Public Interest Advocacy Centre

15 February 2024

Tom Meares
Project leader
Australian Energy Market Commission
By email: tom.meares@aemc.gov.au

Dear Mr Meares,

Review into Electricity Compensation Frameworks

The Public Interest Advocacy Centre (PIAC) welcomes the opportunity to respond to the Review into Electricity Compensation Frameworks (the Review).

PIAC supports the Commission's framing of the problem in the Consultation Paper (the Paper). That is, that the compensation frameworks for directions, administered pricing, and market suspensions must be set in such a way that generators are not incentivised to distort the normal functioning of the market by withholding capacity, but they must also avoid leaving generators out of pocket in times of market stress, and so act to dissuade investment.

We agree with the intent to ensure the market remains intact as much as possible. However, the regulatory system concedes that the consumer interest is not always best served by leaving the market to function. Tools like the administered price cap aim to balance the benefits of a market-based system with protections from the occasional extreme outcomes produced by it.

From a consumer perspective, the aim should be to enable the efficient functioning of the market, and strike a balance between the cost of market interventions and the benefits to consumers.

PIAC's position is that the compensation framework exists to enable efficient intervention in the interests of consumers. The framework should then be designed in a way to minimise the cost of intervention for the consumers who pay for it. The position that directions should only be used as a last resort is reasonable, but it does not actually imply anything about how often the power should be used, or how high the requirements are for its use.

We support the use of directions, and the compensation framework in general, having a relatively low trigger point. We agree there is a need for the framework to include a new positive obligations on generators to offer capacity into the market during periods of market stress. Based on the experience of the 2022 energy crisis, we believe that these could be market-enhancing rather than market-distorting.

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We do not support increasing the compensation provided to encourage participants to provide services during an administered pricing period (APP) or market suspension. Such a change is likely to be market-distorting rather than enhancing.

PIAC supports the expansion of compensation frameworks bespoke to technology types. The increasing presence of market participants with close to zero short run marginal costs makes such a change necessary.

A framework that treats all generators alike over-compensates some generators and under-compensates others. The materiality and risk of over-compensation will increase over time, as more of the market is made up of close to zero short run marginal cost generation and storage providers. Given the inequitable position of generators and consumers noted in the consultation paper (and below), the framework should be geared towards managing this issue, rather than any potential risk of under-compensation. A technology bespoke framework is the best way to do this.

We agree with the Commission's concerns that a framework considering only short run marginal costs inefficiently punishes renewable generators and most storage providers. Again, this is a reason to support a technology bespoke framework, and to develop formulas for compensation that efficiently balance the costs and benefits of intervention from the perspective of the consumer. This may involve a greater weighting towards opportunity costs for some technologies than others, or a definition of opportunity cost that encompasses the substantial differences the propositions of suspensions, APPs or directions pose for different generators.

Inequitable positioning between generators and consumers

PIAC agrees with the Commission's framing of the inequitable positions occupied by generators and consumers with respect to the compensation framework for directed market participants.

The Commission writes:

> … if a directed participant considers that they have been under-compensated, they may lodge a claim for additional compensation to recover a shortfall in their direct costs under NER clause 3.15.7B. However, consumers do not have any mechanism to claim back costs in the event of over-compensation to directed participants. This inherent asymmetry between market participants and consumers means that the risk of over-compensating directed participants is not identical to the risk of under-compensating them.[1]

In light of this, and the difficulty of amending this asymmetry directly, it is important that the compensation framework as a whole is predicated on managing the risk of overcompensation, while still functioning effectively. The risk of under-compensation is smaller, as is its impact, because it is one which can be addressed after the fact.

[1] AEMC, Review into electricity compensation frameworks consultation paper, 2 November 2023, 12.

The AER's analysis of the 2022 energy crisis

The AER's analysis of the 2022 energy crisis raised important concerns regarding the effectiveness and appropriateness of the compensation framework, which need to be addressed. That is, that the compensation framework did not function effectively and that generators appear to have been able to distort the market by withholding capacity in order to access compensation.

The four factors they present as contributing to this unwanted outcome provide a useful schema for determining the changes required.

Factor one: the low awareness and understanding of compensation schemes.
Response: this does not suggest a remedy of altering the framework in any direction. Any suggestion this implies the compensation framework should be simplified should be treated with caution. At most, this implies a positive effort to inform market participants of the arrangements is required. However, we contend that any characterisation of generation or storage providers as either unsophisticated or inattentive market participants strains credulity.

Factor two: an APC of $300/MWh which was insufficient to cover the short-run marginal costs of most conventional gas or coal generation in these particular circumstances.
Response: the APC has been raised to $600/MWh and it is expected to remain at that level for the next regulatory period. We also note the 'particular circumstances' the AER refers to are not necessarily indicative of those likely to prevail longer term. In any case, PIAC has argued against this increase on the same principles that we have reiterated in this submission. Consumers are best served by a protection and compensation framework where the price ceiling is set low, and suppliers are compensated for costs and reasonable foregone earnings.

Factor three: an underpinning principle of the Rules that generators have maximum commercial freedom to operate.
Response: this principle functions within limits. It sits below the overall aim of the energy system providing supply at a given level of reliability and alongside the principle that market participants and consumers should be sheltered from the extremes of market volatility.

Factor four: no positive obligation to supply in response to a LOR notice.
Response: PIAC supports the introduction of new positive obligations to offer capacity.

PIAC welcomes the opportunity to discuss these matters further with the AER and other stakeholders.

Yours sincerely

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