, excluded costs are business operations at a wholesale demand response unit that cannot be directly attributed to the provision of wholesale demand response or market ancillary services during the price limit event.

The draft amended compensation guidelines also include guidance for DRSPs. That is, in making a claim for direct costs, a DRSP would need to explain how the price and quantity response levels that it was dispatched for during an administered price limit event were consistent with how it typically operates when it is not providing wholesale demand response.

2.3 Opportunity costs

The draft amended compensation guidelines clarify that a DRSP may make a compensation for opportunity costs relating to the provision of either wholesale demand response or FCAS.

The draft amended compensation guidelines include guidance for DRSPs in making a compensation claim for opportunity costs, as outlined below.

- The AEMC may consider additional factors including (but not limited to) whether the price and quantity response points and other information provided in dispatch, pre-dispatch and short term projection of system adequacy (ST PASA) during the administered price limit event are consistent with the typical information and operation of the wholesale demand response unit during the normal function of the market. For example if the DRSP bids and is dispatched to provide wholesale demand response when the energy price is capped at \$300/MWh, but it usually offers wholesale demand response only at significantly higher prices, the DRSP would need to explain why it should be eligible for any compensation.
- Commercial losses resulting from lower production of products other than wholesale demand response or market ancillary services (eg if the wholesale demand response unit is a factory, reduced production of goods by the factory), while dispatched during an administered pricing period, can only be claimed at price and quantity response points that are consistent with the typical operation of the relevant wholesale demand response units when it is not providing wholesale demand response.

3 OTHER DRAFT AMENDMENTS TO THE COMPENSATION GUIDELINES

This section sets out other draft amendments made to the Compensation guidelines.

3.1 Clarified that compensation applies to new types of FCAS

On 15 July 2021, the Commission made a rule to introduce two new market ancillary services into the NER under the current FCAS arrangements; these new services are set to commence on 9 October 2023.¹¹ These new market ancillary services are the very fast raise service and the very fast lower service, to be procured through spot markets.

Compensation under clause 3.14.6 can be claimed relating to the provision of ancillary services that are market ancillary services for which a market price exists for the service. The only types of ancillary services that are market ancillary services are FCAS. As the new very fast raise and very fast lower service are FCAS, participants that provide very fast raise and very fast lower will be eligible to make a claim for compensation relating to administered price periods. This eligibility will commence when the very fast raise and very fast lower services commence operation, which are scheduled to commence on 9 October 2023.

3.2 Other minor amendments

Merging sections on record of amendments to the compensation guidelines

Two previous sections of the compensation guidelines that previously contained similar content have been combined to remove duplication. In the current version of the compensation guidelines similar content is included in the:

- version control table; and
- section 1.3.2 that covers the establishment of, and previous amendments to, the compensation guidelines.

In the draft amended compensation guidelines the content of these two sections has been merged and updated into the new version control table in section 1.3. This provides clearer and shorter guidelines.

Changes to other sections

The section on background information has been moved from Chapter 1 to Appendix A.

The section that contains compensation information for specific types of registered participants has been renamed and moved from chapter 9 in the current compensation guidelines to Appendix B in the draft amended compensation guidelines.¹²

¹¹ AEMC, *Fast frequency response market ancillary service, final determination, 15 July 2021*.

¹² AEMC, *Draft amended compensation guidelines, 26 August 2021*.

4 ASSESSMENT FRAMEWORK

The assessment framework the AEMC must follow for changes to guidelines is different to that for the assessment of changes to the NER. For changes to the NER, the AEMC must assess whether a proposed rule, will, or is likely to, contribute to the achievement of the National Electricity Objective (NEO), as set out in Section 7 of the National Electricity Law (NEL).¹³

This is distinct from the assessment of proposed changes to the compensation guidelines. Section 32 of the NEL provides that “in performing or exercising any function under this Law, the Regulations or the Rules, the AEMC must have regard to the national electricity objective”. Therefore, in amending the compensation guidelines, the AEMC must have regard to the NEO. In order to have regard to the NEO the AEMC will consider the following matters in assessing changes to the compensation guidelines:

- the reliability and security of the electricity system;
- the price of electricity supply (including the price of wholesale demand response); and
- regulatory certainty.

13 The NEO is “to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to: (a) price, quality, safety, reliability and security of supply of electricity; and (b) the reliability, safety and security of the national electricity system.”

5 LODGING A SUBMISSION

Written submissions on this explanatory statement must be lodged with Commission by **8 October 2021** online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code **EPR0088**.

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

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

All enquiries on this project should be addressed to Andrew Pirie at andrew.pirie@aemc.gov.au.

ABBREVIATIONS

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AFP	Administered floor price
APC	Administered price cap
Commission	See AEMC
CPT	Cumulative price threshold
DRSP	Demand response service provider
MFP	Market floor price
MPC	Market price cap
NEL	National Electricity Law
NEO	National electricity objective
NER	National Electricity Rules
WDRM	Wholesale demand response mechanism
WDRM rule	National Electricity Amendment (Wholesale demand response mechanism) Rule 2020 No. 9
WDRU	Wholesale demand response unit