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11 October 2024

Ms Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
SYDNEY, NSW, 2001

Dear Ms Collyer

Re: Review into electricity compensation frameworks – Draft Report

The Australian Energy Regulator (AER) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC's) draft report for the Review into electricity compensation frameworks.

In general, the AER supports the intent of the AEMC draft report and its recommendations which reform the objectives, methodologies, governance and administrative structures for administered pricing, market suspension, and directions compensation frameworks. We also believe the recommendations will help to ensure the frameworks provide incentives to support reliability and security during periods of system and market stress.

The Draft Report broadly addresses the primary concerns raised by the AER in its February 2024 submission. The submission noted issues related to the AER taking responsibility for assessing compensation claims, clarifying and aligning the timeframes for assessment of compensation claims, and the mode of assessment of benchmark price premiums.

Responsibility for compensation claims

The AER supports the draft recommendations that all compensation claims are to be received and assessed by AEMO using the independent expert function, with the AEMC retaining the responsibility for the guidelines for assessing opportunity cost claims. We agree with the AEMC that having a single point of receipt for all compensation claims will improve certainty of the process. Further, the AER considers that opportunity cost claims being assessed by the independent expert, while the AEMC retains responsibility for publishing the guidelines, strikes an appropriate balance of expertise and transparency.

Clarifying the timeframe for determining compensation payments

The AER supports clarification of the timeframe for determining compensation payments. Ensuring the timeframes for compensation processes are aligned in all frameworks to a 33 business day period following the end of the billing week in which an intervention or price limit event occurs will aid certainty and administration of the compensation frameworks.

The timeframes for determining compensation payments impact the AER's ability to set the Default Market Offer (DMO) as such payments are a relevant input cost for retailers and need to be reflected in the DMO. Providing greater certainty around the timing of any compensation claims will assist in accurately setting DMO prices.

Benchmark pricing in the directions framework

The move to the volume-weighted average price (VWAP) approach for directions compensation will replace the current approach of using the 90th percentile price for each region over the previous 12 months. The AER's earlier submission¹ to this review had noted that benchmark price premiums for directions compensation could possibly create incentives for generators to deliberately withhold supply to force direction by AEMO.

While generally meeting its aim of providing a more predictable and administratively simple compensation regime, there remain some minor concerns. The AEMC has stated that high VWAPs are expected for certain technology types (e.g. batteries, gas) requiring high spot prices to cover the cost of operation. Further, the draft report does consider that very large compensation payments should be subject to a more thorough assessment. Despite the proposed changes, some potential remains for manipulation of the compensation amount across the frameworks.

In considering options for upfront payments under the directions framework, the AEMC should consider the risk of higher costs from these larger compensation payments being passed through to consumers.

Continued engagement

The AER appreciates the opportunity to provide feedback on the draft report and its recommendations. We look forward to continued engagement as the AEMC progresses this review.

Yours sincerely



Danielle Chifley
Acting General Manager
Policy

Sent by email on: 10.10.2024

¹ <https://www.aer.gov.au/publications/reports/submissions/aemc-review-review-electricity-compensation-frameworks>