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Tuesday, 21 April 2009

Dear Sir

## INTERNATIONAL POWER SUBMISSION ON COMPENSATION GUIDELINES, MARCH 2009 - REFERENCE EMO 0007

International Power (IPRA) appreciates the opportunity to comment on the proposed compensation guidelines.

In reviewing the proposed guidelines it has become evident that there are severe drafting errors in the related provisions of the market Rules, which if not corrected would prevent compensation in cases where it should be provided. Our submission will therefore deal with both the proposed guidelines and the Rule drafting which would, if not corrected, impede the proper functioning of compensation under the guidelines.

### 1. Parties eligible to apply for compensation

The proposed guidelines repeat the provisions of 3.14.6(a), (a1), (a2), and (a3) of the Rules which contain several deficiencies with the effect of excluding parties that should be eligible to have a compensation claim considered. These issues are discussed below.

Proposed changes to these provisions of the Rules are given in an appendix.

### 1.1 Ancillary service pricing process

The provision of 3.14.6(a3) fails to recognise the reality of ancillary service pricing. The dispatch process recognises two costs of providing an ancillary service. These are –

- The cost of providing the service if there were no effect on energy market participation, which is specified in the market ancillary service offer, and
- The cost of reduced participation in the energy market to allow provision of the ancillary service, if applicable.

The separate treatment of these costs in dispatch is efficient because the participant cannot know in advance whether the second component will apply at a particular time, or anticipate its magnitude.

The second cost component may be orders of magnitude larger than the first, especially under conditions where price capping is likely to apply. It is also a clear and easily calculated cost to the relevant participant.

Because the provision of 3.14.6(a3) wrongly fails to recognise the second component of cost, participants with a valid claim to compensation are likely to be excluded from applying.

This error also potentially has system security implications, because the rational response from participants to price capping where valid compensation claims are excluded would be to withdraw all offers for these services.

### 1.2 Referral of prices to regional reference node

The provision of 3.14.6(a) fails to recognise that the price that should be compared to the spot price is the participant's offer price as referred to the regional reference node in accordance with 3.8.6(g), not the price prior to this referral process as currently drafted. It is this referred price which applies in dispatch and which may, if marginal, set the dispatch price.

### 1.3 Disorderly bidding

We note with concern that neither the compensation guidelines nor the relevant Rules recognise the presence of "disorderly bidding" in the market.

Despite the pejorative name given to this activity, it is a commercial imperative for generators affected by network congestion under the current market Rules.

There is significant likelihood that network congestion and the imposition of an Administered Price Cap will overlap, as network congestion generally leads to higher market prices than would apply without congestion, and hence raises the risk that the Cumulative Price Threshold will be reached.

While it is reasonable to infer market intentions from market offers when congestion is not present nor imminent, such an inference is clearly invalid in the case of "disorderly bids" made in relation to network congestion.

This deficiency should be overcome by allowing the panel to use offers made prior to the impact of congestion in determining the threshold issue of whether a compensation claim can be considered. This would not alter the guidelines for the determination of such a claim, once accepted for consideration.

This remedy would require changes to the Rules which would then flow through to the guidelines.

## 2. Basis for compensation

The Rules set out, in 3.14.6(c)(2) the basis for compensation as follows.

"…require the amount of compensation payable in respect of a claim under

this clause to be based on:

(i) the costs directly incurred by the claimant due to the application of the *administered price cap*, *VoLL*, the *market floor price* or the *administered floor price* (as the case may be); and

(ii) the value of any opportunities foregone by the claimant due to the application of the *administered price cap*, *VoLL*, the *market floor price* or the *administered floor price* (as the case may be);"

The phrase "due to the application of the *administered price cap* …" is inconsistent with the reality of the relevant situations. The dispatch process does not include any consideration of the price cap or floor. Hence the dispatch outcome, and the costs incurred by affected participants are the same, regardless of whether or not a cap or floor is then imposed.

Hence the costs "due to" the cap or floor are, by definition, zero and these provisions if complied with would force the determination of zero compensation in every case.

The revised drafting proposed in the appendix overcomes this serious flaw in the drafting.

The same conceptual error is also apparent in item 4 of the information requirements in relation to the claimant.

## 3. Methodology to calculate compensation

The basis calculation displayed is based on the assumption that the participant is in receipt of spot market income, and therefore excludes the case where the participant is a scheduled load.

The determination of operations and maintenance expenses refers to those "directly attributable to the pattern of operation". In many cases this should include the advancement of future maintenance requirements. It should be noted that the maintenance activities so advanced will generally not have occurred when a claim is under consideration.

It would be helpful to clarify that such advancement is a valid basis for claim regardless of whether the expense has been incurred when the claim is considered.

