

## REVIEW INTO ELECTRICITY COMPENSATION FRAMEWORKS (EPR 0095)

1 FEBRUARY 2024

### INTRODUCTION

The Energy Users' Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing, building materials and food processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and in many cases are exposed to the fluctuations and challenges of international trade.

Thank you for the opportunity to make a submission under AEMC's Consultation Paper on the Review into Electricity Compensation Frameworks.

The EUAA agrees with the AEMC and AER that the current Electricity Compensation Frameworks (Frameworks) led to inefficient outcomes during the market events of June 2022, prompting generators to withdraw bids from the NEM during the Administered Price Period (APP) and subsequent Market Suspension and instead waited until AEMO Directions were given to generate. The current Frameworks are confusing and overlaps in eligibility led to multiple compensation claims for a single generator leading directly to higher administrative costs for the generators and AEMO/AEMC. The EUAA agrees that this is probably exacerbated by both the AEMC and AEMO being responsible for various components of the Frameworks.

The EUAA proposes that any changes to the Frameworks need to ensure:

- A single point of application for Compensation (AEMO), with relevant bodies being included in the assessment of compensation (AEMC and/or AER), thereby eliminating duplicate applications and ensuring that information is available in a timely manner to the assessment teams;
- Set timelines for each step of the Compensation process to ensure that applications are received and assessed in a timely manner;
- Unifying definitions and removing overlaps within the Frameworks;
- Incentivising generators to participate during APP and Market Suspension periods by having less compensation for Directions compared to APP and Market Suspension compensation and having generators contribute to the compensation funds;
- Increasing transparency of Compensation Claim applications and decisions so that compensation fund liable entities can prepare financially for their contribution, knowing a claim exists is one thing, knowing how much will be recovered in each NEM region is another. Without this information, Compensation Claims may inadvertently collapse or bankrupt compensation fund liable entities; and
- Futureproofing the Frameworks by including, through careful use of language, bidirectional plant and other technologies that are not yet commercially viable.

The EUAA would also like to see consistency in the Compensation Frameworks across the NER/NEL and NGR/NGL, with bespoke requirements or procedures that are justified by the specific industry and intent of the specific framework. As such, the changes to the Frameworks discussed in this Consultation Paper should align with those in AEMC's impending final determination for the *National Gas Amendment (Compensation and dispute resolution frameworks) Rule*.

## **RESPONSE TO SELECTED CONSULTATION QUESTIONS**

### **QUESTION 2: OBJECTIVES**

- 1. Do stakeholders have any proposed changes to the objectives of the various compensation frameworks?**
- 2. Is the reasoning behind each objective still appropriate and relevant?**
- 3. Regarding the direction's compensation framework, how do we best balance the need to avoid creating a perverse incentive to be directed with the objective of compensating directed participants fairly? How well is this achieved under the current framework?**

While the AEMC has specifically identified batteries as not fitting the current Frameworks in a logical way, the EUAA would argue that using that terminology may create other issues in future years. The AEMC should consider using language that does not preclude other types of bi-directional plant (which includes batteries) and other technologies that are not yet commercially available.

To incentivise participants to respond in a manner that the market bodies expect during APP and Market Suspensions, and to ensure that Directions are a tool of last resort, the Directions may need to carry a smaller compensation amount in the Frameworks.

In addition, the EUAA argues that having generators as part of the cost recovery mechanism included in the Frameworks creates efficiencies as generators can respond to market forces and manage market risks. By including generators as liable entities, generators will do everything in their power to avoid APP, Market Suspensions and Directions. The EUAA is aware that this contradicts the rule change request from Tilt Renewables (as raised in the Consultation Paper) regarding shifting cost recovery of capacity directions to consumers and a claimed inefficiency created by the NER that currently requires partial cost recovery for the capacity direction be fulfilled by generators.

The EUAA does not support shifting risk from those who are best placed to manage the risk onto consumers.

### **QUESTION 3: ACHIEVING THE OBJECTIVES**

- 1. Do stakeholders agree with the observation that the administered pricing and market suspension compensation objectives may not have been achieved in the June 2022 events?**
- 2. If directions compensation was preferred to the other frameworks, were there any specific reasons why this was the case?**

The EUAA agrees that none of the Frameworks compensation objectives were achieved in the June 2022 event. The EUAA considers that the Frameworks need to incentivise market participants to respond during times of market stress, particularly during APP and Suspended Markets. AEMC's observation that some generators withdrew generation capacity from the NEM during the APP and/or Market Suspension in June 2022, preferencing AEMO Directions demonstrates that there exists a significant failure in the processes.

