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10 December 2010

The Chairman
Australian Energy Market Commission
Level 16, 1 Margaret Street
SYDNEY NSW 2000

By email to submissions@aemc.gov.au

Dear Chairman,

Compensation Guidelines under Clause 3.14.6 of the National Electricity Rules - EPR0023

AGL Energy (AGL) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) Compensation Guidelines.

Retailers are significant stakeholders in the compensation process as the compensation payable is to be recovered from Market Customers in the affected region. AGL has a significant customer base and therefore will be required to fund a large portion of any compensation paid to generators.

AGL believes there is an inconsistency between the stated objective that the payment of compensation is to encourage investment and the calculation of compensation which is based on the recovery of the costs directly incurred and the opportunities forgone by participants when the spot price payable is less than their dispatch offer.

The "Objective of paying compensation" as described in Section 5 of the Guidelines and 3.14.6 of the Rules[1] states that;

"(c) The *AEMC* must, in accordance with the *transmission consultation procedures*, develop and *publish* guidelines ('compensation guidelines') that:

(1) identify the objectives of the payment of compensation under this clause as being to maintain the incentive for:

(i) *Scheduled Generators*, *Scheduled Network Service Providers* and other *Market Participants* to invest in *plant* that provides services during peak periods; and

(ii) *Market Participants* to supply *energy* and other services during an *administered price period*;"

As the Commission notes;

"This compensation regime is just one component of the market's broader MPC-Cumulative Price Threshold (CPT)-APC mechanism, which, as a whole, provides a comprehensive

[1] NER Chapter 3 Page 186

framework to provide investment signals and manage risks faced by retailers and other market participants."

The objective of the Cumulative Price Threshold (CPT) is to provide a risk management mechanism for extreme events which result in high prices, without influencing the voluntary clearing of the market at other times.[2] The intention is that the CPT should only be breached in the event of a market failure, where supply fails to meet demand. Price caps do not discriminate between "involuntary clearing" and other high priced events and this is considered in the establishment of the CPT so that prices, prior to the application of the APC are, in theory, sufficiently high to allow participants to recover fixed costs and to encourage investment.

The efficiency objective of the application of the Administered Price Cap (APC) and Administered Floor Price, (AFP) is to avoid efficiency losses associated with high prices, and low prices respectively, that can result when there is a lack of competitive tension and the market is clearing involuntarily.

However as a countervailing efficiency objective, the administered price needs to be set so as to signal to all supply and demand the scarcity of electricity to facilitate market participation. The compensation provision recognises that, to manage risk, this may not always be the case and some plant may have variable costs that are higher than the price cap, and will need to be compensated to facilitate the continuing supply of energy.

The intention in applying the cap is to avoid the efficiency losses that would result from continuing high (or low) prices which is consistent with the Rules and the proposed guidelines where the total of market revenue and compensation will not exceed the identifiable costs of the participant in maintaining supply during the application of the period of the administered price cap and floor.

In AGL's view it is the broader (CPT) – APC mechanism which meets both of the above objectives i.e. 3.14.6 (c) (1) (i) and 3.14.6 (c) (1) (ii).

However with respect to 3.14.6 (c) (1)(i), AGL believes it is not the intention that the payment of compensation will provide an incentive for Scheduled Generators, Scheduled Network Service Providers and other Market Participants to invest in plant that provides services during peak periods. The objective of paying compensation is only to maintain the incentive for Market Participants to supply energy and other services during an administered price period, i.e. 3.14.6 (c) (1) (ii)

In AGL's view the objective in the Rules and the guidelines should be clarified accordingly.

AGL notes that the NGF submission has identified a number of inconsistencies in the compensations in the Rules. These inconsistencies will need to be addressed in the Commissions proposed consultation on determining and paying compensation under NER Clause 3.14.6 and cost recovery under Clause 3.15.10.

Should you have any questions in relation to this submission, please contact Roger Oakley; Manager Wholesale markets Regulation, at roakley@agl.com.au or on (03) 8633 7665.

Yours sincerely,

Alex Cruickshank
Head of Energy regulation

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[2] NECA Reliability Panel VoLL and the cumulative price threshold – Issues paper December 2003, Pages 13 & 40