Australian Energy Market Commission

RULE CHANGE

# CONSULTATION PAPER

## National Electricity Amendment (Application and Operation of Administered Price Periods) Rule 2011

**Rule Proponent**

Australian Energy Market Operator

31 March 2011

**Inquiries**

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

**E**: aemc@aemc.gov.au
**T**: (02) 8296 7800
**F**: (02) 8296 7899

Reference: ERC0121

**Citation**

AEMC 2011, Application and operation of Administered Price Periods, Consultation Paper, 31 March 2011, Sydney.

**About the AEMC**

The Council of Australian Governments, through its Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. The AEMC has two principal functions. To make and amend the national electricity and gas rules – and to conduct independent reviews of the energy markets for the MCE.

# Contents

**1 Introduction** .......... **1**

**2 Background** .......... **2**

**3 Details of the Rule change proposal** .......... **4**

**4 Assessment Framework** .......... **6**

**5 Issues for consultation** .......... **9**

**6 Lodging a submission** .......... **12**

6.1 Lodging a submission electronically .......... 12

6.2 Lodging a submission by mail .......... 12

**Abbreviations** .......... **13**

# 1 Introduction

On 4 January 2011, the Australian Energy Market Operator (AEMO or Proponent) submitted a Rule change proposal to the Australian Energy Market Commission (AEMC or Commission) in relation to the 'Application and operation of Administered Price Periods'.

This Consultation Paper has been prepared by the staff of the AEMC to facilitate public consultation on the Rule change proposal and does not necessarily represent the views of the AEMC or any individual Commissioner of the AEMC.

This paper:

- sets out a summary of, and a background to, the Rule change proposal submitted by the Proponent;
- identifies a number of questions and issues to facilitate the consultation on this Rule change proposal; and
- outlines the process for making submissions.

# 2 Background

*What the Rule change proposal is about*

On 4 January 2011, AEMO submitted a Rule change proposal entitled 'Application and operation of Administered Price Periods'.

AEMO submitted this rule change proposal to address a perceived ambiguity in the National Electricity Rules (NER) with respect to the application and operation of Administered Price Periods (APPs) triggered by high ancillary service prices. AEMO has advised that the reason behind the rule change proposal is to ensure that in the event that an APP is triggered by high ancillary service prices there would be certainty regarding the practical application of the relevant clauses.

AEMO has also proposed that its discretion (in consultation with the Australian Energy Regulator (AER)) relating to extending an APP be removed or amended, the time period for settlement of compensation arising from imposition of price caps and floor be extended and that non-material amendments be made to achieve consistency in the Rules.

The Rule change proposal from the Proponent proposes to:

1. clarify that an APP, triggered by high ancillary service prices, should commence in the dispatch interval immediately following the dispatch interval in which the sum of the ancillary service prices in the previous 2016 dispatch intervals exceeds six times the Cumulative Price Threshold (CPT);
2. clarify that all ancillary service prices, within a region, will be limited by the Administered Price Cap (APC) during an APP;
3. amend the discretionary provision which enables AEMO, in consultation with AER, to extend an APP into the next trading day (clause 3.14.2(c)(3)) by either:
    a) deleting clause 3.14.2(c)(3); or
    b) retaining the clause 3.14.2(c)(3) in an amended form where the decision to extend the APP is based on data in the pre-dispatch schedule;
4. extend the time AEMO has to settle compensation for implementation of an APC, Market Price Cap (MPC) or Market Floor Price (MFP) (clause 3.15.10(c)); and
5. make non-material amendments to address inconsistent references to definitions in the NER and to remove a redundant derogation by: including a reference to 'dispatch prices' in clause 3.14.1(a); ensuring that only the term 'ancillary service price' is used rather than 'market ancillary service price'; and deleting clause 9.45.2 (which sets a unique APC for Tasmania) as it is considered to be a redundant APC derogation.

*Market Ancillary Services (MAS)*

There are eight types of MAS available in the NEM. These are:

(1) the fast raise service;

(2) the fast lower service;

(3) the slow raise service;

(4) the slow lower service;

(5) the regulating raise service;

(6) the regulating lower service;

(7) the delayed raise service; and

(8) the delayed lower service.