Although consultation has occurred for Directions Compensation through the *Improving security frameworks for the energy transition* rule change, the EUAA requests the AEMC to consider the recommendations in that rule change in light of occurrences of the June 2022 event and design all Frameworks to work cohesively. Ideally, this would see a lower compensation and/or higher contribution to fund compensation for Directed generators thereby providing generators with a financial incentive to engage in the NEM during APP and Market Suspensions.

#### QUESTION 4: METHODOLOGY

- 1. Do stakeholders have any suggestions related to the directions compensation framework that could enable it to more effectively meet its objective to fairly compensate directed participants without creating a perverse incentive to be directed?**
- 2. Do stakeholders consider there is value in having different approaches to the various compensation frameworks? Would better outcomes be more likely if the frameworks were consistent where possible?**
- 3. Should opportunity costs be considered in the compensation frameworks? If so, which ones and why?**
- 4. Do stakeholders agree with providing more codification and guidance about how opportunity cost compensation is likely to be assessed?**
- 5. Do stakeholders consider that changes to the compensation frameworks may be necessary due to the advent of battery energy storage systems? If so, are there any specific changes that should be considered?**
- 6. Do stakeholders consider that administered pricing compensation provides a sufficient incentive for participation in the market during an APP? If not, please explain why and include any measures that could be considered as part of this review.**
- 7. Do stakeholders agree with the suggestions made by the AER regarding removing economic considerations for causing a direction given the availability of compensation?**
- 8. Do stakeholders have a preference for a benchmark approach to compensation such as the market suspension compensation framework, or a more open framework such as the administered pricing compensation framework?**

The EUAA sees benefit in allowing generators to manage market risks during times of market stress. By having a lower compensation and/or higher contribution to fund compensation for Directed generators, a financial incentive to engage in the NEM during APP and Market Suspensions will be provided to generators in addition to meeting their NEM obligations to supply electricity.

The EUAA sees benefits in aligning the different approaches currently present in the Frameworks, including compensation amounts (except for Directions compensation which should be lower), compensation methodology and compensation claim eligibility.

Opportunity Cost is a difficult proposition to justify and/or assess as it requires a comparison to business as usual during an unusual period. That said, opportunity costs could be argued to be valid for compensation claims where a generator has limited “fuel” supply (e.g. hydro or bidirectional plant) and is forced by an APP, Market Suspension or Direction to generate outside of their preferred generating strategy and therefore has sustained a demonstrable reduced profit for that period. The EUAA may support opportunity costs under this scenario, depending on the detail of the proposal, the level of evidence required from the generator to justify an opportunity cost as part of a claim and how the claim would be assessed. Codification of opportunity costs assessment may provide some comfort to EUAA.

The AEMC has provided pros and cons of conforming the Frameworks to either the current market suspension benchmark compensation and the APP bespoke framework where claimants can use their “actual” costs. Given that BESS degradation changes with cycling and age (therefore incurring different costs depending on the BESS current life), and the prominence of BESS in the future NEM, compounded with different depreciation models and different capital models, a bespoke framework will be supported by many submissions to this paper.

However, a bespoke framework will be far costlier for claimants to prepare claims and far costlier to the market body performing the assessment, as each individual application will need to be prepared and assessed independently. Benchmarking allows both claimant and assessor to outline and review the quantity of the claim rather than how the cost was derived.

The EUAA supports a SRMC based benchmarking model, however does not support benchmarking against the ISP SRMC as these are subject to biennial updates, too far between updates to be reliable for the entire period. Instead, EUAA recommends that SRMC are published annually in anticipation of market events, allowing generators to effectively know how much compensation they will receive during market events.

#### **QUESTION 5: GOVERNANCE**

- 1. Do stakeholders think it is appropriate to have a single point of receipt for all compensation claims to reduce confusion?**
- 2. Who should be responsible for the various compensation frameworks?**
- 3. Are there any other governance issues that should be considered?**

The EUAA recommends that all compensation claims across the NEM be sent to a single point, and who is also the responsible agency. AEMO seems to be the logical choice for this role. This will eliminate the current debacle where some claims are sent to AEMO, and others to AEMC – with the claims sent to AEMC requiring data regarding the claim from AEMO in order to process the claim.

