AEMC

INFORMATION

Final rule on market suspension compensation framework

AEMC makes rule to establish new market suspension compensation framework

The Australian Energy Market Commission (AEMC) has made a final rule that introduces a framework to compensate participants who incur loss during an electricity market suspension. The rule was made in response to a request from the Australian Energy Market Operator (AEMO) following the 13 day market suspension that occurred in South Australia (SA) in late 2016.

Overview of the final rule

The final rule sets out a compensation framework that is designed to strike a fair and efficient balance between the interests of market participants and consumers. The compensation framework will apply if, during a market suspension, prices are set by the Market Suspension Pricing Schedule (MSPS) rather than by the normal dispatch and pricing process.

The aim of the framework is to ensure that, when prices in the MSPS are too low to cover generators' estimated short run costs, compensation is automatically payable so that generators do not incur loss. This is designed to remove the current incentive for generators to withdraw from the market when MSPS prices are low and await direction by AEMO (which results in the generator receiving compensation at the 90th percentile price). The final rule aims to ensure that generators are not out of pocket when they provide services during a MSPS period, while also ensuring that consumers do not bear excessive costs associated with compensation payments.

The key features of the final rule are:

- compensation will be payable to scheduled generators and ancillary service providers (who are also scheduled generators) in the suspended region if prices in the MSPS are not sufficient to cover their estimated costs
- compensation will also be payable to scheduled generators in neighbouring regions in the event that price scaling results in prices that are too low to cover estimated costs (price scaling occurs when energy flows towards a suspended region and the price in the suspended region is lower than the price would otherwise be in the exporting region)
- estimated costs will be calculated using 'benchmark values': regionally-averaged estimated short run marginal costs for scheduled generators in each category (e.g. black coal, brown coal, open cycle gas turbine, combined cycle gas turbine, hydro, large-scale batteries) supplemented by a 15 per cent premium to account for divergences between estimated and actual costs
- where estimated costs exceed revenue earned by the generator under the MSPS (or under scaled prices in neighbouring regions), compensation will automatically be paid to cover the gap - this reduces the risk that generators and ancillary service providers will incur loss due to low MSPS prices
- 'benchmark values' are to be calculated and published annually by AEMO using data already collected for planning purposes
- if automatically calculated compensation is insufficient or - where no compensation is automatically payable - revenue earned under the MSPS or under scaled prices is insufficient to cover the generator's direct costs of participating in the market, a claim for additional compensation can be lodged with AEMO
- where a participant is eligible for automatic compensation under this framework, if AEMO is required to direct them to provide services during the MSPS period, the compensation

AUSTRALIAN ENERGY MARKET COMMISSION LEVEL 6, 201 ELIZABETH STREET SYDNEY NSW 2000
T: 02 8296 7800 E: AEMC@AEMC.GOV.AU W: WWW.AEMC.GOV.AU

automatically paid will be based on the MSPS compensation framework rather than the directions framework.

The Commission considers that the final rule achieves AEMO's objective, minimises the potential for perverse incentives that could lead to inefficient outcomes, and achieves a fair balance between the interests of market participants and consumers. As a result, the final rule will, or is likely to, contribute to achieving the National Electricity Objective as it promotes the reliability and security of electricity in the long term interests of consumers.

The final rule creates an automatic compensation framework that operates during a MSPS period.

Background

AEMO may suspend the electricity and ancillary service markets where:

- a black system event has occurred
- it is directed to do so by a jurisdiction under a state of emergency
- it determines that the market is inoperable (e.g. due to IT failures or following a power system emergency).

Market suspension events have occurred twice since the NEM began in 1998: once as a result of an IT system failure in 2001 and the other following the black system event in SA. Where the market is suspended, AEMO has two options to set electricity and ancillary service prices. If possible, AEMO will use the normal dispatch pricing mechanism. Where normal dispatch pricing is not possible, AEMO will set prices according to the MSPS (which is based on average prices in the preceding four weeks).

The rule change request

On 25 July 2017, AEMO submitted a rule change request proposing a framework to compensate participants who incur loss due to the application of the MSPS. This followed the SA market suspension during which prices were set in accordance with the MSPS.

AEMO noted in its rule change request that, during the SA event, the absence of a compensation framework meant some participants were incentivised to minimise financial losses due to low prices in the MSPS by withdrawing or reducing their availability for dispatch. As a result, AEMO was reliant on participant goodwill to manage system restoration and operation, or issuing directions so that participants who operated at a loss could recover their costs through the directions compensation framework.

AEMO considers directions should be a last resort. They involve a resource intensive process and, if needed during a market suspension, create significant additional work at a time of already heightened control room stress. Directions are also inconsistent with the principle in the NER that AEMO decision-making should be minimised to allow market participants the greatest amount of commercial freedom to decide how they will operate in the market. In proposing a new compensation framework for market suspension events, AEMO's aim was to remove the incentive for participants to await direction so as to recover their costs through the directions compensation framework.

AEMO proposed that the compensation framework for Administered Price Periods (APP) be extended so it would also apply during MSPS periods. Under the APP framework, each party who incurs loss makes a bespoke claim to itemise and substantiate their costs. The system is costly to administer and provides no predictability to market participants. As such the final rule does not adopt this approach.

For information contact:

Senior Adviser, **Katy Brady** 02 8296 0634

Director, **Shari Boyd** 02 8296 7869

Media: Communication Director, Prudence Anderson 0404 821 935 or (02) 8296 7817

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