Raise MAS raise the frequency whereas lower MAS lower the frequency. The regulating ancillary services are provided by generators via Automatic Generation Control (AGC) whereas the fast, slow and delayed services are provided to address contingencies on a six second, 60 second and five minute basis respectively.

*Administered Price Periods*

APPs apply in both the energy market and the MAS market.

In the case of the energy market, an APP is triggered if the sum of the spot prices for the last 336 trading intervals exceeds the CPT which is currently set at $187 500. APPs triggered by high energy prices commence in the trading interval following the trading interval within which the CPT was breached.

In the case of MAS, an APP is triggered if the sum of the ancillary service prices for the last 2016 dispatch intervals exceeds six times the CPT. The commencement of APPs triggered by high ancillary service prices is being considered as part of this Rule change proposal.

If an APP is triggered by high energy prices, all energy prices are capped by the APC, set at $300/MWh, within the relevant region. Energy prices in regions that export electricity to this region are also capped at the APC, with scaling for inter-regional loss factors. In addition, if an APP is triggered by high energy prices, the prices of all MAS are capped within the relevant regions.

Conversely, if an APP is triggered by high ancillary service prices only, ancillary service prices are capped at the APC while energy prices are left uncapped, unless the sum of the energy prices in the previous 336 trading intervals exceeds the CPT. The number and type of MAS subject to a cap by an APP triggered by high ancillary service prices will be considered as part of this rule change.

In both the energy and MAS markets, once an APP has commenced it stays in place until the end of the trading day, unless it is extended another day under clause 3.14.2(c)(3).

# 3 Details of the Rule change proposal

In its Rule change proposal the Proponent provides its rationale for the Rule change. A number of key points raised in the Rule change proposal are summarised as follows:

1. AEMO is of the opinion that clause 3.14.2(c)(1A) of the NER, which relates to when an APP triggered by high ancillary service prices is to commence, is ambiguous and requires amendment in the interests of clarity. AEMO proposes that the clause be re-worded to clarify that an APP triggered by high ancillary service prices commences in the dispatch interval immediately following the dispatch interval in which the sum of the ancillary service prices for the last 2016 dispatch intervals exceeds six times the CPT. AEMO states that this will provide for increased regulatory certainty for Market Participants.

2. AEMO is of the opinion that clause 3.14.2(d2) of the NER, which relates to which MAS are capped in an APP-imposed region, is ambiguous and requires amendment in the interests of clarity. AEMO proposes that the clause be re-worded to clarify that all MAS are to be capped within an APP-imposed region. AEMO states that this will provide for increased regulatory certainty for Market Participants.

3(a) AEMO is of the opinion that clause 3.14.2(c)(3) of the NER, which provides AEMO with the discretion to extend an APP into the next trading day, is "unnecessary and difficult to implement" and recommends its deletion. AEMO advises that to date there have only been four APPs in the National Electricity Market (NEM) all of which were triggered by high dispatch prices. AEMO advises that it has not exercised its discretion under clause 3.14.2(c)(3) and an APP has never been reinstated shortly after having been closed.

3(b) AEMO believes that if clause 3.14.2(c)(3) was retained in its current form this could "lead to market uncertainty and inconsistent outcomes" as the clause does not prescribe what factors the AEMO and AER must take into consideration to form their decision. AEMO recommends removing the words "AEMO's opinion" and replacing with an "objective test limited to and based on projected pricing outcomes in the pre-dispatch timeframe". In addition, AEMO recommends that the words "next business day" be replaced with "current trading day" since pricing outcomes projected for the next business day are "beyond the pre-dispatch outlook period". AEMO notes however that "This solution may increase the risk of Generators making bids that are influenced by the knowledge that these can indirectly affect the decision as to whether an APP is removed, which could result in a misleading pre-dispatch schedule being published. "[1]

4. AEMO has demonstrated that under some circumstances clause 3.15.10(c) of the NER, which requires AEMO to settle compensation related to the

[1] Cited from AEMO's 'Application and operation of Administered Price Periods' Rule change proposal.

implementation of an APC, MFP or MPC within 15 business days of being notified by the AEMC that compensation is payable, does not provide sufficient time for AEMO. AEMO proposes that this timeframe be extended to 25 business days.