Assuming a SRMC based benchmarking model, AEMO could turn around compensation claims relatively quickly. For more complex claims that include bespoke costs and/or Opportunity Costs, AEMO would need to implement an assessment panel which includes one of the market bodies who regularly deal with economic rationalising (i.e. AER and/or AEMC). EUAA would prefer this to be the AER.

#### **QUESTION 6: OVERLAPPING COMPENSATION CLAIMS**

- 1. Do stakeholders agree with the issues identified regarding overlapping compensation claims?**
- 2. Do stakeholders agree with the potential solutions identified to address issues arising from overlapping compensation claims? Do stakeholders prefer a particular option or propose other options for consideration?**

The EUAA agrees that overlapping compensation claims has created extra administration for claimants and assessors with the potential for double-dipping. The EUAA agrees with the AEMC that part of the problem is that the eligibility periods for APP compensation extend outside of the APP and that the APP impacts inter-jurisdictional transfers of energy (sales) across interconnectors (price scaling).

The EUAA supports AEMC’s Option 1: Aligning the periods of eligibility for administered pricing compensation with other frameworks and only considering compensation in trading intervals affected by one of the Frameworks or price scaling.

#### **QUESTION 7: TIMEFRAMES FOR SUPPORTING INFORMATION**

- 1. Is it appropriate to include timeframes for administered pricing compensation claims?**
- 2. Should additional time be provided for opportunity cost claims, and if so, how much?**

All Frameworks should have time limits for submitting claims for compensation and for assessing the compensation claims with regular public updates on all types of compensation and the value of outstanding claims that may be recovered from each NEM region. This allows for the claimant and liable entities to ensure that they have sufficient cashflow and finances to continue trading until and after either they are paid compensation or they pay their contribution into the compensation fund.

Following the June 2022 events, AEMO were quite good at providing timely information around the value of outstanding claims for the compensation they administered, and the likely amounts attributable to each NEM region. On the other hand, the AEMC, who are STILL evaluating claims for the Administered Price Cap compensation, have never published the value of the outstanding claims nor which NEM region they apply to.

This creates accounting and cashflow problems for compensation fund liable entities, with many EUAA members paying a significant portion of it.

#### **QUESTION 8: HARMONISING DEFINITIONS**

- 1. Do stakeholders agree that there would be benefits in aligning definitions of cost categories across the various compensation frameworks?**

As mentioned above, the EUAA sees benefits in aligning the definitions of cost categories across the Frameworks and supports in principle the AEMC considering this path in its draft determination.

#### **QUESTION 9: COST RECOVERY**

- 1. Do stakeholders consider that cost recovery provisions for administered pricing could be clarified with respect to situations where there are multiple “home regions”?**
- 2. Do stakeholders have any thoughts on the existing cost allocation mechanisms for the compensation frameworks?**

As alluded to above, the current cost recovery is through consumers, who have limited ability of managing the risks associated with the market interventions in the Frameworks. The EUAA argues that having generators as part of the cost recovery mechanism included in the Frameworks creates efficiencies as generators can respond to market forces and manage the market risks associated with the interventions covered by the Frameworks.

#### **QUESTION 10: INFORMATION TO SUPPORT A CLAIM**

- 1. Do stakeholders have suggestions for NER requirements and/or guidelines changes that could provide greater clarity for administered pricing compensation claimants?**
- 2. Do stakeholders have views on the level of evidence that is required to substantiate claims under the current compensation frameworks?**

Information to support a claim varies, depending on the type of governance chosen, e.g. benchmarking versus bespoke and opportunity costs.

The burden of proof of a claim should always rest with the claimant.

For bespoke and opportunity cost claims, financial documents need to have been audited by a third party to determine operating costs and ordinary profit margins.

For all governance approaches, a copy of the trading strategy, and thus evidence of the claim is required.

## **CONCLUDING REMARKS**

In conclusion, the EUAA is pleased to see efforts of the AEMC to align compensation frameworks and create certainty to generators and agrees with much of the proposed arrangement in the Consultation Paper.

However, the AEMC has not considered the impacts to consumers who are currently the liable entities for the compensation funds. The EUAA encourages the AEMC to include these liable entities in its draft determination through:

- Provision of time limits for the claimants to submit claims after an event, for the claim to be assessed and supported.
- Provision of regular public updates on all types of compensation and the value of outstanding claims that may be recovered from each NEM region.

Do not hesitate to be in contact should you have any questions.



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