Justice and Equity Centre

28 September 2024

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

Your Ref: EPR0095

Dear Mr Meares

Review into electricity compensation frameworks

The Justice and Equity Centre (JEC, formerly known as PIAC) welcomes the opportunity to respond to the Review into Electricity Compensation Frameworks draft report (the draft report).

The JEC supports the aims of the review to align the compensation frameworks for the administered price cap (APC) and market suspensions and reduce the incentive for market-distorting behaviour, and so reduce costs consumers pay for the benefits associated with directions.

Objectives of the frameworks

The JEC agrees that each framework should have a formal objective in the National Electricity Rules (NER). However, we contend they should express a substantively identical purpose for each framework, as follows:

Directions:
For participants to be compensated for the costs associated with complying with a direction.

Administered pricing:
For participants to be compensated for the costs associated with supplying under administrative pricing.

Market suspension:
For participants to be compensated for the costs associated with supplying during market suspension periods.

This purpose of compensation reflects an approach more aligned with promoting consumer interests. That is, requiring that participants are available (to the greatest degree possible) in moments of market stress, and then compensating them for losses incurred as a result.

The objectives should also be accompanied with an articulation of the particular aim of each framework as it relates to the long-term interest of consumers. The objectives here are framed exclusively in relation to the generators. But each of the compensation frameworks exists within a wider regulatory structure whose overall objective unambiguously and intentionally refers only to consumers. This apparent misalignment should be resolved by adding a second line to the objective statements in the NER. We recommend:

'To reduce costs to consumers of interventions during periods of market stress.'

This should also be common across all three compensation frameworks.

Treatment of opportunity costs

The JEC agrees that a foundation of opportunity costs is appropriate to each of the three frameworks. We agree that no single methodology for calculating opportunity cost will suffice for all situations. However, we see no reason why the Australian Energy Regulator (AER) cannot produce an exhaustive set of guidelines on opportunity cost methodologies.

We disagree with the treatment of opportunity costs in the draft report.

For the APC framework, the opportunity cost cannot be the profit the generator would receive were the APC not in place. This is inappropriate and would undermine the working (and purpose) of the APC.

The alternative to supplying under administered pricing is not supplying at a higher price. Rather, it is not supplying at all. Accordingly, the opportunity cost should be set to $0/MWh. That is, for generators supplying at a loss in a period of administered pricing, compensation should be provided to the level that equals the losses they bear as a result of being dispatched. For generators who are dispatched at a price above their short-run marginal cost (SRMC), no opportunity cost-based compensation is appropriate.

We appreciate that this does not incentivise generators to supply during an APC period. We do not believe this is the best approach to the problem, as it requires the policy approach to be internally contradictory – on the one hand setting a cap to protect consumers and on the other creating incentives using consumer money to insulate market participants from that cap. It is not practical (or possible) to create an incentive structure to attempt to resolve this impossible situation. Instead the approach should be to require market participants to supply during an APC period as a principle of good faith market engagement, akin to the bidding in good faith principle. Participants should do this confident that they will be made whole from any losses incurred as a result of supplying.

The appropriate construction of opportunity costs for market suspension is more complicated. For market suspensions occurring after the APC has been hit, the opportunity cost should be the same as for the APC opportunity cost - $0/MWh. For other types of market suspension a methodology derived from the Commission's formulation of 'the revenue associated with the alternative opportunity less the costs that would have been incurred in pursuing it' will be appropriate. The same is true of opportunity costs associated with directions.

We appreciate that the Commission intends to continue working on developing an understanding of opportunity costs for the purposes of the compensation framework and we look forward to contributing to this work.

We would welcome the opportunity to meet with the AEMC and other stakeholders to discuss these issues in more depth. Please contact me at mlynch@piac.asn.au regarding any further follow up.

Yours sincerely,

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