5. AEMO is of the opinion that the following minor administrative changes:

    a. Including reference to 'dispatch prices' in clause 3.14.1(a) of the NER;

    b. Ensuring that only the term 'ancillary service price' is used rather than 'MAS price'; and

    c. Deleting clause 9.45.2 of the NER, which sets a unique APC for Tasmania, as it is considered to be a redundant APC derogation,

    will bring about increased clarity in the NER.

Overall, AEMO submits that the rule change proposal will remove ambiguities and redundancies in the NER and thus give rise to increased regulatory certainty and eliminate unnecessary risks borne by Market Participants.

The proponent's Rule change proposal does not include a proposed Rule.

# 4 Assessment Framework

The Commission's assessment of this Rule change proposal must consider whether the proposed Rule promotes the National Electricity Objective (NEO) as set out under section 7 of the National Electricity Law (NEL).

> **Box 4.1: National Electricity Objective**
>
> The National Electricity Objective 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 –
>
> 1. price, quality, safety, reliability, and security of supply of electricity; and
> 2. the reliability, safety and security of the national electricity system.

The Rule change proposal seeks to clarify and achieve regulatory certainty in provisions related to the application and operation of APPs triggered by high ancillary service prices. The Rule change proposal provides AEMO's views on the interpretation of the provisions.

The Commission will assess each of the proposed changes, together with any alternatives, in terms of potential market outcomes and materiality of those outcomes to establish whether the proposed changes contribute to the NEO.

It is envisaged that the proposed changes to the Rules will bring about increased clarity and certainty in terms of how the APP provisions operate. However, the impact these changes have on market price outcomes, on the ability and willingness to invest in services and on the security and reliability of supply in the NEM needs to be further examined. The changes to the Rules may also impact on administrative and compliance costs.

The assessment framework will therefore involve assessing the impact of the proposals and any plausible alternatives and determining the most economically efficient outcomes with respect to price, reliability and security of supply in relation to the application and operation of APPs triggered by high ancillary service prices.

*Pricing outcomes – level and volatility*

- <u>Commencement of APPs</u>

In relation to clarifying when an APP triggered by high ancillary service prices should commence, there are three options:

1. retrospectively applied at the beginning of the trading interval in which the sum of the ancillary service prices in the previous 2016 dispatch intervals exceeds six times the CPT; or

2. in the dispatch interval immediately following the dispatch interval in which the sum of the ancillary service prices in the previous 2016 dispatch intervals exceeds six times the CPT; or

3. at the beginning of the next trading interval following the trading interval in which the sum of the ancillary service prices in the previous 2016 dispatch intervals exceeds six times the CPT.

As noted previously, an APP in the energy market commences at the beginning of the next trading interval following the trading interval in which the CPT breach occurred. The energy market is dispatched every five minutes (dispatch interval) and settled every 30 minutes (trading interval). The MAS market on the other hand is dispatched and settled every five minutes (dispatch interval).

An APP in the energy market triggers an APP in the MAS market. However, an APP in the MAS market does not trigger an APP in the energy market. The Australian Competition and Consumer Commission (ACCC) provided the following rationale for not capping energy prices when an APP is triggered in the ancillary service market:

"…the benefits in having an APC in the energy market as a result of high prices in one of the FCAS markets is not clear given that the volumes in the FCAS markets are small relative to those in the energy market."[2]

AEMO has proposed that the Rules be amended to clarify that an APP in the MAS market should commence in the dispatch interval immediately following the dispatch internal in which the sum of the ancillary service prices in the previous 2016 dispatch intervals exceeds six times the CPT.