In the estimation of opportunity costs for plant in "category (a)" it is proposed that the traded value of cap contracts be used as a basis for determining an energy price. This cannot be done except by "guesswork", since a cap contract is not associated with any defined quantity of energy. Each party to such a contract will make their own private and confidential assessment of the quantity of energy that will be affected by the contract. However, such assessments will not be available to the panel estimating opportunity costs, and hence the energy related to any contract could only be guessed.

As an alternative, we note that that each relevant participant indicates their own assessment of the opportunity value of energy in storage through the marginal value that they seek in their market behaviour. We propose that an evaluation of opportunity cost should be based on the observed behaviour of each relevant participant in the market in the period prior to the event to be compensated.

Further to these detailed issues in relation to the methodology, we with to make two general points.

Firstly, we note that the objective, as stated, includes -

"… 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; …"

We note that, in contrast with this objective, the proposed methodology fails to make any contribution towards the cost of the investment that, under the objective, it should be maintaining. This defect should be remedied by including the costs due to capital charges into the methodology.

Secondly, we note that there is a security issue associated with this compensation regime. If the compensation received for maintaining the market offer (and the resultant dispatch outcome) falls short of the compensation that would be received if the plant were directed by NEMMCO, then the compensation regime will create an incentive for widespread withdrawal of market offers in the expectation of a NEMMCO direction.

This could lead to NEMMCO failing to maintain security or even reliability of supply.

In order to avoid this outcome, the compensation for dispatch in the case of a price cap should be equivalent, at least, to the compensation that would be determined in the case of a NEMMCO direction. Determinations of compensation for direction have included capital charges, and hence compensation in relation to a price cap should also include capital charges.

If you have any questions in relation to this submission, please call Ken Secomb on 03 9617 8321.

Yours sincerely

Stephen Orr
Commercial Director

Enclosed: Appendix

Appendix

**Proposed correction to clause 3.14.6**

## 3.14.6 Compensation due to the application of an administered price, VoLL or market floor price

(a) *Scheduled Generators* may claim compensation from *NEMMCO* in respect of *generating units* if, due to the application of an *administered price cap* during either an *administered price period* or *market suspension*, the resultant *spot price* payable to *dispatched generating units* in any *trading interval* is less than the price specified in their *dispatch offer* for that *trading interval* referred to the *regional reference node* in accordance with 3.8.6(g).

(a1) A *Scheduled Network Service Provider* may claim compensation from *NEMMCO* in respect of a *scheduled network service* if, due to the application of an *administered price cap, VoLL,* the *market floor price* or an *administered floor price*, the resultant revenue receivable in respect of *dispatched network services* in any *trading interval* is less than the minimum requirement specified by its *network dispatch offer* for that *trading interval.*

(a2) A *Market Participant* which submitted a *dispatch bid* may claim compensation from *NEMMCO* in respect of a *scheduled load* if, due to the application of an *administered floor price* during either an *administered price period* or *market suspension*, the resultant *spot price* in any *trading interval* is greater than the price specified in the *dispatch bid* for that *trading interval* referred to the *regional reference node* in accordance with 3.8.7(f)..

(a3) In respect of an *ancillary service generating unit* or an *ancillary service load*, a *Market Participant* may claim compensation from *NEMMCO* if, due to the application of an *administered price cap*, the resultant *ancillary service price* for that *ancillary service generating unit* or *ancillary service load* in any *dispatch interval* is less than sum of the price specified in the relevant *market ancillary service offer* and the price representing the energy market revenue foregone through providing the service.

(a4) Scheduled generators may claim compensation from NEMMCO in respect of *generating units* if, due to the application of an *administered price cap* during either an *administered price period* or *market suspension*, the resultant *spot price* payable to *dispatched generating units* in any *trading interval* is less than the price that would have been specified in their *dispatch offer*, but for the presence or imminent expectation of network congestion, for that *trading interval* referred to the *regional reference node* in accordance with 3.8.6(g).

(b) Notification of an intention to make a claim under paragraphs (a), (a1), (a2) or (a3) must be submitted to both *NEMMCO* and the *AEMC* within 5 *business days* of the *trading interval* in which *dispatch prices* were adjusted in accordance with clause 3.9.5 or notification by *NEMMCO* that an *administered price period* or period of *market suspension* has ended.

(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*;

(2) require the amount of compensation payable in respect of a claim under this clause to be based on:

(i) the shortfall in benefits through market settlement relative to costs incurred by the claimant during the application of the *administered price cap*, *VoLL*, the *market floor price* or the *administered floor price* (as the case may be); and

(ii) the shortfall in benefits through market settlement relative to the value of any opportunities foregone by the claimant during the application of the *administered price cap*, *VoLL*, the *market floor price* or the *administered floor price* (as the case may be);