- <u>MAS that should be capped</u>

In relation to clarifying which MAS within an APP-imposed region should be capped by the APC, there are following options:

1. capping all MAS within the APP-imposed region; or

2. capping all MAS within the APP-imposed region and also capping ancillary service prices for a region exporting MAS to the APP-imposed region or, from an administrative perspective, all regions; or

3. in the case where a lower (or raise) MAS led to an APP in a region, capping only the four lower (or raise) MAS within that region; or

4. capping only that MAS which caused an APP to be applied.

AEMO has proposed that when one MAS exceeds six times the CPT, then all eight MAS in that region should be capped by the APC. That is, all MAS should be subject to an APP.

---

[2] Determination 'Applications for Authorisation: Amendments to the National Electricity Code – Regional Pricing of Ancillary Services' 17 September 2003, p.16.

It is noted that where MAS services can be substituted (either substitution between providing energy and MAS services or substitution between regions) then capping one service may result in that service being offered into a region that is not capped and where prices are higher.

We propose to assess the options to (1) commence an APP triggered by high ancillary service prices and (2) cap MAS within an APP-imposed region with respect to giving effect to outcomes that:

- do not adversely impact on the financial incentives to invest in the provision of MAS; and

- result in efficient price outcomes in terms of level and volatility and risk to participants.

- AEMO's discretion to extend APPs

AEMO has proposed that its discretion to extend an APP into the following trading day be removed or amended. This will be achieved by either removing clause 3.14.2(c)(3) or retaining it in an amended form whereby AEMO is to make its decision based on data in the pre dispatch schedule.

Removing clause 3.14.2(c)(3) may give rise to price volatility since an APP could close at the end of a trading day only to be re-applied shortly afterwards. The reason for AEMO's proposal to remove this provision is that it considers clause 3.14.2(c)(3) unnecessary, difficult to implement and of limited benefit. We understand that AEMO and AER have not used this discretion in the past, and the NEM has not experienced a CPT breach shortly following the closing out of an APP.

For the reasons provided above, AEMO has requested that in the event the Commission decides to retain the clause, then it should be amended to specify that AEMO is to base its decision on data in the pre-dispatch schedule. The benefits of certainty need to be balanced against the risks of the pre-dispatch schedule not reflecting actually market outcomes. It not clear if the pre-dispatch schedule is an accurate representation of the actual outcomes in the NEM, or if any risks may arise from the use of the pre-dispatch schedule including the materiality of such risks.

We propose to investigate the impact of the removal of, or amendment to, the provisions relating to AEMO's discretion to continue an APP giving consideration to the potential for price volatility.

*Incentives to invest in services and reliability of supply*

Commencing an APP in the MAS market could result in substitution from the MAS market to the energy market if the energy price is above the APC.

This could result in providers of MAS, choosing to participate in the energy market rather than in MAS, reducing the ability of AEMO to use MAS to manage the system. Further, this could potentially impact on investment in or provision of MAS. There is also the question of materiality, frequency and incidence of the scenario outlined above.

It should be noted however, that the NEM has not yet experienced an APP that has been brought about by high ancillary service prices.

AEMO has proposed that when one MAS exceeds six times the CPT, then all eight MAS in that region should be capped to the APC. That is, all MAS should be subject to an APP.

Where the MAS services can be substituted then capping one service may result in that service being offered as one that is not capped, and where prices are higher. The Rule change proposal would reduce the potential for such substitution thereby ensuring services are available.

Further, unlike energy which is capped in the region in which the APP occurs and in regions exporting energy to the APP-imposed region, MAS is only capped in the region in which an APP is triggered. It may be possible that services are then offered in regions that are not capped (provided prices are high), impacting on the availability of services in the capped region. This could impact on AEMO's ability to manage system security. We propose to investigate whether MAS can be offered into energy or other regional markets.

Finally, the relationship between the different MAS needs to be understood. For example, an assessment of whether a breach of six times the CPT in raise services is likely to impact on the price outcomes for lower services or whether the services are unrelated is also proposed.

*IT and administrative costs*

The Rule change proposals may result in administrative and compliance costs to Market Participants and AEMO.

We propose to investigate the current interpretation and practice in the NEM in relation to the provisions that are subject to this Rule change proposal and seek input in relation to costs arising from implementing the options outlined above.

In particular, we propose to assess:

- to what extent increasing the time for AEMO to settle compensation related to imposition of an APC, MFP or MPC will reduce AEMO's compliance costs and any impact on market participants of the delayed settlement; and
- whether a specific option would greatly increase AEMO's or market participants' operating costs.

# 5 Issues for consultation

Taking into consideration the assessment framework and potential requirements to implement the proposed Rule change, we have identified a number of issues for consultation that appear to be relevant to this Rule change proposal.

These issues outlined below are provided for guidance. Stakeholders are encouraged to comment on these issues as well as any other aspect of the Rule change proposal or this paper including the proposed framework.

*Pricing outcomes – level and volatility*

**Question 1**

**What would be the likely impact and materiality of the impact on pricing outcomes and availability of services between the following alternatives:**
**(a) an APP triggered by high ancillary service prices commences in the dispatch interval immediately following the dispatch interval in which a breach of six times the CPT occurs?;**

**(b) an APP triggered by high ancillary service prices commences at the beginning of the next trading interval following the trading interval in which a breach of six times the CPT occurs?; and**

**(c) an APP triggered by high ancillary service prices is applied retrospectively at the beginning of the trading interval in which a breach of six times the CPT occurs?**

**Question 2**

**What would be the likely impact and materiality of the impact on pricing outcomes and availability of services between the following alternatives:**

**(a) capping all MAS prices within an APP-imposed region?;**

**(b) capping all MAS within an APP-imposed region and also capping ancillary service prices for a region exporting MAS to the APP-imposed region or, from an administrative perspective, all regions?;**

**(c) in the case where a lower (or raise) MAS brought on an APP in a region, capping only the four lower (or raise) MAS within that region?; and**

**(d) capping only that MAS which caused an APP to be applied?**

*Price volatility and ability and incentive to influence the imposition of APPs*

**Question 3**

**What would be the likely impact and materiality of the impact on price volatility in both the energy and MAS markets if clause 3.14.2(c)(3) was removed?**

**Question 4**

**What is the risk that Market Participants are able to exert influence over the imposition of an APP by way of their bidding behavior?**

*IT and administrative costs*

**Question 5**

**What would be the likely impact and materiality of costs, if any, resulting from an extension in the time AEMO takes to include compensation payable from an APP, MFP or MPC event in preliminary and final statements?**

**What would be the likely impact and materiality of costs arising from rule changes in relation to the application and operation of APPs?**

# 6 Lodging a submission

The Commission has published a notice under section 95 of the NEL for this Rule change proposal inviting written submission. Submissions are to be lodged online or by mail by Thursday 12 May 2011 in accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on Rule change proposals.[3] The Commission publishes all submissions on its website subject to a claim of confidentiality.

All enquiries on this project should be addressed to Arianwyn Lowe on (02) 8296 7800.

## 6.1 Lodging a submission electronically

Electronic submissions must be lodged online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code ERC0121. The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic submission, the Commission will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

## 6.2 Lodging a submission by mail

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Or by Fax to (02) 8296 7899.

The envelope must be clearly marked with the project reference code: ERC0121.

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the Commission will issue a confirmation letter.

If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

3 The Guidelines are available on the Commission's website at www.aemc.gov.au

## Abbreviations

| | |
|---|---|
| ACCC | Australian Competition and Consumer Commission |
| AEMC | Australian Energy Market Commission |
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| AFP | Administered Floor Price |
| APC | Administered Price Cap |
| APP | Administered Price Period |
| Commission | See AEMC |
| CPT | Cumulative Price Threshold |
| MAS | Market Ancillary Service(s) |
| MFP | Market Floor Price |
| MPC | Market Price Cap |
| NEL | National Electricity Law |
| NEO | National Electricity Objective |
| NER | National Electricity Rules |
| Proponent | See AEMO |